CHAPTER 1

INTRODUCTION

1.1 THE CONTEXT

Putting it simply, insolvency law is concerned with companies and individuals who are debtors and who are unable to repay their debts. Such a law is going to be necessary in a system that employs credit and, of course, life in the UK is very dependent on credit. At one time, not too far in the past (perhaps 20 years ago), it would have been possible to find that most people, not associated with the law and even some associated with it, had either not heard the word 'insolvency' or did not understand what it meant. It is submitted that that is no longer the case. The savage recession of the last days of the 1980s and the early 1990s which saw some high-profile companies (eg Maxwell Communication Corporation, Bishopsgate Investment Management Ltd, Bank of Credit and Commerce International) collapse and huge leaps in the number of people entering bankruptcy, together with more and more significant media coverage of corporate collapses at the end of the twentieth century and the beginning of this century, has seen to that.

In recent times we have seen, for instance, the collapse of Enron and the problems of WorldCom in the United States, and the insolvency of HIH Insurance, Ansett Airlines and One Tel in Australia, Parmalat and Alitalia in Italy and Marconi, Railtrack, ITV Digital and Rover in the UK, as well as the well-documented struggles experienced by Equitable Life. All of these companies were regarded, not as fly-by-night companies, but as substantial companies that had a significant share of the relevant markets and were worth investing in. The fact that many English professional football clubs, which are household names in England (such as Leeds United, Derby County, Coventry City, Crystal Palace, Bradford City, Hull City, Barnsley),[1] have struggled financially, most of which have entered, at some time in the past, into administration, has further brought home insolvency to the British public in recent years. People have begun to realise that the insolvency of a large company, in particular, can have knock on effects for others. Take for example, the financial woes at the car-maker, Rover. Although a consortium was put together in 2000 to buy

[1] Even Italian clubs have not been saved the ignominy of being subjected to some form of administration. For example, Fiorentina.

the car-maker from BMW and the car-maker appeared to be operating acceptably from a financial point of view, in 2005 it was clearly having severe financial problems and it went into administration. This had a great impact on many people, particularly those living in south Birmingham where the Rover factory was situated. When the factory was closed, thousands of people were thrown out of work, but besides that others not employed by Rover were affected, for when a big company like Rover stops production it sends a ripple effect through the local communities.[2] Because the major employer ends its production suppliers and those who rely in turn on the suppliers are often pushed into insolvency. And these days with large companies like Rover not only operating nationally, but internationally, people in other countries can be affected by the insolvency of a company. Rather worryingly, we have seen in the UK the continuation of a significant number of individuals becoming bankrupt, despite the fact that since about 1996 the UK has enjoyed good economic conditions – low interest rates, low unemployment and low inflation – and the economic strength to ride out a downturn in the United States' economy in 2000. The bankruptcy figures are most instructive. In 1960 only 2,944 persons became bankrupt. This probably reflected the fact that few people were conversant with the notion of insolvency. But by 1992, when the effect of the recession at the end of the 1980s was really biting, the numbers rose, alarmingly, to 32,106. From 1993–1999 the figures fell, but in 2000 onwards we have seen significant increases, with 64,481 people becoming bankrupts during the 2007 year[3] (and many more others (42,166)[4] entering individual voluntary arrangements (IVAs)) and there appears to be no indication that we will not continue to see further increases.

The broader perception of insolvency as a not uncommon phenomenon in British life parallels, not surprisingly, the rise of insolvency law as a separate field of law in the UK. Until the late 1980s insolvency law in the UK was rarely the subject of scholarly articles or texts, and was often never broached in undergraduate and postgraduate law courses. If it was, it was generally simply tacked onto the end of company law modules, or mentioned briefly in commercial law modules. Now, however, there are journals devoted to insolvency law and general journals even carry articles focusing on relevant insolvency issues. Many universities in their company law modules now include corporate insolvency as a separate topic in the module and a number of university law schools now offer insolvency law as an option, both at undergraduate and postgraduate level. More and more legal practitioners have during the past 20 years specialised in insolvency law and related areas. Many practitioners, both legal and accounting, have come to realise that insolvency law impinges on many

[2] See A Keay 'Insolvency Law: A Matter of Public Interest?' (2000) 51 NILQ 509.

[3] Insolvency Service statistics and accessible at http://www.insolvency.gov.uk/otherinformation/statistics/200802/index.htm (last visited, 15 February 2008).

[4] Insolvency Service statistics and accessible at http://www.insolvency.gov.uk/otherinformation/statistics/200802/index.htm (last visited, 15 February 2008).

other areas of the law, such as company, family, employment, banking, consumer and environmental law, just to mention a few. Certainly while it cannot be said that insolvency has enjoyed significant government focus, since 1986 the British government, as we will shortly see, has devoted more resources and time to the issues surrounding insolvency law than ever before. The cynic might say that the government has had to do so due both to the failure of past governments to do anything worthwhile and to make them look good by tackling the financial malaise affecting some businesses. The most recent attentions of the government have, as we will shortly consider, seen the enactment of legislation to lessen the effects of insolvency on individuals and to streamline the procedure to be followed to try to rescue companies that are suffering from insolvency.

The heightened interest in, and focus on, insolvency law in the UK is mirrored in other jurisdictions. Insolvency law, or as it is usually referred to, 'bankruptcy law', in the United States has had a prominent role for many years and particularly since the late 1970s when a form of insolvency administration known as 'Chapter 11 bankruptcy', utilised by many US corporations that are global players, such as Continental Airlines, WorldCom, United Airlines and K-Mart (the retailer), was introduced. The story of the rise in the awareness of insolvency in the UK is very similar to the same development in Australia (whose insolvency law framework is modelled on the English), from where the present form of administration (discussed in detail in Part II) hails. There have been significant discussions on the international stage for some years, but particularly in the last decade, about streamlining the insolvency administration of global enterprises. This is known as cross-border insolvency. It is trite to state that, due to increased globalism, the insolvency of a company in one country can affect companies and people in many more countries than just those in the insolvent's home jurisdiction. This effect can be direct, or it can even be indirect as we saw when Enron collapsed in the United States. This collapse indirectly affected the positions of many companies and the lives of countless people around the world.

Until recently attempts to make it easier for insolvency practitioners to administer insolvent companies that had been trading across borders bore little fruit. INSOL (International Association of International Insolvency Practitioners) had made some headway in the 1980s and early 1990s at getting countries to think a little more internationally when it came to insolvencies. However, it was not until in 1997 that a major step was taken when UNCITRAL (United Nations Commission on International Trade Law) adopted a Model Law on Cross-Border Insolvency which was approved by the General Assembly on 15 December 1997.[5] The General Assembly of the United Nations established UNCITRAL in order to act as a vehicle for the United Nations to play a greater part in 'reducing the

[5] For a discussion of the Model Law, see, for instance, in IF Fletcher *Insolvency in Private International Law* (Oxford University Press, 2nd edn, 2005), ch 8.

disparities caused by the domestic rules governing international trade'.[6] The Model Law was designed to permit countries to adapt it to their own conditions and needs, so as to gain greater acceptance around the world, although UNCITRAL's recommendation to countries has been that they should make as few changes as possible. It must be added that the Model Law is an attempt to facilitate more beneficial administrations of insolvent estates and does not purport to confer substantive rights, something that is left to individual countries. Following the adoption of the Model Law, a Guide to Enactment of the Model Law was issued by UNCITRAL to aid states that wanted to enact the Model Law by way of their own legislative instruments. The UK has adopted the Model Law in the Cross-Border Insolvency Regulations 2006[7] which came into force on 12 April 2007.[8] These regulations and the issue of cross-border insolvency is discussed in Chapter 25.

