WARLEY CONTINENTAL SERVICES LTD v JOHAL

Chancery Division (Birmingham District Registry)

His Honour Judge Norris QC

8 August 2002

Individual voluntary arrangement – Challenge under Insolvency Act 1986, s 262 – Extension of time for applying under Insolvency Act 1986, s 262

On 26 June 2001, the creditors approved by a margin of 77.76% for and 22.24% against Mr Johal's proposal for an individual voluntary arrangement (IVA). The report of the chairman of the meeting was made on 2 July 2001. On 13 July 2001, the liquidator of Warley Continental Services Ltd (the company), of which company Mr Johal was formerly a director, wrote to the supervisor of the IVA on behalf of the company in its capacity as a creditor of Mr Johal making various complaints concerning the creditors' meeting and the proposal itself. No substantive response was received to the same and on 12 September 2001, but outside the time limit specified in s 262(3) of the Insolvency Act 1986 (the 1986 Act), the liquidator of the company applied for the IVA to be revoked or suspended on the ground that a material irregularity occurred at or in relation to the creditors' meeting. As the said application was out of time, the liquidator of the company also sought an extension of time under s 376 of the 1986 Act.

Held – refusing the application for an extension of time and dismissing the liquidator's application –

(1) The discretion under s 376 of the 1986 Act should not be exercised in ignorance of and without reference to the merits and the convenient course in the instant case where adequate court time had been allocated for the entire application was to hear the entire application, although a different course might be appropriate in other cases.

(2) The discretion under s 376 of the 1986 Act was not to be exercised by reference only to the demands of s 262 of the 1986 Act and the requirements of IVAs, but rather such discretion was broad and entirely unfettered in terms; nevertheless it was necessary to note the short statutory time limit contained in s 262 of the 1986 Act which was a substantive provision of the Act and that whatever guidance might be obtained from other statutory powers as to relevant factors the weight to be attached to the same would inevitably differ as between different statutory contexts.

(3) The exercise of such discretion involved the balancing of various considerations including the length of the delay, the reasons for the delay, the merits of the underlying complaint and the prejudice to the parties other than the prejudice inevitably involved in extending a time limit; additionally the conduct of the parties (the applicant on the one hand and the supervisor and debtor on the other) would be relevant.

(4) Having regard to the above factors in the present context where, broadly speaking, prejudice to the debtor and the conduct of the parties were neutral, the substantive issue was whether a strong case on the merits in favour of the liquidator outweighed the significant delay in making the application for which there was no really satisfactory justification; giving proper weight to the need for certainty, the short time limit in s 262(3) of the 1986 Act and the observations of Carnwath J in *Plant v Plant*, the proper course was to reject the application under s 376 of the 1986 Act.

Statutory provisions considered
Insolvency Act 1986, ss 260, 262, 263, 276, 376
Insolvency Rules 1986, rr 5.7, 5.17, 5.18, 5.19
Civil Procedure Rules 1998 (SI 1998/3132), Parts 1, 44

Cases referred to in judgment
Bournemouth & Boscombe Athletic Football Club Co Ltd, Re [1998] BPIR 183, ChD
Cadbury Schweppes plc v Somji [2001] 1 WLR 615, [2001] BCLC 498, [2000] All ER (D) 2397, CA
CM Van Stillevoldt v EL Carriers Incorporated [1983] 1 WLR 207, [1983] 1 All ER 699, CA
Company (No 004539 of 1993), Re a, [1995] BCC 116, [1995] 1 BCLC 459, ChD
Debtor (No 222 of 1990), Re a, ex parte Bank of Ireland [1992] BCLC 137, ChD
Mohammed Naeem (a Bankrupt) (No 18 of 1988), Re [1990] 1 WLR 48, ChD
National Westminster Bank v Scher [1998] BPIR 224, [1998] BCLC 124, ChD
Plant v Plant [1998] 1 BCLC 38, ChD
Salmon (deceased), Re; Coard v National Westminster Bank Ltd and Others [1981] Ch 167, [1980] 3 WLR 748, [1980] 3 All ER 532, ChD
Tager v Westpac Banking Corporation and Others [1997] BPIR 543, [1997] 1 BCLC 313, [1998] BCC 73, ChD

Alistair Wyvill for the applicant
Daniel Lightman for the respondent

Cur adv vult

HIS HONOUR JUDGE NORRIS QC:

[1] On 26 June 2001 a meeting was held of the creditors of Paul Johal (Mr Johal) for the purpose of considering, and if thought fit, approving a voluntary arrangement. The proposal for the arrangement had been prepared in consultation with Mr Papanicola, Mr Johal's nominee, an insolvency practitioner in practice with Langley & Partners. The creditors attending in person or by proxy approved the proposal by a margin of 77.76% in favour and 22.24% against. Given that r 5.18 of the Insolvency Rules 1986 (the 1986 Rules) provides that any resolution approving the proposal must be passed by a majority in excess of three quarters in value of the creditors present in person or by proxy and voted on the resolution, the approval was a close-run thing; and the admission of relatively small claims, or the exclusion of relatively small amounts could prove critical to the outcome.

[2] This is an application brought on 12 September 2001 by the liquidator of Warley Continental Services Ltd (Warley), a company of which Mr Johal was formerly a director, seeking an order that Mr Johal's individual voluntary arrangement (IVA) be revoked or suspended on the ground that a material irregularity occurred at or in relation to that meeting of creditors.

