

Case report

The prescribed part: Disapplication should be the exception, not the rule

Re International Sections Ltd (in CVL) (2009) EWHC 137 (Ch)

Background:

Section 176A(5) Insolvency Act 1986 (“IA”) enables a liquidator, administrator or receiver (as the case may be) to apply to the Court for an order that the requirement in section 176A(2) IA to make a prescribed part of the company’s net property available for the satisfaction of unsecured debts shall not apply on the ground that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits.

Rule 12.2 Insolvency Rules 1986 (“the Rules”) provides that:-

- (1) All fees, costs, charges and other expenses incurred in the course of winding up, administration or bankruptcy proceedings are to be regarded as expenses of the winding up or the administration or, as the case may be, of the bankruptcy
- (2) The costs associated with the prescribed part shall be paid out of the prescribed part.

Facts:

The liquidator of International Sections Ltd applied for an order under section 176A(5) IA that he should not be required to distribute the prescribed part to the unsecured creditors on the basis that:-

- (1) The amount of the prescribed part was £6,731.09
- (2) The estimated costs of agreeing unsecured claims and making distributions was £3,332 (although they could be higher depending on the work actually required to agree claims and pay dividends)
- (3) Those costs would have to be taken out of the prescribed part pursuant to Rule 12.2, leaving a balance of not more than £3409.09 to be distributed.
- (4) This would result in a dividend of only 1.48p in the £ to each of the 66 unsecured creditors
- (5) 46 creditors were owed less than £1,000 and therefore, the maximum dividend they would receive would be £14.80 each (and many would receive far less than that)
- (6) Even the four largest unsecured creditors would receive only modest sums – between £311.80 and £906.70.

There was also some debate before the Court regarding the reference in Rule 12.2(2) to “costs associated with the prescribed part”. It was argued that the word “costs in Rule 12.2(2)” had to be contrasted with the expression “fees, costs, charges and other expenses” in Rule 12.2(1), such that Rule 12.2(2) did not extend to “fees” and “charges” and therefore limiting the prescribed part’s susceptibility to anything other than disbursements in making the payments.

Held:

Rejecting the liquidator's application, the High Court held as follows:-

- In deciding whether to disapply the prescribed part, the Court had to be satisfied that the cost of making the distribution would be disproportionate to the benefits and that it was right to disapply the prescribed part on that ground.
- The Court might well take the view, even where the cost of making the distribution to the unsecured creditors would be disproportionate, that unsecured creditors should still receive the “remaining crumbs”.
- The proper approach was to look at the benefits to the creditors as a body. The Court should not analyse the benefit to individual creditors. In the circumstances, the factors set out in paragraphs (5) and (6) above had to be ignored.
- The disapplication of the prescribed part should be the exception and not the rule. The Court should not be too ready to disapply the prescribed part merely because the dividend would be small. That, sadly, would often be the case irrespective of the costs of making any distribution.
- In the present case, a significant, albeit relatively small sum, would remain for distribution once the costs had been catered for.
- The Court was not persuaded that the cost of making the distribution would be disproportionate to the admittedly small benefit to unsecured creditors and in any event, even if it were, the Court was not inclined to exercise its discretion to deprive the unsecured creditors of what remained.
- Although the application, if granted, would result in a much greater return to the secured creditor (rather than being used to pay less than 1.5% of the company's unsecured debts), the Court was not persuaded that this was an adequate reason for disapplying the prescribed part.
- Finally, the Court had no doubt that the word “costs” in Rule 12.2(2) included the charges made by the liquidator for his and his staff's time referable to the distribution, including identifying who the creditors were, and the amount of their debts. The difference in language between Rule 12.2(1) and Rule 12.2(2) was no doubt attributable to the legislative history. Rule 12.2(2) had been added in 2003 and its language reflected the terms of section 176A IA, which had also been an addition at that time. It could not have been intended that the prescribed part creditors should be able to benefit from the work of a liquidator without bearing the expense of his so doing and in the circumstances, the reference to “costs” in Rule 12.2(2) should be regarded as no more than a shorthand reference to the more general “fees, costs, charges and other expenses” contained in Rule 12.2(1),

Commentary:

It is now clear, following the decision in this case, that an office holder should distribute the prescribed part, unless there are exceptional circumstances. Unfortunately, the Court did not give any guidance in its judgment as to what will constitute exceptional circumstances. However, given the decision in this case, to the effect that costs representing nearly half of the total prescribed part and leading to a dividend to unsecured creditors of only 1.48p in the £, are not disproportionate, the threshold would appear to be relatively high.

In the light of the decision in this case, office holders must now consider more carefully whether it is appropriate to make a Court application to disapply the prescribed part. Office holders need to bear in mind that ultimately, if the Court considers that an office holder has brought an application unreasonably, it has power to order the office holder to bear the costs of the application personally rather than recovering them as an expense.

On the plus side for office holders, however, the Court has clarified that it is legitimate for an office holder to deduct his professional time costs and those of his staff in identifying who the unsecured creditors are and in distributing the prescribed part in addition to the disbursements he incurs in connection with that process.

Contact us

For more information on any of the above, please contact:

Sue Lowry

DD 0845 310 7215

E sue.lowry@berryman.co.uk

Carl Mifflin

DD 0845 310 7265

E carl.mifflin@berryman.co.uk

Berryman Park House Friar Lane Nottingham NG1 6DN

DX 10004 Nottm 1 **T** 0115 945 3700 **F** 0115 948 0234

W www.berryman.co.uk

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