

# Stewardship, insolvency practitioners and the personal insolvency scenario<sup>1</sup>

## Introduction

A trustee in bankruptcy is a “steward” in a number of senses of the term. Primarily the trustee in bankruptcy is responsible for the protection (and subsequent realisation) of the debtor’s bankruptcy estate which vests automatically upon him on appointment, as s. 306 of the Insolvency Act 1986 indicates<sup>2</sup>. There is also an obligatory element in this custodianship, because the trustee must according to s. 311 of the Insolvency Act 1986 take control of any financial records. The aforementioned components may be seen as the proprietary aspect of this particular genre of stewardship. It therefore has a lot in common with the general concept of trusteeship at large. But equally, public trust is invested in the trustee in bankruptcy to ensure that the collective bankruptcy regime is properly maintained and there are suitable mechanisms provided to ensure that this happens. There are obligatory elements in play here which are imposed upon trustees in bankruptcy. Here we have what may be termed a public law perspective on this form of stewardship<sup>3</sup>. Bearing in mind this distinction, the purpose of this article is to trace the evolution of the

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<sup>1</sup> Stewardship issues can arise in a range of insolvency contexts – see D. Milman, “Stewardship and the Insolvency Practitioner: A Review of the Current Position” [2012] (Winter) 92 *Amicus Curiae* 2.

<sup>2</sup> After-acquired assets of the bankrupt do not now vest automatically, but instead must be claimed by the trustee within 42 days of receiving notice of their existence – Insolvency Act 1986 ss. 307 and 309. Trust property does not form part of the estate as we are informed by s. 283(3)(a)– but the trustee in bankruptcy as an involuntary steward of trust assets may be expected to preserve such property and can claim an indemnity for the costs incurred under the principle in *Re Berkeley Applegate Ltd (No. 2)* [1989] Ch 32. Note that the vesting does not occur immediately on the grant of the bankruptcy order – instead the official receiver acts as receiver and manager without vesting until the trustee is appointed – see s. 287(1) and *Pathania v Adedeji* [2014] EWCA Civ 681.

<sup>3</sup> This is reinforced by the fact that the administration of many bankrupt estates is carried out by the public sector officer known as the official receiver (see Insolvency Act 1986 ss. 399-400). Even if a trustee is appointed the official receiver will investigate the causes of the bankruptcy (s. 289 of the Insolvency Act 1986), but now has more discretion in the matter as a result of changes made in 2004 – see s. 289(2). It is also true that a person may be bankrupted even though there is no estate to distribute and therefore in such circumstances the stewardship role lacks a proprietary foundation – see *Re Field* [1978] 1 Ch 371.

stewardship<sup>4</sup> regime as applied to trustees in bankruptcy and to offer an insight into its current significance in English Law.

### What does stewardship require in the personal insolvency context?

Looking at the model of stewardship through the paradigm of the trustee in bankruptcy, the requirements would include a number of standard custodianship elements, coupled with some customised components mandated by the peculiar context in which trustees in bankruptcy operate. First and foremost, there is an expectation that a trustee in bankruptcy will observe the strict requirements of a person holding such a fiduciary position. This is reinforced by the fact that he/she enjoys the status of an officer of the court. One consequence of this position is the need to maintain independence from competing stakeholders in the bankruptcy process; the comments of Lightman J in *Re Ng*<sup>5</sup> where he warned against the “hired gun” syndrome are relevant here. This independence is reinforced by controls on removal laid down in Insolvency Act 1986 s. 298(1): a specially convened creditors’ meeting<sup>6</sup> can remove a trustee, as can the court. But the court sees removal of a trustee in bankruptcy very much as a last option<sup>7</sup>. Notwithstanding this, it is no surprise that a high standard of competence is imposed on trustees in bankruptcy in the discharge of their responsibilities. They are well paid professionals and the entitlement to receive appropriate remuneration plus reimbursement of expenses is a reasonable expectation on their part. The required degree of competence must also encompass timely performance of functions, an aspect that has been upgraded in recent years with the introduction by the Insolvency Act 1986 s. 283A of the “use it or lose it” requirement in respect of the sale of any “homestead” forming part of the estate. It is also important that the key stakeholders know how things are progressing; to this end a new system of “progress reports” was introduced in 2010 to provide greater transparency<sup>8</sup>. The challenging nature of the role of a trustee in bankruptcy suggests an effective range of powers is essential. Trustees in bankruptcy need wide powers to investigate the debtor’s conduct and to realise all property (including intangible assets) comprised in the estate. This in turn might involve the pursuit of litigation seeking the setting aside of questionable pre bankruptcy transactions entered into by the debtor<sup>9</sup>. It might involve placing pressure

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<sup>4</sup> On stewardship generally in the context of debt management see R. Mohon, *Stewardship Ethics in Debt Management* (Kluwer, 1999).

<sup>5</sup> [1997] BCC 507. Cited with approval by Robert Walker LJ in *Trustee in Bankruptcy of Bukhari v Bukhari* [1999] BPIR 157 at 160.

<sup>6</sup> For further details see Insolvency Rules 1986 rr. 6.129-6.131.

<sup>7</sup> This is apparent from the approach of Proudman J in *Doffman and Isaacs v Wood and Hellard* [2012] BPIR 972.

<sup>8</sup> See now Insolvency Rule 1986 r. 6.78A.

<sup>9</sup> The strict application of the 2010 Jackson reforms on litigation costs, which were embodied in the Legal Aid, Sentencing and Punishment of Offenders Act 2012 ss. 44-46, to recovery litigation by trustees in bankruptcy with effect from April 2016 will not assist in this goal.

on the bankrupt to cooperate with the bankruptcy process; an application to the court under s. 279(3) of the Insolvency Act 1986 to suspend automatic discharge can be used to this end. Some 711 suspensions of discharge occurred in 2015-16 according to Insolvency Service enforcement statistics. Recoveries for creditors might depend upon successful transactional avoidance in respect of dubious pre-bankruptcy transactions and a careful cost/benefit analysis of the pros and cons of any litigation will be required. Creditors will judge the effectiveness of the stewardship process by reference to the dividend they receive at the conclusion of the bankruptcy. The bitter truth is that this is a form of stewardship that has an inherent degree of disappointment embedded within it. There will be losers amongst the creditors and the bankrupt will certainly be aggrieved at the loss of the assets in the estate; this combination provides a volatile cocktail that often results in litigation which ironically makes matters worse for all concerned. Management of expectations is an important stewardship skill to be deployed in this context.