[3] The jurisdiction invoked is that conferred by s 262(1) of the Insolvency Act 1986 (the 1986 Act), and the relief sought is that specified in s 262(4)(a). The section itself, however, provides (in subs (3)) that:

> 'An application under this section shall not be made after the end of the period of 28 days beginning with the day on which the report of the creditors meeting was made to the Court …'

The report to the court was made by Mr Papanicola on 2 July 2001, so this application is plainly brought out of time. Accordingly, in the witness statement of Mr Russell Davies, Warley's solicitor, made in December 2001 in support of the application (and afterwards in a formal application notice), a request was made for the court to extend time for making the application pursuant to s 376 of the 1986 Act. That section provides:

> 'Where by any provision in this Group of Parts … the time for doing anything is limited, the court may extend the time … after it has expired, on such terms, if any, as it thinks fit.'

[4] Within the time limited for making an application the liquidator of Warley notified Mr Papanicola (who had been appointed the supervisor of the IVA) of matters which concerned Warley. By a letter dated 13 July 2001 the liquidator of Warley first objected to the exclusion of some £463,286-odd of claim which Warley had against Mr Johal in respect of an allegedly unpaid director's loan account. The liquidator, secondly, also raised a question about the admission of the claims of five named creditors who lodged sizeable claims, voted in favour of the proposal, but who waived their claims in the IVA. The liquidator, thirdly, complained of a number of material irregularities in relation to the proposal itself. Amongst these were: (a) a complaint that a property known as 67 The Bantocks, was shown as having no equity available to Mr Johal (which was said to be wrong); (b) a complaint that a group of parcels of land known collectively as 814 Wolverhampton Road had been sold at an apparent undervalue and the proceeds applied in a transaction that was also at an undervalue; and (c) that a property known as 1 Moat Road was not included in the properties dealt with in the proposal, although it appeared still to belong to Mr Johal.

[5] The letter of 13 July 2001, and the witness statement of Mr Russell Davies, both canvassed a number of other alleged material irregularities, but with commendable good sense, Mr Wyvill (who appeared for Warley) selected the five matters I have identified as his five best points and argued his application by reference to them alone in order to keep argument within the (extended) court day.

[6] The first issue for my determination was an application by Mr Lightman (who appeared for Mr Johal), that I deal first, and separately, with Warley's application to extend time under s 376 of the 1986 Act. His submission to me was that this was a discrete matter, a classic preliminary issue, which (if determined against Warley) would obviate the necessity for him to argue, or me to consider, the merits. I ruled against this submission, because in my judgment the discretion to be exercised under s 376 could not be exercised in ignorance of and without reference to the merits of the application itself, and that (given that court time had been allocated for the argument of the entire application) the convenient course was to hear the entire application together. If I was to be referred to the merits I might as well hear full argument on them from the outset, rather than truncated argument in the context of an application to extend time, followed by full argument if that application succeeded. A different course may be appropriate in other cases.

[7] Nonetheless Mr Lightman was right to identify s 262(3) of the 1986 Act as the first, and substantial, hurdle that Warley must overcome before

obtaining the relief sought in its application. It is a genuine prior question not, as the form of application itself would suggest, an afterthought.

[8] For the purposes of the hearing before me (although with Mr Lightman reserving his position should the matter go further) it was agreed that the court did have a discretion to extend the time limit imposed by s 262(3) of the 1986 Act. In the absence of that agreement I would have held that such a power exists, in agreement with the decision of His Honour Judge Weeks QC in *Tager v Westpac Banking Corporation and Others* [1997] BPIR 543.

[9] There was, however, disagreement between counsel upon the considerations material to the exercise of this discretion. Mr Wyvill, counsel for Warley, aligned himself with the reasoning of His Honour Judge Weeks QC. Mr Lightman, counsel for Mr Johal, both distinguished the decision in *Tager v Westpac Banking Corporation and Others* [1997] BPIR 543 and urged that His Honour Judge Weeks QC had been in error in following guidelines laid down by Griffiths LJ in *CM Van Stillevoldt v EL Carriers Incorporated* [1983] 1 WLR 207 in relation to the discretion to extend the time for setting down an appeal.

[10] As to distinguishing *Tager v Westpac Banking Corporation and Others* [1997] BPIR 543 Mr Lightman pointed out that time was extended in favour of a debtor who discovered (outside the 28 day period) that his IVA was being challenged by two dissenting creditors. Those creditors attacked the admission of the claim of a creditor who had supported Mr Tager's proposal. If that creditors' vote were eliminated Mr Tager's proposal would fail. Accordingly Mr Tager applied to attack the admission to vote of a third dissenting creditor: if that dissenting creditor's vote were eliminated the voting would swing back to approval of the arrangement. The debtor had no reason to apply within the 28 day period, because it was only at the very end of that period that there was a challenge for the approval of his IVA. Mr Lightman submitted that although His Honour Judge Weeks QC expressly founded himself upon the exercise of a discretion based on an evaluation of specific competing factors, the true ground for the decision was that the debtor could not have brought the application within the 28 day period, and the decision was to be distinguished from the facts before me on that ground. I reject that submission. The analysis of the facts was correct: but a reading of the judgment shows that the learned judge did not isolate one fact (the impossibility of bringing the application within a 28 day period) and found his decision upon that. That one fact was but one element in the exercise of the discretion, and the discretion was quite plainly exercised on four clearly identified grounds.

[11] As for the nature of the discretion, Mr Lightman's submission was that His Honour Judge Weeks QC erred in applying to s 376 factors relevant to the extension of a time limit contained in the procedural rules of the Court of Appeal. It was submitted that the considerations relevant to an insolvency time bar were wholly different (because of the need for speed, and because the decision affected third parties, not merely those who were parties to a particular action) so that the jurisdiction I was being asked to exercise was wholly exceptional (if not actually unique). It was submitted that no order should be made if it was possible for the applicant to have brought the application within the 28-day time limit, and the gist of the complaint was known to the applicant within that period. In support of the former proposition reliance was placed on the decision of Lloyd J in *Re Bournemouth &*

Boscombe Athletic Football Club Co Ltd [1998] BPIR 183 to the effect that in relation to company voluntary arrangements (as opposed to individual voluntary arrangements) the time bar was absolute and the court had no discretion to extend that time. In support of the latter proposition reliance was placed on the observations of Carnwath J in *Plant v Plant* [1998] 1 BCLC 38, at 53 to the following effect:

> '… I do see the force of the point that the Court will not grant an extension of time, other than in special circumstances. Certainly, I see it as inconceivable that the Court would grant an extension of time to someone who was seeking to rely on an irregularity, the gist of which was fully known to him at the time the IVA was established, and in circumstances where he had full opportunity to pursue the point at that time …'

He also made reference to *Butterworths Practical Insolvency* Part IV, paras 40ff which suggest that reasons for the delay are by far the most important (if not the only) consideration relevant to the exercise of the power.