Also, in May 2000 a European Community (EC) Regulation (No 1346/2000)[9] was adopted and this imposes control over the exercise of jurisdiction to commence insolvency proceedings in any of the states comprising the EU and provides uniform rules for choice of law and the law applying to proceedings. A couple of years was allowed for states to make changes to their laws to accommodate the Regulation and from 31 May 2002 the Regulation applied across the EU. The EC Regulation is discussed in Chapter 26.

The UNCITRAL Model Law, together with other promising contacts and commitments, like the EC Regulation on Insolvency Proceedings, will, it is hoped, make insolvency administration easier and will bear more fruit for creditors. We may even see more companies saved from the scrap heap as rescue packages are formulated for implementation across borders as well in national contexts.

Insolvency law is voluminous and growing all of the time. What we have sought to do in the remaining part of the book is to tackle the formal insolvency administrations permitted under law, as well as explaining some of the informal arrangements that do occur and address the primary issues that have to be faced in the course of an insolvency administration.

With the above as background we come to considering the field of insolvency law, no longer the poor relation of commercial law and no longer regarded as peripheral.

6 P Omar 'The UNCITRAL Insolvency Initiative: a five-year review' [2002] *Insolvency Lawyer* 228.
7 SI 2006/1030.
8 The Insolvency Act 2000 made provision for the Model Law to be given effect in the UK by Regulations made by Statutory Instrument.
9 [2000] OJ L 160/1.

1.2 HISTORICAL BACKGROUND

1.2.1 General

It is not intended to provide a detailed discussion and evaluation of the history of insolvency law, but a few comments might be helpful to provide some background for the reader in coming to an understanding as to how insolvency law has developed over the years.[10]

There have been various kinds of laws regulating the relationship between creditors and debtors for a very long time. One commentator has traced such laws as far back as the Hammurabi dynasty, in Babylon, which may have existed in about 2250 B.C.[11] From that time we can see that many different cultures have provided for the situation where a person becomes a debtor and unable to pay his or her debts. As commerce has developed so have the laws regulating the credit relationship. By necessity, these laws have had to deal with the consequences of a person being unable to pay his or her debts. Without doubt, many of the laws and customs which have arisen over the years (particularly those introduced by the Romans) have, directly or indirectly, found their way into the laws of insolvency which we have today.

1.2.2 Bankruptcy

The insolvency of companies is a relatively modern phenomenon, because the limited liability company is a rather recent form of legal animal. Individual insolvency, which until recent times usually meant bankruptcy, dominates the early history of insolvency in England and Wales. The law of bankruptcy can be traced back to the law that was applied in a number of Italian city states to merchants during the medieval period.[12] This law had its roots in Roman law.[13] Like the laws of these Italian states, in medieval times the early bankruptcy laws of England were formulated to act as an additional remedy to enable a creditor to attach the property of the debtor.[14]

The beginning of insolvency law in England is usually taken as the enactment of the first bankruptcy statute in 1542,[15] although the common law stretching back to medieval times did make some provision for debtors. The 1542 statute sought to prevent 'crafty debtors' escaping the

10 Professor Ian Fletcher provides a useful outline of the history in I F Fletcher *The Law of Insolvency* (4th edn), pp 6–10. A readable account of the history of bankruptcy law is provided in D Rose *Lewis' Bankruptcy Law* (Law Book Co, 11th edn, 2000), pp 8–18.
11 L Levinthal 'The Early History of Bankruptcy Law' [1918] *University of Pennsylvania Law Review* 223 at 230.
12 Jordan and Warren *Bankruptcy* (Foundation Press, 1985), p 17.
13 Ibid.
14 A Keay 'Balancing Interests in Bankruptcy Law' [2001] *Common Law World Review* 206 at 222.
15 34 & 35 Hen 8, c 4.

realm,[16] to ensure that all of the debtor's assets were available for creditors and that these assets were divided equally and rateably among the debtor's creditors. It is safe to say that at this point in time and for some years later, bankruptcy was regarded as quasi-criminal and even criminal by some such as Lord Kenyon who said, in 1798 in *Fowler v Padget*[17] 'Bankruptcy is considered as a crime and a bankrupt in the old laws is called an offender'. This was in line with the general view that bankrupts were fraudsters. Bankruptcy was, during the sixteenth century and all the way until the nineteenth century, restricted to 'traders', which meant that those persons who were not traders could not be bankrupted, leaving them subject to the general debtor laws which were unrealistic and generally unfair, essentially because imprisonment was the main 'remedy' invoked by creditors.[18] Charles Dickens in several of his novels, such as David Copperfield, drew attention to this situation.

From 1542 until the last one in 1914, there were numerous bankruptcy statutes enacted for England and Wales, many of which were passed to overcome some inefficiency or inequity produced by their precursors. It has been asserted that:[19]

> 'For the most part the history of bankruptcy law in England manifests a litany of *ad hoc* decision-making, with changes based on pragmatism and not predicated on any policy or attempt to achieve a balance between the stakeholders. Parliament reacted and over-reacted to every problem or perceived problem which arose.'

Notwithstanding the volume of legislation, it is possible to pick out, besides the initial bankruptcy statute in 1542, some critical points. Perhaps the first was legislation in 1705[20] which gave the Lord Chancellor the authority to discharge a bankrupt once he or she had a certificate of the bankruptcy commissioners providing that there had been full disclosure and adherence to their directions. Discharge has been, ever since, a marked aspect of Anglo-American law, providing bankrupts with a 'fresh start.' In 1825 legislation[21] allowed debtors to initiate proceedings for their own bankruptcy. Hitherto, bankruptcy could only occur where a creditor took proceedings. Subsequently, in the Bankruptcy Act 1869,[22] bankruptcy became something that was open to all persons and not just traders.

16 I Treiman '*Escaping the Creditor in the Middle Ages*' (1927) 43 LQR 230 at 233–234.
17 (1798) 7 Term Rep 509; 101 ER 1103.
18 A Keay 'Balancing Interests in Bankruptcy Law' [2001] *Common Law World Review* 206 at 222–225.
19 Ibid at 225.
20 3 Anne, c 17. The legislation was not in fact passed until 19 March 1706.
21 6 Geo IV, c 16.
22 24 and 25 Vict c 134, s 69.

1.2.3 Corporate insolvency

With the growth of joint stock companies during the nineteenth century came legislation to regulate the winding up of such entities.[23] The Joint Stock Companies Act 1844[24] incorporated companies that registered under its provisions. But the first statute enacted to regulate the winding up of companies was the Winding-up Act 1844.[25] Until this latter statute creditors could proceed not only against the company's property but also against the property of shareholders. The Winding-up Act provided for the first time that remedies of creditors of companies only extended to company property. Its purpose was, inter alia, to enable companies to be forced into bankruptcy in a like manner to individuals.[26] After this statute there were a few more statutes introduced to govern the winding up of companies in England and Wales,[27] and then from the time of the enactment of the Companies Act 1862,[28] the winding-up provisions were incorporated in companies legislation. The similarity between bankruptcy and winding up meant that many of the principles included in bankruptcy legislation were adopted by statutes regulating company windings up. While companies have been, and are, wound up for several reasons other than insolvency, insolvency is easily the most common reason for winding up and is the one on which we focus.[29]

At one time winding up was the only real option available when a company was insolvent, but as companies became more critical to commercial life and legislation developed, provision has been made for forms of insolvency administration other than winding up and this book will discuss the traditional options available. The same can be said in relation to personal insolvency. At one stage there was little option but for a person who was insolvent to let his or her creditors initiate bankruptcy proceedings to send him or her bankrupt, or, since the nineteenth century, to actually commence proceedings himself or herself to become a bankrupt. But in more recent years there are viable options for individual debtors to consider.