We have delineated the basic obligations and required characteristics of a trustee in bankruptcy above. But adequate mechanisms must exist to provide a degree of accountability<sup>10</sup> and effective means of enforcing these obligations. Of particular importance is that there should be rigorous cost control of the stewardship operation. Another critical consideration is that there must be a clear beginning<sup>11</sup> and an end to the period of stewardship: in the case of a trustee in bankruptcy in the latter sense we are referring to the concept of “release”. An illuminating fact that is often overlooked is that the stewardship of a trustee in bankruptcy will continue for some time after the discharge of the bankrupt, which now occurs automatically after the elapse of one year from the commencement of bankruptcy<sup>12</sup>. There is nothing revelatory in this observation<sup>13</sup>, but its implications have become more significant with foreshortened periods of bankruptcy. So, for instance, a trustee in bankruptcy looking to use the bankrupt’s future income stream in an effort to repay creditors must apply for an income payments order under s. 310 of the Insolvency Act 1986 before the bankrupt is discharged, even though any such order can run

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<sup>10</sup> On related issues concerned with accountability See A. Keay and J. Loughrey, “The Framework for Board Accountability in Corporate Governance “ (2015) 35 Legal Studies 252.

<sup>11</sup> On the making of a bankruptcy order the official receiver will initially assume the role of receiver and manager according to s. 287 of the Insolvency Act 1986. If the creditors think it worthwhile they will then appoint a private practitioner to assume the role as trustee in bankruptcy. But that trustee remains subject to the oversight of the official receiver – see s. 305(3)

<sup>12</sup> See now Insolvency Act 1986 s. 279(1) which was amended with effect from 2004 to reduce the period of automatic discharge from bankruptcy from 3 years to one year. As a quid pro quo for shorter discharge periods the legislature introduced the bankruptcy restrictions regime to be applied to undeserving bankrupts – see Insolvency Act 1986 s. 281A and Sched 4A. But the enforcement of this penal regime falls very much within the public law dimension of stewardship and is entrusted to the official receiver. See generally K. Moser, “Restrictions after Personal Insolvency” [2013] JBL 679.

<sup>13</sup> See *Re A Debtor (No. 6 of 1934)* [1941] 3 All ER 289 where a similar point was made.

for a maximum of three years. This temporal discrepancy is not always fully appreciated and it is important because the exploitation of a bankrupt's future income is a strategy employed in some 15% of bankruptcies these days.

Reflecting in particular on the context in which trustees in bankruptcy operate in practice there should be an effective market for the provision of insolvency services. There must be an adequate pool of potential stewards to choose from and effective competition within the profession to drive down costs. The pool of talent unfortunately is limited, with only 1328 active authorised practitioners carrying the load of all personal and corporate insolvencies in the UK<sup>14</sup>. As appointments of insolvency office holders in English Law are made *ad personam*<sup>15</sup>, this means that active practitioners may at any one time hold multiple appointments. Although this rarely generates conflicts of interest, it does raise other stewardship issues<sup>16</sup>. The brutal truth is that the officially designated steward in bankruptcies will rely heavily upon subordinate managerial staff to carry out the role, though ultimately he/she remains responsible for the proper conduct of the bankruptcy process. The standard fiduciary duty not to delegate a role that has been entrusted therefore remains unimpeached. This market for insolvency services also requires the provision of sufficient rewards for those private practitioners taking on the role. Incentivisation is important. Where this is not the case, and a private practitioner cannot be induced to take on the task, there needs to be a safety net provided by state through the operation of the official receiver system; there must be a steward in order for the bankruptcy model to work. Even where there is a private trustee in bankruptcy appointed the official receiver will be involved in some capacity at some stage in every bankruptcy; in effect therefore a stewardship dyarchy will operate with the private trustee very much in the subordinate role<sup>17</sup>. Questions therefore need to be asked about effective use of public expenditure in this regard. It is also essential that there be appropriate qualification and professional regulation for those assuming a stewardship role as a trustee in bankruptcy.

### Why does good stewardship matter in the personal insolvency context?

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<sup>14</sup> See *Annual Review of Insolvency Practitioner Regulation 2015* (March 2016) p. 14. In 2010 the Office of Fair Trading produced a valuable report on the market for insolvency practitioner services but the focus was very much upon the corporate insolvency sector.

<sup>15</sup> Only individuals (and not corporations) can act – Insolvency Act 1986 s. 390(1) – this reinforces notions of personal responsibility.

<sup>16</sup> For example when an insolvency practitioner retires or is otherwise disabled there may be a need to effect a block transfer of multiple offices. Procedures have been adopted by the courts since 1993 to mitigate the burden on the estates of such a change in stewardship – see now Insolvency Rule 1986 r. 7.10A.

<sup>17</sup> So for instance the official receiver and not the trustee will be the applicant for a public examination under Insolvency Act 1986 s. 290 or for a bankruptcy restrictions order under s. 281A of the Act. The private trustee can seek suspension of discharge or a private examination of the bankrupt under s. 366.

Having mapped out the basic features, we now need to take a step back and ask ourselves why good stewardship matters in the personal insolvency context. Three reasons are immediately apparent. First and foremost, as bankruptcy involves a collective process of recovery of debtor assets for the benefit of creditors there is the imperative of economic efficiency/maximising returns for creditors. But it is a mistake to view bankruptcy purely in such narrow monetary terms<sup>18</sup>. There is a public interest dimension. Good stewardship is needed to maintain confidence in the bankruptcy system which is a key part of our credit default regime. This was recognised in the Cork Committee<sup>19</sup> and, as the nature of society has changed in the intervening 30 years, that linkage has been amplified. Finally, there is the need to maintain professional standards, both from the viewpoint of individual practitioners, who are anxious to preserve their personal reputation, and of the profession as a whole, who are aware of the imperative of protecting the integrity of the profession in a climate where insolvency practitioners in general viewed with scepticism by the media.

