CREDITORS AND AVAILABLE ASSETS

LECTURE TO THE
LONDON SOLICITORS LITIGATION ASSOCIATION
BY
WILLIAM TROWER QC

1. There are few more basis questions for insolvency lawyers than (a) who is a creditor, (b) what assets are available for distribution or execution and (c) when is a company unable to pay its debts?

2. In bankruptcy, the word "creditor" is defined to mean a person to whom any of the bankruptcy debts is owed (s.383(1) of Insolvency Act 1986). This takes one back to the definition of "bankruptcy debt" which is very wide indeed and includes all debts and liabilities whether present or future, certain or contingent, fixed or liquidated or capable of being ascertained by fixed rules or as a matter of opinion. There is almost no limitation on the source of the liability so long as it is a liability to pay money or money's worth – it can arise under an enactment or be a liability for breach of trust or in contract, tort, bailment or restitution (s.382 IA 1986).

3. In the context of corporate insolvency, there is no similar definition of "creditor", but for all material purposes he is a person to whom a "debt" is at the relevant time owed. The Rules contain a definition of "debt" which is in the same form as s.382 (see rule 13.12 of Insolvency Rules 1986). For the debt or liability to be provable in any insolvency, the insolvent must be subject to the debt or liability at the commencement of the bankruptcy or at the time the company goes into liquidation or administration as the case may be.

4. All of this is relatively well-known and, given the detailed form of the drafting,

one might have thought that there is not much room for argument as to who is a creditor, what is a debt and what are the insolvency rights which the creditor has in respect of his debt. Basic though these questions are, however, there has been much litigation about them over the course of the past couple of years and some helpful clarification has been obtained from the appellate courts.

5. In *Kapoor v National Westminster Bank Plc* [2011] EWCA Civ 1083, the Court of Appeal had to consider whether, where there has been an assignment of part of a debt, the person entitled to vote as a creditor is the assignor or the assignee. Remember, of course, that the assignment of part of a debt will not be an absolute assignment for the purposes of s.136 of the Law of Property Act 1925: it can only take effect in equity.

6. This type of issue is one, which arises in many different contexts. It arises whenever two or more claimants (let's call them A & B) assert the right to participate in an insolvency (whether to prove or to vote) and those competing claims to participate derive from what is in substance the same debt. The competition may be between assignee and assignor (as it was in *Kapoor*), it may be between trustee and beneficiary or it may be between surety and creditor each seeking to claim against the principal debtor (the issue in a case called *Re Kaupthing Singer and Friedlander Ltd* [2011] UKSC 48 to which I will turn later). The relevance is sometimes for the purposes of ascertaining which claimant is ultimately entitled to recover from the debtor, but it may also be about the technical consequences of whether A or B is the person recognized in law as the true creditor.

7. In *Kapoor* the issue arose on the true construction of rule 5.21 of IR 1986, which makes provision for the entitlement of persons wishing to vote at a creditors' meeting called to approve an IVA. As you will know an IVA or a CVA is only effective to bind all creditors if at least 75% by value vote in favour. Moreover, and critically for the present case, a creditors' resolution to approve a voluntary arrangement will not be valid if more than half in value of the independent creditors (i.e. those who are not associates of the debtor) vote against it (rule 5.23(4) for IVAs and rule 1.19(4) for CVAs).

8. What happened in *Kapoor* was as follows:

   8.1. Before the date on which the debtor applied for an interim order under s.252 of IA 1986 he had three creditors: Bank £1.85m, HMRC £35,000 and Crosswood Ltd (an associate) £8.5m. As Crosswood was an associate, the effect of rule 5.23(4) was that, if Crosswood voted in favour, but the Bank and HMRC voted against, the IVA resolution would be bound to fail, even though Crosswood's total claim was for more than 75% of the total debt.

   8.2. On the date on which the debtor applied for an interim order, Crosswood assigned £4m of its debt to a Mr Chouhen, who was not an associate (anyway within the meaning of the statute). The assignment was made for valuable consideration and was not a sham, but it had a number of uncommercial aspects to it which meant that Crosswood did not in substance dispose of any more than a small economic interest in the assigned part of the debt. Furthermore the judge was satsified that the sole purpose of the assignment was to circumvent the "associate" provisions of rule 5.23(4).