[12] I reject this submission. I do not regard the discretion which I am being asked to exercise as involving a unique body of jurisprudence (or to be developed) by reference only to the demands of s 262 of the 1986 Act and the requirements of IVAs. First, the discretion as conferred by s 376 is (on its face) to be applied a time limit imposed 'by any provision in this Group of Parts'. It is therefore broad in reference and entirely unfettered in terms. Secondly, a statutory power to extend statutory time limits is something that the court is familiar with exercising. Even if one highlights the need for certainty and the fact that the rights of third parties may be affected, the insolvency regime is not unique. It deals with the estates of debtors: but in relation to the estates of deceased persons (where the need for certainty, for speedy administration and for considering the rights of third parties are equally material) very similar powers are granted to the court to permit rectification of wills or the making of reasonable provision for spouses, cohabitees and dependants outside statutorily imposed time limits. I do not see why experienced gained in the exercise of those powers should not inform the exercise of the power conferred by s 376 of the 1986 Act.

[13] In the result I shall follow the approach of His Honour Judge Weeks QC and hold that the exercise of the discretion involves balancing considerations such as the length of the delay, the reasons for the delay, the merits of the underlying complaint, and the prejudice to the parties (other than that inevitably involved in extending the time limit). I do not consider that His Honour Judge Weeks QC intended that list as a complete enumeration of the relevant factors: one must remember that the power actually conferred by the section is unfettered, so that any circumstance is of potential relevance in the particular case. For my part, I would see the conduct of the parties (that is, the applicant on the one hand and the supervisor and the debtor on the other) as being of potential significance in a wide range of cases. Such conduct would include (on the applicant's side) warning given of the application; and on the supervisor's/debtor's side the promptness and openness in addressing concerns raised by potential applicants (particularly bearing in mind the status of the supervisor as an independent professional responsible to the court, not a servant of the debtor).

[14] Although I have rejected Mr Lightman's submission as to the uniqueness of the power to extend time under s 262 of the 1986 Act there are two points, related to arguments advanced by him, that are worthy of note. Although reference to other powers to extend or abrogate time limits is useful as a guide to the nature of the factors that may be relevant, there are two clear qualifications. First, the time limit is a substantive provision laid down in the Act itself, not a procedural time limit. To quote the words of Sir Robert Megarry V-C in *Re Salmon (deceased); Coard v National Westminster Bank Ltd and Others* [1981] Ch 167, at 175:

> 'The burden on the applicant is thus … no triviality; the applicant must make out a substantial case for it being just and proper for the court to exercise its statutory discretion to extend the time.'

Secondly, whilst guidance may be obtained as to the range of relevant factors, the weight to be given to each factor will inevitably differ as between different statutory powers.

[15] I now turn to the exercise of the power conferred by s 376 of the 1986 Act in this particular case, considering first the length of delay. The application should have been brought by the end of July. It was not brought until 12 September. Mr Wyvill's submission was that the applicant had only exceeded the relevant time limit by 49 days, and the application was still brought within less than 3 months. Mr Lightman's retort was to the effect that that was nearly three times as long as the statute allowed. In absolute terms the delay may not have been long: but by comparison with the limit stated in the statute it was excessive. He submitted that in a CVA certainty was sacrosanct: in an IVA it should be treated as vital. He cited a passage from the judgment of Robert Walker LJ in *Cadbury Schweppes plc v Somji* [2001] 1 WLR 615, at [34]–[35] to this effect:

> '[34] … Legal certainty is important if the debtor, the creditors and the supervisor are to know where they stand. That is no doubt the reason for the short limit for challenge imposed by section 262(3), and the prohibition on other challenges on the ground of irregularity imposed by section 262(8) …
>
> [35] … The approval of an IVA at the creditors' meeting is of central importance to the whole of Part VII as appears from section 260. If a proposed IVA has apparently been approved by creditors' meeting, the only routes to challenge or circumvent it are … a direct challenge under section 262(1) or an indirect challenge by means of a bankruptcy petition under section 276(1).'

In the balance the period of delay would count against Warley.

[16] I turn next to the reasons for the delay. These are set out in the witness statement of Mr Russell Davies. In summary they are as follows:

(a) There was a change in the identity of the liquidator of Warley. Beyond that bare fact, there is no statement of the actual practical difficulties occasioned by that change. It is not inevitable that there were any: the actual personnel handling the liquidation file (and so with the detailed knowledge of the facts and issues) may

not have altered. That this is, indeed, the case is suggested by the fact that the change of liquidator took place on 13 July 2001, the very day the detailed letter of complaint was written to Mr Papanicola on Warley's behalf.

(b) There was a necessity to consult the creditors' committee of Warley, and a necessity to consult the preferential creditors (who stood to benefit most from any recovery from Mr Johal). The views of the creditors' committee were not received until 27 July. The matter was discussed with the preferential creditors on 26 July but both HM Customs and Excise and the Inland Revenue informed the liquidator's employee: 'that they were likely to take a number of weeks before they could decide whether they wanted the application … to be made' apparently because of the absence on holiday of relevant people. The liquidator of Warley can hardly bear personal blame for this: but those who stand to benefit from the recovery could hardly complain if the court were to take the view that their relaxed approach was inappropriate in the context of a 28 day statutory time limit.