## THE EVOLUTION OF THE LAW

### Foundations laid in the late 19<sup>th</sup> and early 20<sup>th</sup> Century

We note the development of the idea from 1883 onwards of an independent trustee in bankruptcy who manages the estate with a view to its realisation. This was the date of the watershed Victorian consolidation legislation (the Bankruptcy Act 1883, 46 and 47 Vict c. 52) that brought to an end a period of considerable turmoil in bankruptcy stewardship practice<sup>20</sup>. The management of bankrupt estates was not to be vested in the assignees or creditors, nor was it the sole province of the state. Rather an independent trustee was to take on this role, supported by the new public institution of the official receiver. It ushered in a period of relative stability that was then put into “modern” statutory format through the Bankruptcy Act 1914. It has to be conceded however that stewardship was to a large extent geared towards protecting the creditor interest.

At the same time as this legislative matrix took shape, the common law was developing principles geared to promoting good stewardship: the most celebrated of these was the

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<sup>18</sup> Lord Millett made the same point in connection with company liquidation – see *Official Receiver v Wadge Rapps and Hunt* [2003] UKHL 49 at paras [64] and [75].

<sup>19</sup> *Insolvency Law and Practice: Report of the Review Committee*, Cmnd 8558, 1982.

<sup>20</sup> The classic analysis is provided by V.M. Lester, *Victorian Insolvency* (Clarendon Press, 1995). See also D. Milman, *Personal Insolvency Law, Regulation and Policy* (Ashgate, 2005) pp. 5-12.

rule in *Ex parte James*<sup>21</sup> where James LJ decreed that it was duty of a trustee in bankruptcy<sup>22</sup> as an officer of the court to act “honourably”. This rule survives in name in modern practice, but when invoked it is usually trumped by other more pragmatic considerations<sup>23</sup>. In many senses, recourse to opportunism may be said not to be honourable, but, if it assists in the maximisation of the bankruptcy estate, it is permissible. It may even be expected.

The foundation of bankruptcy stewardship for much of the 20<sup>th</sup> century was provided by Bankruptcy Act 1914 (as amended). Provisions that were central to the notion of stewardship would include s. 20, which provided for the establishment of an optional creditors’ committee of inspection to oversee the trustee in bankruptcy<sup>24</sup>. This represented an additional stewardship safety mechanism. Section 80 established a complaint mechanism for aggrieved persons who wished to challenge the actions of a trustee in bankruptcy. Remuneration controls were detailed in s. 82 of the Bankruptcy Act 1914. Section 95 outlined a mechanism for removal of a trustee by creditors. We must not forget the input into this stewardship regime by the Bankruptcy Rules 1952<sup>25</sup>. Under these secondary rules there were controls placed upon remuneration claims (rr. 335/336), maintaining a security bond (r. 338), self-dealing with the estate (rr. 349/350) and on operating proper accounts (rr. 362-373). All in all, this constituted a well-developed stewardship regime. Stewardship philosophy has thus been applied to trustees in bankruptcy for many a year; it is not a recent fad.

#### The Cork Committee suggestions for reform

That said, the Cork Committee concluded that, although there was much to commend it, there was a general recognition in practice that the 1914 Act regime as applied to the stewardship of trustees in bankruptcy, needed an upgrade. A number of suggestions were made to this end. There was a recommendation that all insolvency practitioners should be licensed through a system of compulsory qualification<sup>26</sup>. A clear statutory duty to take reasonable care should be formulated<sup>27</sup>. It was also proposed that there should be wider/ more flexible powers for trustees<sup>28</sup>. But at the same time it proposed a more benign

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<sup>21</sup> (1874) LR 9 Ch App 609. For an excellent historical overview see I. Dawson, “The Administrator, Morality and the Court” [1996] JBL 437 at 444.

<sup>22</sup> The rule has been applied to official receivers acting in respect of a bankrupt estate – *McGrath v Finnegan* [2009] NI Master 74.

<sup>23</sup> See for example *Boorer v Trustee in Bankruptcy of Boorer* [2002] BPIR 21.

<sup>24</sup> Note the link with s. 79 which required the trustee to have regard to directions given by creditors. Members of this committee stand in a fiduciary position vis a vis the estate – see *Re Bulmer, ex parte Greaves* [1937] Ch 499. This is now reflected by Insolvency Rule 1986 r. 6.165.

<sup>25</sup> SI 1952/2113.

<sup>26</sup> Cmnd 8558 Chapter 15.

<sup>27</sup> Cmnd 8558 para 788.

<sup>28</sup> *Ibid* Chapters 26-28.

approach towards honest bankrupts and their families<sup>29</sup>. In the case of any realisation of the family home this involved giving the family a period of grace before they were turfed out onto the street. Moreover, in order to reassure the public that complaints against insolvency practitioners were being adequately addressed, a public office of Insolvency Ombudsman should be established<sup>30</sup>.

### The reformed regime in the Insolvency Act 1986 and the Insolvency Rules 1986

The first two of these recommendations were implemented via the Insolvency Act 1986. Thus the requirement of universal licensing and professional qualification was introduced by Part 13 of the 1986 Act. Changes were made to the nature of trustee's powers. Otherwise there were only limited changes made with regard to trustees in bankruptcy

Looking at the 1986 Act certain provisions seen as fundamental to the operation of an effective stewardship regime stand out. So, under Insolvency Act 1986 s. 292(2) the trustee must be a properly qualified individual with a security bond in place<sup>31</sup>. The committee of inspection has been rebranded as the creditors' committee (see s. 301) but with less extensive powers of direction over the trustee, though the trustee was made subject to a duty to keep it informed (insolvency Rule 6.152). However, it seems that such committees are rarely used in practice. Insolvency Act 1986 s. 305(2) preserves the exercise of discretion by the trustee in bankruptcy. One result of this is that judicial intervention will be limited because considerable latitude is given to trustees.

The central stewardship provision is located in Insolvency Act 1986 s. 303(1), which is the complaint mechanism for a wide range of dissatisfied persons (including the bankrupt) who are aggrieved at the actions of the trustee<sup>32</sup>. This provision has attracted a fair amount of judicial attention over the years. The leading case now is *Bramston v Haut*<sup>33</sup> where the Court of Appeal stated that the court will require proof of perversity to justify intervention. This is a slight departure from the language used previously, where the focus was on the

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<sup>29</sup> Ibid paras 1114-1131.

