[2020] IEHC 104

THE HIGH COURT
CIRCUIT APPEAL
MIDLAND CIRCUIT
COUNTY OF SLIGO

[2019 No. 69 C.A.]

IN THE MATTER OF THE PERSONAL INSOLVENCY ACTS, 2012 TO 2015
AND IN THE MATTER OF DENISE LOWE (A DEBTOR)

JUDGMENT of Mr. Justice Denis McDonald delivered on 2 March, 2020

1. The issue addressed in this judgment relates to the lawfulness (or otherwise) of a personal insolvency arrangement which proposes what is colloquially known as a debt for equity swap. Under the personal insolvency arrangement proposed in this case by the personal insolvency practitioner (*"the practitioner")* on behalf of the above named debtor, Ms. Lowe, the amount due (currently in excess of €358,000) on foot of the mortgage loan owed by Ms. Lowe to the Governor and Company of the Bank of Ireland (*"the bank"*) would be deemed to be €300,000 (which is the agreed market value of the family home of Ms. Lowe). Repayment would then be effected as follows:-

   (a) An *"active part"* (comprising €170,000.00) would be repaid by regular instalments of principal and interest;

   (b) A debt for equity swap would be effected in respect of the balance of €130,000.00. This is intended to give the bank an interest in the family home of Ms. Lowe (which is her principal private residence for the purposes of s. 115A of the Personal Insolvency Act, 2012). According to the proposed arrangement, the bank will assume a *"43.3% equity share in the house"*. As I understand it, €130,000 represents 43.33% of the sum of €300,000.

Relevant facts

2. The question in issue arises in the context of an appeal brought by the practitioner from an order of the Circuit Court made on 14th February, 2019 under which the Circuit Court refused the practitioner's application for an order pursuant to s. 115A of the 2012 Act confirming the coming into effect of the proposed arrangement.

3. The arrangement in question was proposed by the practitioner in 2017. A meeting of creditors took place on 4th August, 2017. A majority of creditors representing 95.40% in value of Ms. Lowe's total indebtedness voted against the proposed arrangement while one creditor representing 4.60% of Ms. Lowe's overall indebtedness voted in favour. The practitioner argues that the latter should be regarded as a separate class of creditors for the purposes of s. 115A(9)(g) and (17).

4. Ms. Lowe has a total indebtedness of €561,685.33. The bulk of her indebtedness is to the bank in respect of a number of loans which are secured by way of mortgage over her family home where she resides with her partner (who is jointly indebted to the bank with her) and three children. The current market value of the family home is €300,000 while the amount due to the bank in respect of two loan accounts secured on the property is €358,502.56 (together with a further sum of €9,913.00 which is secured by way of

judgment mortgage). In March 2016, the bank issued proceedings in the Circuit Court seeking possession of the property. However, those proceedings were adjourned pending the outcome of the process under the 2012-2015 Acts.

5. If confirmed by the court, the arrangement in this case would be for one year. As noted above, the arrangement proposes that the debt of €358,502.56 would be written down to the value of the family home namely €300,000. Under s. 103 (2) of the 2012 Act, the arrangement could not lawfully propose a reduction in the amount owed to the bank below the value of the family home – namely €300,000. The remaining element of the mortgage loan in the sum of €58,461.56 will be written off and rank as an unsecured debt in the arrangement. It is important to note that, although the practitioner has made the case that the mortgage loan is to be reduced to €300,000, the only element of that sum that will be treated as a live mortgage balance is the sum of €170,000 which would be repaid by instalments of principal and interest over the remaining term of the mortgage. On the basis of the material before the court, it appears that Ms. Lowe would not be in a position to service payments of a loan for more than €170,000.

6. In light of the fact that the arrangement proposes that only €170,000.00 would be treated as a "*live*" balance to be repaid by instalments, the practitioner proposes to address the remaining indebtedness of €130,000.00 by swapping that debt for an "equity share" in the property ostensibly in accordance with s. 102 (6) (f) of the 2012 Act. The way in which this is to occur is expressed in a number of different ways in the proposed arrangement. For example, in the executive summary on p. 6 (repeated in largely similar terms on p. 15 of the proposed arrangement), the "*debt for equity*" swap is described in the following terms:-

> *"The mortgage of the principal private residence will be restructured as follows. The new live mortgage balance will be €170,000. A further €130,000 of the Bank's debt will be swapped for an equity share in the property as provided for in Section 102 (6) (f) …. The CMV per the … Practitioner's best information is €300,000 and therefore the Bank will assume a 43.3% equity share in the house. The remaining amount of the current mortgage of €58,461.56 will be written off and rank as an unsecured debt in this arrangement. The live balance of €170,000 will be paid on a full capital and interest basis at a fixed rate of 2.25% over 25 years of the entire mortgage at a par value of €130,000. Should this option not be exercised during the 25 year duration of the mortgage then this option will cease to exist. The secured creditor will only be able to exercise its equity share vis a vis a sale following the death of the debtor providing the terms of the restructured mortgage are adhered to by the debtor…."*

