McLinden v Lu

[2021] EWHC 3171 (Ch), [2021] All ER (D) 15 (Dec)

The Chancery Division, ruling on preliminary issues, held, among other things, that a petition presented by the defendant against an individual (K) had not been defective and that there had not been any material non-compliance with s 269(1)(b) of the Insolvency Act 1986. The preliminary issues arose in circumstances where K had been indebted to the defendant, the claimant had obtained a substantial judgment against the defendant, concerning his unpaid professional fees in representing her in her litigation against K, and where the claimant had taken further steps to enforce his judgment against the defendant. The preliminary issues related to a final charging order the defendant had obtained in respect of a property which had been registered in K's name. The court was not persuaded that the nil valuation placed on the charging order, both in the relevant statutory demand and in the petition had been anything other than a genuine estimation, by, or on behalf of, the defendant of the value of that security, as at the date of the statutory demand and of the petition, and it accepted that that valuation had been placed on the 2011 charging order by the defendant's legal advisers and on their advice.

Further, the court considered that a district judge's had erred in making the charging order final without resolving a question of beneficial ownership of the property. Further, the court held that the effect of r 6.116 of the Insolvency Rules 1986, SI 1986/1925, in the context of the non-disclosure of a security, was to give rise to an automatic surrender of that security, subject to the right to seek relief from that consequence. Exercising its discretion, the court ruled that the defendant would be relieved from the statutory surrender, which otherwise arose under r 6.116 of the Insolvency Rules 1986 due to her failure to disclose the 2011 charging order in her proof of debt, because it had never been her intention to surrender that order and, viewed objectively, she, had not conducted herself in such a way as to demonstrate an unequivocal intention to waive, or surrender, her rights under it. Accordingly, it held that it was an appropriate case in which to grant of relief under r 14.16 of the Insolvency (England and Wales) Rules 2016, SI 2016/1024, and the 2011 charging order remained extant in her hands.

Catchwords

BANKRUPTCY – PETITION – CHARGING ORDER

Background

K was indebted to the defendant (L) in sums totalling some £840,000, concerning unpaid judgments and costs due to L, resulting from long-standing litigation between the parties.

In December 2013, L presented a bankruptcy petition and, on 3 February 2014, K was made bankrupt
Part of the debts owing to L at the date of the bankruptcy related to her unpaid costs of enforcement proceedings she had taken against K, concerning two properties registered in his name; 82 Westminster Way and 45 Avarn Road. L had secured final charging orders in respect of both properties and, in respect of Westminster Way, she had, on 24 July 2013, secured an order for sale.

The Westminster Way property was sold by receivers appointed by the court by way of equitable execution. Those receivers had been appointed on the application of the claimant (M), as a means of enforcing a substantial judgment, in the order of £340,000, that he had obtained against L, concerning his unpaid professional fees in representing her in her litigation against K.

Certain issues (the bankruptcy issues) arose out of the further steps that M had taken to enforce his judgment against L and related to the final charging order L had obtained in respect of 45 Avarn Road (the property). On 4 November 2011, a district judge (the district judge) had granted that final charging order, purporting to secure £546,578.53, together with interest and costs, due and owing to L, pursuant to a judgment she had obtained against K in June 2010. On 24 July 2019, M applied for a charging order over L's equitable mortgage over the property, created by her 2011 charging order. The effect of such an order, if granted, would be that any recovery L made, by way of enforcement of her charging order, would, itself, be subject to an equitable mortgage in favour of M, to the extent of L's judgment debt, such that, in practice, the bulk, if not all, of her recovery would accrue to M in diminution, or extinction, of that debt. An interim charging order was granted in favour of M over L's 2011 charging order on that same date.

L had not appeared at the hearing of the application to make M's interim charging order final. Further, there had been, before the court, an application notice by a third party (S) for an order that she represented the estate of her grandmother (F) and objected to M's interim charging order being made final, on the basis that the 2011 charging order had been wrongly granted, because the beneficial ownership of the property lay with F, such that the 2011 charging should be discharged, along with the interim charging order granted to M over the equitable mortgage created by the 2011 charging order.

Notwithstanding the objection, the district judge made the charging order final (the district judge's approach). Subsequently, it was contended that S's intervention, on behalf of her grandmother's estate, amounted to an abusive attempt to re-litigate matters already decided and/or to re-open a matter already res judicata. At the hearing of the application, the master was not prepared to make a finding of abuse, or res judicata. Instead, she gave permission for S to represent her grandmother's estate and she directed that she should apply in the proceedings, which were transferred to the Chancery Division, for a determination as to whether the estate had an interest in the property and standing to impugn the restriction which had been entered in the proprietorship register in respect of the property to protect the 2011 charging order.