<sup>30</sup> Ibid para 1772. Sir Gavin Lightman famously supported this idea in his piece "The Challenges Ahead: Address to the Insolvency Lawyers' Association" published in [1993] JBL 113 at 118. In its 1994 Report JUSTICE called for the adoption of the ombudsman model to restore public confidence in the insolvency system – see *Insolvency: An Agenda for Reform* at paras 5.13, 7.13 and 7.16. Note also D. Milman, *Personal Insolvency Law, Regulation and Policy* (Ashgate, 2005) at 156.

<sup>31</sup> Insolvency Act 1986 s. 390(3).

<sup>32</sup> Apparently the provision cannot be used to challenge the public law actions of the official receiver – *Hardy v Focus Insurance* [1997] BPIR 77. Other options may be available here. For example, there is an internal complaints system operated by the Insolvency Service featuring independent Adjudicators with the ultimate possibility of a complaint being channelled through to the Parliamentary Ombudsman. On judicial intervention see D. Milman, "Judicial Review of Insolvency Practitioners Decisions and Actions" [2014] 27 *Insolv Intell* 97.

<sup>33</sup> [2012] EWCA Civ 1637.

public law *Wednesbury*<sup>34</sup> criterion of unreasonableness as the justification for judicial intervention. One can understand why the Court of Appeal felt the need to cut the link with public law considerations, but the test it substituted is equally restrictive. Not surprisingly, most complaints under s. 303(1) get nowhere<sup>35</sup>.

Moving on, Insolvency Act 1986 s. 303(2) offers a directions facility for trustees in bankruptcy seeking judicial guidance on contested issues. It therefore supports a scheme of “assisted stewardship”. This facility must not be accessed too liberally or else the problem of “defensive stewardship” will rear its ugly head. The courts are aware of this danger as is apparent from the comments by Registrar Barber in *Re Chinn*<sup>36</sup> on what have been labelled as “bomb shelter” applications. This phenomenon will add to administration costs if the trend is allowed to develop. This qualified aspect of stewardship is reinforced by Insolvency Act 1986 s. 363, which confirms the overall supervisory control of the court. We should also take note of Insolvency Act 1986 s. 305(3), which explicitly states that the trustee is subordinate to the Official Receiver.

Insolvency Act 1986 s. 304, albeit in convoluted linguistic form, establishes the possibility of liability in negligence<sup>37</sup>. This form of liability was confirmed in practice in *McAteer v Lismore*<sup>38</sup> where the court (Deeny J) felt that the trustee in bankruptcy could have done more to ensure that a property included within the estate and which was being sold was properly marketed so that its realisation value was maximised. When it comes to competence there is a curious dichotomy between what is expected of stewards hailing from the private section (i.e. trustees in bankruptcy) and what is required from those operating in the public service (official receivers). In *Mond v Hyde*<sup>39</sup> the Court of Appeal

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<sup>34</sup> As laid down in *Associated Provincial Picture Houses v Wednesbury Corporation* [1948] 1 KB 223. For the use of this criterion in the bankruptcy context see *Osborn v Cole* [1999] BPIR 251.

<sup>35</sup> This pattern is reflected by *Aslam v Finn and Field* [2013] EWHC 3405 (Ch). A rare success was notched up in *Faryab v Smith* [2001] BPIR 246 where a trustee in bankruptcy was directed to assign a legal claim that formed part of the estate. Note that failure to exercise the right to complain under s. 303(1) does not preclude a later claim for restitution or compensation under s. 304 – *Bramston v Oraki* [2014] EWHC 2982 (Ch) at para [8] per Nicholas Strauss QC (sitting as a Deputy Judge of the High Court).

<sup>36</sup> [2016] BPIR 346.

<sup>37</sup> There was no direct statutory predecessor located in Bankruptcy Act 1914. Note also that there is no equivalent of the judicial pardon facility found in s. 61 of the Trustee Act 1925. The bankrupt with leave can apply under s. 304 and there is no need to show that the bankruptcy will produce a surplus – *McGuire v Rose* [2014] BPIR 650. That said, claims made under s. 304 face a high hurdle before they can succeed – see for instance the approach of Proudman J in *Oraki v Bramston* [2015] BPIR 1238 where the claimant failed to show that the trustee had fallen short of the standards expected of a reasonably skilled and careful practitioner.

<sup>38</sup> [2012] BPIR 812.

<sup>39</sup> [1999] QB 1097 – for critique see J. Murphy, “*Mond v Hyde: Negligence Immunity for the Official Receiver?*” [1999] Ins Law 206.



upheld the immunity from suit of an official receiver in circumstances where the trustee in bankruptcy who took over from the official receiver had been misled by an allegedly negligent misstatement. When the trustee in bankruptcy challenged this immunity in the Strasbourg court in *Mond v UK*<sup>40</sup> this immunity was found to be a proportionate breach of Art 6 of the European Convention on Human Rights.

The powers of a trustee in bankruptcy are delineated largely by Insolvency Act 1986 s. 314 and Sched 5. But there are additional powers founded in legislation, such as the power of disclaimer of onerous assets mapped out by s. 315 of the 1986 Act. This is a radical power that condones the breach of contract by a steward. The power dates back to 1869 and is best viewed as a compensating power to deal with any issues arising from the automatic vesting of property in the trustee. The gentler attitude towards the bankrupt's family was manifested in s. 335A of the Insolvency Act 1986 which required a trustee to prioritise the family interest for the first 12 months, whereafter creditor interests (which often favoured sale) would prevail<sup>41</sup> unless there were exceptional circumstances present. We are talking about truly exceptional circumstances here; a trustee in bankruptcy is not required to have a bleeding heart.

There is a complex combination of provisions located in the Insolvency Act 1986 ss. 298(8), 299(3) and 331 which explain how the trustee in bankruptcy is released from the stewardship position. Release is important in that it draws a line under the period of stewardship. But it does not confer a complete pardon on a trustee in bankruptcy if defalcations subsequently come to light, as s. 299(5) indicates. Under s. 304(2) of the 1986 Act an application seeking compensation from a trustee who has been released will only be permitted if the leave of the court is first obtained.

