

# **BANKRUPTCY AND VOLUNTARY ARRANGEMENTS**

## **NOTES FOR SEMINAR 1**

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### **BANKRUPTCY**

#### 1. What is bankruptcy?

- It is a way of rehabilitating an insolvent individual (as opposed to a company or partnership), as it provides for the automatic discharge from debts pre-dating the bankruptcy.
- It also is a way of providing for an independent third party, in the form of an IP, to collect the bankrupt's assets, investigate his affairs and distribute the estate among those entitled to it.
- Purely statutory and now governed by Part VII to XI of the Insolvency Act 1986

#### 2. What is the effect / consequences?

- The effect of bankruptcy order is to vest all property automatically belonging to or vested in the bankrupt at the commencement of the bankruptcy (subject to certain exceptions) in the OR on the making of the bankruptcy order (as trustee in bankruptcy): section 306.
- Where a person is made bankrupt any disposition of property made by that person after presentation of the petition void unless ratified by the court: section 284(1).
- After a petition is presented, the court may stay any action, execution or legal process against the property or debtor: section 285(1).
- Once an order is made, no person who is a creditor in respect of a provable debt can have any remedy against the property or person of the bankrupt and before

discharge they cannot commence any action or legal proceedings without consent from the court: section 285(3). The creditors are limited to proving in the bankruptcy for a dividend.

### 3. How long does it last?

- It starts with the day on which the order is made and lasts until the individual is discharged which occurs automatically at the end of one year beginning with the date on which bankruptcy commences: section 278 and 279(1).
- The court can extend that period until the end of a specified period or a specified condition if the bankrupt has failed or failing to comply with an obligation under IA: section 279(3):
  - Normally, this is where the bankrupt is not co-operating with the trustee.
- The effect of discharge is to release the bankrupt from all bankruptcy debts but has no effect on the functions of the trustee and provisions of the IA for the trustee to carry out those functions: section 281(11).

I.e. the trustee can continue to collect in bankruptcy assets, bring claims and distribute property and the creditors can prove after that date.

- At high level, bankruptcy debts are debts or liabilities which the bankrupt is subject to at the commencement of the bankruptcy (that is the date of the BO section 278) or which he may become subject to after the commencement of the bankruptcy by virtue of an obligation incurred before the commencement of the bankruptcy: section 382(1).

### 4. How do you make someone bankrupt?

- A petition can be presented by a creditor (and certain other categories of persons including an IVA supervisor): section 264.
- It must be in respect of a debt that equals or exceeds £5,000, is liquidated, payable immediately or at some certain future time and is unsecured: section 267(2). Liquidated means a debt which is ascertained or ascertainable by some contractual formula or machinery (*McGuinness v Norwich & Peterborough Building Society* [2011] EWCA Civ 1286)

e.g. no solicitors' fees (unless taxed or agreed or there is an estoppel) or service charges (unless fixed by a contractual formula) but rent is and a guarantee liability may be (depending on wording of contract).

- The debtor must be unable to pay or have no reasonable prospect of being able to pay-section 267(2)
- This means that:
  - the creditor has served a document called as statutory demand on the debtor;
  - 3 weeks have elapsed, and
  - it has neither been set aside nor has the debt been paid, secured or compounded for (and there is no outstanding application to set aside the statutory demand) section 267(2)(c), (d) and section 268.

NB If the alleged debtor disagrees that he owes the money then he has to apply to the court to set aside the SD

- The court will not make a bankruptcy order unless it is satisfied the debt is one which was payable at the date of presentation or has since become payable and has neither been paid nor secured nor compounded for or there is no reasonable prospect of being able to pay it when it falls due: section 271(1).

- The court can dismiss the petition if it is satisfied the debtor is able to pay all the debts or is satisfied the debtor has made an offer to secure or compound the debt and the creditor has unreasonably refused the offer: section 271(3).

5. Can it be challenged and, if so, on what grounds and how?

- Save for the usual ways that you can appeal an order of the court, a bankruptcy ordered can be ‘annulled’, under section 282 or ‘rescinded’, under section 375 (rescission does not apply to decisions to approve a VA because they are not orders of the court).

- Annulment is discretionary and there are two bases on which the court can exercise its discretion:

- If, on grounds existing at the time when the order was made, it is satisfied that the order ought not to have been made: section 282(1)(a).
- The bankruptcy debts and expenses have all been paid or secured for to the satisfaction of the court: section 282(1)(b).

