Julian Dobson SOLICITORS

Insolvency Lawyers

Protecting the bankruptcy estate
from the costs of an unmeritorious appeal

Bankruptcy can be a contentious process involving numerous hearings and substantial costs. A bankruptcy estate starting from a position of insolvency can ill afford to bear the costs of repeated hearings and applications often made by the bankrupt himself. Such applications serve only to erode the bankruptcy estate, even where they are successfully resisted by the trustee in bankruptcy. The prospect of recovering any of the costs from the bankrupt in relation to such applications will be minimal.

The recent case of **Cooke v Dunbar Assets plc [2016] EWHC 1888(Ch)** considered how the costs of an unmeritorious appeal against the making of a bankruptcy should be treated within the bankruptcy estate.

Following the dismissal of his appeal against the making of the bankruptcy order, the bankrupt sought to challenge how the costs of the unsuccessful appeal should be treated. The bankrupt argued that the costs should be treated as an expense of the bankruptcy, whereas the petitioning creditor, who was the successful respondent to the appeal, sought an order that the bankrupt should pay the costs.

The court identified three possible outcomes for the treatment of the appeal costs as follows:

1. they are a cost and expense of the bankruptcy
2. a provable debt
3. a liability outside the bankruptcy estate of the bankrupt personally

If found to be an expense of the bankruptcy, then the costs would be payable in accordance with the statutory order laid out in **Rule 6.224** of the **Insolvency Rules 1986** and would rank at paragraph (h) in the list of priority of expenses.

For the bankrupt, reliance was placed on the decision in **Re Nortel GmbH [2014] AC 209**. In **Nortel**, the Supreme Court held that a liability under a financial support direction under the **Pensions Act 2004** constituted a provable debt.

In **Nortel** Lord Neuberger overruled a number of earlier cases where it was held that where an order was made for costs against a party after an insolvency process had begun in respect of proceedings commenced before the insolvency process started, that liability did not arise from an obligation existing before the insolvency process commenced. Refusing to follow this approach, Lord Neuberger held that an order for costs made against a company in liquidation, in proceedings begun before it went into liquidation, is provable as a contingent liability, as the liability for those costs will have arisen by reason of the obligation which the company incurred when it became a party to the proceedings. The bankrupt sought to rely on **Nortel** to argue that not only were the costs of the appeal a provable debt but also an expense of the bankruptcy.

Cooke v Dunbar – the decision

In reaching its decision in **Cooke v Dunbar** it was noted that if the costs of the appeal were to rank as an expense, then this would enable bankrupts to litigate in bankruptcy without being at risk as to costs and would result in the bankruptcy estate being dissipated by unmeritorious claims being pursued by bankrupts in this way. In **Cooke v Dunbar**, the Judge distinguished the position in **Nortel** and stated that he considered:

"…..it is difficult to apply the reasoning in Nortel to the costs incurred in the insolvency proceedings themselves"

He continued that the costs of the insolvency proceedings do not constitute a contingent or provable debt, and ordered that the bankrupt should pay the costs personally and, to the extent that those costs are not recovered, then on a secondary basis they would rank as an expense within **Rule 6.224(1)** at **paragraph (h)**.

But there is a problem

Whilst the decision in **Cooke v Dunbar** provides some clarity, it does not completely resolve such matters. Where a bankrupt wishes to appeal the bankruptcy order and is unsuccessful, then the costs of the appeal will not automatically rank as an expense of the bankruptcy but will be ordered to be paid personally by the bankrupt. Only if the costs are not recovered from the bankrupt do the costs then fall to be treated as an expense at **paragraph (h)** of **Rule 6.224(1)**. As the bankrupt's assets will have vested in his trustee in bankruptcy it is unlikely that the bankrupt will have any free assets against which any costs order might be successfully enforced. This was the problem recognised by Hoffman LJ in **Heath v Tang [1993] 1WLR 1421** when he noted that where the bankrupt is the defendant he has no further interest in the defence, because the only assets out of which the claim can be satisfied will have vested in the trustee. Even if the bankrupt is working, the liability is unlikely to be met from income as, where the bankrupt's income is sufficient, it will usually be subject to an income payments order/agreement in favour of the bankruptcy estate.

Protecting the bankruptcy estate...

Will the petitioning creditor issue a second petition?
In **Cooke v Dunbar**, the petitioning creditor who was given the benefit of the costs order against the bankrupt personally, could initiate further bankruptcy proceedings, although this would be at significant cost and with limited benefit.

How does the trustee in bankruptcy deal with the costs?
From the trustee's perspective, it will be a question of deciding how long the bankruptcy estate should wait before it is established that the costs are irrecoverable from the bankrupt personally and that they should rank as an expense. Eventually the trustee will seek to recover his costs and remuneration from the estate. However, as the trustee's costs and remuneration rank at **paragraph (o)** i.e, after payment of the appeal costs as an expense under **paragraph (h)**. The trustee will be unable to draw any remuneration until the question of whether or not the costs order will rank as an expense has been resolved. Appeal costs are often substantial and may result in a situation where there are insufficient funds left to pay the costs and remuneration of the trustee in bankruptcy.

Once identified, the priority of an expense cannot be moved
Following the decisions in **Nortel** and **Cooke v Dunbar**, once a claim is identified as an expense, then it will be ranked with the position that is afforded in **Rule 6.224(1)**, even if this were to have the effect of the appeal costs as in **Cooke** creating a situation where the trustee may not receive any remuneration. On that point Jeremy Cousins QC stated:

"it is not open to the court to direct that they should instead rank at positions (a) or (r) or in any other position somewhere in between ".

IP's beware of a bankrupt's appeal
Insolvency practitioners will need to be alive to the possibility that an on-going appeal or subsequent appeal that may be made by the bankrupt will potentially result in the appeal costs being borne by the bankruptcy estate as an expense which will have to be discharged before any remuneration is payable to the trustee.

If the decision in **Cooke v Dunbar** was intended to operate to deter bankrupts from dissipating the estate, then a more effective solution would have been to limit the order to the costs being paid personally by the bankrupt outside the estate without any fall-back provision that the costs would rank as an expense in the event that they were unpaid.

Julian Dobson

Julian Dobson SOLICITORS

Insolvency Lawyers

1 Frederick Terrace, Frederick Place, Brighton BN1 1AX
Tel 01273 766 355 Fax 01273 766 350 **email: info@juliandobson.com Web: www.juliandobson.com**