7. During the course of the hearing, it was acknowledged by the practitioner (through his counsel) that it was unfair to the bank to give the debtor an option during the term of the mortgage, to repurchase, at a par value of €130,000, the "*equity*" which, under the proposed arrangement, would be "*owned*" by the bank. This is in circumstances where the value of the property may well increase over the remaining 22 years of the mortgage

term in which case the value of the "*equity*" owned by the bank might be worth more than €130,000 at the time the option is exercised. Yet, all Ms. Lowe would have to pay in such event would be €130,000. This would be so even if the value of the property had increased significantly in the intervening period. In those circumstances, as the written submissions on behalf of the practitioner made clear, it was proposed that a written and legally binding commitment would be given by Ms. Lowe to waive her right under the proposed arrangement to acquire the bank's "*equity*" in the property at a par value of €130,000. However, the bank, in the course of the hearing, made clear that it does not accept that a practitioner is entitled to make a modification in this way after the arrangement has been presented to the creditors of Ms Lowe and voted on by her creditors. The bank draws attention to the fact that, on the hearing of an application to confirm a proposed arrangement, neither the court nor a practitioner is given any power to modify or alter the arrangement previously placed before the creditors of the debtor for their approval. For completeness, it should be noted that there are provisions in the Acts which permit variations to be made to an arrangement but those provisions only apply where an arrangement has previously come into effect.

8. The treatment of secured debt is further addressed in Appendix 1 to the arrangement. One of the curious features of this arrangement is that, while Appendix 1 provides that the "*equity part*" is to be "*repaid*" on or before June 2039, the method by which this is to be repaid is not spelt out. Furthermore, no date in June 2039 is identified for this purpose. In addition, notwithstanding the reference on p. 1 of Appendix 1 to repayment being made in June 2039, p. 2 of the same Appendix has the notation "*N/A*" opposite the "*repayment due date*" for the "*equity part*" of the loan and the same notation appears opposite the entry for "*mortgage loan expiry date at the end of the arrangement".*

9. It is also clear from Appendix 1 to the arrangement that no interest will be paid on the "*equity part*" of the loan. This is consistent with the intention underlying the arrangement in its unmodified form that, on or before June 2039, Ms. Lowe would be entitled to buy back the equity held by the bank at par value. This provision in respect of interest would clearly give rise to the same concern about fairness as the provision set out on p. 6 (and repeated on p. 15) that Ms. Lowe would have the option during the currency of the loan to repurchase the bank's "*equity*" at a par value of €130,000.

10. The impression created by Appendix 1 that Ms. Lowe will be entitled to buy back, at par the "*equity* "owned by the bank is reinforced by the statement in the same Appendix that the interest rate on the "*equity part*" of the loan will be 0.00%. Notwithstanding what is stated in Appendix 1, the practitioner, in his affidavit grounding the application under s. 115A, has suggested that the bank will get the benefit of the increase in value of its "*equity*" in the property at the end of the mortgage term. In paras. 15-16 of his affidavit sworn on 20th June, 2018, the practitioner says:-

> *"15. I say for the avoidance of any doubt that the exchange of 36.26% (€130,000) of the mortgage debt is offset by the debtor giving the creditor a 43.3% share in the ownership of the property. I say and believe that it is likely that the Creditor's*

ownership of the 43.33% share of the property would increase over time in line with capital appreciation, and thus give the Creditor a higher and more beneficial return in due course….

16. I say and believe there [is] not a simple 'write-down' in this PIA…for the Secured Creditor and the Objector is incorrectly categorising the exchange of a 43.33% equity share as same. I say and believe that based on the current market value of the Principal Private Residence of €300,000 the Creditor's ownership will be €130,000 and as set [out] above even based on a modest 2% capital appreciation to age 82 (in accordance with CSO figures) it is anticipated that this increase will release a return to the Creditor in the sum of €254,887.88 …".

11. I find it difficult to identify any provisions in the proposed arrangement which clearly set out the bank's rights in these terms. Moreover, the only circumstance in which the arrangement appears to envisage that the bank might be entitled to realise the value of the "*equity part*" is on the death of Ms. Lowe (assuming that she has not decided to buy back the "*equity part"* at par either during the currency of the mortgage loan or immediately before the expiry of the term of the mortgage loan). This seems to me to follow from the last sentence of the extract from p. 6 of the proposed arrangement quoted in para. 6 above. It is difficult to reconcile some of the aspects of the arrangement as described in Appendix 1, on the one hand, with the description of the arrangement on p.p. 6 and 15, on the other. However, doing the best I can, my understanding of the arrangement is that Ms. Lowe would have the right to buy back the "*equity share*" from the bank at any time prior to the expiry of the mortgage term in 2039 but that, if she did not do so within that time, she would lose the right to do so thereafter. Conversely the bank would not be entitled to realise its interest in the "*equity share"* until Ms. Lowe died at which stage they would be entitled to 43.3% of the proceeds of sale of the property following her death. There is, however, no detail in the proposed arrangement as to how the property is to be sold after the death of Ms. Lowe. Thus, for example, there is no provision dealing with who should have conduct of the sale. Nor is there any provision dealing with the mode of sale (whether by private treaty or public auction) and there is likewise no provision dealing with the carrying out of any valuation prior to sale. It is unsurprising, in these circumstances, that, in the course of the hearing before me, counsel for the bank strongly criticised the lack of specificity in the proposed arrangement in relation to how the respective rights of Ms. Lowe and the bank are to be regulated and managed under the proposed arrangement.