- Court can annul whether or not the bankrupt has been discharged and the effect is that the bankrupt’s estate will revert to the bankrupt (on such terms as the court may direct) subject to any sale or disposition being valid: section 282(4).

- Rescission is also discretionary. It will be exercised only in exceptional circumstances, particularly where there are events which have occurred since the original court made its order and/or there were facts which were not brought to the court’s attention. CPR 39.3(3)-(5) are relevant although not formally engaged.

6. How does a BO affect the landlord and tenant relationship?

- After BO landlord cannot issue a money claim for payment of rent or any other type of proceedings claiming a provable debt without leave-section 285(3) but
- L can issue proceedings for forfeiture, including on the ground of arrears of rent – *Ezekiel v Orakpo* [1977] QB 260 and *Places for People Homes Ltd v Sharples* [2012] Ch 382.
- L can peaceably re-enter if that right is otherwise available-*Re Lomax Leisure* [2000] Ch 502 and *Razzaq v Pala* [1997] 1 WLR 1336.
- CRAR is exercisable but only for up to 6 months’ rent before the commencement-section 347.
- Section 6 of the Law of Distress Amendment Act 1908 has been abolished so L cannot collect rent from a sub-tenant unless CRAR is exercisable and L can use section 81 of the Tribunals, Courts and Enforcement Act 2007.

## **VOLUNTARY ARRANGEMENTS**

### 7. What is a voluntary arrangement?

- Two different types: CVAs for companies (governed by Part 1 of the Insolvency Act 1986); IVA for individuals (governed by Part VIII of IA 1986)
- Essentially a statutorily recognized binding agreement between a company or individual and its/his unsecured creditors whereby the debtor agrees to pay and (provided 75% by value of those creditors agree and 50% of unconnected creditors) the creditors are bound to accept a lesser sum over a longer period than the creditors might otherwise be able to claim.
- The concept of the voluntary arrangement was introduced by the Insolvency Act 1986 for companies. Prior to that, only individuals could enter into

arrangements with their creditors for the composition of debts. Companies had to get the consent of each creditor, unless it went through either a scheme of liquidation and reconstruction under section 582 of the Companies Act 1985; a scheme of compromise or arrangement under sections 425 – 427 of the Companies Act 1985; or a binding arrangement under section 601 of the Companies Act 1985. Individuals could use the Deeds of Arrangements Act 1914 to come to an agreement with their creditors and voluntary arrangements were introduced a more effective way to reach of composition of debts.

- The aim is to find a binding solution with creditors who the debtor could not otherwise pay and avoid the need to go into formal insolvency.
- Three quarters of the creditors by value can bind the minority creditors into an arrangement even if they do not consent: IR 15.34(3) (companies) and (6) (individuals).
- The arrangement then effects a valid compromise of the debts subject to the VA.

#### 8. How does it work?

- The directors or individual have the burden of taking the initiative to set up the VA: section 1(1) (companies) and section 256A (individuals).
- If the company is in administration or liquidation, the office-holder may also make a proposal: section 1(2) of the IA.
- A proposal is formulated and then voted on by creditors (and in the case of a company its members). If the proposal is accepted, the scheme becomes binding on the debtor and all its creditors – even dissenting creditors or those who did not vote (or even get notification of the proposal).

- A supervisor then administers the VA: section 7(2) (companies) and section 263(2) (individuals). The supervisor will hold the funds collected on trust for the creditors entitled under the arrangement but the property of the company/individual does not vest in the supervisor.
- If a company goes into liquidation or an individual is made bankrupt post VA (*Re NT Gallagher & Sons Ltd* [2002] EWCA Civ 404):
  - Funds collected by the supervisor would generally be held on trust exclusively for the VA participants.
  - Whether this is the case depends on the terms of the arrangement itself. At its heart, VAs are a matter of contract.
  - If the VA states what the effect of liquidation will be on the VA trust, then that will be respected.
  - It is possible for the VA to come to an end but the VA trust to survive.
  - In the absence of express provision, the court should incline towards a rule which furthers rather than hinders the purpose of VAs.
  - VA creditors who have not been reimbursed can prove for the balance in liquidation.
- The court oversees the arrangement in that creditors and the supervisor can apply to the court for directions or to replace the supervisor: sections 7(3) and (5) (companies) or sections 263(3) to (5) (individuals).