(c) The liquidator undertook a detailed assessment of the available evidence in support of the application. This involved consideration of material held by the official receiver in connection with a contemplated prosecution of Mr Johal in relation to his conduct as a director of Warley, contact with the former voluntary liquidator of Warley, and contact with Javed & Co who had been Warley's accountants. Office copy entries in relation to properties currently or previously owned by Mr Johal were also sought. The material gained by these extra investigations was not identified to me in the course of the hearing and I therefore cannot assess what contribution it made to the case ultimately presented. What was identified in the course of the hearing was that all but one of the office copy entries to which my attention was drawn predated the letter of 13 July 2001 (and the exception was dated 7 August 2001). These searches may well have been obtained by others and only made available to the liquidator of Warley at some later date: but, if so, my attention was not drawn to any part of the evidence which demonstrated this. The reasons for the delay are unpersuasive and would count against Warley in the balance.

[17] I turn to the question of merit and say immediately that in my judgment the merits count in favour of Warley. The anticipation that I may express that view no doubt lies behind the preliminary procedural skirmish which I determined.

[18] The first complaint relates to the disallowance of the major part of Warley's claim. Warley had recovered judgment against Mr Johal in the Birmingham County Court in the sum of £46,682-odd in respect of goods wrongly taken by Mr Johal. One instalment in discharge of that judgment had been paid, and there was outstanding the sum of £23,341-odd. In addition, on 15 June 2001 Warley's costs of obtaining that judgment were assessed in the sum of £16,620-odd. At the meeting of creditors held on 26 June 2001 Warley

submitted a claim to vote in the sum of £38,364-odd (intended to constitute the outstanding instalment plus the judgment for costs, but which understated the judgment for costs by about £1,500). Mr Papanicola admitted this claim, based as it was, on unsatisfied judgments. However, Mr Papanicola rejected a second claim for £463,286-odd. This sum was said, (in Warley's statement of case which was verified by the witness statement of Mr Russell Davies) to consist of the balance due on a director's loan account recorded on Warley's balance sheet in the sum £316,027-odd 'and interest accrued thereon etc'. Investigation at trial suggested that, in fact, this sum consisted of an entry on Warley's balance sheet report dated 15 June 1999 for the period ended 31 May 1999 of a 'loan account: P Johal £316,027.12' plus 'loan accounts: £147,259.25'. Warley was placed in compulsory liquidation on 13 September 1999, so that there was a 3 month gap between the preparation of that balance sheet and liquidation, and just over a 3 month gap between the balance sheet date and liquidation. At a public examination of Mr Johal in the course of the liquidation of Warley, on 15 May 2000 at Leicester County Court Mr Johal was ordered by the court to prepare 'a balanced and dated Director's loan account' between Warley and himself for the period from 1 May 1997 to 22 July 1999. In his first witness statement (made on 12 July 2002, less than a fortnight before the hearing before me) Mr Johal explained 'unfortunately, however, I was unable to do this'. He explained that any accounts so prepared could not be substantiated because there were no journals, no opening entries, and many books and records had been lost by the official receiver's office. Furthermore, Warley's accountant, Mr Javed, had died in December 1999. Mr Javed had lost all of Mr Johal's personal papers so it would not be possible for Mr Johal to explain how much money he had drawn from Warley on a director's loan account or how much he had repaid by reconstituting the account from his personal records. It was therefore impossible to prepare a statement of the director's loan account either from Warley's papers or from his own. Mr Johal also relied on a witness statement provided by Mr Patel, a chartered accountant and senior partner of Sinclair & Co, the firm of accountants retained to prepare the balance and dated director's loan account ordered by the court. His evidence was that at least 454 man hours (at a cost of £27,000) would be needed to undertake the exercise, but that it would be fruitless unless the opening balances from 30 April 1997 year end could be produced together with the relevant journal entries for those year end accounts. He had, in fact, prepared evidence to this effect, and attended at the hearing when the order was actually made on 15 May 2000, the order being made in spite of the representations he advanced on behalf of Mr Johal as to the difficulty of the exercise. That left the balance sheet report dated 15 June 1999. Mr Patel dismissed that as having been produced 'by an unqualified book keeper and [has] not included the input of Javed & Co'. He concluded:

> 'In the light of the aforementioned, I cannot see that the "accounts" produced as at 31 May 1999 would be anything other than a set of balances produced by running off a trial balance and extracting a profit and loss account and a balance sheet. Certainly there appears to have been nobody to produce the relevant adjustments, reserves and journal entries to produce accounts which could be relied on.'

[19] Whether any of this was known to Mr Papanicola is not clear on the evidence, for he has tendered none. I have from him only his report to the creditors which was in these terms:

> 'The debtor … totally refuted the claim of £463,286.37. According to the debtor, there was no doubt that the claim was invalid. However, Grant Thornton, representing the claimant in question, were of the view that the Meeting should be adjourned in accordance with the provision of Rule 5.19 to enable corroboratory documentation in relation to the claims to be submitted in the interim. Since the debtor had been in correspondence with the claimant for approximately two years preceding the meeting and no demand had been made on the debtor and nor had any evidence been provided to substantiate the claim, the request for an adjournment was considered to be wholly unwarranted. That claim was accordingly rejected.'