1.2.4 Modern developments

Notwithstanding the fact that bankruptcy and winding up were very similar, the provisions dealing with them were retained in separate legislation – for the most part the Bankruptcy Act and the Companies Act. Not only that, bankruptcy and winding up were administered by

23 For a detailed discussion of the development of winding up law, see A Keay *McPherson's Law of Company Liquidation* (Sweet & Maxwell, 2001), pp 11–24.
24 7 & 8 Vict c 110.
25 7 & 8 Vict c 111.
26 Section 1.
27 A Keay *McPherson's Law of Company Liquidation*, pp 17–21.
28 25 & 26 Vict c 89.
29 See Pt IV in particular.

administrator is going to consider the prior conduct of the directors. If the practitioner's advice to the directors prior to the administration is in some way questionable, or if proper advice was given but there are questions as to how it was interpreted by the directors, there is every chance that no-one will ever get to hear of it. It appears possible that the courts will, in certain circumstances, consider that an administrator, acting under the instructions of an appointing debenture holder, may be constituted the agent of the debenture holder.[87] In a pre-pack administration, which is subsequently converted to a creditors' voluntary liquidation or which moves straight to dissolution, there does not appear to be any realistic likelihood of an independent person considering the actions of the directors, the debenture holder or the administrator.

[87] See *Barclays Bank plc v Kingston* [2006] 1 All ER (Comm) 519 at paras 10 and 12.

CHAPTER 8

COMPANY VOLUNTARY ARRANGEMENTS

8.1 INTRODUCTION

When a company finds itself in financial difficulty it may attempt to come to some arrangement with its creditors. It may be that the company has short-term cash flow problems and may need its creditors to accept some delay in receiving payment. It may be that the company runs into difficulty where one of its major customers drops the company or itself becomes insolvent. In these circumstances, the company's underlying business may be sound, but it cannot afford to pay all its creditors all that it owes them. Although the company's controllers may consider putting the company immediately into liquidation, it may prove to be more beneficial to the company's creditors to come to some arrangement whereby the creditors are paid less than they are owed, but the amount paid is more than the creditors could expect on a winding up. If the creditors can be persuaded to agree to some such agreement the company may be saved.

The problem with a company negotiating an informal agreement with its creditors is that it will not be binding upon the creditors. The other problem likely to arise is that all the creditors may not agree to an arrangement. It will only take one creditor to break ranks and bring an action to enforce his or her debt and any proposed arrangement will immediately fall apart. The Cork Committee[1] recognised that there was a need for a simple procedure to be introduced, where the will of the majority of creditors in agreeing to a debt arrangement could be made binding on a minority. Entering into a company voluntary arrangement (hereafter 'CVA') with its creditors is usually the most effective way to achieve this. Sections 1–7B of the Act contain the primary legislation governing CVAs.

There are other ways of rescuing a company in distress which will be discussed in outline in Chapter 10. The approval of a CVA is one of the ways in which a company in administration can achieve the primary object of company rescue. These two procedures are often seen together in practice, as the moratorium given by administration allows time and

[1] Insolvency Law and Practice, Cmnd 8558 (1982), Ch 7.

protection from creditor interference for the administrator to draft a proposal for a CVA. Note that when this happens the procedure to put the company into administration must first be followed and then, if the requisite majority of creditors support the proposing of a CVA, the administrator will draft the proposal and call meetings of both members and creditors to consider its approval. Both procedures will need to be followed. (It should be noted that a liquidator of a company may propose a CVA, but this is extremely rare in practice.)

It is, of course, possible for the directors of a company to propose a CVA without first putting the company into administration. This option suffers from the weakness that there is no moratorium on actions against the company while the CVA proposal is being prepared. Creditors may therefore frustrate a possible CVA by enforcing their rights prior to the meetings called to approve the proposal. This weakness of the CVA system was, in theory, remedied, at least for small companies by the Insolvency Act 2000 introducing a CVA specific Schedule A1 to the Act.

As we shall see in Chapter 9, an individual debtor may propose an individual voluntary arrangement (hereafter 'IVA'). The law regarding IVAs is broadly the same as for CVAs. For this reason, in this chapter we shall be considering some IVA cases as well as those dealing with CVAs. One of the main differences between IVAs and CVAs historically has been that an individual proposing an IVA has always been able to ask the court for an Interim Order while the IVA proposal is being prepared. The Interim Order acts as a temporary moratorium against certain creditors enforcing their rights while the proposal for the IVA is put together and put to a meeting of the individual's creditors.[2] A similar protection for companies is now possible, as explained above, either under Schedule A1 or by putting the company into administration.

8.1.1 What is a company voluntary arrangement?

When one first reads Part I of the Act and Part I of the Rules, one is immediately struck with how little detailed guidance is given as to what a CVA should look like or do. There were originally only seven sections and 30 rules. Even though these have been added to, there is still a distinct lack of detail in places. The provisions look particularly sparse when compared with, for example, the amount of legislation dealing with liquidation. In obtaining a clear understanding of CVAs, much depends on judicial interpretation. The whole idea of pushing through a CVA is usually to prevent the creditors putting the company into winding up. The way this goal is achieved is by offering the creditors a better deal than they would realise in a liquidation. The statutory effect of a CVA is that, once

[2] Another rather striking difference is that IVAs have become extremely common whilst CVAs remain relatively rare. For the years ending 2005, 2006 and 2007 there were respectively 20,293, 44,332 and 42,165 IVAs in England and Wales whilst for the same years there were respectively 604, 534 and 399 CVAs.

it has been agreed by the requisite majorities of members and unsecured creditors, it becomes binding on all unsecured creditors who were entitled to vote at the meeting, even if they voted against the proposal or did not attend the meeting (subject to preferential creditors retaining their preferential rights under section 4(4)).

The CVA regime has not proven as popular as it had been hoped when the Cork Committee recommended its creation back in 1982. There are arguably a number of reasons for this. The first is that the arrangement cannot prevent a secured creditor from enforcing its security without the secured creditor's consent.[3]. A rescue package needs therefore, usually to promise full payment to secured creditors otherwise they are unlikely to consent to the CVA. If a secured creditor chooses not to consent it can proceed to enforce its security against the company with the likely consequence that the company will be wound up and not rescued.

The second perceived problem, as mentioned above, was that there was no provision within the CVA regime, as originally drafted, for a moratorium on creditor action while the proposal was drawn up and considered. It has always been possible to put the company into administration, and at the same time obtain the benefit of the administration moratorium, before putting together a proposal for a CVA. The problem with this route, under the old administration regime, was that the time and expense of obtaining an administration order was often prohibitive. Due to this second weakness, the CVA provisions of the Insolvency Act 2000, introducing a new Schedule A1 to the Act, were passed in order to allow small companies to obtain a moratorium, pending a draft CVA proposal. The Schedule A1 procedure therefore permits a moratorium to be obtained without the need to put the company into administration. The Schedule A1 procedure is little used in practice. It has been superseded by the ease with which a company can now enter administration under the new administration regime.

A third reason why CVAs have not really taken off is perhaps due to the fact that although administrators are under a duty to consider mechanisms for rescuing the company, in practice, such rescue attempts occur in less than 10% of administrations.[4] Administrators appear to favour a sale as a going concern of the company's business rather than a

[3] In addition, but less of an issue nowadays due to the abolition of the Crown preference by the Enterprise Act 2002, preferential creditors cannot be treated under the arrangement in a way which does not recognise their right to be paid rateably ahead of non-preferential creditors. This requirement is subject to the preferential creditors agreeing otherwise.