9. What are the consequences for creditors and other contractual arrangements?

- If the voluntary arrangement is approved, it takes effect as if made at the time the creditors decided to approve it: section 5(2)(a) (companies) and section 260(2)(a) (individuals).

- VA binds every person who in accordance with the rules was entitled to vote or would have been entitled if he had had notice of the decision procedure: section 5(2)(b) (companies) and section 260(2)(b) (individuals):
  - Every creditor, secured or unsecured, who has notice of the decision procedure is entitled to vote in respect of that creditor's debt: IR 15.28(5). Entitled to vote according to the amount of their claim: IR 15.31(1). If the claim is unliquidated or unascertained, the creditor can vote if the chair or convener gives the debt an estimated minimum value for the purpose of entitlement to vote. It will be estimated at £1 unless the chair or convener decides to put a higher value of the claim: IR 15.31(2) and (3).
- The VA is a statutory "contract" so what its consequences are (save for binding the creditors) depends on a construction of the arrangement. It can compromise future debts but this will depend on the wording of the VA.
- A voluntary arrangement cannot affect the rights of a secured creditor to enforce their security, except by that creditor agreeing: section 4(3) (companies) and section 258(4) (individuals).

10. How is one set up? A very simple what do you need to do to get one, including the moratorium

- The directors of a company may make a proposal to the company and to its creditors for a composition in satisfaction of its debtors or a scheme of arrangement of its affairs: section 1(1) of the IA.
- Likewise an individual who is an undischarged bankrupt or would be able to make a bankruptcy application can make a proposal: section 256A(1) of the IA.



- The proposal will provide for a qualified insolvency practitioner to act as a nominee in relation to the voluntary arrangement either as trustee or otherwise for the purpose of supervising the VA: section 1(2) of the IA (companies) and section 253 and section 256A (individuals).
- The nominee will make a report to court within 28 days for companies or 14 days for individuals of being given notice of the proposal: section 2(2) of the IA (companies) or section 256A(3) (individuals). The report will state whether the VA has a reasonable prospect of being approved and implemented and whether it should be considered at a meeting of creditors (and the company).
- If the nominee thinks the proposal should be considered, they must seek a decision from the creditors (and the company): section 3(1) of the IA (companies) or section 257(2) (individuals).
- The creditors' decision in CVA must be by a qualifying decision procedure which means:
  - Qualifying decision procedure means any decision procedure save for a physical meeting unless requisitioned: section 246ZE(2). The deemed consent procedure cannot be used: section 246ZF(1)(b).
- Similarly, a decision procedure in IVA cannot be by a physical meeting unless requisitioned or by deemed consent: sections 379ZA(2) and 379ZB.
- Where the creditors are asked to decide, they can approve the VA with or without modifications: section 4(1A) (companies) or section 258(1) (individuals). Similarly, for the company itself: section 4(1A).
- After the decision procedure in CVA, the nominee must report the decision of creditors and the company to the court and, immediately after reporting, give notice to the prescribed people: sections 4(6) and (6A) (companies). For

individuals, the notice must be given to the prescribed persons: section 259(1) (individuals).

- Prescribed persons for companies: registrar of companies and everyone who was invited to consider the proposal or to whom notice of the meeting or decision procedure was delivered: IR 2.38(5) and (6).
  - Prescribed persons for individuals: everyone invited to consider the proposal and to whom notice of a decision procedure was given, any other creditor, and, if the individual is bankrupt, the OR and any trustee: IR 8.24(5).
- A moratorium can be obtained for certain companies when directors intend to propose a VA: section 1A of the IA.
- Rarely used procedure.
  - Only companies with two or more of following requirements: a turnover of no more than £10.2million, balance sheet of not more than £5.1 million and no more than 50 employees: section 382(3) of the Companies Act 2006. That must be for the year ending with the filing or the financial year which ended before that date: para 3 of Schedule 1A. A number of exclusions: does not apply if the company is in admin or liquidation, has a parent which is not a small company, if it has certain liabilities such as one of £10m or more.
  - If the directors want a moratorium, they must file with the court the proposal, a statement that the company is eligible for the moratorium and the nominee's statement that the VA is likely to be approved, there are likely to be sufficient funds to be able for the company to carry on business during the proposed moratorium and the proposal should be

considered by the creditors and company: para 7 of Schedule A1. The moratorium then comes into force when the documents are filed and lasts until the later of the day on which the company is first held or creditors decide, unless that does not happen within the first 28 days after it beginning when it will end automatically unless it is extended: para 8 of Schedule A1.