The submissions of counsel for the practitioner

12. Counsel for the practitioner has argued that, in fact, the "*debt for equity*" element of the proposed arrangement is a sensible and practical way to deal with the difficulty that arises where, on the basis of a debtor's current financial circumstances, repayment of the mortgage loan (even where it is reduced to the value of the underlying security) is unaffordable to the debtor. One of the solutions which is sometimes mooted in such circumstances is that the mortgage debt should be split as between a "*live*" debt and a "warehoused" balance. In such cases, payment of the warehoused amount is postponed

until the expiry of the term of the mortgage. In the meantime, the debtor will be required to service the "*live*" element of the debt. However, as counsel for the practitioner highlighted, such an arrangement can be extremely problematic in practice in circumstances where the debtor may not have the means, at the end of the mortgage term, to pay the warehoused amount. Such an arrangement therefore has the potential to leave the debtor insolvent at the end of the mortgage term. Thus, an arrangement of that kind will often be self-defeating and inconsistent with the purpose of the 2012-2015 Acts which, as recorded in the long title, were intended (*inter alia*) to enable insolvent debtors to resolve their indebtedness in an orderly and rational manner and without recourse to bankruptcy. While Baker J., in *Paula Callaghan* [2018] 1 I.R. 335 accepted that warehousing of this kind was not precluded under the 2012-2015 Acts, she made clear that such an arrangement would only be suitable in circumstances where there is a proper basis to believe that the debtor concerned would be in a position to pay the warehoused amount at the time of expiry of the mortgage. In that case, the relevant warehousing suggestion was in fact made by way of counterproposal by the objecting creditor. In para. 81 of her judgment, Baker J. explained why the counterproposal was not appropriate. In that para. she said:-

> *"It is crucial in this context that s. 90 precludes a debtor entering into more than one personal insolvency arrangement in his or her lifetime. This means that the legislation envisages an arrangement which will deal with all present insolvency of the debtors or at least the achieving of solvency within five years. While the counterproposal made by KBC may seem attractive and to some extent benevolent, it is capable of creating circumstances amounting to insolvency at the end of the mortgage term in approximately 23 years' time. Because a PIA is a once in a lifetime solution it would be wrong to test the reasonableness of a proposal in the light of a preferred solution or counterproposal that could on its terms result in insolvency at a future date.... A warehousing solution should on present or known figures offer a solution to indebtedness that is likely to be achieved. Neither of the debtors has the benefit of a pension which might provide a lump sum on retirement to deal with the warehoused amount. The repayment of the inactive account therefore is not predicated on any anticipated ability to pay in the future, and is entirely on the hazard. This results in unfairness at a level which I consider material."*

13. Counsel for the practitioner argued that, in contrast, the "*debt for equity*" solution provides significant benefits in cases where a debtor does not have the means to service repayment of the mortgage debt (even where it is reduced to the market value of the underlying security). In such cases, the debt can be split between an affordable tranche (which will be repaid by monthly instalments) and an unaffordable tranche which will be swapped for a share of the secured property. In such cases, the difficulty identified above in relation to warehousing does not arise. This is for the simple reason that no debt becomes due at the end of the mortgage term. Instead, counsel submitted that the creditor gets the benefit of an interest in the property which is likely to increase in value

over time such that the creditor will achieve an uplift when the property is ultimately sold after the death of the debtor.

14. Counsel for the practitioner submitted that an arrangement of this kind is consistent with one of the purposes of the 2012-2015 Acts which is to enable a debtor to remain in his or her family home. Counsel referred, in this context, to the provisions of s. 99 (2) (h) which makes clear that an arrangement: *"shall not require that the debtor dispose of his or her interest in the debtor's principal private residence or to cease to occupy such residence unless the provisions of s. 104 (3) applies".*

15. Counsel for the practitioner argued that, under the arrangement proposed here, Ms. Lowe will dispose of some of her ownership rights in her family home but, crucially, will remain in occupation of her home. The practitioner also submits that, in accordance with s. 102 (6) (f), one of the methods of dealing with secured debt expressly available to a practitioner is a "*debt for equity*" swap. Insofar as relevant, s. 102 (6) provides as follows:-

> *"(6) Without prejudice to the generality of section 100 or subsections (1) to (3) and subject to sections 103 to 105, a Personal Insolvency Arrangement may include one or more of the following terms in relation to … secured debt:*
>
> *(a) …*
>
> *(f) that the principal sum due on the secured debt be reduced provided that the secured creditor be granted a share in the debtor's equity in the property the subject of the security".*

16. In making this submission in relation to s. 102 (6) (f), counsel for the practitioner has argued that the word "*equity*" in the subsection must mean ownership. Counsel argued that "*equity*" is not defined in the 2012 Act and that the concept of negative equity "*goes to value not ownership of security*". This argument is made circumstances where it is clear, having regard to the extent of the debt owed to the bank by Ms. Lowe, that the value of her family home is far outweighed by the extent of the debt such that she is now in what is known colloquially as "*negative equity*".

The submissions on behalf of the bank and KBC

17. Detailed written and oral submissions were made by counsel on behalf of the bank which I summarise below. In addition, I heard submissions from counsel on behalf of KBC Bank (Ireland) Plc ("*KBC*") in relation to the interpretation of the relevant provisions of the 2012 Act (as amended). I did so in circumstances where the present case was specifically listed for hearing together with a similar appeal in the case of *Anthony Mooney (a debtor)* for the same day in which KBC was involved. Both cases were specifically listed to be heard together in circumstances where both of them involved issues in relation to the validity of arrangements which proposed "*debt for equity*" swaps. Both cases were selected with a view to hearing detailed argument from the practitioners, on the one side, and the objecting creditors, on the other, with a view to the court providing a written