   8.3. At the meeting, the Bank and HMRC voted against, but Crosswood and Mr Chouhen voted in favour. The nominee accepted that it was proper for the £4m assigned part of the debt to be voted by Mr Chouen. One of the questions which then arose (there were also issues on material irregularity to which I will return briefly) was whether the nominee was correct to admit the Chouhen vote in favour (it being common ground that, if it was properly his vote, it should be treated as independent for the purposes of rule 5.23(4)). This depended on whether the "creditor" for £4m was, for the purposes of rule 5.21, the associated assignor or the "independent" assignee.

9. Having reviewed the authorities the Court of Appeal reached the clear conclusion that the equitable assignee, Mr Chouhen, was indeed the relevant creditor for the purposes of rule 5.21, and therefore the IVA did not fail to gain the requisite majority on the "associate" grounds contained in rule 5.23(4). The grounds for this conclusion (see para 30 of the judgments) are directly related to the

circumstance in which assignors and assignees can sue for the assigned debt and so are of general relevance when formulating any claim where the underlying cause of action has been subject to some form of assignment.

10. The Court of Appeal explained that an equitable assignee of a debt is entitled in its own right and name to bring proceedings for recovery of that debt. It may be required to join the assignor to the proceedings in order to ensure that the debtor is not exposed to double recovery, but that is a purely procedural requirement and can be dispensed with by the Court.

11. The court also explained that the assignor is in a very different position; it cannot bring proceedings to recover the assigned debt in its own name for its own account. It can sue as trustee for the assignee if the assignee agrees, and, in that event the claim must disclose the assignor's representative capacity. But otherwise it must join the assignee, not because of a mere procedural rule, but as a matter of substantive law, in view of the insufficiency of the assignor's title.

12. It is to be noted, however, that, even though for voting and proving purposes an equitable assignee will be the creditor in respect of the assigned portion of the debt, that does not mean to say that an equitable assignor may not be entitled to seek a winding up order. Both can proceed (as confirmed by the decision of the Privy Council in *Parmalat Capital Finance Limited v Food Holdings Limited* [2008] UKPC 23 at [para 8]). This is because a winding-up order does not affect the legal rights of the creditors or the company. It only puts into effect a process of collective execution against the assets of the company, for the benefit of all creditors. In the course of that process, the rights of creditors may have to be determined. But such a determination is not necessary at the stage when the order is made. An equitable assignor therefore has a sufficient interest without joining the assignee.

13. Even though the appeal on this aspect of the decision was successful, you will not be surprised to hear that the IVA did not survive. This was because the Court of Appeal upheld the judge’s conclusion that there had been a material irregularity at or in relation to the creditors’ meeting and so granted relief pursuant to s.262 of

IA 1986. The basis for this conclusion is also of more than passing interest and has an impact on what a creditor may or may not do *qua* creditor and notwithstanding his status as such.

14. The Court of Appeal held that the assignment demonstrated an absence of the good faith required by the case of *Cadbury Schweppes plc v Somji* [2001] 1 WLR 615. This principle encapsulates the fundamental rule that, in the context of a voluntary arrangement, there should be complete good faith between the debtor and his creditors, and between the creditors *inter se*. In the case of *Kapoor* the assignment was intended to subvert the legislative policy relating to the claims of associates. In the words of Etherton LJ at para 69:

    > *"It was an uncommercial arrangement inconsistent with any notion of good faith between Mr Kapoor and his independent creditors, or between Mr Chouhen and Crosswood, on the one hand, and the independent creditors, on the other, and was designed solely to subvert a critical principle of legislative policy as to the conditions for approval of an IVA. That is a perfectly apposite example of "irregularity", giving the word one of its normal meanings as something which is lacking in conformity to rule, law or principle (see the Shorter Oxford English Dictionary)"*

15. A different context in which the rights of a creditor in a formal insolvency have arisen is the recent decision of the Supreme Court in *Re Kaupthing Singer and Friedlander Ltd* [2011] UKSC 48. As I am sure that you all know, Kaupthing (or KSF) was a bank which was a victim of the Autumn 2008 banking crisis. It had a subsidiary, Singer & Friedlander Funding plc ("Funding"), whose sole function was to raise funds for the general business of the Kaupthing Group. Funding issued some floating rate notes, guaranteed by KSF, the net proceeds of which were advanced to KSF by way of unsecured loan. All of the actual group assets were held by KSF – Fundings' only asset was its claim against KSF.