That is not a complete account because I was told that a copy of the balance sheet report (or an equivalent management account) was faxed to the meeting and placed before Mr Papanicola (and there is an unchallenged statement to that effect in the correspondence between solicitors). The role of the nominee/supervisor, and the duty of the chairman of the creditors' meeting in relation to a disputed debt are both the subject of clear judicial comment. The nominee, when discharging any of his functions, has a duty to exercise a professional independent judgment, informed by his qualification and skills: per Harman J in *Re a Debtor (No 222 of 1990) ex parte Bank of Ireland* [1992] BCLC 137. The object of the 1986 Act and of the rules is to ensure that every proposal for an individual voluntary arrangement is characterised by complete transparency and good faith by the debtor: per Judge LJ in *Cadbury Schweppes plc v Somji* [2001] 1 WLR 615, at 629. It was part of the nominee's function to see that that duty is discharged. Where at a creditors' meeting an issue is raised as to the validity of a debt intended to be voted at that meeting then the chairman cannot be expected to rule on any difficult disputes, and should ordinarily exercise the power conferred by r 5.17(4) of the 1986 Rules to admit the claim for the purpose of entitlement to vote and by r 5.7(6) to mark the claim as objected to: see *National Westminster Bank v Scher* [1998] BPIR 224, at 226 per John Martin QC applying *Re a Debtor (No 222 of 1990), ex parte Bank of Ireland* [1992] BCLC 137, per Harman J, at 144. On this formulation, a chairman should only disallow a claim if it is obviously bad.

[20] There is no defence, in these proceedings, by Mr Papanicola of the course which he took: but he is not a respondent (perhaps following the indication given by Hoffmann J in *Re Mohammed Naeem (a Bankrupt) (No 18 of 1988)* [1990] 1 WLR 48, at 50H). Some caution must therefore be exercised in judging Mr Papanicola's conduct. On the other hand, in none of the correspondence conducted on his behalf before the issue of this application was there anything approaching a justification for this apparent departure from the expected standard of conduct of a nominee, or any explanation as to why he felt able to prefer the bare and unsupported denial of the debtor over the claim of his fellow insolvency practitioner (supported by a management account prepared at the time when Mr Johal was a director of Warley and responsible for the accuracy of its accounting information) to

such a degree that he was able, there and then and without consideration or investigation, to say that Warley's claim was obviously bad. I regard this as a serious and obviously material irregularity. On the material I have it seems to me that the only proper course would have been to admit a claim for £316,000-odd for voting (and mark it objected to) (because I can understand why the claim for £146,000-odd could be considered 'obviously' bad). Had Warley's claim been admitted in that manner the proposal would have failed.

[21] Furthermore, Mr Johal failed to discharge his obligations of good faith and total transparency: the faxed balance sheet report was not the only document which showed a substantial historic director's current account. Mr Johal had been party to the preparation and presentation to Warley's bankers of a group forecast which proceeded on the footing that there was at that date an outstanding loan due from Mr Johal to Warley of £420,000 which was to be repaid (by transactions which did not in the event occur), and which built into the forecast fresh advances to be made to Mr Johal. A bare refutation of liability did not suffice. There should have been disclosure of the historic debt, explanation of its payment, and an explanation of whether the contemplated further advances did take place (and if not, what other funds were used).

[22] Mr Papanicola's attitude to Warley's claim (which would have been voted against the proposal) was in very marked contrast to his attitude to the five specified creditors (whose claims were to be voted in favour of the proposal). The general form of proof of debt gives the opportunity for the creditor to give his name and address, the total amount of the claim, details of any documents by reference to which the debt can be substantiated (item 4), particulars of how and when the debt was incurred (item 9) and other particulars. Mr Atwal claimed to be a creditor in the sum of £50,000, gave no details under item 4, and answered item 9 by saying 'borrowed him the money'. Mr Bassi claimed £80,400, but provided no further information at all. Mr Bedesha claimed £67,000, gave no information in relation to item 4 and completed item 9 with the simple word 'loan'. Mr Mahel made a claim for £50,000 but gave no other details at all. Mr P Singh claimed £35,000 but gave no details at all. In his proposal, Mr Johal described Mr Atwal, Mr Bassi and Mr P Singh as 'associated creditors', but at the creditors' meeting Mr Papanicola said that was a mistake and that were 'not in fact associated creditors, but friends of the debtor'. In the proposal, at a time when they were believed to be associated creditors, it was declared that they would not press a claim in the case of a voluntary arrangement, but would press a claim in a bankruptcy. This remained the case even though they ceased to be associated creditors so that they voted (without the disabilities attaching to associated creditors) in favour of the proposal under which they received nothing. Mr Papanicola admitted all claims in full.

[23] In his witness statement of 12 July 2002 Mr Johal explained that within the Sikh community it is an established custom to lend substantial amounts in cash without any written record being made and that (in effect) there would be partial repayments and redrawings and cross-lending without, at any stage, there being a written account. He said that one of these arrangements (with Mr Bassi) had started in 1991, another (with Mr Bedesha) in 1992, and another (with Mr Atwal) in 1993. In a second witness statement (dated 24 July 2002, the day before the hearing) Mr Johal stated (in answer to a suggestion that the debts might by now be statute-barred) that he had spoken on

approximately a monthly basis by telephone with these gentlemen and 'on each occasion I acknowledged the existence of the debts I owed them'. In his first witness statement he had spoken of part of the debt due to Mr Mahel as having derived from a cheque in the sum of £26,000; in answer to criticism by Mr Russell Davies, the day before the hearing Mr Johal stated in his second witness statement that he had 'managed to obtain a copy of that cheque dated 14 April 1999' (which proved to be in the sum of £23,600, not £26,000) and he exhibited a copy. The photocopy annexed to the witness statement was of poor quality, the name of the payee (which was Mr Johal) was in a different hand to the other writing on the cheque, and the cheque itself appeared not to bear the stamp of a collecting bank. I therefore asked to see the cheque from which the photocopy had been produced: I was told after the short adjournment that that would not be possible, since all that Mr Johal had ever had was a photocopy of the face of the cheque which he had taken before presenting it for payment. I was instead shown a photocopy of Mr Mahel's bank statement showing that a cheque bearing the same number as the photocopy in the sum of £23,600 was debited to Mr Mahel's account; but when I asked for a copy of the bank statement showing that the cheque had been credited to Mr Johal's bank account I was told that that would not be possible. None of the named creditors themselves gave evidence in support of their claims.