[4] See *A* Katz and M Mumford *Study of Administration Cases – Report to the Insolvency Service* (October 2006) – http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/studyofadmincases.pdf (last accessed 21 February 2008).

rescue of the company itself. An administrator can then distribute the proceeds of sale to the creditors (including unsecured creditors with the court's permission).[5]

Under section 1 of the Act, the CVA itself may take one of two forms (or be a combination of the two). It may be:

(1) a 'composition of debts' whereby the company agrees to pay only a certain proportion of the debt it owes, for example, 50p in the pound; or

(2) a 'scheme of arrangement' whereby the company agrees to pay its creditors in full but cannot pay them immediately. The scheme may be merely a moratorium. Usually a scheme is drawn up with a schedule as to when the creditors will be paid and the amounts of each payment. Schemes may include the granting to creditors of an interest in the company. This may be in the form of a debt-equity swap, whereby the creditor exchanges its debt for an equity shareholding in the company. If a company is large, the scheme may take the form of a complex reconstruction of the company (possibly involving a takeover of the company by a purchaser who is able to inject expertise or capital).[6]

A CVA may be either what is termed a 'trading' or an 'assets' based CVA. A 'trading' voluntary arrangement will usually state that the company agrees to pay a certain amount each month to the supervisor of the CVA who will, for the duration of the arrangement, distribute the funds according to the terms of the CVA. The CVA may go on for a number of years. The 'assets' based CVA will usually be to the effect that certain assets will be sold and the proceeds used to pay off the creditors the agreed amount. The supervisor will usually hold cash or other assets on behalf of the company's creditors. The supervisor is usually understood to be holding such assets on trust for the creditors subject to the terms of the CVA.

Prior to looking at the procedure to approve a CVA, it may be useful to become familiar with what information must be included in a CVA. A CVA may be proposed by the company's directors or if the company is in administration or liquidation, by the administrator or liquidator as the case may be. The Rules contain a list of matters which must be included in a directors' proposal for a CVA (rule 1.3). If the proposal is by an administrator or liquidator the proposal's contents are essentially the

[5] See Chapter 7; Sch B1, para 65; *Re GHE Realisations Ltd* [2006] 1 All ER 357.

[6] See the discussion in *March Estates plc v Gunmark Ltd* [1996] 2 BCLC 1 and *Commissioners of Inland Revenue v Adam & Partners Ltd* [2001] 1 BCLC 222. For an example of an arrangement which constituted neither a composition nor a moratorium and therefore did not qualify as a voluntary arrangement see the IVA case *Commissioners of Inland Revenue v Bland* [2003] BPIR 1274.

same (rule 1.10). The following must be contained in a proposal for a CVA (the notation is taken from rule 1.3):

(1) The proposal shall provide a short explanation as to why, in the opinion of the directors (or the responsible insolvency practitioner as the case may be), a voluntary arrangement is desirable, and give reasons why the company's creditors may be expected to concur with such an arrangement.

(2) The following matters shall be stated, or otherwise dealt with, in the proposal—
  (a) the following matters, so far as within the immediate knowledge of the directors (or the responsible insolvency practitioner as the case may be)—
    (i) the company's assets, with an estimate of their respective values,
    (ii) the extent (if any) to which the assets are charged in favour of creditors,
    (iii) the extent (if any) to which particular assets are to be excluded from the voluntary arrangement;
  (b) particulars of any property, other than assets of the company itself, which is proposed to be included in the arrangement, the source of such property and the terms on which it is to be made available for inclusion;
  (c) the nature and amount of the company's liabilities (so far as within the immediate knowledge of the directors (or the responsible insolvency practitioner as the case may be)), the manner in which they are proposed to be met, modified, postponed or otherwise dealt with by means of the arrangement, and (in particular)—
    (i) how it is proposed to deal with preferential creditors (defined in section 4(7))[7] and creditors who are, or claim to be, secured,
    (ii) how persons connected with the company (being creditors) are proposed to be treated under the arrangement, and
    (iii) whether there are, to the knowledge of the directors (or the responsible insolvency practitioner as the case may be), any circumstances giving rise to the possibility, in the event that the company should go into liquidation, of claims under—
      section 238 (transactions at an undervalue),
      section 239 (preferences),
      section 244 (extortionate credit transactions), or
      section 245 (floating charges invalid);

[7] If the company is in administration, the proposal must include details of the identity of the preferential creditors and the amount of debt owed to each of them (r 1.10(1)(a)).

and, where any such circumstances are present, whether, and if so how, it is proposed under the voluntary arrangement to make provision for wholly or partly indemnifying the company in respect of such claims;

(ca) an estimate by the directors or the responsible insolvency practitioner of the value of the prescribed part under section 176A and the value of the company's net property. If the company is in administration or liquidation, the responsible insolvency practitioner must also state whether, and if so, why an application under section 176A(5) is to be made.[8]

(d) whether any, and if so what, guarantees have been given of the company's debts by other persons, specifying which (if any) of the guarantors are persons connected with the company;

(e) the proposed duration of the voluntary arrangement;

(f) the proposed dates of distributions to creditors, with estimates of their amounts;

(fa) how it is proposed to deal with a person bound by the CVA under section 5(2)(b)(ii), that is, a creditor who is bound by the CVA as a person who could have voted at the creditors' meeting but who did not receive notice of the meeting (for example, an unknown creditor);

(g) the amount proposed to be paid to the nominee (as such) by way of remuneration and expenses;

(h) the manner in which it is proposed that the supervisor of the arrangement should be remunerated, and his expenses defrayed;

(j) whether, for the purposes of the arrangement, any guarantees are to be offered by directors, or other persons, and whether (if so) any security is to be given or sought;

(k) the manner in which funds held for the purposes of the arrangement are to be banked, invested or otherwise dealt with pending distribution to creditors;

(l) the manner in which funds held for the purpose of payment to creditors, and not so paid on the termination of the arrangement, are to be dealt with;

(m) the manner in which the business of the company is proposed to be conducted during the course of the arrangement;

(n) details of any further credit facilities which it is intended to arrange for the company, and how the debts so arising are to be paid;

(o) the functions which are to be undertaken by the supervisor of the arrangement;

(p) the name, address and qualification of the person proposed as supervisor of the voluntary arrangement, and confirmation that he is either qualified to act as an insolvency practitioner in relation to the company or is an authorised person in relation to the company; and

[8] For a consideration of s 176A see Chapter 30.

(q) whether the EC Regulation[9] will apply and, if so, whether the proceedings will be main proceedings, secondary proceedings or territorial proceedings.

It should be borne in mind that the above contents are not necessarily exhaustive as to what should be included. Further information may be necessary in order to explain fully the proposal. If, for example, the proposal is for a 'trading' CVA it may be necessary or desirable to explain the business plan which will be followed. The clearer the proposal, the more likely the creditors are to understand it and agree to it. Certain standard terms[10] have become commonplace such as clauses dealing with certain powers of the supervisors (both substantive and administrative), how the CVA may be varied if circumstances alter and how contingent or prospective creditors are to be dealt with under the CVA.

8.2 PROCEDURE

8.2.1 Procedure to approve a company voluntary arrangement

The main procedure under Part 1 of the Act will be considered first. We shall then look at the little used procedure under Schedule A1.

Under section 1 of the Act, the persons who may commence the procedure leading to a CVA will be the directors of the company, unless the company is in liquidation or administration, in which cases the procedure will be initiated by the liquidator or administrator as the case may be.[11]

If the directors begin the process, under section 2, they must approach a person authorised to act as 'nominee'.[12] The Act states that the directors will submit to the nominee a proposal for a CVA along with a statement of the company's affairs (essentially details of the company's liabilities and assets). In practice, what usually happens is that the directors will

[9] See Chapter 26.

[10] There is no one general form of standard terms and conditions for CVAs but R3 (the Association of Business Recovery Professionals) have drafted standard terms for IVAs and many of these terms are commonly imported into CVA with necessary adjustments.

[11] The meaning of 'company' for these purposes is defined in s 1(4) and (5) and includes companies registered in the UK or other European Economic Area ('EEA') member states or any other company whose 'centre of main interests' is in an EEA member state (other than Denmark).