16. This gave rise to a triangular relationship. The trustee for the noteholders had two claims (a) a claim under the notes against Funding as principal debtor and (b) a claim under the guarantee against KSF as surety. Funding had a claim against KSF for recovery of the unsecured loan. KSF as guarantor of the notes had a surety's right to an indemnity from Funding as principal debtor. When both Funding and KSF went into administration in October 2008, the trustee for the

notes claimed in the administrations of both companies, which it was perfectly entitled to do, exercising a right colloquially known as "double dip". Funding claimed in the administration of KSF for the amount of the unsecured loan.

17. The side of the triangle which gave rise to the difficulty was KSF's claim as surety to an indemnity against Funding as principal debtor. KSF was a contingent creditor of Funding in respect of this claim and contingent claims are normally (a) provable in a winding up or administration and (b) available for set off. Indeed the statute makes plain that this is the case: see the definition of provable debt in rules 12.3(1) and 13.12(3) of IR 1986.

18. The first point dealt with by the Supreme Court was to confirm that the administrators of KSF could not actually make this claim, nor could they use it by way of statutory set off against Funding's claim for the unsecured loan, because of the rule against double proof. This rule prevented KSF from proving its suretyship claim to an indemnity against Funding as principal debtor until such time as the noteholders, as principal creditors in respect of what was in substance the same debt, had been paid in full. On this point, Lord Walker in *Kaupthing*, drawing on the speech of Lord Hoffmann in *Secretary of State v Frid* [2004] 2 AC 506) gives a useful summary of how this rule works. In broad terms it applies so as to protect the other creditors of the principal debtor (in this case KSF) against the consequences of two separate proofs (in this case from the noteholder trustee and Funding) in respect of what is in substance the same debt.

19. It is of more than passing interest that the Supreme Court recognised that no specific provision was made for the rule against double proof in the Insolvency Act or Rules, but said that the rule was long-established and was "implicit" in the legislation. It follows that, in this special circumstance, the law provides, in a manner which is not spelt out in the Act, that a person who is a creditor as defined by the Act and the Rules does not in fact have the principal right available to all creditors in any insolvency, namely an enforceable right to prove for a dividend. Having said that, it is not surprising that this should be the case – it would be most peculiar if such a rule did not exist, because the prejudice to the other creditors of the insolvent would be impossible to justify.

20. Faced with the rule against double proof, the administrators of KSF took an alternative tack, not by challenging the exclusion of KSF's right as surety to prove against Funding, but rather by seeking to limit Funding's right to prove against KSF in respect of its claim on the unsecured loan. This way around, the challenge was to the right of a creditor (Funding) with an unimpeachable accrued claim (the claim in debt to recover the money lent) to prove in the insolvency of its debtor (KSF) – how was this to be achieved?

21. Procedurally, what the KSF administrators did was to seek directions that they should not admit Funding's claim in KSF's administration, until such time as KSF's right to an indemnity from Funding had been satisfied in full. In support of their case, they relied on the recent decision of the Court of Appeal in *In Re SSSL* [2006] Ch 610. As both Funding and KSF were insolvent, the effect of such a direction was quite likely to be that Funding would never be permitted to prove in KSF's insolvency, and so its creditors (primarily the noteholders) would receive no distribution, anyway in their capacity as creditors of Funding. The noteholders would be restricted to their claims against KSF as surety for the notes, but the, admittedly small number of creditors with no guarantee would receive nothing at all.

22. The basis of KSF's argument was the rule in *Cherry v Boultbee* (1839) 4 My & Cr 442 and the question was whether this rule required Funding to satisfy KSF's claim to an indemnity before it could receive any dividend from KSF. In over-simplified terms the rule in *Cherry v Boultbee* is unexceptional – it provides that if you owe an estate a sum of money, and are also a beneficiary of that estate, you cannot claim your aliquot share until you have paid what you owe. The authorities describe the principle as one which entitles the trustee or administrator of the estate to pay you your share by retaining such part of the whole as you would receive if you had paid what you owe.

23. If it were to have that effect in a case such as *Kaupthing*, it would cut across the rule against double proof. The reason for this is that, KSF would be able to use its suretyship claim to an indemnity against Funding in order to resist Funding's

claim in its own liquidation. This would give value to the claim by KSF against Funding which is precisely the consequence that the rule against double proof was designed to avoid for so long as the claim was being advanced in competition with the trustee for the noteholders, who was of course the principal creditor.