The matter came before the present court which directed a trial of the bankruptcy issues.

Issues and decisions

(1) Whether the district judge's approach in making a final charging order had been incorrect.

The district judge's approach had been incorrect. The jurisdiction to make a charging order under the Charging Orders Act 1979 (COA 1979) could only be exercised in respect of a beneficial interest, usually in land, held by the judgment debtor. It followed that, before granting a charging order, the court had to be satisfied that the judgment debtor held a beneficial interest in the property to be charged and, therefore, that, if that question had been disputed, the matter had had to have been resolved before the charging order had been made final (see [9] of the judgment).

The result, or consequence, of the district judge's failure to resolve the question of beneficial ownership of the property when, nonetheless, making the 2011 charging order final, had been reflected in the current litigation and in the approaches which had been adopted by counsel who had appeared then, as currently, for S and the estate of F, when the matter had come before the master on 17 September 2019 (see [10] of the judgment).

(2) Whether, given the effect of ss 267, 269 and 383 of the Insolvency Act 1986 (IA 1986) and the Insolvency (England and Wales) Rules 2016 (the 2016 Rules), SI 2016/1024, in particular r 14.16, L had waived or surrendered her security in the property in the course of the bankruptcy proceedings she had brought against K; in particular, by valuing her security in the property as nil in her petition and/or by failing to disclose her security in her proof of debt form, in those proceedings, and/or by electing to give up that security/proceed as unsecured in respect of the property in order to allow, or enable, K's trustee in bankruptcy to pursue the property as an asset in the bankruptcy.

S submitted that, when L, in her 2013 petition, having earlier ascribed a value of £200,000 to the 2011 charging order, had ascribed a nil valuation to the same security and, had correspondingly, asserted that she was unsecured, save to the extent of the value that she placed on her security over Westminster Way, she, had thereby, given up the security, such as it had been, afforded by the 2011 charging order for the benefit of all K's creditors, with the consequence that,

from the date of that petition onwards, she had no longer retained that charging order.
It was common ground that, in respect, in particular, of the effect of L's alleged failure to disclose the 2011 charging order in her proof of debt, r 6.116 of the Insolvency Rules 1986 (the 1986 Rules), SI 1986/1925, was specifically in point.

One of the fundamental tenets of the bankruptcy regime was that a secured creditor had to elect as between the benefit of his security and the potential benefits flowing from a bankruptcy and he could, in consequence, only petition for bankruptcy if, either he gave up his security for the benefit of all the creditors of the debtor and proceeds as if unsecured, or if he limited his bankruptcy petition to the amount of his debt which was unsecured (see [54] of the judgment).
The relevant statutory starting point was IA 1986 s 267(2)(b), which required, as one of the conditions precedent to the presentation of a petition, that the debt, in respect of which the petition was brought, was unsecured. A debt was secured, for purposes of that provision, 'to the extent that the person to whom it was owed held any security for the debt (whether a mortgage, charge, lien or other security)': IA 1986 s 383(2). A charging order took effect as an equitable mortgage under hand and, in consequence, the entire judgment sum purportedly secured by the 2011 charging order was 'secured' for purposes of IA 1986 and, prima facie, not available as a debt on which a petition could be founded (see [56] of the judgment).

However, s 267(2)(b) had to be read with IA 1986 s 269(1), which provided that 'a debt, which was the debt, or one of the debts, in respect of which a creditor's petition was presented need not be unsecured if either: (a) the petition contained a statement by the person having the right to enforce the security that he was willing, in the event of a bankruptcy order being made, to give up his security for the benefit of all the bankrupt's creditors, or (b) the petition was expressed not to be made in respect of the secured part of the debt and contained a statement by that person of the estimated value at the date of the petition of the security for the secured part of the debt' (see [57] of the judgment).
In a case where a statement had been made, in compliance with s 269(1)(a), and where a bankruptcy order was then granted on the petition in which that statement had been made, s 383(3) provided that the creditor who made that statement was to be deemed to have given up the security specified in the statement (see [58] of the judgment).

In a case falling within IA 1986 s 269(1)(b), s 269(2) provided that, for purposes of ss 267 to 270, the secured and unsecured parts of the debt were to be treated as separate debts (see [59] of the judgment).