- The moratorium means that no petition can be presented to wind up the company or resolution passed for its winding up, no landlord can forfeit premises, no other steps can be taken to enforce security or repossess goods and no proceedings or execution can be commenced or continued unless the court gives consent: para 12(1) of Schedule A1.
- An individual can get an interim order under section 252 of the IA, which prohibits a petition from being presented or proceeded with, prevents a landlord exercising a right of re-entry peaceably without leave of the court and prohibits proceeding without the court's permission:
  - An application can be made where a debtor intends to propose a VA, on the day the application was made the debtor was undischarged bankrupt or able to make a bankruptcy application, no previous application for an interim order has been made and the nominee is willing to act in relation to the proposal: sections 253 and 255(1) of the IA. The court may make an order if it thinks it would be appropriate for facilitating the consideration and implementation of the proposal: section 255(2). The interim order will last for a period 14 days after the making of the order: section 255(6).

- A stay comes into effect while the application is pending: section 254 of the IA.

11. Can it be challenged and, if so, on what grounds and how?

- Voluntary arrangements can be challenged on the basis that it unfairly prejudices the interests of a creditor (or a member or contributory of a company) and/or that there has been some material irregularity in relation to the relevant qualifying decision procedure (or at the company meeting): section 6(1) (companies) and section 262(1) (individuals).
- The people who can challenge are those who were entitled to vote in the relevant qualifying decision procedure (or meeting of the company) or would have been entitled had they had notice; the nominee; and if the company is being wound up or in administration, the administrator or liquidator: section 6(2) (companies) or section 262(2) (individuals).
- The application must be made within 28 days beginning the first day on which the reports to court were made or, if the person did not have notice of the decision procedure, within 28 days of the day he became aware that the decision procedure had taken place: section 6(3) (companies) or section 262(3) (individuals).
  - Note: the court has no power to extend the time limit for companies but does for individuals: *Re Bournemouth and Boscombe AFC Co Ltd* [1998] BPIR 183.
- If the court is satisfied on either of the grounds, it can:

- Revoke or suspend the decision approving the VA or any decision taken at a meeting or in the decision procedure: section 6(4)(a) (companies) or section 262(4)(a) (individuals);
  - Whether it can be revoked after the VA is terminated is a question in *Williams v Carraway Guildford (Nominee A) Ltd*, the Regis hair salon CVA challenge by a group of landlords, and on 14/11/19, High Court in [2019] EWHC 3073 (Ch) said it was not a question suitable for summary judgment/strike out.
- Give a direction to summon a further company meeting to consider a revised proposal or reconsider the original proposal: section 6(4)(b) (companies).
- Direct any person to seek a decision from the company's creditors as to whether they approval a revised proposal: section 6(4)(c)(i) (companies) or section 262(4)(b)(i) (individuals).
- If the case is a material irregularity case, direct any person to seek a decision from the creditors as to whether they approval the original proposal: section 6(4)(c)(ii) (companies) or section 282(4)(b)(ii) (individuals).
- If satisfied that the person does not intend to make a revised proposal, it can revoke an earlier direction to seek a decision on that proposal and revoke or suspend any decision approving the VA: section 6(5) (companies) or section 262(5) (individuals).
- Give supplemental directions as it thinks fit, in particular with regard to things done in the VA since it took effect: section 6(6) (companies) or section 262(7) (individuals).

- If the VA is not challenged, a decision is not invalidated by any irregularity at or in relation to a meeting or in relation to a qualifying decision procedure: section 6(7) (companies) and section 262(8) (individuals).

How does a VA affect the landlord and tenant relationship?

12. Once a VA is in place and depending on its terms:

- CRAR would not be available for debts the subject of the VA
- L cannot resort to sub-tenants because CRAR is not exercisable
- L is bound in respect of both past and future rent-*Discovery (Northampton) v Debenhams [2019] EGLR 47*
- However the right of re-entry is unaffected-*Discovery (Northampton) v Debenhams [2019] EGLR 47*