24. There is normally no place for the rule in *Cherry v Boultbee* in the context of insolvency, because set off will normally supply the answer. The mandatory and self-executing nature of insolvency set off (rule 4.93 in liquidation and rule 2.85 in administration) means that each claim will be set off the one against the other and only the net balance will be payable. What happens though, when insolvency set off is not available for whatever reason? (and those of you who have been concentrating will recall that set off is not available in this situation, because of the operation of the rule against double proof.)

25. *SSSL* indicated that, where set off was not available, and a debtor to an estate was also seeking payment from that estate, the rule in *Cherry v Boultbee* applied. The effect of this was that, rather than achieving a net balance, the distributing fund can refuse to pay a dividend, which in the case of a double insolvency where each is proving against the other, will give a somewhat arbitrary result. The benefit will always enure to the entity which will otherwise be paying the greater dividend. In *Kaupthing*, the Chancellor simply decided that he was bound by *SSSL*, but conscious of the oddity of the result and concerned that the decision may well be wrong, granted a leapfrog certificate. The case therefore came on for hearing in the Supreme Court without any judgment from the Court of Appeal.

26. As one might expect, Lord Walker treated us to a comprehensive and learned dissertation on the history and true extent of the rule in *Cherry v Boultbee* and in particular the extent to which it had been applied in the context of insolvency. He did not resist the temptation to say exactly what he thought of Chadwick LJ's judgment in *SSSL*, describing parts as "too widely stated", much of his reasoning as "difficult to follow" and some of the distinctions he drew as "distinctions without a difference". He also criticised Chadwick LJ's discussion of some of the cases as demonstrating that he "with respect" missed their point and characterised the complex mathematical notation he used to describe the rule as giving the

unnecessary appearance of a branch of rocket science. Strong words from Lord Walker who plainly thought that the court below had seriously overcomplicated the situation, a sentiment with which anyone who has read the judgment in *SSSL* might be inclined to agree.

27. In the end, however, the ratio of *Kaupthing* can be found right at the end of the judgment, and can be shortly stated. The rule against double proof is the dominant rule and will trump the rule in in *Cherry v Boultbee*. The administrators of KSF were not entitled to withhold any part of the dividend payable to Funding, and the trustee for the noteholders must be paid in full before KSF can exercise its right as guarantor to make a claim by way of indemnity against Funding as principal.

28. I now want to turn to a rather different context in which the question of whether a person is a creditor has recently arisen for decision. It did so on an appeal to the Privy Council from the Cayman Islands in case called *Culross Global SPC Limited v. Strategic Turnaround Master Partnership Ltd* [2010] UKPC 33. The procedural context was an application to strike out a winding up petition, and the underlying issue was whether the petitioner was a current creditor of Strategic Turnaround or whether it remained a member for all relevant purposes. It could not proceed with its petition as a contingent creditor.

29. The entity concerned was a mutual fund, which like many similar structures formed under the applicable Cayman legislation solicited subscriptions for shares, the proceeds of which were then invested in a Master Fund, which itself then invested in the underlying business (in this case the US micro-cap turnaround sector). The shares were redeemable in certain defined circumstances, and more especially for the purposes of enabling members to realise their investment, a process which required the directors (through a fund manager) to set a NAV per share. As is relatively commonplace, the Strategic Turnaround board had a power, expressed in very general terms, to suspend redemptions,

30. On 17 April 2008 the board exercised the power to suspend in the light of the extreme volatility and illiquid state of the underlying sector. By the time it did so

the petitioner (Culross Global) had already served a redemption notice, with an agreed redemption date of 31 March 2008 (i.e. before the board resolved to suspend). The NAV applicable to the Culross shares was set as at the redemption date and amounted to just under US$1 million. Critically, the fund administrator was entitled under the Articles to identify the time for payment of the redemption monies and it did so by stipulating that 90% would be paid within 30 days after redemption (i.e. by 30 April 2008) with the balance payable on completion of the annual audit. It follows that the resolution to suspend was passed between the redemption date under the notice and the date on which the redemption monies became actually payable.