[24] Where the acceptance of claim which has been voted at a creditors' meeting is the subject of challenge under s 262 of the 1986 Act (or r 5.17 of the 1986 Rules) it is the task of the court, to decide, on the evidence before the court at the hearing, whether the claim is maintainable: *National Westminster Bank v Scher* [1998] BPIR 224, at 227 per John Martin QC applying *Re a Company (No 004539 of 1993)* [1995] BCC 116, at 120 per Blackburne J. If it were necessary for me to decide that question I would hold that none of the claims of the specified creditors should have been admitted, and I would have felt unable to rely on Mr Johal's witness statement at face value in the absence of any supporting evidence. A complete absence of any written record of any transaction of this magnitude strikes me as incredible, and complete reliance on unaided recollection to establish a current balance on a running account (which is demonstrably unreliable, as is proved by Mr Johal's own inaccurate recollection of his indebtedness to Mr Mahel) is very unlikely. Furthermore, I would accept Mr Wyvill's submission that there was a material irregularity in the failure of Mr Johal to draw to the attention of the general body of his creditors (pursuant to his duty of complete openness and transparency) that these claims, which could well be critical to the acceptance of his proposal by a sufficient majority of the creditors, and were advanced on behalf of people who, themselves, were not taking anything under that proposal, lacked objective verification, and were unspecified as to time, nature and circumstance.

[25] The third matter of complaint related to a property known as 67 The Bantocks. This property was owned by Mr Johal. His proposal disclosed that it had been purchased by him in 1990 at a cost of £90,000, that the property was rented out, and was subject to a current mortgage in the sum of £80,145. There was an associated endowment policy. The proposal stated:

> 'Although the property was purchased in my sole name and I am the sole beneficiary of the endowment policy it is likely that my wife will

> be entitled to claim at least 50% of any equity therein and this is reflected in my Estimated Statement of Affairs.'

That estimated statement of affairs showed the property to be valued at £95,000, from which there was deducted the mortgage and the estimated costs of sale (together amounting to £84,645), there was then deducted the value of the endowment and a spouse's 50% interest to produce a deficiency on this asset in the sum of £17,822. For that reason it was excluded from the arrangement. The complaint made by Warley was that in excluding 67 The Bantocks from the proposal in this way, Mr Johal was not dealing openly and transparently with his general body of creditors, and that failure constituted a material irregularity in relation to the meeting. The three grounds on which this submission was based are as follows:

(a) That the property was undervalued. It would unnecessarily encumber this judgment to set out a detailed review of all the evidence on this issue. It suffices to indicate that the burden of Warley's case was that a property which had been purchased for £90,000 in 1990 could not be worth only £95,000 in 2001: and that it was the focus of Mr Johal's response that the 2001 valuation represented the tenanted value, which stood at a hefty discount to the vacant possession value because of the uncertainty surrounding the nature of the tenancy that he had created. This complaint is not made out.

(b) That the endowment policy was deducted as a liability set against the value of the property, whereas it could not be any such thing. The response of Mr Papanicola and Mr Johal was that the value of the endowment policy was correctly deducted because the policy was charged to secure the mortgage. This is nonsense. The mere existence of a charge does not convert an asset into a liability. There would be no circumstances in which both the sum outstanding on the mortgage and the sum payable on the endowment policy would be deducted from the proceeds of sale. The proceeds of the endowment policy should have been added to (not subtracted from) the net proceeds of sale in order to constitute the fund available for the redemption of the mortgage. This complaint is made out.

(c) That there was no basis in fact or law for treating Mr Johal's estranged wife as entitled to 50% of the equity in the property (which was not the matrimonial home). This much was virtually conceded by Mr Johal in the witness statement he made the day before the hearing. He stated that his estranged wife had paid for and installed a new back fence, new upstairs carpets, a new cooker, a new garage door, and guttering and tarmac on the front drive but:

> 'If, notwithstanding what she has contributed, my wife is not entitled to 50% of the equity in 67 The Bantocks, then I apologise.'

In my judgment, disclosure of that material ought to have been made in the proposal (and Mr Papanicola should have ensured

that it was made) in order to enable the creditors to make up their own minds whether the freely available asset should have been included in the debtor's proposal. The correct treatment of the endowment policy as an asset (and not as a liability) and a proper disclosure of the basis and expense of the wife's claim to an equitable interest may well have led the creditors to the view that there was another £30,000 available for them which ought to be brought within the scope of the arrangement to their material advantage (increasing the scheme funds by some 15%). This complaint is also made out.

[26] The fourth complaint related to 814 Wolverhampton Road. This was another property formerly in the ownership of Mr Johal (bought for £1,000,000 in 1996), but which had been contracted to be sold by him to PJ Properties Ltd (PJL) for the sum of £800,000, of which a deposit of £135,000 had been paid, the balance being left outstanding pending the raising of finance by PJL to bring about completion. The complaint made before me differed from that originally advanced. Mr Johal's proposal simply said that these properties were 'currently being sold for a total price of £800,000'. It stated that contracts had been exchanged, and that completion was due in August 2001, and, when achieved, would release the sum of £55,000 which would be paid into the arrangement for the benefit of the creditors. The payment of the deposit of £135,000 was disclosed, as was the use of the deposit to pay a tax debt of 'the limited company'. The original complaint was of a sale at an undervalue and the use of the deposit moneys in a transaction at an undervalue. The complaint made before me was that investigation had shown that the disclosure made in the proposal in relation to 814 Wolverhampton Road was by no means complete, and there was strong grounds for suspecting that the sale to PJL was not an arm's length sale (so that it could not be assumed that the sale for £800,000 was a sale at market value).