[12] The nominee must be either a licensed insolvency practitioner or otherwise licensed to act as nominee. The latter reference is to persons who are not licensed insolvency practitioners but who are authorised to act as nominees and supervisors of voluntary arrangements under s 389A. At present, due to uncertainty as to the meaning of s 389A, no licensing bodies other than those with insolvency practitioners as members have applied for recognition. It is likely that the meaning of s 389A will be clarified shortly with the intention of encouraging applications from, for example, bodies representing 'turnaround professionals' such as the Society of Turnaround Professionals.

CHAPTER 20

DEBTOR'S PETITION

20.1 INTRODUCTION

It has for many years been the case that an individual debtor can seek the protection of the bankruptcy procedure by way of the presentation of the debtor's own petition. The effect of presenting the petition immediately removes the debtor's estate from separate enforcement proceedings by unsecured creditors. At the time of writing the Insolvency Service is consulting on a proposal to remove the requirement for a debtor to petition the court but instead to apply to the Official Receiver who will decide whether or not to make a bankruptcy order as an administrative rather than a judicial decision.[1] For present purposes we shall concentrate on the current law.

Under section 272 of the Act, a debtor can only be made bankrupt if he or she is unable to pay debts that are owed. The sole ground for a debtor's petition is in fact the inability to pay debts. If the debtor can pay debts which are currently enforceable and due, the debtor cannot petition for his or her own bankruptcy. There is no minimum debt level which must have been reached. The test is based upon the debtor's ability to pay currently due debts.[2] It is a matter of current liquidity. It is not an issue whether or not the debtor's assets are greater than his or her liabilities. In *Re A Debtor, ex parte the Debtor v Allen (No 17 of 1966)* ([1967] Ch 590):

> A debtor owed £2,400. Judgment was obtained by a creditor and the court ordered the debt to be paid by instalments of a little over a pound a week. The debtor petitioned against himself on the grounds that he was unable to pay his debts. The debtor was hoping to be made bankrupt and get discharged from the full debt of £2,400. The court made the order but it was annulled on appeal on the basis that he could pay all the debts due i.e., the weekly instalments.

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1 See the Insolvency Service document 'Bankruptcy: proposals for reform of the debtor petition process' (October 2007). One of the main reasons for proposal is that over 80% of bankruptcy orders are made on the basis of a debtor's petition and the courts are getting clogged up with record numbers of petitions. For the years 2005, 2006 and 2007 respectively in England and Wales there were 47,291, 62,956 and 64,480 bankruptcy orders made. This is three times as many as in the late 1990s/early 2000s.

2 See, eg, *Re Coney* [1998] BPIR 333.

The petition must contain details of:[3]

(1) the debtor's place of residence;

(2) the debtor's occupation or business;

(3) any names other than the debtor's true name used either in business or otherwise;

(4) a statement that the debtor is unable to pay his or her debts and requests a bankruptcy order;

(5) whether or not the debtor has, in the previous five years, been made bankrupt, been subject to a voluntary arrangement or county court administration order;

(6) if there is in force an individual voluntary arrangement, details of the supervisor must be given.

Under section 285, at any time when proceedings on a bankruptcy petition are pending the court may stay any action, execution or other legal process against the property or person of the debtor. The court, or any court where proceedings are pending, may stay proceedings or allow them to continue on such terms as it thinks fit. Once a bankruptcy order is made, creditors are generally prevented from commencing any action against the bankrupt or claiming any remedy against the property or person of the bankrupt. The creditors' rights to enforce their claims are stayed.

Any attempt by the debtor to petition for bankruptcy to protect himself or herself from creditor harassment in the short term and then later withdraw the petition after the protection is obtained is prevented by section 266. This section states that a petition can only be withdrawn with the consent of the court. A debtor cannot therefore use the expedient of a bankruptcy petition to create a temporary lull in creditor enforcements and then later unilaterally withdraw the petition.

The court has the power to refuse to consider a petition if its presentation amounts to an abuse of process.[4] Under section 375 the court has a wide power to 'review, rescind or vary' any order.[5] The court may also annul a bankruptcy order under section 282 where it is of the opinion that the order should not have been made. An example from the old pre-1986 law is *Re Betts* ([1901] 2 KB 39):[6]

[3] See rr 6.38–6.39.
[4] See, eg, *Re Micklethwaite* [2003] BPIR 101.
[5] See, eg, *Amihyia v Official Receiver* [2005] BPIR 264.
[6] See also *Re Bond* (1888) 21 QBD 17.

> The debtor had evaded committal proceedings against him twice before by presenting bankruptcy petitions against himself. Such petitions protected him from enforcement proceedings. The third attempt to remove himself from his creditors' actions failed when the court rescinded the order made. The court pointed out that it was by no means illegal to obtain protection from one's creditors by petitioning for bankruptcy. It was just that on the facts, the debtor was clearly abusing his legal privilege.

The petition must be accompanied by a statement of the debtor's affairs which contains particulars of the debtor's creditors and debts and other liabilities. The court fee for such a petition is currently £150 (SI 2007/2176) which may be waived if the debtor is in receipt of benefit payments. Upon filing, the court sends notice to the Chief Land Registrar for registration in the register of pending actions. If the court can be persuaded that it is necessary for the protection of the debtor's property, it may (under section 286) at any time after the presentation of the petition appoint the official receiver to be interim receiver of the debtor's property. The interim receiver has wide powers under section 287 to act as receiver and manager to protect the property pending the hearing of the petition.[7]

The petition, together with three copies and the statement of affairs accompanied by one copy, must be filed at court. A deposit of £345 must also be paid.[8] This deposit goes towards covering the costs of the official receiver. One copy of the petition is returned to the debtor. One copy of the petition together with the copy of the statement of affairs is sent to the official receiver. The remaining copy petition is retained by the court to be sent to an insolvency practitioner if one is appointed under section 273 to consider a possible voluntary arrangement.[9]

A bankruptcy commences on the day on which the order is made and continues until the bankrupt is discharged (section 278).

20.2 CONSIDERATION OF POSSIBLE VOLUNTARY ARRANGEMENT

Under section 273 the court will not make a bankruptcy order in the following circumstances:

(1) if a bankruptcy order were made the amount of the unsecured bankruptcy debts would be less than the small bankruptcies level (currently £40,000 under the Insolvency Proceedings (Monetary Limits) (Amendment) Order 2004 (SI 2004/547));

[7] See, eg, *Re Baars* [2003] BPIR 523.
[8] See r 6.42 and Insolvency Proceedings (Fees) (Amendment) Order 2008 (SI 2008/714). The payment of the deposit is mandatory and this requirement is not a breach of a debtor's human rights – see *R v Lord Chancellor, ex parte Lightfoot* [1999] 4 All ER 583.
[9] See r 6.42.

(2) if a bankruptcy order were made the estate would be equal to or more than the minimum amount (currently £4,000 (SI 2004/547);

(3) the debtor has not in the previous five years either been made bankrupt or entered into a composition or scheme with his or her creditors; and

(4) it would be appropriate to appoint a person to prepare a report which may lead to an individual voluntary arrangement being approved.

The policy behind section 273 is to discourage bankruptcy wherever possible. The Act assumes that it may be more appropriate to consider a voluntary arrangement where the debts are not enormous and there is at least some value in the estate. The insolvency practitioner appointed, under section 273, must submit a report to the court stating whether or not the debtor is willing to make a proposal for a voluntary arrangement. The report will also state whether or not meetings of the debtor's creditors should be called to consider such a proposal. Depending upon the contents of the report, the court may decide to make a bankruptcy order. If the voluntary arrangement proposal seems feasible the court may make an interim order to ensure that creditor harassment does not interfere with the putting of the proposal to the creditors as a whole. The voluntary arrangement regime contained within Part VIII of the Act applies to the situation thereafter, as if the whole thing had been commenced as a voluntary arrangement.