31. The Privy Council concluded that the directors had no power to suspend the payment of redemption proceeds once the redemption date had passed. In consequence Culross Global was a creditor with an accrued claim from the date at which the redemption monies became payable. In other words the suspension of redemptions did not have the effect of restricting Culross Global to the status of a mere contingent creditor with rights that were no more enforceable than those of a member – it was able to proceed as an unpaid redemption creditor as from 30 April 2008.

32. In large part that conclusion was based on the true construction of the Articles, but as part of that analysis, the board considered the many different contexts in which the court has had to determine when a persons rights as a member of a company become those of a creditor. All will depend on the specific provisions, but the court should not approach the question on the basis of any *a priori* view that until payment of redemption proceeds a shareholder must necessarily remain a member of a company (para 16 of the judgment), nor on the other hand that redemption necessarily takes place on the redemption date (although that was the result in *Strategic Turnaround*).

33. Indeed, having reviewed some of the older cases, the Board stressed that there may be respects in which a former member continues to be bound by provisions to which he originally signed up when he became a member, even though his economic rights as such may have been replaced by a creditor's right to the

payment of redemption monies. The lesson from this case is that care is sometimes required in identifying the precise nature of the rights which the member or former member has against the company and the time at which those rights become those of a creditor.

34. Finally as to creditor status and rights, I cannot avoid reference to the important recent decision of the Court of Appeal in *Re Nortel GmbH, Bloom v. the Pension Regulator* [2011] EWCA Civ 1124. This case is all about the insolvency status of of a financial support direction ("FSD") and a contribution notice ("CN") under sections 43 and 47 of the Pensions Act 2004. Many of you will know this, but for present purposes what matters is that, where an employer in respect of a defined benefit occupational scheme is insufficiently resourced (a technical term), the pensions regulator ("TPR") can take steps to procure support from associates of the employer. These steps can ultimately lead to the issue of a CN under s.47 in accordance with certain statutory reasonableness criteria, but the amount of which is ultimately quantified at the discretion of TPR. TPR is required to exercise its functions with the objective of protecting members benefits under such schemes (s.5 of Pensions Act 2004).

35. Once a CN is issued, the target comes under a statutory liability to pay the sum identified in the CN to the trustees of the relevant pension scheme. The issue which arose in Nortel is whether, where an FSD and/or a CN is issued after the commencement of the insolvency of the target this gives rise to a claim (a) which is payable in the liquidation or administration of the target as an expense, or (b) which is provable as an unsecured claim or (c) which is not payable at all by a company subject to a formal insolvency process.

36. Both at first instance and in the Court of Appeal, the conclusion was that, if the statutory liability arose out of an FSD issued <u>after</u> the relevant commencement date, it would be a necessary disbursement within the meaning of rules 2.67(1)(f) and 4.218(3)(m) of IR 1986 and therefore payable as an expense. This gives rise to serious practical difficulties for administrations, both because it is not possible to establish the amount of the potential liability at the commencement of the relevant insolvency and because the effect is to give to one category of creditor

(the trustees of the pension scheme) a super-priority status as a result of the exercise of a post insolvency discretion by a person whose primary statutory duty is not to the act in the best interests of the insolvent estate, but is to maximize pensioner protection. Furthermore, in nearly all cases, the facts and events which give rise to the liability will have occurred before the insolvency commencement date, which makes it feel as if the liability ought to be provable. For an insolvency lawyer, the practical effect is, therefore, both unprincipled and a source of great uncertainty for the conduct of administrations.

37. More generally, the importance of this case is that it exposes a policy conflict between the need to encourage the rescue culture and the aims of the pensions legislation in maximizing pensioner protection. Doubtless for that reason, amongst others, the Court of Appeal took the highly unusual step of itself granting permission to appeal to the Supreme Court. As judgment was only handed down last month, we do not yet know when that appeal will come on for hearing.

38. The relevance of the decision to creditor rights more generally is not just that the case raises the vexing question of what is and what is not a necessary disbursement. It was an important part of the decision that a CN liability must be an administration expense simply because it is a statutory liability which does not give rise to a provable claim. On this point, the judges have concluded that the decision of the House of Lords in *Re Toshoku Finance UK plc* [2002] UKHL 6 is authority for the proposition that, if a statute imposes a liability capable of being incurred by a company in a formal insolvency process, and if for whatever reason the liability is not provable, it will for that reason and for that reason alone, be an expense.