[27] The purchaser of 814 Wolverhampton Road was PJL. On 28 February 2000 PJL granted a legal charge to secure payment of £200,000 plus fixed interest of £30,000 (plus costs, charges and expenses) to Lynbrook Associates (Lynbrook) secured on properties which PJL was buying from Mr Johal. That same day Mr Johal also granted Lynbrook a charge: this was over Mr Johal's property at Beech House, Little Aston Park, Sutton Coldfield. The terms of the entry of this charge on the registered title to Beech House record it as 'affecting also other titles to secure the moneys therein mentioned'. Although a copy of this charge had been requested by Warley it was not exhibited to either of Mr Johal's witness statements, nor was it available at the hearing. The charge would have demonstrated whether or not the debt secured by the charge on Beech House (which Mr Johal's proposal said was of the order of £250,000) was the debt of £230,000 plus expenses owed by PJL and secured on properties it was purchasing from Mr Johal. Warley did not seek an order for disclosure (and an adjournment for that purpose). Nor did Warley seek to cross-examine Mr Johal on his explanation of the coincidence that both PJL and he charged the property on the same day to Lynbrook, his own charge being but part of a larger security. This explanation is that PJL is the creature of Mr Bedesha. Mr Bedesha borrowed money from Lynbrook using Needleman Treon as his solicitors. Mr Johal needed to borrow money (of an

unspecified amount for an unspecified purpose). Mr Bedesha introduced Mr Johal to Needleman Treon who in turn introduced him to Lynbrook. Mr Johal arranged his own loan (the proceeds of which have not been accounted for in the arrangement) at the same time as Mr Bedesha arranged PJL's loan. Mr Johal states as the truth:

> '… it does not surprise me that the paperwork was completed contemporaneously. Nor, in retrospect, does it surprise me that "other properties" was a mention on the Land Registry record of … Beech House. It would be easy for a clerk in Mr Treon's office to confuse the registering of the charges as one transaction.'

The file of Needleman Treon was not exhibited to Mr Johal's statement.

[28] I do not accept that the entry on the title to Beech House (which resulted, as is recorded in the entry itself, from the lodgement of the original charge, a copy of which was filed at the Land Registry) results from the mistake of a conveyancing clerk. And I am deeply suspicious of the truth of the account given by Mr Johal the day before the hearing. But I cannot say on this state of the evidence that is has been proved on the balance of probabilities that there is a connection between PJL and Mr Johal such that the transaction was not one at arm's length and for full value. I therefore do not consider this complaint established.

[29] The fifth complaint related to a property known as 1 Moat Road. This had been in the former ownership of Mr Johal. In a group forecast for the 2 years ended 30 November 1999 prepared for Warley it was noted that one of the group companies was proposing to sell this property for £120,000, it having been introduced into the group by Mr Johal at £125,000 a few months before the preparation of the forecast. Reference was also made to an attendance note prepared by Warley's bankers which recorded that they had been told (at a meeting attended by Mr Johal) in January 1998 that 1 Moat Road had a value of £120,000. This property was sold in October 1999 by Mr Johal to his brother for the sum (net of costs) of £82,000. The complaint made was that this was a sale at an undervalue to an associate which was not even mentioned in Mr Johal's proposal to his creditors. Mr Johal's response was to rely on a 'drive by' valuation of the property on a tenanted basis in September 1999 of £63,000. I would hold that the failure to disclose this transaction (and specifically to address the question of sale at an undervalue to an associate) was an irregularity, but the state of the evidence of value is not such as to enable me to say that, on the balance of probabilities, the irregularity was 'material'. It is as likely that £120,000 (the figure at which the property was introduced by Mr Johal, reacquired from the Warley Group, and proffered to the bank as security) is an overvaluation as it is that the figure for which it was sold to Mr Johal's brother is an undervaluation. I would therefore not regard this complaint is made out.

[30] It is for these reasons that I say the merits of the complaint count in favour of Warley: and in my judgment count strongly.

[31] The next factor to consider is prejudice. Under the IVA Mr Johal was to pay his creditors in respect of their admitted claims about 30p in the pound. The funding for this was derived from a sale of 814 Wolverhampton Road and from contributions of £2,020 per month for 5 years. To make those payments Mr Johal took an additional part-time job as a breakdown recovery operative.

At the time when Warley's application was sent to the court for issue, one instalment of £2,020 had been paid by Mr Johal. By the time Warley's application had actually been issued by the court and served on Mr Johal he had made two further payments (a total of £6,060). Between the service of the application upon him in October 2001 and the hearing of the application in July 2002 he had continued to make monthly instalments. It was submitted by Mr Wyvill that no prejudice could be occasioned to a debtor from the fact that he had worked to pay off his debts. It was submitted by Mr Lightman that it was highly prejudicial to Mr Johal for creditors to take advantage of the proceeds of the extra job taken on by Mr Johal but to deprive him of the benefit which he thought he was gaining by taking on that additional burden. In my judgment prejudice has, principally, to be assessed as at the time when the application under s 262 of the 1986 Act is made, rather than at the time when that application falls to be determined. Only rarely would events occurring after the date of the application and before the date of the hearing come into consideration: one instance may be where the applicant's conduct of the application itself has served to prolong the period of uncertainty. The possibility of prejudice arising between the date of the application and the date of its determination is inherent in the process of challenge itself. In an appropriate case the supervisor could use any power in the arrangement itself (and if none, then the power conferred by s 263(4)) to propose a suspension of the IVA pending the outcome of the application. In the instant case no relevant prejudice has been suffered. The prejudice relied on is the partial implementation of the IVA. But that was extremely limited at the time when Warley submitted its application, and very limited at the time when that application was served on Mr Johal. Furthermore, prejudice of that type (a monthly contribution by the debtor under the scheme) is unlikely to weigh heavily. This is not a case, for example, where there has been a significant third party contribution which has been distributed after the 28 day period and before the application is made. I therefore regard prejudice as neutral.