The secondary legislation in the former of the Insolvency Rules 1986 (as amended)<sup>42</sup> laid down in the wake of the introduction of the modern system adds to the matrix of stewardship requirements. For instance, Insolvency Rule 6.147 provides that "sweetheart" deals between the trustee and his/her associates may be set aside. These are important provisions that one might have expected to find in the Act itself. The reason for its location is that the statutory predecessor was in the former Bankruptcy Rules and legislative stasis has been applied. We could also cite Insolvency Rule 6.148 which imposes prohibition on touting for business as a trustee in bankruptcy as a provision deserving of a more high profile location. For completeness we should note the Insolvency Regulations 1994 (SI 1994/2507) especially Part 3 which deals with handling funds and record keeping by trustees in bankruptcy.

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<sup>40</sup> [2003] BPIR 1347.

<sup>41</sup> See in particular s. 335A(3) - note also similar provisions are located in ss. 336(5) and 337(6).

<sup>42</sup> Amendments have been made to the Insolvency Rules on an annual basis. We are currently awaiting the publication of the new consolidated Insolvency Rules which have been 10 years in the making. It is not expected that they will make any major changes in substance to the matters under discussion in this article.

There are also the Insolvency Practitioner Regulations 2005 (SI 2005/524) which deal with the training of insolvency practitioners, lodging of bonds<sup>43</sup> and record keeping.

### Stewardship adapted to cater for individual voluntary arrangements

We now need to diverge in order to introduce an important qualification into our study. Although historically the trustee in bankruptcy has been the paradigm steward in personal insolvency cases, the picture has changed in the past decade. The Insolvency Act 1986, as a result of the urging of the Cork Committee, introduced a bankruptcy alternative, the so-called individual voluntary arrangement, or IVA for short. This proved immediately popular and in recent years the IVA has supplanted bankruptcy as the leading personal insolvency regime prescribed by law. Some 39,993 new IVAs were entered into in 2015.

It is necessary to say a few words on how the stewardship notion applies to this novel regime. The IVA model has resulted in the advent of **nominees** and **supervisors** of IVAs. Both are private sector practitioners. The nominee is a licensed insolvency practitioner who “sells” the IVA package to creditors. This promotional role is not found in the bankruptcy context where the trustee in bankruptcy appears on the scene after the event. The supervisor<sup>44</sup> carries out the IVA if agreed to by creditors. This will typically involve the supervisor standing at arms’ length and collecting the promised payments from the debtor and possibly involved in the limited realisation of assets. There is no automatic vesting of the debtor’s assets in the IVA supervisor. There are discrete roles here as part of this procedure<sup>45</sup>, but invariably they are executed by the same insolvency practitioner. How are standards of good stewardship encouraged in this environment?

Looking at the performance of nominees our attention is directed to Insolvency Act 1986 s. 262 which enables a party to challenge the establishment of IVA on grounds of unfair prejudice and/or material irregularity. Such an application will often involve criticism of the nominee, particularly in his/her capacity as chair of the creditors’ meeting which voted upon the IVA. Failures as a nominee or chair which are subsequently revealed on challenge may prove expensive for the insolvency practitioner, not least in costs<sup>46</sup>. But s. 262 enables other types of complaint to be aired in court. We should also note the existence of the IVA

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<sup>43</sup> On security bonds required of trustee see S. Hunt and J. Tribe, “Insolvency Bonds: Practice and Reform” [2014] 27 *Insolv Intell* 17. Valuable perspective is offered by J. Tribe and S. Hunt, “Insolvency Bonds: History, Policy and Substance” [2012] 25 *Insolv Intell* 37.

<sup>44</sup> The supervisor will usually be the erstwhile nominee. It is arguable that an IVA supervisor is an officer of the court – see *King v Anthony* [1999] BPIR 73 – but this is not without doubt, particularly now that since 2000 an IVA can be set up without an initial interim order from the court.

<sup>45</sup> Confirmed by *Prosser v Castle Sanderson* [2003] BCC 440.

<sup>46</sup> See *Re A Debtor (No. 222 of 1990) ex parte Bank of Ireland (No. 2)* [1993] BCLC 233, *Re N (A Debtor)* [2002] BPIR 1024.

Protocol<sup>47</sup> which is designed to promote balanced behaviour on the part of all sides when an IVA is proposed and voted upon. In effect it provides an industry standard.

Turning to the case law, in *Pitt v Mond*<sup>48</sup> the supervisor was held not responsible for general economic changes that affected the success of an IVA plan that was viable when agreed. The court concluded that the supervisor did not have special powers of foresight to predict such changes. That said, IVA supervisors, rather like trustees in bankruptcy, are expected to maintain a degree of professional competence and not to become too closely aligned either to the debtor or to the creditors<sup>49</sup>.

There is the standard grievance facility provided by Insolvency Act 1986 s. 263(3) in that dissatisfied persons can complain about the supervisor. Again, prospects of success on such an application are remote because of the reluctance of the court to double guess professional judgment<sup>50</sup>.

Contractual provision in any IVA proposal that has been agreed will often determine the precise role of the supervisor. There is a model IVA document produced by the profession, but customised IVAs are found in practice. These provisions may require the supervisor to consult creditors in defined circumstances or to terminate the IVA in the event of a specified condition occurring. These are important policing mechanisms and policing an IVA is relatively easy because the debtor will be required to make payments to the supervisor on agreed dates. Under s. 264(1)(c) of the Insolvency Act 1986 a supervisor is empowered to seek the bankruptcy of the debtor if there is default. The court, which enjoys discretion, can only make the bankruptcy order if the requirements of Insolvency Act 1986 s. 276 are met: there must be evidence of misleading information being provided in the submission of the IVA proposal or default in carrying out obligations thereunder. This has happened on a number of occasions<sup>51</sup>. The courts have commended insolvency practitioners for displaying standards of good stewardship in terminating IVAs that have no prospects of success<sup>52</sup>.

The sad truth is that many IVAs fail<sup>53</sup>. This raises an additional stewardship concern. In practice the IVA supervisor may be holding funds deposited by the debtor which the participating IVA creditors will have expected to receive as part of their forbearance. Should the supervisor pay these over to the newly appointed trustee in bankruptcy for the benefit

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<sup>47</sup> For judicial comment upon the legal status of this Protocol see *Mond v MBNA Europe Bank Ltd* [2010] BPIR 1167.