The procedure under section 273 does not apply where the petition is brought by a creditor.

20.3 CONSIDERATION OF POSSIBLE DEBT RELIEF ORDER

As was briefly explained in Chapter 10, the Tribunals, Courts and Enforcement Act 2007 has provided for a new form of insolvency procedure, the Debt Relief Order, which, although not in force at the time of writing, is designed to provide a solution for debtors who have virtually no income and no assets. It is a procedure short of bankruptcy, but only just. We previously referred to it as "bankruptcy lite". Once the Debt Relief Order regime is in force, the court may under section 274A, on the debtor's own petition (or application if debtors are permitted to apply for bankruptcy administratively) for bankruptcy, instead of dealing with the bankruptcy petition, refer the debtor to an approved intermediary for the purposes of making an application for a Debt Relief Order. The court will do so, if it thinks it would be in the debtor's best interests.

CHAPTER 21

CREDITOR'S PETITION

21.1 INTRODUCTION

It is extremely common for a bankruptcy order to be made on the petition of a creditor.[1] The law and procedure in this area are based upon and have much in common with a creditor's petition for the compulsory liquidation of a company.[2]

Under section 383 of the Act, a creditor is defined for the purposes of bankruptcy as a person to whom any 'bankruptcy debt' is owed. In relation to a creditor's petition a creditor is defined as any person who would be a creditor in the bankruptcy if a bankruptcy order were made on that petition. 'Bankruptcy debt' is defined in section 382 and includes the following:

(1) any debt or liability to which the debtor is subject at the commencement of the bankruptcy;

(2) any debt or liability to which the debtor may become subject after the commencement of the bankruptcy (including after discharge) by reason of any obligation incurred before the commencement of the bankruptcy.

Liability in tort is included as long as the cause of action arose prior to the commencement of the bankruptcy. The debt may be present or future, certain or contingent, for a fixed sum or unliquidated or capable of being ascertained by fixed rules or as a matter of opinion.[3]

The definition of debt for these purposes would include debts which have been assigned to third parties although the assignee may have difficulty in petitioning unless the assignment satisfies section 136 of the Law of

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1 See S Baister 'Bankruptcy Basics – preparing the bankruptcy petition' (2006) 22 *Insolvency Law and Practice* 210.

2 See Chapter 14.

3 It would appear a petition can even be based upon a non-provable debt although the court would appear reluctant to make an order in such circumstances unless a creditor with a provable debt obtained a change of carriage order: *Levy v Legal Services Commission* [2001] 1 All ER 895.

Property Act 1925.[4] Most debt factoring and invoice discounting agreements will satisfy section 136 and so this should not be a problem for debt factors and invoice discounters wishing to put the debtor into bankruptcy.

21.2 THE PETITION

Where a single debt is owed to two or more joint creditors, a bankruptcy petition can only be brought if all the joint creditors are a party to it.[5] It is possible, if no single creditor is owed the minimum statutory level of debt, for two or more creditors to join in presenting a petition on the basis that the aggregate amount is at least as much as the bankruptcy minimum.[6]

Although the definitions mentioned in the introduction above suggest that a creditor may petition for the debtor's bankruptcy on the basis of a future or contingent debt, the matter is clarified by section 267 which lays down a number of qualifications for the presentation of a petition:

(1) The petition must be in respect of one or more debts owed by the debtor and the petitioning creditor must be a person to whom the debt is owed. The section permits a joint petition by more than one creditor in which case each of the petitioning creditors must be owed at least one of the debts; and

At the time of the petition:

(2) the amount of the debt is at least the amount of the bankruptcy level, currently £750;

(3) the debt must be for a liquidated sum payable either immediately or at some certain, future time;

(4) the debt is unsecured;

(5) the debt is one which the debtor appears either to be unable to pay or to have no reasonable prospect of being able to pay; and

(6) there must be no pending application to set aside a statutory demand served in relation to the debt.

Some important points may be made in light of this. The debt, required to be for at least £750, must be payable immediately or at some future time.[7]

[4] If the assignment is only an equitable assignment, the assignee will in theory need to join the assignor to the petition. *Re Baillie* (1875) LR 20 Eq 762 suggests that an equitable assignee can petition without such joinder but the position remains somewhat uncertain.
[5] See *Brickland v Newsome* (1808) 1 Camp 474.
[6] See *Re Allen, Re A Debtor (No 367 of 1992)* [1998] BPIR 319.
[7] See, eg, *Coulter v Chief of Dorset Police* [2005] 1 WLR 130.

Under rule 6.30, if the petitioning creditor fails to appear at the hearing or withdraws, the court may substitute another creditor to take the original petitioning creditor's place. This can be done as long as the substitute would have been entitled to petition himself or herself on the date of the presentation of the petition.

Contractual entitlements to interest may be added to the principal sum in calculating the overall debt. Costs of failed enforcement proceedings cannot be added to take the debt over the bankruptcy level.[8] The petition should not add to the petition debt, the costs of the petition to date.[9] Any right of set-off under section 323 must be taken into account before any final figure is reached. If the debt has been reduced below the bankruptcy level by the time of hearing of the petition, it is at the court's discretion whether or not to make the order.[10] The petition could of course continue with the substitution of the petitioning creditor under rule 6.30. As with winding up orders, a bankruptcy order will not be made where the debt is subject to a genuine dispute unless the undisputed part is equal to or exceeds £750.[11]

The debt must be liquidated at the date of the petition or at some certain future time. Outstanding tort claims cannot, by definition, be liquidated until the court makes an award. Contractual claims will usually be for a certain amount and will therefore be liquidated.[12] An unassessed bill of solicitor's costs cannot be a liquidated debt upon which a bankruptcy petition can be founded.[13] The liability must be an existing liability even if it is not payable until some future specific moment. The liability cannot be one that is contingent on the occurrence of some event.

As the bankruptcy process does not prevent a secured creditor from enforcing his or her security, such a creditor is prevented from petitioning for a bankruptcy.[14] Under section 269 a petitioning debt need not be unsecured if the creditor agrees to give up the security upon bankruptcy, or the petition is made in respect of an unsecured part of the debt owed.

Section 267 states that the debtor must appear to be unable to pay or have no reasonable prospect of paying the debt. The debtor's inability to pay debts is defined in section 268. There are only two ways in which it can be shown that the debtor is unable to pay currently due debts:

[8] See, eg, *Re Long* (1888) 20 QBD 316.
[9] See, eg, *Lilley v American Express Europe Ltd* [2000] BPIR 70
[10] Much will depend upon whether the court believes the debtor is playing games with the petitioning creditor: *Lilley v American Express Europe Ltd* [2000] BPIR 70.
[11] See *TSB Bank plc v Platts (No 2)* [1998] BPIR 284 at 293.
[12] See, eg, *Re King, ex parte Furber* (1881) 17 Ch D 191.
[13] See, eg, *Klamer v Kyriakides and Braier (a firm)* [2005] BPIR 1142.
[14] See s 285(4). For the meaning of security, see Chapter 31.

CHAPTER 38

TRANSACTIONS AT AN UNDERVALUE

38.1 INTRODUCTION

This chapter deals with transactions that have left the insolvent's estate short of funds or property, because the insolvent has either made gifts to others or received consideration of a value that is significantly less than that which was given by the insolvent and the provisions, namely sections 238 and 339, enable office-holders to challenge such transactions in an attempt to conserve the insolvent estate. Transactions entered into by a company may be challenged by either a liquidator or administrator and transactions entered into by an insolvent individual might be impugned by a trustee in bankruptcy.