39. Whether or not something is provable does not just depend on the substance of the thing in issue, it also gives rise to a timing question. Thus, a debt will be provable if it is either (a) "a debt or liability to which the company <u>is subject</u> at the date on which it goes into liquidation or (b) a debt or liability to which the company <u>may become subject</u> after that date by reason of <u>any obligation incurred</u> before that date.

40. It is undoubtedly the case that a lawful decision by TPR to issue a CN imposes a liability to the pension trustees on the relevant target company. This would cause the relevant pension trustees to become creditors with the benefit of a statutory debt. The decisions of the courts to date, however, are that if the FSD was not issued by the time the company went into administration or liquidation, the pension trustees will not have been creditors at the administration date, and therefore will not have a provable claim. This means that the question of provability, and more particularly the question of timing, is at the heart of the dispute.

41. At Court of Appeal level the position is now clear. It has been established by a trio of cases (*Glenister v Rowe* [2000] Ch 76, *R (Steele) v Birmingham City Council* [2005] EWCA Civ 1824 and now *Nortel* itself) that if the events which justify the imposition of the liability have not matured into what has been described as a legal obligation before the relevant date, the claim will not give rise to a provable debt. It does not matter that all of the events themselves occurred pre-insolvency and that all that remains is for TPR to intervene and exercise its discretion to impose an FSD and then a CN – that will not be sufficient to give rise to a "obligation" within the meaning of rule 13.12(1)(b). As Lloyd LJ explained when analyzing the conclusion of Briggs J at first instance:

> *"However it seems to me that he was right to decide that he was bound by decisions of the Court of Appeal to the effect that a prior legal obligation is essential to establish that a liability which has matured after the commencement of an insolvency process was, at the outset of that process, already a contingent liability, so that it is provable in the relevant process, whether bankruptcy, administration or liquidation. We too are so bound. The existence, before the onset of the insolvency, of the financial support direction regime and of the facts on which it could be invoked does not show that any company which might be made the subject of an eventual financial support direction or contribution notice is then under a legal obligation for the purposes of r 13.12(1)(b)."*

42. The appeal to the Supreme Court in *Nortel* should give rise to an opportunity not just for the law on administration expenses to be reviewed at the highest level, it should also enable a fresh look at the question of when it is that a contingent liability can be said to arise so that it is provable in a liquidation or administration. It is to be hoped that this will include a full consideration of when it is that a

person with an inchoate claim becomes a creditor for the purposes of the insolvency legislation.

43. I now turn to the other side of the coin. Their lordships have not been idle on issues relating to the property which might be available both for distribution to creditors generally and for execution at the suit of an individual creditor. I shall briefly consider one recent case in the Supreme Court and one recent case in the Privy Council.

44. So far as concerns the availability of assets to creditors generally, at the end of July the Supreme Court handed down a decision in *Belmont Park Investments Pty Ltd v. BNY Corporate Trustee Services and LBSFI* [2011] UKSC 38. The decision of a seven-member panel was that a flip clause in certain financing documentation which changed the priority of creditor rights on the occurrence of an event of default, did not contravene the anti-deprivation principle. This principle is to the effect that a putative insolvent cannot contract in such a way that an asset is withdrawn from his estate on the occurrence of his bankruptcy, liquidation or administration. Where it does apply, assets that might otherwise be excluded from the estate will become available for creditors generally.

45. There is no time to go into the facts, but there are three points of general application of which you should be aware. The first point is that the Supreme Court confirmed the existence of the rule. Lord Collins, who gave the leading judgment approved statements of principle that:

> *"the law is too clearly settled to admit of a shadow of doubt that no person possessed of property can reserve that property to himself until he shall become bankrupt, and then provide that, in the event of his becoming bankrupt, it shall pass to another and not to his creditors."*

46. The second point is that the extent and application of the principle has been more tightly confined than has hitherto thought to be the case. In particular, Lord Collins concluded that, in cases where parties act in good faith and for sound commercial reasons, the rule will not apply. Put another way a commercially sensible transaction entered into in good faith should not be held to infringe the rule.

47. The third point is that the anti-deprivation principle is quite separate and distinct from the *pari passu* principle (i.e. an arrangement which purports to procure that the assets of a company in liquidation will be distributed otherwise than equally amongst its creditors). Since the well-known decision of the House of Lords in *British Eagle* [1975] 1 WLR 758, that distinction had been lost sight of. It is an important one, because, where there is a breach of the *pari passu* principle, that arrangement will be of no effect whatever the commercial justification for it.