<sup>48</sup> [2001] BPIR 624.

<sup>49</sup> *Smurthwaite v Simpson-Smith* [2006] EWCA Civ 1183.

<sup>50</sup> Note *Linfoot v Adamson* [2012] BPIR 1033 at para [58] where HHJ Behrens made the apt comparison with judicial attitudes to applications made under s. 303.

<sup>51</sup> See *Harris v Gross* [2001] BPIR 586, *Varden Nuttall Ltd v Baker* (unreported, Proudman J, 6th May 2016). Compare *Kaye v Bourne* [2005] BPIR 590.

<sup>52</sup> See *Vadher v Weisgard* [1997] BCC 219.

<sup>53</sup> This is apparent from Insolvency Service statistics. Figures released in October 2015 point to a failure rate over three years approaching 30%. But these statistics do need a health warning attached as much depends upon when the IVA commenced and at any one point in time many IVAs were still ongoing with their outcome unclear.

of general creditors in the bankruptcy<sup>54</sup>, or should these funds be held exclusively for the participating IVA creditors? The answer to this conundrum was provided by the Court of Appeal in *Re NT Gallagher & Son Ltd*<sup>55</sup>. Although a case dealing with the company voluntary arrangement variant, the principle enunciated is equally applicable to IVAs. That principle is that in default of specific provision in the particular IVA itself, the residual funds are held by the supervisor on trust for the participating IVA creditors and cannot be claimed by the general creditors in the follow-up bankruptcy. Thus, the IVA supervisor is constituted a trustee with respect to these funds.

### Advances in stewardship since 2000

This was the basic structure of stewardship in personal insolvency law that was introduced in the 1986 reforms. It remained largely intact for just over a decade, though minor modifications were made in the 1990s. Things have moved on since then. Factors influencing change in stewardship law and practice include the massive growth of personal insolvency in the UK in the 1990s, increased demands in society at large for greater professional accountability and changes in interacting general substantive laws<sup>56</sup>.

Throughout the past 15 years there has been an increased focus upon the impact and effectiveness of self-regulation within the insolvency practitioner profession<sup>57</sup>. At the moment the profession is regulated by five recognised professional bodies (RPBs) with general oversight being provided by the Insolvency Service. The RPBs have cooperated through the Joint Insolvency Committee to produce what are known as the Statements of Insolvency Practice, or SIPs for short. For example, there is the revised Statement of Insolvency Practice 9 on remuneration, the latest version of which was promulgated in December 2015. These SIPs do not have the force of law, but they are judicially

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<sup>54</sup> Who is often the same individual wearing a different stewardship hat. On the attitude of the courts towards continuity of stewardship see *Landsman v de Concilio* [2005] BPIR 829.

<sup>55</sup> [2002] EWCA Civ 404.

<sup>56</sup> For once the EU has not had a great influence in this field. Professional regulation of insolvency practitioners must be compliant with the EU Services Directive (2006/123) – for implementation see the Provision of Services (Insolvency Practitioners) Regulations 2009 (SI 2009/3081). The EC Regulation on Insolvency Proceedings (1346/2000) could be relevant to stewardship management in a cross border context – see Arts 18 (extent and exercise of powers) and Art 31 (duty to communicate and cooperate). Certainly the growth of cross border insolvency has posed an additional challenge to the exercise of stewardship in recent years as bankrupts increasingly have assets and liabilities extending over a range of legal jurisdictions.

<sup>57</sup> Professor Ian Fletcher regards the changes in this sphere as representing one of the most significant advances in modern insolvency practice – see I. Fletcher, “Spreading the Gospel: The Mission of Insolvency Law, and Insolvency Practitioners, in the Early 21<sup>st</sup> Century” [2014] JBL 523 at 526. See also V. Finch, “Insolvency Practitioners: the Avenues of Accountability “ [2012] JBL 645 especially at 647-648.

recognised<sup>58</sup>. Breaches of a SIP could lead to disciplinary action and may be relevant in a case coming before a court where breach of duty is alleged. In addition RPBs will have their own published codes of ethics which must be observed<sup>59</sup>. Complaints mechanisms<sup>60</sup> and disciplinary procedures within the RPBs have been enhanced through greater rigour and transparency. The Insolvency Service has played a significant role here with the development of the Complaints Gateway since 2013. The Gateway coordinates the handling of complaints against insolvency practitioners. It operates an initial filtering process that weeds out non-viable complaints. It then forwards the remaining complaints to the appropriate RPB. The Insolvency Service Annual Review of Insolvency Practitioner Regulation is a mine of valuable information on how the system works in practice. So in 2015 some 895 complaints were received via the Gateway. Of these 629 were referred to the relevant RPBs and 237 were dismissed before reaching that stage. Looking at the statistics in more depth more than 38% of complaints related to IVAs with only 18% being related to bankruptcy. Nearly half of all complaints come from debtors with only 24% coming from creditors. Clearly the RPBs are central players in the regulatory system governing personal insolvency; that reality raises stewardship issues as to how they perform.

Turning to changes in the substantive law, the Insolvency Act 2000 (s.3 and Sched 3) put into statutory form the former “viability” requirement introduced for nominees putting forward IVAs to creditors<sup>61</sup>. This provides a prophylactic quality control mechanism to be applied by nominees that is designed to prevent “bad IVAs” entering the system. It has not been completely effective because as we have noted above a significant number of IVAs fail.

The Human Rights Act 1998 (effective from October 2001) is an important benchmark in English law and it has had some limited impact in the area under discussion<sup>62</sup>. In particular the potential impact of Art 6 of the European Convention on Human Rights and Fundamental Freedoms on delayed realisation needs to be noted. Art 6 requires a citizen’s civil rights to be determined within a reasonable time. It has been applied in Northern Ireland to the stewardship of an official receiver in *Official Receiver for Northern Ireland v*

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<sup>58</sup> See *Brook v Reed* [2011] EWCA Civ 311.

<sup>59</sup> The courts will sometimes refer to these ethical guides – see Proudman J in *Doffman and Isaacs v Wood and Hellard* [2012] BPIR 972 at para [25].