judgment on the issue. KBC was the objecting creditor in Mr. Mooney's case. Furthermore, in his case, distinguished conveyancing experts had provided reports on behalf of both KBC and the practitioner acting on behalf of Mr. Mooney. Mr. Rory O'Donnell had been retained on behalf of KBC while Ms. Michelle Linnane had been retained on behalf of the practitioner acting in that case. The hearing was initially fixed for two days in October 2019 but was adjourned in circumstances where the practitioner in the Mooney case required authorisation from the Legal Aid Board to retain Ms Linnane as an expert. Once that authorisation was forthcoming, the hearing was then scheduled to commence on Thursday 19th December, 2019. That hearing date was fixed long in advance. Regrettably, the appeal brought by Mr. Mooney was withdrawn very soon prior to the hearing date. This occurred on Monday 16th December, 2019. The Mooney case would never have been selected as a test case if I had known that there was to be any risk that the appeal would be withdrawn. In those very particular circumstances, in fairness to KBC (who had invested very considerable effort in the preparation of that case), and in light of the wider repercussions of any judgment on the "*debt for equity*" issue, I gave liberty (without objection from the practitioner in this case) to KBC to address me on the interpretation of the 2012 Act. The submissions of counsel were confined to that issue. In circumstances where KBC was not a party to Ms. Lowe's appeal, it would obviously not have been appropriate for KBC to make any submissions in relation to the substance of the appeal in Ms. Lowe's case. It would also have been inappropriate to have regard in Ms. Lowe's case to any of the evidence in Mr. Mooney's case which, unfortunately, meant that the expert reports of Mr. O'Donnell and Ms. Linnane were no longer available for consideration by the court.

18. The application under s. 115A was opposed by the bank on a number of grounds:-

(a) In the first place, the bank argued that, on a proper interpretation of the 2012-2015 Acts, a "*debt for equity*" swap could only take place with the consent of the relevant secured creditor. This was also the focus of the submission made by counsel on behalf of KBC;

(b) The bank also argued that a "*debt for equity*" swap can only take place where the debtor has some equity (i.e. positive equity) in the secured property. In the present case, Ms. Lowe has no such equity;

(c) The bank submitted that the proposed arrangement is contrary to s. 103 (2) of the 2012 Act in that, in substance, the arrangement proposes a reduction of the principal sum due on foot of the mortgage to less than the value of the family home over which the bank holds security;

(d) Far from getting any interest in the property, the bank argued that, under the proposed arrangement, it will get no more than the "*hope value*" of the property based on the hope that the value of the property will increase in the future.

(e) The bank also made the case that the proposed arrangement is inherently unfair and that, accordingly, the requirements of s115A(9)(e) and (f) cannot be satisfied in this case;

(f) As noted above, the bank also contended that the proposed arrangement is unworkable and fails to spell out all of the details. For example, the proposed arrangement does not address issues such as the insurance of the property or the maintenance of the property;

(g) Having regard to Ms. Lowe's financial circumstances, the bank submits that the arrangement is, in any event, unsustainable.

19. To the extent that it is necessary to do so, I now deal, in turn, with each of the issues identified in para. 18 above. However, some of those issues may become moot depending on the conclusion which I reach in relation to the questions relating to statutory interpretation. It may therefore not be appropriate to deal with all of the issues canvassed by the bank. On the other hand, if I decide those issues against the bank, it will be necessary to consider the entire of the requirements of s. 115A and consider, in particular, whether, on the evidence before the court, those requirements have been satisfied in this case.

Is the consent of the secured creditor required?

20. As Baker J. emphasised in *Paula Callaghan* at p. 345, secured debt is given special statutory protection in a variety of respects under the 2012-2015 Acts. These protections are to be found in a number of statutory provisions of which the most important is s. 103 which contains very detailed and comprehensive provisions in relation to the position of a secured creditor. In particular, the section makes very clear that the principal sum secured in favour of the secured creditor over the relevant secured property cannot be reduced, under the terms of a proposed arrangement, to a sum less than the market value of the property. In turn, there are detailed provisions in s. 105 as to how the market value of the secured property is to be assessed. Section 105 envisages that, where possible, the valuation of the security will be agreed between the practitioner and the secured creditor concerned. However, s. 105(3) provides that, in the absence of agreement, an appropriate expert will be appointed by the practitioner, the debtor and the relevant secured creditors. In the event that the practitioner, the debtor and secured creditor are unable to agree on the identity of an independent expert, the issue may be referred by any of them to the Insolvency Service of Ireland ("*ISI*") and it will be for the ISI to appoint an appropriate independent expert to determine the market value. Section 105(5) sets out the matters to be taken into account in carrying out a valuation of the secured property and s. 105(6) contains a definition of "*market value*". In turn, s. 105(6) provides that the market value of property (the subject of security for a secured debt) equates to the price which that property might reasonably be expected to fetch on a sale in the open market.

21. As noted above, s. 103 is the key provision insofar as the protection of a secured creditor is concerned. Section 103(1) provides that, in cases where the relevant arrangement

proposes a disposal of property which is the subject of security, the amount to be paid to the secured creditor under the arrangement must amount, at least, to the value of the security determined in accordance with s. 105 or the amount of the secured debt as of the date of issue of the protective certificate (whichever is the lesser). The relevant text of s. 103(1) is set out in para. 23 below.

22. In turn, s. 103(2) deals with the position of a secured creditor in cases where the relevant property, the subject of the security, is to be retained under the arrangement and it is also proposed to reduce the principal sum due to the secured creditor. The precise terms of s. 103(2) are set out in para. 26 below. The effect of the subs. is that, in cases governed by it, the amount of the principal sum may not be reduced below the value of the security determined in accordance with s. 105.