While other provisions included in the adjustment sections of the Act were based directly on previous provisions in either the companies or the bankruptcy legislation, sections 238 and 339 were new provisions clearly providing that undervalued transactions could be adjusted. But, it is undoubtedly true to say that the provisions have their roots in the law which first provided for the avoidance of fraudulent conveyances, in 1571. This is because the provisions are designed to prevent debtor misbehaviour, namely preventing insolvents disposing of assets, particularly to associates, at an undervalued amount just before the advent of a formal insolvency administration, thereby reducing the pool of property which would be available to the office-holder to distribute to creditors. Provisions like sections 238 and 339 are designed to discourage those in control of companies and individual debtors from transferring assets or opportunities to associates so that they benefit and the creditors of insolvents lose out. Whilst, arguably, the provisions differ, as far as purpose goes, from sections 239 and 340 which deal with the adjustment of preferences,[1] it has been held that a transaction could in fact be adjusted on the basis of being both a preference and a transaction at an undervalue (*Barber v CI Ltd* [2006] BCC 927), although that view has been adroitly, it is respectfully submitted, subjected to criticism.[2]

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1 See A Keay 'In Pursuit of the Rationale Behind the Avoidance of Pre-Liquidation Transactions' (1996) 18 *Sydney Law Review* 55.

2 For example, see L Ho and R Mokal 'Barber v CI' (2006) 22 I L & P 183. The Court of Appeal did not comment on the view propounded at first instance, taking the view that

It should be noted that liquidators and trustees in bankruptcy need to secure approval from either the liquidation committee or the court in the case of the former and the creditors' committee or the court in the case of the latter, before initiating proceedings under either sections 238 or 339 (para 3A of Schedule 4 and para 2A of Schedule 5).

38.2 CONDITIONS FOR ADJUSTMENT

Before a court will consider making any order adjusting a transaction at an undervalue under sections 238 and 339, an office-holder must establish the following:

- the insolvent is in liquidation, administration (section 238(1)) or bankruptcy (section 339(1));
- the insolvent, if a company, entered into a transaction at an undervalue in the two years preceding the onset of insolvency (sections 238(2), 240(3)), or the insolvent, if an individual, entered into a transaction at an undervalue in the 5 years preceding the date of the presentation of the bankruptcy petition (sections 339(1), 341(1)(a));
- at the time when the transaction was entered into a company was unable to pay its debts or it was unable to pay its debts as a result of entering into the transaction (section 240(2)), or an insolvent person was insolvent or became so as a result of entering into the transaction (section 341(2)) (in bankruptcy if the transaction occurred in the two years proceeding bankruptcy there is a presumption of insolvency).

Importantly, demonstration of any intention to defraud or injure the creditors, or that the insolvent was aware of insolvency at the time of the transaction, is not necessary.

The onus of proving insolvency is removed in circumstances where the defendant is a connected person (section 240(2)) or an associate (section 341(2)). In such a situation there is a rebuttable presumption that the insolvent was in fact insolvent at the time of the transaction.

38.3 THE TRANSACTION

The meaning of a transaction at an undervalue is set out, for insolvent companies, in section 238(4). Such a transaction occurs where:

as the transaction could be adjusted as a preference there was no need to consider whether it was a transaction at an undervalue (*Re Sonatacus Ltd; CI Ltd v Barber* [2007] EWCA Civ 31, [2007] 2 BCLC 627).

(a) the company makes a gift to that person [the person the subject of the proceedings] or otherwise enters a transaction with that person on terms that provide for the company to receive no consideration; or

(b) the company enters into a transaction with that person for a consideration the value of which, in money or money's worth, is significantly less than the value, in money or money's worth, of the consideration provided by the company.

The equivalent provision for individuals (section 339(3)) is almost identical save for the fact that in addition a transaction can be covered by the section if the individual enters into the transaction in consideration of marriage (section 339(3)(b)). The inclusion of this category is probably to address the fact that in equity marriage is valid consideration (*Attorney-General v Jacobs Smith* [1895] 2 QB 341) and also under previous legislation (Bankruptcy Act 1914, section 42) marriage could render an otherwise voidable transaction valid.

'Transaction' is defined in section 436 as including 'a gift, agreement or arrangement' and it is indicated that the references to 'entering into a transaction' in the Act are to be construed accordingly. 'Transaction' is defined broadly and embraces a potentially wide range of possibilities (*Re Taylor Sinclair (Capital) Ltd* [2001] 2 BCLC 176 at 184). The courts have said that they should not strain to limit the width of the definition and the courts have said that they should not strain to limit the width of the definition: (*Phillips v Brewin Dolphin Bell Lawrie Ltd* [1999] BCC 557 at 565, CA).[3] It is not necessary that there is a contract (*Re HHO Licensing Ltd (in liq)* [2007] BPIR 1363 at [31]). 'Transaction' would appear to cover:

- gifts;[4]
- agreements to perform tasks for no consideration;
- purchases of property which has a market value less than the price paid;
- leases of assets over their rental value;
- dispositions of property for prices less than their market value;
- the supply of an asset on lease below its rental value;

[3] On appeal the House of Lords ([2001] 1 WLR 1430) appeared to agree with this approach.

[4] For an example of this, see *Re Barton Manufacturing Co Ltd* [1998] BCC 827, [1999] 1 BCLC 740.

- agreeing to pay for services a sum which exceeds their value;
- agreeing to provide services for a sum less than their value;
- providing a guarantee for no benefit or a benefit less than the value of the benefit conferred by the guarantee;
- providing security for a previously unsecured loan.[5]

In *Re MC Bacon Ltd* ([1990] BCLC 324) Millett J took the view, which has generally been accepted, that the granting of security by the debtor could not constitute a transaction within the section. However, the judgment of the Court of Appeal in *Hill v Spread Trustee Co Ltd* ([2006] EWCA Civ 542, [2006] BPIR 789) (a case dealing with section 423 and considered in Chapter 40) suggests that this does not automatically result in the fact that there can be no transaction at an undervalue.[6]

Millett J in *Re MC Bacon Ltd* broke section 238 down into parts as far as a transaction is concerned. His Lordship said that the transaction must be:[7]

> '(i) entered into by the company; (ii) for a consideration; (iii) the value of which is measured in money or money's worth; (iv) is significantly less than the value; (v) also measured in money or money's worth; (vi) of the consideration provided by the company (at 340).'

The House of Lords in *Phillips v Brewin Dolphin Bell Lawrie Ltd* ([2001] 1 WLR 143) indicated that it was not necessary to search for one transaction, as inter-connected transactions could be considered in assessing whether there was a transaction at an undervalue.[8] Their Lordships actually said that the focus should not be on finding the transaction, but on finding the consideration (if any) that is given and received (at [20]). Lord Scott gave the following example to explain the view: 'if a company agrees to sell an asset to A on terms that B agrees to enter into some collateral agreement with the company, the consideration for the asset will, in my opinion, be the combination of the consideration, if any, expressed in the agreement with A and the value of the agreement

5 The transactions are based on R Goode *Principles of Corporate Insolvency Law* (Sweet and Maxwell, 3rd edn, 2005), p 419 and para 668 of the Australian Law Reform Commission's *General Insolvency Inquiry* ('the Harmer Report'), Report No 45 (1988, Canberra).

6 See J Levy, J and A Bowe 'Transactions at an undervalue – a new departure' (2006) 22 I L & P 222; R Stubbs 'Section 423 of the Insolvency Act in Practice' (2008) 21 *Insolvency Intelligence* 17.

7 This breakdown was approved of by the House of Lords in *Phillips v Brewin Dolphin Bell Lawrie Ltd* ([2001] 1 WLR 143 and the Court of Appeal in *Ramlort Ltd v Reid* [2004] EWCA Civ 800, [2005] 1 BCLC 331, [2004] BPIR 985.