48. In another appeal from the Cayman Islands (*Tassarruf Mevduati Sigorta Fonu v. Merrill Lynch Bank and Trust Company (Cayman) Limited* [2011] UKPC 17) ("*TMSF*"), the Privy Council looked at what is and what is not property which might be made available to the creditors of a judgment debtor. The precise question in issue was whether the Cayman courts should apply the decision of the English Court of Appeal in *Masri v Consolidated Contractors International (UK) Ltd (No 2)* [2008] EWCA Civ 303 so as to enable the appointment of a receiver over a judgment debtor's power to revoke a trust. This would then enable the receiver to exercise the power of revocation so as to reach the trust funds for the benefit of the judgment creditor.

49. The judgment debtor was a Mr Demirel, who had established two Cayman Island discretionary trusts in 1999 and against whom the claimant had obtained judgment in Turkey as long ago as 2001. In establishing the trusts, Mr Demirel reserved a power of revocation expressed in very broad terms. In the event of revocation, the assets held within the trusts would revest in Mr Demirel as settlor and thereby become available for execution by, or distribution amongst, his creditors.

50. The argument revolved around the distinction between something which qualifies as "property" for the purposes of execution and something short of property, such as a power of appointment or revocation, which would not normally be available for exercise by anyone other than the donee of the power. In particular, it is established that, if a power is fiduciary in nature, it is non-delegable and so cannot be exercised by anyone other than the donee in person.

51. At first instance the Chief Justice refused the relief sought (the appointment of a receiver) on the basis that, although the jurisdiction to appoint receivers was not limited to property available for legal execution, it was still necessary that it be in the nature of property and that, in the absence of legislation, a mere power (whether of appointment or revocation) was not tantamount to property. The Court of Appeal disagreed with the Chief Justice in the sense that it decided that there was jurisdiction to appoint receivers over such a power of revocation, but it declined to do so, because the judgment Debtor had been made bankrupt in Turkey at the behest of the claimant and the natural person to deal with his assets was his trustee in bankruptcy.

52. For present purposes, the interest of the case is that, in reaching its conclusion, the Privy Council went back to first principles on the distinction between what is property and what is a mere power. The Board cited the well-known passage from the judgment of Fry LJ in *Ex parte Gilchrist Re Armstrong* (1886) 17 QBD 521:

    > *"A 'power' is an individual personal capacity of the donee of the power to do something. That it may result in property becoming vested in him is immaterial; the general nature of the power does not make it property. The power of a person to appoint an estate to himself is, in my judgment, no more his "property" than the power to write a book or to sing a song. The exercise of any one of those three powers may result in property, but in no sense which the law recognises are they 'property.'"*

53. This important distinction is not, however, one which applies to all powers. The court must look, not just at the source of the rights which are sought to be exercised, but also at the incidents which attach to the power, in order to work out whether it can in truth be regarded as akin to ownership for the purpose of deciding whether the fruits of its exercise ought to be available to the creditors of the donee. As Lord Collins said in *TMSF*:

    > *"There is no doubt that while for some purposes a power was not property, for other purposes the holder of a general power could be regarded as being for all practical purposes an owner."*

54. Having reviewed the law, the Privy Council explained that, where a power to revoke cannot be regarded as in any sense a fiduciary power, which will be the case where the only discretion which the donee (i.e. the judgment debtor) has is whether to exercise the power in his own favour, it is in fact something which is

tantamount to ownership. Likewise, in the case of a general power, the law for many purposes regards the donee as the effective owner of that property, because he has what has been described as the "absolute disposing power" over the property, and can appoint the subject-matter of the power to himself.

55. In that kind of circumstance, there can be no objection to the appointment of a receiver over the power (whether it be of revocation or appointment), and the Privy Council so held. The power of revocation meant that the judgment debtor had rights tantamount to ownership. There was no third party with rights which competed with the rights of the claimant against the judgment debtor as holder of the power.

56. There is, of course one crucial difference between execution and a formal insolvency process when it comes to the exercise of a power. In winding up or administration, the liquidator or administrator will be able exercise any such power vested in the company by reason of their office. In bankruptcy, the position is different again; the statutory definition of the bankrupt's estate (s.283(4) of IA 1986) is treated as including a power exercisable over and in respect of property unless it is a power which cannot be exercised for the benefit of the bankrupt, and so that power will vest in the trustee under s.306 of IA 1986.