23. Section 103(1) provides as follows:

> *"(1) A Personal Insolvency Arrangement which includes terms providing for the sale or other disposal of the property the subject of the security shall, unless the relevant secured creditor agrees otherwise, include a term providing that the amount to be paid to the secured creditor shall amount at least to —*
>
> *(a) the value of the security determined in accordance with section 105; or*
>
> *(b) the amount of the debt (including principal, interest and arrears) secured by the security as of the date of the issue of the protective certificate,*
>
> *whichever is the lesser."*

24. It was submitted at the hearing by counsel for the bank and counsel for KBC that the use of the word "*shall*" in s. 103(1) is truly mandatory. In this context, the courts have recognised that the use of the word "*shall*" will not always be construed as imposing a mandatory statutory requirement. The relevant principle was explained as follows by Henchy J. in the Supreme Court in *the State (Elm Developments Ltd) v. Monaghan Co. Council* [1981] ILRM 108 at p. 110 where he said:

> *"Whether a provision in a statute …, which on the face it is obligatory (for example, by the use of the word 'shall'), should be treated by the courts as truly mandatory or merely directory depends on the statutory scheme as a whole and the part played in that scheme by the provision in question. If the requirement … may fairly be said to be an integral and indispensable part of the statutory intendment, the courts will hold it to be truly mandatory, and will not excuse a departure from it. But if, on the other hand, what is apparently a requirement is in essence merely a direction which is not of the substance of the aim and scheme of the statute, non-compliance may be excused."*

25. In my view, the provisions of s. 103(1) are clearly an integral and indispensable part of the statutory scheme established by the 2012-2015 Acts. The provisions are therefore mandatory such that there is no scope to excuse any failure to comply with them. It is

clear from the terms of s. 103(1) (both, when read on their own and when read in the context of the remaining sub-sections within s. 103) that the provision was enacted by the Oireachtas in order to guarantee a minimum level of protection for a secured creditor and, in particular, to ensure that, where an arrangement proposes that property the subject of security should be sold, the secured creditor will be paid, at least, the market value of the property in question (or the amount of the debt if less than the value of the property). The Oireachtas, in enacting s. 103, was plainly concerned to ensure that the property rights of secured creditors would be respected. In my view, the protection available under s. 103(1) would be illusory if practitioners, in formulating arrangements, were free to depart from the requirements set out in the subsection. That would make a nonsense of the subsection. Accordingly, I cannot see any basis on which s. 103(1) could be construed as merely directory rather than obligatory.

26. Very similar language is used in s. 103(2) such that it, too must be construed as a mandatory obligation rather than as a directory or aspirational provision. Section 103(2) is in the following terms:

"(2) A Personal Insolvency Arrangement which includes terms providing for —

(a) retention by a secured creditor of the security held by that secured creditor, and

(b) a reduction of the principal sum due in respect of the secured debt due to that secured creditor to a specified amount,

shall not, unless the relevant secured creditor agrees otherwise, specify the amount of the reduced principal sum referred to in paragraph (b) at an amount less than the value of the security determined in accordance with section 105."

27. To my mind, for similar reasons to those set out above in relation to s.103(1), s. 103(2) can only be read as imposing a mandatory obligation. The subsection makes very clear that the principal sum cannot be written down to less than market value without the consent of the secured creditor concerned. The requirement of consent would be meaningless if the subsection was to be interpreted as being merely directory or aspirational. It is therefore clear that, in cases where, as here, the arrangement proposes both a reduction of the principal sum and the retention of the family home (over which the security is held) the principal sum may not be reduced to less than the market value of the property determined in accordance with s. 105. There is no dispute in the present case that, for this purpose, the market value of the property is €300,000. The practitioner maintains that the principal sum has not been reduced below this figure of €300,000. However, the bank argues that it has, in fact, been reduced to €170,000. Counsel for the bank argued that this is the only sum that the arrangement envisages will be repaid to the bank. While the arrangement proposes that the bank will be given an interest in the property, the bank argues that there is no guarantee that the bank will ever recover €130,000. As noted above, the bank characterises the "*equity*" in the property as no more than "*hope value*". In particular, the bank argues that, if the value

of the property were to fall, the bank could receive considerably less than €130,000 and would have no recourse to Ms. Lowe or her estate for the balance.

28. The bank submits that it is a fallacy to suggest that the principal sum has not been written down below €300,000. On the contrary, the bank submits that it is manifest that, under the arrangement proposed by the practitioner in this case, the principal sum has been reduced to €170,000. That is the only sum that Ms. Lowe will be required to repay over the remaining term of the mortgage. With regard to the argument made by the practitioner that the value of "*equity share*" (currently valued at €130,000) should be taken into account, the bank argues that there is no scope to interpret the words "*principal sum*" in s. 103(1) and s. 103(2) as including anything other than a money sum. The bank submits that "*principal sum*" cannot be construed as extending to a payment in kind or the provision of some form of compensation (such as an interest in land).

29. The bank also draws attention to the language used in the arrangement itself which the bank suggests constitutes a clear acknowledgement by the practitioner that the arrangement proposes a reduction of the principal sum to €170,000 (which is obviously less than the market value of the property). On p. 6 and again on p. 15 the following statement appears:

> *"The new live mortgage balance would be €170,000. A further €130,000 of the Bank's debt will be swapped for an equity share in the property …".*

30. Counsel for the bank submitted that this statement in the proposed arrangement makes its crystal clear that the principal sum is being reduced to €170,000. Counsel argued that this was a clear breach of the provisions of s. 103(2)(b) of the 2012 Act in circumstances where the market value of the property is €300,000. Counsel submitted that, absent consent of the bank, this was manifestly impermissible under the 2012 Act.