[32] The final factor for me to consider is the conduct of the parties. I have indicated that Warley gave early notice of its complaints. It remains to record that Mr Papanicola simply did not respond to Warley's letter of 13 July, nor to a reminder on 9 August 2001. Nor did Mr Papanicola provide copies of the proofs of debt of the five named creditors (requested in the letter of 13 July 2001) until 21 September 2001. Nor did Mr Johal respond when the complaints were put to him. In his conspicuous fairness, however, Mr Wyvill does not seek to blame either Mr Papanicola or Mr Johal for the delay in issuing the application. He frankly acknowledged that he was seeking indulgence from the court for an avoidable mistake. In these circumstances the lack of co-operation by the supervisor and the debtor, whilst regrettable, is not relevant to the exercise of the power to extend time because it had no real impact on the making of the application.

[33] Having reviewed the relevant factors the essential question distils itself into this: does a strong case on the merits outweigh significant delay for which there is no really satisfactory justification?

With very considerable regret I answer that question in the negative. Giving proper weight to the need for certainty, and recognising the very short time limit which the Act imposes to achieve that objective (to which Robert Walker LJ drew attention in *Cadbury Schweppes plc v Somji* [2001] 1 WLR 615), and giving proper weight to the need for consistency of approach at first

instance (bearing particularly in mind the observation of Carnwath J in *Plant v Plant* [1998] 1 BCLC 38) I consider that a proper exercise of the power requires me to reject the application. The complaint about the rejection of the claimed director's loan account was identified and the material in support was available before the letter of 13 July 2001 was written and (if instructions from the preferential creditors in the Warley liquidation had been obtained) could have been pursued within the statutory time limit. The complaint about the admission of the claims of the five named creditors could have been made at any time after Mr Papanicola's report of 2 July, and the proofs of debt could then have been sought. It is not said that the absence of the sight of the proofs of debt themselves caused difficulty in the formulation of the objection. The gist of the complaint was summarised in the letter of 13 July 2001. The complaint about 67 The Bantocks could have been made on the basis of the proposal itself, and its gist was summarised in the letter of 13 July 2001. These are the complaints with real merit (and which I have considered and ruled upon in case the matter goes further): but all could have been advanced within the statutory period. Accordingly, a substantial case needs to be made in support of the application to extend time: substantial merits count, but substantial reasons for the delay are also required, and they are lacking.

[34] I accordingly refuse permission to extend time for the bringing of this application, and I dismiss it.

[35] My provisional order on costs is that there shall be no order as to costs. CPR Part 44 requires me first to consider whether I should make an order about costs. I decline to do so in this case because of the conduct of the application on Mr Johal's side, and because I consider that no order as to costs reflects the overall justice of the situation. When the liquidator of Warley indicated an intention to apply to the court for relief under s 262 of the 1986 Act in response of Halliwell Landau (who were then acting for the supervisor) was as follows:

> 'For the avoidance of doubt, should you seek to bring a Section 262 challenge out of time, our instructions will be to apply to have it dismissed at the outset and to apply for an order for costs on an indemnity basis against your client.'

When the liquidator of Warley indicated that he intended to ask the court to exercise its jurisdiction under s 376 of the 1986 Act the response of those solicitors was:

> 'We would repeat that we have our client's instructions to resist any application to the Court at the outset and to apply for an order for costs on an indemnity basis against your client.'

When the application was eventually served on Mr Johal, those solicitors accepted instructions to act for him. Their response was:

> 'We have our client's instructions to have your client's application dismissed and to apply for an order for costs on an indemnity basis against your clients should we not receive confirmation from you by return that the application is withdrawn and our client's costs in dealing with the application are paid.'

Regrettably, the correspondence continues in this vein. Even when fair procedural points are taken Mr Johal's solicitors insist on adding:

> 'We will seek an order for your client to pay our client's costs occasioned there from on the indemnity basis, such costs to be assessed summarily and paid forthwith.'

There then follow extensive and persistent requests for further information by Mr Johal's solicitors (only a few of which were truly warranted), but with little or no attempt to address the substantive case being advanced. On 4 February 2002 the solicitors indicated that they were intending to apply to strike out Warley's application and they were 'currently preparing the evidence in support'. No such application was ever issued and the evidence relied on by Mr Johal was eventually prepared only on 12 and 24 July for the hearing on 25 July 2002. My provisional view (based on a review of the solicitor's correspondence which is in evidence) formed without the benefit of submissions is that the conduct of litigation in this way is not consistent with the objective set out in CPR Part 1, and the order on costs should reflect this.

[36] I have found that Mr Johal secured the approval of his IVA because of the wrongful rejection of Warley's claim. I have found that he failed in his obligations of openness and transparency in the disclosure that he made to his creditors. He does not face the usual consequences of such conduct because he can take advantage of a statutory time limit, and I have held that, in justice, he is entitled to that advantage. To make the victim of that wrongful conduct and the party prevented from bringing an otherwise meritorious claim pay or contribute to Mr Johal's costs would, in my judgment, in this instance be to do injustice. In reaching that view I have given what I hope is due weight to orders for costs made in other limitation cases.

[37] If either party wishes to make submissions on my provisional view as to costs, or to bring to my attention other material, I will receive short written submissions. I will formally hand down judgment on 2 September 2002. Attendance will be excused if my provisional view is accepted or some other order as to costs is agreed. I will otherwise hear counsel on 2 September, short written submissions to be with me by 9 am on the morning of the hearing.

Application dismissed. Applicant to pay 20% of costs of respondent, such costs to be subject of a detailed assessment in default of agreement.

Solicitors: *The Smith Partnership* for the applicant
Halliwell Landau for the respondent