<sup>60</sup> See the valuable research on complaint procedures conducted for the now defunct Insolvency Practices Council by M. Seneviratne and A. Walters here – *Complaints Handling in the UK Insolvency Practitioners Profession* (2008) and *Complaints Handling by the Regulators of Insolvency Practitioners: A Comparative Study* (2009).

<sup>61</sup> See now Insolvency Act 1986 ss. 256(1)(a) and 256A(3) which require the nominee to state that the proposal has a reasonable prospect of being implemented..

<sup>62</sup> It has influenced changes in the procedures for intercepting a bankrupt’s made pursuant to s. 371 of the Insolvency Act 1986 but many attempts by bankrupts to invoke the European Convention on Human Rights have fallen on deaf ears.

*Rooney*<sup>63</sup> where a 12 year delay in realising the family home was deemed unacceptable by Weir J. The importance of Art 6 is that it is capable of applying to the entire estate and not just the family home where discrete provision has been made by legislation. So under the Enterprise Act 2002 (effective in English Law from April 1 2004) we have seen the introduction of the “use it or lose it” provision within IA 1986 s. 283A to deal with the problem of protracted realisation of the family home. The courts have adopted a purposive approach to interpretation and this has impacted upon the stewardship requirement. Thus, in *Lismore v Davey*<sup>64</sup> an attempt to extend the 3 year window of opportunity was dismissed by Horner J. The judge observed that once the 3 years had elapsed from the commencement of the bankruptcy and the property had re-vested in the erstwhile bankrupt the trustee had lost the opportunity to realise this important asset. There is a salutary lesson for trustees in bankruptcy here.

Perhaps the most contentious aspect of bankruptcy stewardship lies in the matter of the costs of the stewardship regime. There is an irony here: small scale bankruptcies may appear to cost more in proportionate terms due to the fixed cost element arising in every bankruptcy. This fixed cost element arises out of obligations imposed upon trustees in bankruptcy by statute<sup>65</sup>. A significant watershed in this area of stewardship regulation is represented by the 2004 *Practice Direction on Remuneration*<sup>66</sup> which was published under the hand of Chief Registrar Baister. It is now reconstituted as Part 6 of the *Practice Direction on Insolvency Proceedings*<sup>67</sup>. This marks rise of the criterion of **value for money**. In other words, it subordinates any remuneration claim based upon time spent to the test of whether that time was well spent. This has encouraged the judicial review of claims for remuneration and expenses. Whilst the right of a trustee to claim remuneration has been stoutly defended by the courts<sup>68</sup> the result of such challenges has often been that the quantum of the claim has been scaled back by the courts<sup>69</sup>. This syndrome has been accentuated by the Insolvency (Amendment) Rules 2010 (SI 2010/686) which have made further amendments of Insolvency Rules to promote challenges to remuneration claims submitted by IPs (see revised Insolvency Rule 6.142). In particular the possibility of a bankrupt challenging levels of remuneration was enhanced by this reform<sup>70</sup>. More recently we have seen the introduction of the idea of binding fee estimates by the Insolvency (Amendment) Rules 2015 (SI 2015/443) with effect from October 2015. This reform builds

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<sup>63</sup> [2009] BPIR 536. The bankruptcies here predated the introduction of the “use it, or lose it” regime into Northern Ireland in 2006 and the application to the court was made under the local Partition Acts 1868 and 1876.

<sup>64</sup> [2015] BPIR 1425.

<sup>65</sup> A point well made by David Richards J in *Simion v Brown* [2007] BPIR 412 at para [25].

<sup>66</sup> [2004] BPIR 953.

<sup>67</sup> [2014] BCC 502.

<sup>68</sup> See for example the comments of Etherton C in *Salliss v Hunt* [2014] 1 WLR 2402.

<sup>69</sup> See *Secondus v Atkinson* [2013] BPIR 632 (Registrar Jones).

<sup>70</sup> For discussion see J. Curl, “Challenging the Trustee’s Remuneration: A New Right for Bankrupts?” [2011] 24 *Insolv Intell* 5.

upon the research undertaken as part of the Kempson Review<sup>71</sup>. Under the new Insolvency Rules the trustee in bankruptcy will need further approval to exceed any estimate (see Insolvency Rule 6.142AB).

The changes noted above have all reinforced stewardship notions in bankruptcy. But these reforms must be viewed against a changing legal environment in personal insolvency law. We have already commented upon the rise of the IVA. We need also to take account of the changes brought about by the Tribunals, Courts and Enforcement Act 2007 which introduced the debt relief order (DRO) procedure from 2009 for debtors with low income and few assets. There are now more DROs put in place annually than bankruptcies, with some 24,175 DROs commenced in 2015. This bankruptcy alternative for small scale debtors with few assets and low income potential involves an out of court administrative procedure that is managed by official receivers and offers a form of debt relief. It is a procedure designed for debtors and not for creditors. As there is in effect “no income and no assets” in the DRO regime there is limited scope for stewardship issues to come into play. Certainly the proprietary aspect of stewardship is not relevant. But the public law characteristic is still applicable. Thus, there is a filtering mechanism requiring applications for DROs to be promoted by an approved intermediary<sup>72</sup>. Indeed, the main stewardship responsibility of the official receiver who manages the DRO is to seek the revocation of the DRO if the strict financial criteria are exceeded. In *R (Howard) v Official Receiver*<sup>73</sup> Stadlen J held that in determining whether to revoke a DRO an official receiver could be said to be acting judicially and so was not subject to the equality duty found in s. 149 of the Equality Act 2010. Several hundred such revocations have occurred annually leading to a relaxation of the financial criteria in 2015<sup>74</sup>.

It is too early to tell what the impact of the Enterprise and Regulatory Reform Act 2013 will be on the picture given above. Section 71 and Sched 18 of this Act have introduced a new adjudicator system for debtor-initiated bankruptcy (effective from April 2016). This reform introduces new ss. 263H to 263O into the Insolvency Act 1986 and is designed to provide a simpler access to bankruptcy for debtors without going to court. The reform however relates to the initiation of bankruptcy by debtors; it says virtually nothing about the conduct of the bankruptcy process thereafter, so presumably standard stewardship principles as delineated above will continue to apply.