31. On behalf of the practitioner, it was submitted that the arrangement is in fact consistent with s. 103(2) in circumstances where the arrangement envisages that, in addition to repayment of €170,000, the bank is to receive a 43.3% interest in the family home which, on the basis of the current market value of €300,000, equates in value to €130,000. The practitioner contends that, in that way, the proposed arrangement conforms to the requirements of s. 103(2) in that the entire of the market value of €300,000 is accounted for.

32. I can see that it might be argued, notwithstanding the terms of the arrangement quoted in para. 29 above that, in substance, the principal sum has been reduced to €300,000, of which €170,000 will be paid by instalments and of which €130,000 will be satisfied by the grant of an equity interest in the family home. It might thus be argued that the principal sum has not been reduced to less than the current market value of the home. However, while such arguments may appear to have some superficial attraction, I do not believe that they withstand any serious level of scrutiny. In this context, it is important to keep in mind the language used in s. 103(2) which speaks of *"a reduction of the principal sum due in respect of the secured debt due to that secured creditor to a specified amount"*

(emphasis added). Those words clearly envisage that, in any arrangement to which s. 103(2) applies, a precise figure will be given for the reduced principal sum. While the reason for requiring this to be done is not spelt out in s. 103(2), the rationale seems clear. The secured creditor needs to know the precise amount of the reduction so that it can assess whether the reduced principal sum, at the very least, matches the value of the underlying property. Equally, the relevant debtor and secured creditor need to know what is the amount that will have to be paid by the debtor to the secured creditor subsequent to confirmation of the proposed arrangement. It is crucial, if the debtor is to be returned to solvency, that the arrangement should expressly identify the amount of the ongoing liability on the part of the debtor and that it should address how that amount is to be repaid. In the usual way, this will be done in one or more of the ways set out in s. 102(6). It will be essential, in due course, to consider the specific provisions of s. 102(6)(f). However, the most common way in which an arrangement addresses repayment of the principal sum due on foot of a secured debt is to specify an amount that will be paid on a monthly basis to ensure that, based on current interest rates, the principal sum together with accrued interest, will be paid over the course of the mortgage term specified in the arrangement. In order that a practitioner will be in a position to draft an arrangement on that basis and in order that the debtor will be in a position to know what payments are to be made, it is critically important that the precise amount of the principal money to be repaid should be specified.

33. I do not believe that one can plausibly treat the amount of principal due under the arrangement proposed here as being €300,000 rather than €170,000. This is for the simple reason that, while the element represented by the "*equity*" to be given to the bank under the arrangement may have had a value of €130,000 at a particular point in time, that value will fluctuate with the highs and lows of the property market. This makes it impossible to say, at any given moment, what is the principal sum specified for the purposes of the arrangement. Accordingly, I cannot see how it can be said that the principal sum has been reduced to a specified amount for the purposes of s.103 (2). Furthermore, even if one could overcome that difficulty, the fact remains that, if the value of the property were to fall, the principal sum could no longer be said to be specified at €300,000 but would, in truth, be less than that. This would entirely undermine the clear object and purpose of s. 103(2) which is to ensure that a secured creditor will, at minimum, be assured that, in any arrangement proposed under the 2012 – 2015 Acts, the secured debt will not be reduced below the market value of the underlying security (as valued in accordance with s. 105).

34. In the circumstances, it seems to me to follow that one could not properly conclude for the purposes of s. 103 (2) that the reduction in value of the principal debt here was specified at €300,000. The reality is that the principal sum has been reduced to €170,000. That is the sum which, under the terms of the proposed arrangement, Ms. Lowe will be required to repay by instalments over the remaining term of the mortgage. The fact that the arrangement provides some other form of value to the bank does not, in my view, alter the fact that the principal sum has been reduced to €170,000. It seems to me that the reduction in principal occurs even where compensation is also provided to the

secured creditor under the terms of the arrangement in the form of an equity share. By its very nature that "equity share" will fluctuate in value.

35. In circumstances where the principal sum has been reduced below the market value of the family home (assessed in accordance with s. 105), the proposed arrangement cannot be confirmed in the absence of consent of the bank or in the absence of some other provision of the 2012- 2015 Acts which permits an arrangement of this kind. It is therefore necessary to consider whether there is some other provision of the Acts that would permit the practitioner to proceed in the manner proposed here.

Is the proposed arrangement within s. 102 (6) (f) ?

36. In the present case, the practitioner relies on s. 102 (6) (f) which he submits expressly permits an arrangement of the kind proposed. Section 102 (6) sets out a non-exhaustive list of ways in which secured debt may be addressed under a personal insolvency arrangement. Section 102(6) (f) provides as follows:

> *"(6) Without prejudice to the generality of section 100 or subsections (1) to (3) and subject to sections 103 to 105, a Personal Insolvency Arrangement may include one or more of the following terms in relation to the secured debt:*
>
> *(a) ...*
>
> *(f) that the principal sum due on the secured debt be reduced provided that the secured creditor be granted a share in the debtor's equity in the property the subject of the security".*

37. The first point to note about s. 102(6) (f) is that, consistent with the view which I have formed about the interpretation of s. 103(2), it clearly contemplates that the share of a debtor's equity to be given to the secured creditor is not treated as part of the reduced principal sum. On the contrary, the granting of a share in the debtor's "*equity*" is treated as the *quid pro quo* for the reduction in the principal sum.

