

The Prescribed Part – It's all or nothing

ILA Technical Committee wishes to draw members' attention to the decision in *Re Courts plc (in liquidation)* [2008] EWHC 2339 (Ch), in which, in an extempore judgment, Blackburne J. declined to direct that liquidators might properly distribute to some only of the unsecured creditors the prescribed part under s.176A (2) IA 1986.

The prescribed part so far

In our bulletin sent out to members on 4 January 2008 we commented on the first of the reported cases (*Permacell*) to address the operation of s.176A (2): “Prescribed Part and Charge Shortfalls”.

Permacell was followed by the decision in *Airbase*, which was the subject of our bulletin dated 13 March 2008 -“Unsecured creditors and the Prescribed Part (Again)”.

Both of those cases concerned the extent, if at all, to which the proprietor of a floating charge might participate in the prescribed part as an unsecured creditor. They both decided that such a person had no right to participate.

It will be recalled that the cost of administering the prescribed part is paid out of the prescribed part itself (r.12.2(2) IR 1986), such that the operation of s.176A(2) can be uneconomic, even counter-productive. For this reason, the court has power to disapply s.176A(2), effectively causing the prescribed part to be re-classified as a realisation under the floating charge. It was the extent of the power to disapply which was in issue in *Courts plc*.

Courts plc

In *Courts plc*, there were 297 unsecured creditors owed an aggregate sum of £94 million. 37 creditors had large claims and were owed 86% of the overall debt. Some 260 creditors had claims which were less than £28k.

The liquidators held £600k (i.e. the statutory maximum sum which might be made available as the prescribed part). They sought a “qualified disapplication order”. In effect, they asked the court to relieve them of having to distribute the prescribed part to unsecured creditors save to creditors with debts in excess of £28k. This was on the grounds that the cost of making a distribution to smaller creditors would be disproportionate to its benefits.

This raised the question of the extent of the power of the court to disapply the operation of s.176(A)(2) under s.176A(5), which provides:

- “(5) Subsection (2) shall not also apply to a company if –
- (a) the [office-holder] applies to the court for an order under this subsection on the grounds that the costs of making a distribution to unsecured creditors would be disproportionate to the benefits; and
 - (b) the court orders that subsection (2) shall not apply.”

Decision

The judge decided that the court had no jurisdiction to direct a partial disapplication in respect of one sub-class of the unsecured creditors on 2 grounds:

1. To do so would offend the pari passu principle – that unsecured claims should rank equally amongst themselves - a principle so fundamental that the court would be entitled to expect its disapplication in the manner suggested to have been addressed expressly within s.176A.
2. When assessing the ratio between benefit and cost as directed by ss.(5), it was not permissible to do so by reference to individuals creditors or to sub-classes of the unsecured creditors, but only to the unsecured creditors as a whole. He referred to the normal position in a liquidation where expenses are "top-sliced" off the assets without reference to the costs relating to any particular claims and he saw no reason why the prescribed part should be treated any differently.

In the result, in a given case, either the court would make an order disapplying s.176(A)(2) in respect of all creditors and the whole of the prescribed part – in which case it would fall to be treated as a floating charge realisation, or the officeholder would have to incur the high cost (borne by the prescribed part fund itself) of distributing the prescribed part to all the unsecured creditors.

Comment

These are potentially deep waters. The pari passu principle is the 9th of the 10 principles listed by Professor Goode in *Principles of Corporate Insolvency Law* (3rd Edn, p. 77). It only applies to uncharged assets. Section 176A represents a form of statutory release of charged assets for a particular purpose, with power in the court to disapply that release. For that reason alone, it might be said that the application of the pari passu rule to the released assets is not as all-pervasive as it is in respect of "free" assets (i.e. properly so-called).

Moreover, the fact that the costs of administering the prescribed part are paid only out of the prescribed part suggests that Parliament regarded this regime as a closed universe, at least partially excluded from the statutory scheme.

Finally, as Professor Goode observes (p.189), there are various exceptions to the pari passu principle based on a "combination of history, policy and pragmatism" and the courts have shown ingenuity when necessary to circumnavigate the principle in favour of an overall more beneficial result (see e.g. *Re BCCI (No.3)* [1993] BCLC 1490).

On the other hand, the all or nothing construction preferred by the judge might well be considered to be the more natural interpretation of s.176A, read as a whole, and the resulting inflexibility does lead to certainty. Finally, to allow partial disapplication might arguably engage rights of the smaller creditors under Article 1 of Protocol 1 (enjoyment of possessions) and/or Article 14 (enjoyment of rights without discrimination).

Given the number of large insolvencies now reasonably anticipated in which many small consumer claims will stand cheek by jowl with larger institutional claims, it is reasonable to assume that the desire for more flexibility will recur. It might be possible for an office-holder in a future case to persuade a judge of co-ordinate jurisdiction to depart from the reasoning after fuller argument. Otherwise, it would appear that either the Court of Appeal or Parliament might need to re-visit this issue sooner rather than later.

Postscript

Members are reminded that, as part of the technical sessions to be held on 28 March 2009 during the annual conference at the St David's Hotel in Cardiff, Philip Jones QC of Serle Court Chambers will be delivering a paper on the nature and scope of the pari passu rule.