In the present case, there was nothing in the 2013 petition which could be said to amount to a statement compliant with IA 1986 s 269(1)(a) and having, therefore, the consequences, by way of the deemed giving up of any part of L's security, set out in s 383(3). The placing of a nil value on the 2011 charging order had no relevance in regard to s 269(1)(a) (see [60] of the judgment).

Nor was the nil value placed on the 2011 charging order in the 2013 petition of any avail, or advantage, to counsel for S, in terms of a statutory surrender by L of that security. The overall effect of the 2013 petition was to make plain, or express, that it had only been brought in respect of that part of the debt (£490,323.01) not covered by the value of the security and, in that sense, not secured. As was clear from authority and, in particular, the statement that a petition could proceed in respect of a secured debt 'if the debt is more than the value of the security by at least the minimum amount to found a bankruptcy petition', a petition which was so expressed was sufficient, at least in principle, to satisfy s 269(1)(b), such as to enable the petition to proceed (see [61] of the judgment).

In regard to the estimation of the value of the security, required by the section, there were a number of things to note. First, there was nothing definitive about the required estimate of value. It was open to challenge by the debtor who was entitled to lead evidence, such as to show that the true value of the security was such as to exceed the alleged amount of the unsecured debt, or that the true value of the security reduced the unsecured element of the debt below the bankruptcy level (see [62], [63] of the judgment).

Second, the estimation of the value of a security as nil, or as £0, remained an estimation of the value of the security. It was hard, if not impossible, to see how the valuation of something as nil, or as being valueless, was not ascribing, or estimating, a value to that thing (see [64] of the judgment).

Third, in a case where s 269(1)(b) was relied on, non-compliance with the section, even to the extent of failing to mention a security, or asserting the non-existence of a security, although a serious procedural flaw, did not render the petition a nullity, or preclude it from being cured by amendment. The inclusion, in a petition, of a value for a security, including a nil value, which was not, in truth, an estimate of value would fall into the same category of error (see [65] of the judgment).

Fourth, there was nothing in s 269(1)(b) to suggest that, in a case where that section applied to ground a petition, the consequence of a failure to mention a security, or to put in a true, in the sense of a genuine, estimate of the value of a security, gave rise to a surrender of the security, or a limitation of the value of the security to the amount put forward in the petition as a purported estimate. Counsel for S could point to no other provision of IA 1986, or the relevant Insolvency Rules giving rise to such a total or partial surrender (see [66] of the judgment).

Fifth, the true consequence of a failure to comply with the provisions of s 269(1)(b), in a case where that section was relied on to found a petition, was, simply, that the petition was defective and, susceptible of discharge, or dismissal, at the court's discretion, unless amended (see [68] of the judgment).

In the present case, the court was not satisfied that the petition had been defective or that there had been any material non-compliance with IA 1986 s 269(1)(b). In particular, the court was not persuaded that the nil valuation placed on the 2011 charging order, both in the relevant statutory demand and in the 2013 petition was anything other than a genuine estimation, by, or on behalf of, L of the value of that security, as at the date of the statutory demand and of the petition. It was accepted that that valuation had been placed on the 2011 charging order by L's legal advisers and on their advice. No suggestion had been made that, in so doing, L, by her advisers, had not been acting in good faith, or, therefore, that the estimate had not been made in good faith. The court had no reason at all to think that that had not been the case (see [69], [70] of the judgment).

In Platts v Western Trust & Savings Ltd [1993] Lexis Citation 3929, Sir Christopher Slade had indicated, at page 347, that, in his view and in the context of that case, the proper basis on which the value of a security should be assessed, for purposes of determining, in that case in respect of a statutory demand, whether a debt was fully secured, or the extent to which it was not fully secured, was on the footing of the price obtainable upon a forced sale. It was accepted that, in many cases, that would be the correct mode of estimation for purposes of s 269(1)(b) and, further, that a forced sale of the property, at the date of the demand, or the petition, would not have resulted in a nil valuation (see [71] of the judgment).

However, the present court did not think that Sir Christopher Slade, in Platts, had been intending to lay down any kind of a general rule. The forced sale value of a property was only one aspect, or ingredient, in the determination of the value of any security held over that property. Equally, if not more important, was the question of the existence and value of prior security or, in the case of jointly owned property, the true availability of a sale (see [72] of the judgment).