38. Secondly, and crucially, it is clear from the opening words of s. 102(6) that the provisions which follow (including para. (f)) are expressly made subject to ss. 103-105. This means that the provisions of s. 102(6) (f) are subject to s. 103(2). Accordingly, it follows that any reduction in the principal sum due in respect of secured debt (on the basis that the relevant secured creditor will be granted a share in the debtor's equity in the secured property) cannot be set at a figure less than the market value of the secured property without the consent of the relevant secured creditor. When one takes account of the language of s. 102(6) and in particular the words "*subject to sections 103 to 105*", it is not possible, to my mind, to construe s. 102(6) (f) as overriding or in any way taking precedence over the requirements of s. 103(2). On the contrary, the Oireachtas, in enacting the 2012 Act, was careful to make it clear, for the purposes of the protection of secured creditors, that the different methodologies available under s. 102(6) could not be used to override or displace the protection afforded under s. 103 which guarantees that, at the very least, the principal sum due on foot of a secured loan will not be reduced,

under any arrangement proposed under the 2012 – 2015 Acts, below the market value of the secured property.

39. I therefore believe that it is clear that s. 102 (6) (f) does not authorise a reduction in the principal sum beneath the market value of the secured property. Accordingly, it follows that the consent of the secured creditor (in this case the Bank) is required before a practitioner can formulate a proposal for a personal insolvency arrangement under which it is envisaged that the principal sum due to a secured creditor will be reduced below the market value of the property (and where the secured creditor is given, instead, an "*equity*" in the property of the debtor).

In the absence of bank consent, the "debt for equity" proposal is not capable of being confirmed under s 115A

40. In the present case, the bank has not consented to the proposed treatment of the debt due by Ms. Lowe to it on foot of the mortgage loans secured over her family home. In circumstances where the proposal involves a reduction of the principal sum to a figure less than the value of the family home, the consent of the bank would be required before any such proposal could be confirmed by the court. It is clear that the consent of the bank will not be forthcoming and, in those circumstances, there is no basis upon which I could make an order pursuant to s. 115A (9) confirming the coming into effect of the proposed arrangement. The court is given no discretion under s. 115A to override the requirements of s. 103(2). On the contrary, the court is not permitted to even consider an application under s. 115A (9) unless it is satisfied that the mandatory requirements referred to in s. 99 have been complied with. Section 115A (8)(a) (ii) makes this very clear. One of the requirements of s. 99 of the 2012 Act is contained in s. 99(2)(k) under which an arrangement is required to make provision for the manner in which security held by a secured creditor is to be treated and this requirement is expressly made subject to ss. 102 – 105 of the 2012 Act. Having regard to the fact that the arrangement proposed here does not comply with s. 103(2) I am not permitted under s. 115A (8)(a) (ii) to even consider the application that is made under s. 115A (9).

Other issues

41. As noted in para. 17 above, there were a significant number of other arguments canvassed during the course of the hearing on behalf of the bank. In light of the conclusion which I have reached in para. 40 above I do not believe that it would be appropriate for me to address these issues in any detail. In particular, I do not believe that I should address any of the issues which would ordinarily fall to be considered under s.115A (9) on an application of this kind. In circumstances where the gateway requirements in s.115A (8) of the 2012 Act have not been complied with, the court is enjoined from any consideration of those issues.

42. It may, nonetheless, be helpful to address, at least to some extent, the argument made by the bank that a '*debt for equity*' swap can only take place where the debtor has some equity (i.e. positive equity) in the secured property. That is an issue which arises as a matter of principle and can be considered independently of the issues that would arise under s.115A (9). I stress that anything I say on this issue is purely *obiter*.

43. As recorded in para. 16 above, counsel for the practitioner has argued that the word '*equity*' as used in s.102(6)(f) should be interpreted as meaning ownership. Counsel was constrained to make that argument in circumstances where, on the facts of this case, it is clear that the debt due to the bank exceeds the value of the family home. The difficulty with this argument is that it is contrary to the ordinary meaning of the word '*equity*' which is concerned not with legal ownership but with the extent of the value held by the legal owner in property which is subject to a mortgage. This is very clearly explained by Wylie in '*Irish Land Law*', 5th Edition at para. 12.05 as follows: -

> *"While at common law the mortgagee was regarded as owner of the property, in equity the mortgagor is regarded as owner and the mortgagee as an incumbrancer only. This equity of redemption, sometimes rather loosely referred to as the mortgagor's 'equity' in the property, is a valuable interest in property which can be sold, demised or mortgaged, like any other item of property. Furthermore, it is usually quite easy to put a monetary value upon it, especially in former days of rising property values in Dublin. The figures used here for illustration purposes are probably unrealistic at the time of writing because of the recent property slump stemming from the banking crisis, but they will serve to make the point. For example, if in 2000 X bought a house for €300,000 and borrowed €250,000 from a bank…to help pay for it, he immediately had an equity in the house of about €50,000 in value. By 2005 the market value of the house might have risen to €500,000, so that by then X had an asset worth €500,000 in respect of the which the liabilities amounted to rather less than €250,000 (assuming he had been repaying capital as well as interest charged on the original loan). Thus his equity in the house had increased in value from €50,000 to €250,000 (i.e. the 2005 market value of €500,000 less the outstanding debt of something less than €250,000 originally borrowed) and, if he had sold his house, he could have expected to make a profit of roughly this amount…."*

44. I cannot see anything in the terms of the 2012/2015 Acts (and counsel for the practitioner did not identify anything in the terms of those Acts) which would suggest that the Oireachtas intended that the word '*equity*' (which is not defined in the 2012 Act) was intended to have a meaning other than that explained by Wylie. I appreciate that the passage quoted above from Wylie was not concerned with the 2012-2015 Acts. However, his explanation of the way in which the word "*equity*" is used is nonetheless illuminating and is consistent with the common usage of that word in the context of property ownership.