57. It will be recalled that the grounds of the Court of Appeal's decision was not that the court had no power to appoint receivers, but that it would be wrong to do so because of the Turkish bankruptcy. On this point the Privy Council disagreed. The reason it did so gives rise to other interesting questions on which I shall not dwell, but broadly speaking the Board was satisfied that, because the power of revocation did not vest in Mr Demirel's Turkish trustee, and because the claimant had undertaken to make the proceeds of the receivership available to creditors generally, the fact that he was bankrupt in Turkey was not an impediment to the order. This demonstrates the rather different point that, although the court will be sensitive to ensure that a foreign collective insolvency process is not disrupted by an English (or Cayman) execution, it will do nothing to prevent creditors from exercising their creditor rights in England (or Cayman), so long as the interests of the creditors as a whole are given appropriate protection.

58. I can now turn, albeit briefly, to the third basic issue: when is a debtor unable to pay its debts for the purposes of s.123 of IA 1986? Colloquially speaking the answer has traditionally been reached by asking whether the evidence establishes that the debtor is insolvent on either a going concern basis or a balance sheet basis. This is shorthand for asking whether the requirements of s.123(1) (going concern) or s.123(2) (balance sheet) are satisfied. A decision of the Court of Appeal earlier on this year considered the answer to the balance sheet question (is it proved that the value of a company's assets is less than the amount of its liabilities, taking into accounts its contingent and prospective liabilities?), although it did so in the context of a complicated suite of financing documentation, in which the issue affected waterfall rights, rather than in proceedings to establish insolvency for the purposes of a winding up petition.

59. The case is called *BNY Corporate Trustee Services Limited v. Eurosail-UK 2007-3BL plc* [2011] EWCA Civ 227. It is authority for the following propositions:

59.1. the question whether s.123(2) applies does not simply turn on the issue of whether the liabilities of a company (however they are assessed) exceed its assets (however they are assessed). As Lord Neuberger MR said at para 44:

> *"In practical terms, it would be rather extraordinary if s.123(2) was satisfied every time a company's liabilities exceeded the value of its assets. Many companies which are solvent and successful, and many companies early on in their lives, would be deemed unable to pay their debts if this was the meaning of s.123(2). Indeed, the Issuer is a good example of this: its assets only just exceeded its liabilities when it was formed, and it was more than possible that, even if things went well, it would fall from time to time within the ambit of s.123(2) if the Appellants are right as to the meaning of that provision."*

59.2. S.123(2) was included to cover cases in which, although it could not be said that the company "is [currently] unable to pay its debts as they fall due" (either because it has no debts which are currently payable, or because it has, or can achieve, the cash flow to pay such debts), it is, in practical terms, clear that it will not be able to meet its future or contingent liabilities.

59.3. Mere prejudice to future creditors is not sufficient. Thus, a future or

contingent creditor of a company can often claim to be prejudiced by the company using its cash or other assets to pay current creditors or even for some other purpose, but, the Court of Appeal pointed out that, within bounds, that is an inherent risk in the futurity or contingency of the liability. The test that Lord Neuberger came up with (at para 49) is:

> *"It is only when it can be said that the company's use of its cash or other assets for current purposes amounts to what may be vernacularly characterised as a fraud on the future or contingent creditors that it can be said that it "has reached the point of no return"."*

60. Toulson LJ developed the point of no return test a little further. He said:

> "*I recognise that Professor Goode's reference to a company having "reached the point of no return because of an incurable deficiency in its assets" illuminates the purpose of the subsection [s123(2)] but does not purport to be a paraphrase of it. Essentially, section 123(2) requires the court to make a judgment whether it has been established that, looking at the company's assets and making proper allowance for its prospective and contingent liabilities, it cannot reasonably be expected to be able to meet those liabilities. If so, it will be deemed insolvent although it is currently able to pay its debts as they fall due. The more distant the liabilities, the harder this will be to establish.*"

61. On the facts, the Court of Appeal concluded that the requirements of s.123(2) had not been satisfied. The result in that case, although reached in quite a special context, is likely to have more general application. It shows that reliance on the balance sheet test will (more often than had previously been thought), be a shaky basis on which to establish insolvency. Whether that is still the case after the Supreme Court has had a look at the point remains to be seen.

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South Square

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