8 For a recent outworking of this idea, see, *Griffin v Awoderu* [2008] All ER (D) 140 (Jan).

with B.' (at [20]). Unfortunately, the decision does not indicate how far one can go in including transactions that were not entered into between the company and the respondent.[9]

38.4 CONSIDERATION

From what Millett J said in *Re MC Bacon Ltd*, and approved of by Jonathan Parker J, in *Re Brabon* ([2000] 1 BCLC 11, [2000] BPIR 537), it is plain that a liquidator must establish a significant undervalue by proving the respective values of the consideration given by the parties to the transaction and this must be done in money terms.[10] So, in the classic case where the company sells an asset for £10,000 to X and the liquidator maintains that the asset was worth £20,000, he or she must establish the latter value.

The issue of consideration is very much central to the transaction under scrutiny and it is more important to ascertain the consideration received by the insolvent than identifying the actual transaction itself. The actual consideration given to the company by the other party to the transaction will usually be examined carefully. The House of Lords in *Phillips v Brewin Dolphin Bell Lawrie Ltd* ([2001] 1 WLR 143)[11] said that if the value of the consideration for which a company enters into a transaction is speculative, then the party who relies on the consideration is required to establish the value.[12]

The use of the word 'consideration' in sections 238(4) and 339(4) might well lead to confusion. The word is used regularly in the contract law field and in that sense it has a rather specialised meaning. It is debatable whether the word is being used in its contractual sense[13] and in the Court of Appeal in *Phillips v Brewin Dolphin Bell Lawrie Ltd* ([1999] 2 All ER 844 at 853) Morritt LJ refrained from coming to a decision one way or the other. His Lordship said that the critical thing was that there was a quid pro quo 'for that which it is alleged that the company disposed of at an undervalue' (at 853). In any event, the interpretation of 'consideration' is likely to have no bearing on the end result. For example, X provides £1 in exchange for a car owned by Y Ltd where the car is in fact worth £10,000.

9 For an analysis of the case and consideration of its effects, see R Mokal and L Ho 'Consideration, Characterisation, Evaluation: Transactions at an Undervalue After Phillips v Brewin Dolphin' (2001) 1 JCLS 359.

10 Also, see *National Bank of Kuwait v Menzies* [1994] 2 BCLC 306, [1994] BCC 119.

11 For an analytical discussion of this case, see R Mokal and L Ho 'Consideration, Characterisation and Evaluation: Transactions at an Undervalue After *Phillips v Brewin Dolphin*' (2001) 1 JCLS 359. Also, see the discussion by Professor Rebecca Parry in *Transaction Avoidance in Insolvencies* (Oxford University Press, 2001), pp 90–91.

12 In this case the House of Lords held that the party had not done so.

13 Professor Goode assumes that it is (*Principles of Corporate Insolvency Law*, 2005, p 426) while other commentators (E Bailey, H Groves, C Smith *Corporate Insolvency Law and Practice* (Butterworths, 1992), p 364) take the view that it is not. The latter see the word as meaning benefit in financial terms.

Although X had given good consideration in a contractual sense, the transaction would be attacked by Y's liquidator. The liquidator would argue that the transaction falls within section 238(4)(b) in that the company received consideration which is significantly less than the value of the consideration provided by the company. What is important is the value of the consideration to the one who receives it, ie, it is subjectively evaluated.[14]

Any consideration given to a third party may be taken into account in deciding whether a transaction is at an undervalue, as might any consideration given by a third party. This was indicated in *Phillips v Brewin Dolphin Bell Lawrie Ltd.*

One issue that warrants comment is whether a transfer of property pursuant to an order in matrimonial proceedings could be a transaction at an undervalue on the basis that no consideration is given by the transferee (the beneficiary of the order).[15] In reversing a decision at first instance that held that it could, the Court of Appeal in *Hill v Haines* ([2007] EWCA Civ 1284, [2007] 3 FCR 785, overturning [2007] EWHC 1012 (Ch), [2007] BPIR 727), held that it could not on the basis that the right to apply for and obtain orders under the Matrimonial Causes Act 1973 was a right conferred by law and any entitlement to a transfer of property ordered by a court pursuant to that right is effectively the measure of the value of the property transferred (at [29]).[16]

38.5 VALUATION

Whether a transaction is a transaction at an undervalue will depend on the question of value. In the typical case the main issue is likely to be whether the insolvent received significantly less consideration than was given. Resolving this issue will entail a valuation in money terms of the consideration provided both by the insolvent and the other party to the transaction. It has been held that the office-holder must establish the respective values in money or money terms of the consideration given and received by the insolvent and, also, demonstrate that what was received was significantly less than what was provided.[17]

The same valuation principles should be employed for valuing both the consideration received by the company and the consideration disposed of by the company (*Re Thoars* [2003] 1 BCLC 499 (decision affirmed on

[14] R Parry *Transaction Avoidance in Insolvencies*, p 88 and referring to *Re MC Bacon Ltd* [1990] BCLC 324 at 340.

[15] This issue demonstrates the tension that exists between the statutory scheme protecting an insolvent's creditors on the one hand, and the statutory scheme financially protecting his or her family on the other.

[16] Leave has been granted for the trustee in bankruptcy to appeal to the House of Lords.

[17] See *Re MC Bacon Ltd* [1990] BCLC 324 at 340–341 and approved of in *Phillips v Brewin Dolphin Bell Lawrie Ltd* [1999] BCC 557 at 566, CA.

appeal at [2004] EWCA Civ 800, [2005] 1 BCLC 331; [2004] BPIR 985). While the consideration should be valued as at the date of the transfer, in appropriate circumstances the occurrence or non-occurrence of events subsequent to the transfer that is impugned, and before the assessment of the consideration, may be considered in assessing the value of consideration in money or money's worth (*Phillips v Brewin Dolphin Bell Lawrie Ltd* [2001] 1 WLR 143, HL; *Re Thoars* at [8], [17]). The Court of Appeal in hearing an appeal in *Re Thoars* (*Ramlort Ltd v Reid* [2004] EWCA Civ 800, [2005] 1 BCLC 331, [2004] BPIR 985 at [103]) said that there was nothing that actually required the court considering an alleged transaction at an undervalue to ascribe a precise figure to the value of the consideration received by the debtor (the incoming value) or the value of the consideration provided by the debtor (the outgoing value). The provision would apply whenever the court was satisfied that, whatever the precise values might be, the incoming value was 'significantly less' than the outgoing value. This does not appear to sit well with the view expressed by a differently constituted Court of Appeal in *National Westminster Bank plc v Jones* ([2001] 1 BCLC 98, [2000] BPIR 1092, CA), where it was said that when determining whether consideration received was significantly less than the consideration passed to the debtor(s) (this was a case involving a claim under section 423 of the Act), the court has to form the view as to the price which the property representing the consideration given by the defendant and that given by the debtor(s) would fetch in the open market, thus providing a 'correct valuation'(at 122; 1115). The court will have to compare the value of property as against what consideration was given for it, and then consider 'in percentage or proportionate terms, how much less the consideration is than the value' (at 123; 1116). However, Jonathan Parker LJ (with whom the other judges agreed) in *Ramlort Ltd v Reid* said that the Court's view in *National Westminster Bank plc v Jones* must not be taken out of context, for it was in fact dealing with a contention by counsel (which it rejected) that in considering undervalue courts must take the same approach as used for addressing cases involving allegedly negligent valuations (at [106]).

Presently it is not possible to say what will constitute 'significantly less', as the expression has not been interpreted by the courts.[18] It is not possible to say how much less than market value constitutes 'significantly less' in any given case.

The likely difficulty that will confront office-holders is the valuing of assets that are the subject of the impugned transactions. As Professor Sir Roy Goode says in relation to valuing:

[18] I Snaith *The Law of Corporate Insolvency* (Waterlow Publishers, London, 1990), p 648 argues that a de minimus rule must apply.