In the usual case, however, the validity of the security, itself, was not in issue. In the present case, because of the approach adopted by the district judge, that validity had, explicitly, been left open to question, with the result that the security was, at least potentially, defeasible. In that context, one could well see that, looked at as an asset, the 2011 charging order could well be seen to have a nil, or minimal, value. Anyone acquiring the charging order would face the risk, both that the security would prove to be unenforceable, and that a failed attempt to enforce the security would result in significant liabilities as to costs (see [73] of the judgment).

In the result, the court was not persuaded that the nil value placed on the 2011 charging order was anything other than a genuine and realistic estimation of value. There had, in consequence, been no non-compliance with s 269(1)(b) and, even if there had been, that non-compliance would not have resulted in any form of statutory surrender by L of the 2011 charging order (see [74] of the judgment).

Wave Lending Ltd v Parmar and another [2017] EWHC 681 (Ch), [2019] BPIR 451 applied

State Bank of India and others v Mallya [2020] EWHC 1981 (Ch), [2021] BPIR 189, [2020] All ER (D) 128 (Jul) applied

Piers, Re, ex p Piers [1898] 1 QB 627, 46 WR 475 distinguished

Platts v Western Trust & Savings Ltd (1993) Times, 7 April, [1993] Lexis Citation 3929, [1996] BPIR 339 explained

Barclays Bank plc v Mogg [2003] EWHC 2645 (Ch), [2003] All ER (D) 56 (Oct) explained

(3) The court considered the effect of L's failure to mention, or include, the 2011 charging order in her proof of debt. The starting point was r 6.116 of the 1986 Rules, being the insolvency rules in force at the date of L's proof of debt. That rule provided that, if a secured creditor omitted to disclose his security in a proof of debt, he should surrender his security for the general benefit of creditors, unless the court, on application by him, relieved him from the effect of the rule on the ground that the omission was inadvertent or the result of honest mistake. Rule 6.116 had to be read with r

6.98(1)(e) of the 1986 Rules, which provided that a creditor's proof of debt should state the particulars of any security held, the date when it was given and the value which the creditor put on it (see [76], [77] of the judgment).

Counsel for L, by way of a preliminary point, sought to argue that the fact that L's proof of debt had included some references to costs which had been incurred in respect of the proceedings which had given rise to the 2011 charging order, including the abortive appeal, meant that that charging order had not been omitted from her proof of debt. That argument was untenable. The simple fact was that the 2011 charging order had not been mentioned at all in L's proof of debt, let alone with the degree of particularisation required by r 6.98(1)(e) (see [79] of the judgment).

As a consolidating provision, r 14.16, was not intended to change the effect, or meaning, of its predecessor. Rather than r 6.116 taking its meaning from r 14.16, r 14.16 should take its meaning from r 6.116 and, accordingly, the essential question remained the construction of r 6.116 (see [87] of the judgment).

The effect of r 6.116 of the 1986 Rules, in the context of the non-disclosure of a security, was to give rise to an automatic surrender of that security, subject to the right to seek relief from that consequence set out in the rule, or in its successor (see [88]-[96] of the judgment).

In the light of that conclusion, the position in the present case was that, subject to the result of her application for relief from the effects of r 6.116, L had surrendered the 2011 charging order in 2014 (see [99] of the judgment).

Candey Ltd v Crumpler and another (as joint liquidators of Peak Hotels and Resorts Ltd (in liquidation)) [2020] EWCA Civ 26, [2020] Costs LR 131 applied

Safety Explosives Ltd, Re [1904] 1 Ch 226 considered

LCP Retail Ltd v Segal [2006] EWHC 2087 (Ch), [2006] All ER (D) 31 (Aug) considered

JT Frith Ltd, Re [2012] EWHC 196 (Ch) considered

Re Peak Hotels and Resorts Ltd (in liquidation) Candey Ltd v Crumpler and another (as joint liquidators of Peak Hotels and Resorts Ltd (in liquidation)) [2019] EWHC 282 (Ch), [2019] All ER (D) 116 (Feb) considered

(4) The court considered L's application for relief from the effects of rr 6.116 and 14.16.

Counsel for S submitted that, in the context of K's discharge from bankruptcy in 2015, and the fact that the application had been made some three years after the trustee(s)' final report and after service in that report of the trustee(s)' notice, under IA 1986 s 331, the administration of the bankrupt's estate was complete and there remained no extant bankruptcy proceedings in which the application could be made.