45. Thus, for example, where the owner of a home which is already subject to a mortgage seeks to obtain further loans on the security of that property (in order, for example, to carry out house repairs) the first question that the home owner will be asked by any prospective finance provider will be: "*How much equity do you have in the house*?" That question is directed at identifying the difference between the value of the house, on the one hand, and the extent of any existing indebtedness secured on the property, on the other. That difference is often described as the "*equity*" of the mortgagor. The existence

of such an equity was recognised by both Barron J. in the High Court and by Walsh J. in the Supreme Court in *Bank of Ireland v. Purcell* [1989] I.R. 327. In that case, an issue arose in relation to s. 3 (1) of the Family Home Protection Act, 1976 *("the 1976 Act")* under which a conveyance of an interest in the family home by one spouse, without the consent of the other, is rendered void. Section 1 of the 1976 Act defines a "*conveyance*" as including a mortgage. The plaintiff bank in that case held a form of security which was then common, namely an equitable charge created by virtue of a deposit of title deeds. Such a deposit was made in 1975 by the defendant to secure both present and future advances by way of loan from the plaintiff. The title deeds included title to the family home of the defendant and his wife. No consent was required from the wife at the time the original advance was made in 1975. The original advance predated the enactment of the 1976 Act. However, subsequent to the commencement of the 1976 Act, further advances were made (on the security of the same deposit of title deeds) by the plaintiff bank to the defendant. At no time was the wife asked to give her consent for the purposes of s. 3 to any such advances. Both the High Court and the Supreme Court on appeal came to the conclusion that her consent was required because, on each occasion when further advances were made, the equity of the defendant in the family home was reduced. At p. 330-331, Barron J. explained the position as follows:-

> *"The conveyance of the estate in lands is the conveyance of an interest for the purposes of [s. 3 of the 1976 Act], but the fact that the estate has already been conveyed [by means of the deposit of title deeds] need not prevent a subsequent transaction from conveying an 'interest' in the lands. In the case of a mortgage the extent of the estate depends upon the amount which has been borrowed. Even in a case of a legal mortgage where there is a conveyance of the fee simple the interest of the mortgagor and of the mortgagee in the lands so mortgaged will depend at any given time upon the extent of the monies lent and borrowed. No doubt so long as any monies are charged on the lands the fee simple estate will be in the mortgagee. However, that of itself does not mean that thereafter the mortgagor cannot purport to convey a further interest to the mortgagee, because in that situation the value of the equity of redemption is being altered on the occasion of each further advance. The same situation arises in the present case. Each time there is a further advance the amount which is being charged on the lands is altered and accordingly the interest of the mortgagor in those lands is altered. I have no doubt that future further advances are the conveyance of an interest in the lands for the purposes of s. 3…".*
> (emphasis added).

46. Furthermore, when one considers the way in which the word 'equity' is used in s.102(6) it reinforces the view that '*equity*' is being used in the same sense as explained by Wylie. The way in which the word '*equity*' is used suggests that the intention is that the secured creditor will be compensated for the reduction in the principal sum by getting something valuable in return namely a share in the debtor's equity. If the debtor has no equity in the property in the sense described by Wylie, the grant of a share in the *equity* to the

secured creditor would not compensate for the reduction in the principal sum. At best, it would, as counsel for the bank submitted, give the secured creditor the hope that, at some stage in the future, the share in the '*equity*' would have some value. Regrettably, if the secured indebtedness exceeds the value of the property, the debtor concerned may never have any valuable interest in the property.

47. I have accordingly come to the view (albeit on a purely *obiter* basis) that '*equity*' must be construed as valuable equity or, more colloquially, positive equity in the property in the sense described by Wylie.

48. All of that said, I fully appreciate the force of the submission made by counsel for the practitioner (recorded in paras. 12-14) above that an arrangement of the kind proposed here might, for the reasons which he described, work significantly better in practice than most forms of warehousing. Depending on the circumstances of an individual case, the latter can give rise to unwelcome insolvency at the end of the mortgage term at a time when the debtor may, depending upon his or her age, have very limited finances available to discharge the warehoused element of the debt. An arrangement of the kind proposed here has the capacity to avoid that difficulty. However, if arrangements of that kind are to be available, it seems to me that significant amendments would need to be made to the 2012-2015 Acts. It is not for the court to suggest what form any such amendments should or might take. That is a matter entirely for the Oireachtas. However, if any such amendments are to be made, I would strongly urge that any such statutory provisions introducing new debt resolution solutions should be set out in sufficient detail to enable practitioners, debtors and creditors to identify and fully understand the precise scope and boundaries of any such solutions.

Conclusion

49. In light of the views which I have formed in relation to the proper interpretation of s.103(2) and s.102(6)(f), I am unable to reach a view that the requirements of s.99 have been satisfied in this case. It follows that the application under s.115A cannot succeed. In those circumstances, the only order which I can make is to dismiss the appeal and, instead, to make an order affirming the order previously made by the learned Circuit Court judge dismissing the application under s.115A.