The Deregulation Act 2015 s. 17 (inserting a new s. 390A into the Insolvency Act 1986) finally introduced the partial authorisation possibility for insolvency practitioners. Insolvency practitioners when seeking authorisation might choose to go down particular

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<sup>71</sup> See Review of Insolvency Practitioner Fees (2013). This was followed up by the Insolvency Service Consultation Document entitled *Strengthening the Regulatory Regime and Fee structure for Insolvency Practitioners* (2014).

<sup>72</sup> See Insolvency Act 1986 s. 251B(1).

<sup>73</sup> [2014] BPIR 204.

<sup>74</sup> Under the Insolvency Proceedings (Monetary Limits) (Amendment) Order 2015 (SI 2015/26) the maximum debt level was raised to £20K and the maximum asset value was increased to £1K. The maximum monthly surplus income level was left unchanged at £50.

“career routes” if they so wish. This might lead to increased specialisation and it might lead to an increased number of practitioners entering the personal insolvency market. This is speculative, and quite frankly the profession has responded with some scepticism.

The changes brought about by the Small Business, Enterprise and Employment Act 2015 are more significant. They offer wider powers for trustees in bankruptcy by removing need for obtaining sanction from the court or the creditors’ committee (s. 121)<sup>75</sup>. There are provisions in the Act that seek to reduce red tape and to deregulate proceedings relating to the giving of notices, holding of creditor meetings and proof of small debts (ss. 123, 125 and 132). The thinking here is that these changes will reduce the costs of the bankruptcy process without undermining fundamental stewardship considerations. This could be particularly important in more modest bankruptcies. The Small Business, Enterprise and Employment Act 2015 ss. 137-146 and Sched 11 is also responsible for introducing a fundamental change creating a new regulatory regime for IPs and RPBs that mirrors the regime introduced for the legal profession in the Legal Services Act 2007. So under new ss. 391d-E of the Insolvency Act 1986 the Secretary of State can impose regulatory directions upon RPBs to enhance their performance. A system of financial penalties for non-compliant RPBs is put in place by ss. 391F-H. Reprimands for RPBs are available under ss. 391J-K. Ultimately recognition of an RPB could be revoked under s. 391L. The 2015 Act also enables the Secretary of State to apply to court under ss. 391O-R to seek direct sanctions against an individual insolvency practitioner. One of the grounds for taking such direct action includes failure to comply with the ethical code of an RPB (see s. 391Q(1)(b)). One variant upon a direct sanctions order involves the making of a compensation order against an individual insolvency practitioner<sup>76</sup>. This package of reforms is certainly a move away from the self-regulatory regime for insolvency practitioners that has operated since 1986. It will impose tighter stewardship pressures upon the RPBs themselves to ensure that they are maintaining standards and are dealing with errant practitioners in an appropriate fashion. Failure to do this will have consequences for the RPBs who may be penalised for inadequate performance. Indeed, the 2015 Act contains a threat in the form of ss. 144-146 of further intervention through the creation of a single regulator for the insolvency profession if the latest structural reforms fail to deliver.

## Conclusions

For any observer concerned with the promotion of good stewardship in personal insolvency case handling, the verdict must be that the travel is in the right direction. There have been positive moves to promote effective, but balanced, stewardship in the past 30 years. Powers of trustees in bankruptcy have been extended, but equally expectations of a more responsible approach towards bankrupts and their families have been raised. Bankruptcy stewardship has become more nuanced. But this observation requires some qualification.

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<sup>75</sup> Amending s. 314 and Schedule 5 of the Insolvency Act 1986.

<sup>76</sup> Insolvency Act 1986 s. 391O(1)(e).



With the relative decline of bankruptcy<sup>77</sup> in statistical terms when set against other formal personal insolvency procedures, the issue of stewardship in the traditional sense of the responsibilities of a trustee in bankruptcy as the paradigm steward appears to have become a less predominant question. The idea of stewardship in bankruptcy harks back to the time when bankruptcy was an institution geared primarily towards creditor interests. That no longer applies. Most bankruptcies these days are debtor-initiated and most personal insolvencies fall outwith bankruptcy. IVAs and DROs are in effect “defensive” regimes triggered by debtors and not by creditors.

Another change that has become more apparent in the past year or so has been the switch in the stewardship focus away from individual insolvency practitioners and towards their RPBs. The stewardship debate now has an organisational focus. In some senses this change could be viewed as a criticism of the personalised regime with its focus upon individuals and self regulation. In other senses it reflects a recognition that the insolvency practitioner profession has truly arrived and should be regulated in a similar way to other established professions.

The further irony is that many individuals in debt these days do not enter any of these formal insolvency procedures: instead they have recourse to so-called debt management plans operated in the private sector. These are largely unregulated by primary legislation<sup>78</sup>, but they do fall under the strict rules of the Financial Conduct Authority (FCA), which took over in this area from the Office of Fair Trading in April 2014. Stewardship in this context is much more difficult to prescribe as stewardship issues can arise here in somewhat different form from those previously encountered. We need therefore to focus upon the role of debt management plan provider when discussing stewardship matters. Was the debt management plan appropriate to the needs of this particular debtor? How are the actions of the manager to be supervised? The state has a responsibility to police such debt advisory/management firms and should be prepared to exercise its draconian power under s. 124A of the Insolvency Act 1986 to have such firms wound up in the public interest where there is evidence of misbehaviour. There is clearly an important role for the FCA here. The signs are that it has taken on board this challenge by refusing authorisation, intervening in practices, freezing bank accounts and by pursuing prosecutions in appropriate instances where client money has been misappropriated<sup>79</sup>. These are all positive developments that will help to ensure that stewardship principles survive in the personal insolvency context notwithstanding fundamental changes in the nature of the legal regimes applied to deal with personal debt.

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<sup>77</sup> There were only 15,797 bankruptcies commenced in 2015 in England and Wales.

<sup>78</sup> There were a suite of provisions in the Tribunals, Courts and Enforcement Act 2007 (especially in Part 5), but for some reason these sections were never brought into force.

<sup>79</sup> See the FCA Press Notice dated 22 September 2014 warning debt management firms that they needed to raise their game.