The wide power of the court under IA 1986 s 363(1) 'to decide all ... questions, whether of law or fact, arising in any bankruptcy' was not limited to any particular period, or, in particular, to the period prior to the closure, or completion, of the bankruptcy, that the question as to whether L should be relieved from the effects of the surrender arising under r 6.116 was a question arising in K's bankruptcy and, therefore, that that section afforded a sufficient jurisdiction to enable the court to determine L's application (see [102] of the judgment).

Further, the ostensible breadth of the s 363 jurisdiction, coupled with the fact that jurisdiction existed under IA 1986 s 300(8) to revive a trusteeship after the discharge of the trustee, in order to deal with previously undisclosed assets, tended to the conclusion that, in bankruptcy, the bankruptcy proceedings, in their broadest sense, remained available as a vehicle, or platform, for the making of any necessary applications, notwithstanding the formal closure or completion of the bankruptcy (see [103] of the judgment).

On the footing that jurisdiction existed, the next question was whether, L should be relieved from the statutory surrender which otherwise arose under r 6.116 on the ground that her omission to disclose the 2011 charging order had been 'inadvertent or the result of honest mistake'. The court had no doubt but that L's failure had not been inadvertent. Inadvertence, in the context of a failure to disclose security, was applicable to the situation where a security was omitted by forgetfulness, or accident. It was not applicable where a person, being aware of the existence of a security elected, having considered the advantages and disadvantages of his action, not to disclose the security, even if that decision was based on incorrect information. L had been well aware of the existence of the 2011 charging order and, whatever her reasons for non-disclosure, that non-disclosure had not been based on inadvertence (see [104], [105] of the judgment).

The harder question was whether L's failure to disclose the 2011 charging order could properly be attributed to an honest mistake on her part. On the facts, it could. Among other things, regard had been had to the fact that, when submitting her proof, L had, evidently, been unrepresented and she had filled in the document to the best of her ability (see [106]-[113] of the judgment).

The court's finding of honest mistake did not, as the court read r 6.116, entitle L to relief from the statutory surrender of the 2011 charging order as of right. What it did was to open up the court's jurisdiction to grant that relief. The exercise of that jurisdiction remained a matter of discretion [115] of the judgment).

The omission of the 2011 charging order from the proof of debt had not afforded L any advantage in the bankruptcy, such as to render it unfair for her to be relieved from the consequences of that omission. Nor, had her omission, in any other way, interfered with the proper conduct of the trustee(s) in respect of the bankruptcy estate. L's failure did not affect the quantum of her proof or her voting rights arising from that proof. Had the security been disclosed it would have been disclosed at nil value and would not, therefore, have reduced the quantum of L's proof, or, correspondingly, the extent of her voting rights in the bankruptcy. Likewise, while, had the security been disclosed at nil value, the trustee(s) could have redeemed it for the bankruptcy estate at nil value (rr 6.117, 14.17), the fact was that the trustee(s) had been offered and had declined the security and could, in any event and at any stage in the bankruptcy, have sought to take advantage of the statutory surrender arising out of the non-disclosure (see [117]-[119] of the judgment).

It followed that it was an appropriate case for the grant of relief under r 14.16. L's conduct had not given rise to a waiver, or surrender, of the 2011 charging order under the general law. It had never been L's intention to surrender the 2011 charging order and, viewed objectively, she, had not conducted herself in such a way as to demonstrate an unequivocal intention to waive, or surrender, her rights under the 2011 charging order (see [121]-[134] of the judgment).
In the result, because the court would, by its order, relieve L from what would otherwise have been the effect of her omission of the 2011 charging order from her proof of debt, the charging order remained extant in her hands (see [135] of the judgment).

The court would have to go on to consider: (a) whether the result of the district judge's ruling, and notwithstanding his expressed intention that that ruling would not be determinative of the beneficial ownership of the property, the effect of that ruling, given the terms of COA 1979, had been to render the beneficial ownership of the property by K res judicata and any challenge by the estate in respect of that ownership an abuse; and (b), if the estate's challenge was not abusive, whether the estate made out that challenge, such that the 2011 charging order and M's parasitic interim charging order were both discharged (see [137] of the judgment).

Safety Explosives Ltd, Re [1904] 1 Ch 226, 73 LJ Ch 184 considered

Judgment date
26 November 2021

Judge
Deputy Master Bowles

Representation
Morwenna Macro (instructed by Regal Law Solicitors Ltd) for S.
Oliver Phillips (appearing pro bono under the auspices of Advocate) for L.
K did not appear and was not represented.