THE HIGH COURT

CIRCUIT APPEAL

[2022] IEHC 380
[Record No. 2021/25 CA]

IN THE MATTER OF PART 3, CHAPTER 4 OF THE PERSONAL INSOLVENCY ACTS 2012-2015

AND IN THE MATTER OF JOHN AND SHERALYN MCEVOY OF 34 ATHLUMNEY HALL, NAVAN, CO. MEATH

AND IN THE MATTER OF AN APPLICATION PURSUANT TO SECTION 115A(9) OF THE PERSONAL INSOLVENCY ACTS 2012-2015

JUDGMENT of Mr. Justice Mark Sanfey delivered on the 22nd day of June 2022

Introduction

1. This matter concerns an important point of principle in relation to whether or not a personal insolvency arrangement ('PIA') which proposes what is known colloquially as a 'debt for equity' swap is lawful in the sense that it could be the subject of an order of the court pursuant to s.115A (9) of the Personal Insolvency Acts 2012-2015 (referred to collectively as 'the Act') confirming its coming into effect.

2. The lawfulness of a debt for equity swap was the subject of a comprehensive review by McDonald J in *Re Denise Lowe, a Debtor* [2020] IEHC 104. In that case, the

court took the view that the proposed debt for equity swap could not be approved unless the secured creditor – in that case, Bank of Ireland – consented to the proposal, or to put it another way, that the swap could not be imposed by the court on the creditor against its will.

3. In *Lowe*, the amount due to the secured creditor on foot of the mortgage loan was in excess of the agreed value of the principal private residence ('PPR'). It was proposed that repayment would be effected by dividing the value of the PPR - €300,000 – into an "active" part of €170,000, which would be repaid by regular instalments of principal and interest, and a debt for equity swap in respect of the balance of €130,000, by which the bank would assume a 43.3% equity share in the PPR.

4. It will be apparent therefore, that in *Lowe*, the debtor was in "negative equity" in respect of the PPR. For reasons set out in the judgment, the court held that the Act did not authorise a reduction in the principal sum beneath the market value of the secured property, and that the consent of the secured creditor would be necessary before the personal insolvency practitioner ('PIP') could promote a proposal which involved such a reduction. As Bank of Ireland did not consent in that case, the court held that there was no basis upon which it could order the coming into effect of the PIA under s. 115A (9).

5. The court did note that the bank had argued that a debt for equity swap could only take place where the debtor has positive equity in the property. McDonald J addressed the question of what constituted "equity", but stressed at para.42 of his judgment that the views he expressed were "purely obiter".

6. The PIP in the present case, Tara Cheevers, applied on behalf of John and Sheralyn McEvoy ("the debtors") by Notice of Motion issued on 27th February 2018 to the Circuit Court for an order pursuant to s. 115A(9) of the Act following the refusal of

their sole creditor, EBS DAC, to approve the proposed arrangement pursuant to section 111A of the Act. The application was heard by the Circuit Court (Her Honour Judge O'Malley Costello) on 25th February 2021. The Circuit Court refused the application; the order recites that "… this is a breach of Section 113.2 [sic – it is clear that this is a typographical error, and that it was intended to refer to Section "103.2"] of the Act therefore the Court is not in a position to approve the arrangement". By notice of appeal of 2nd March, 2021, the debtors appealed to this court.

7. I was informed by counsel for the PIP that there was a number of debt for equity cases which involved positive equity and would therefore possibly not be bound by the *ratio decidendi* of *Lowe*, but that there was a widely held view that a definitive ruling was required as to whether PIAs proposing debt for equity solutions involving positive equity were in principle lawful or not. I was further informed that the present case was regarded among personal insolvency practitioners as the "lead" case, in which it was hoped that the issue might be clarified by the court. Counsel suggested that a preliminary issue be tried as to whether such an arrangement was permissible in principle. Although the objecting creditor – EBS DAC – did not agree to this course of action, I accepted that this was the most efficient way of dealing with the matter.

8. Accordingly, the matter was heard by me on 25th April, 2022 as a preliminary issue only, on the understanding that a finding in favour of the objecting creditor would necessarily result in the dismissal of the application, but that a finding in favour of the debtors would require further consideration of the various arguments for or against a s.115A (9) order. Both sides proffered written submissions in relation to the preliminary issue.

9. This judgment therefore deals with the issue of principle, and with the facts only insofar as they are relevant to that issue.

The agreed facts

10. The parties agreed the following facts for the purpose of the hearing of the preliminary issue:

- the principal private residence is valued at €330,000;
- the sums outstanding to the creditor are €210,887.58;
- there is equity in the principal private residence of €119,112.42;
- the rejected arrangement proposes a reduced principal sum of €31,633.14 representing a reduction of €179,254.44 (*i.e.* €210,887.58 - €31,633.14); and
- no consent was given by the creditor to the aforementioned treatment under s.103(2) of the Acts.

The agreed issue

11. The parties have also agreed the terms of the issue to be decided by the court as follows:

> "Whether, irrespective of whether the Proposed PIA will in fact operate to grant a share in the debtors' equity in the PPR to EBS within s.102(6)(f) of the Act, the Proposed PIA offends the provisions of s.103(2) of the Act and is therefore un-approvable under s.115A".

The statutory provisions

12. Section 102 of the Act deals with the position of secured creditors as it relates to the PIA. Section 102(1) provides that the secured creditor must furnish to the PIP an estimate of the market value of the security and may also indicate how it wishes to have the security and secured debt treated under the PIA; section 105 of the Act sets out a procedure for determining the value in the absence of agreement. Section 102(6) sets

out a number of terms which may be included in the PIA in relation to the secured debt, and in particular 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:
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> …(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; …".

13. The possibility of a debt for equity swap therefore appears to be envisaged by the Act. However, s.103(1) and 103(2) provide as follows:

> "103. - (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 –
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> (a) the value of the security determined in accordance with section 105; or
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> (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,
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> whichever is the lesser.
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> (2) A Personal Insolvency Arrangement which includes terms providing for—
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> (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,
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> 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."

14. As s.102(6) is expressed to be "subject to sections 103 to 105", the question arises as to whether a reduction of the principal sum below the value of the security could ever be effective without the agreement of the secured creditor, notwithstanding that a share of the debtors' equity in the property would also be conferred on the creditor.

The debtors' position

15. The debtors argue that s.102(6)(f) expressly enables the principal sum to be reduced once an equity share is given, and that it cannot have been intended "…that one section would conflict with the other and inhibit the working of debt for equity swaps (which is a solution expressly provided under the Acts but also under the Code of Conduct on Mortgage Arrears) …" [submissions, para. 48]. The submissions neatly expressed the debtors' position as follows:

> "51. It is therefore the case that either of two options arise. Either section 102(6)(f) and section 103(2) are unworkable together (or certainly unworkable absent consent and unworkable in a section 115A (which was introduced to enable solutions be imposed)) or section 102(6)(f) is to be read as an exception to the rule in s.103(2); as in, the only way the principal sum can be reduced below the value of the security is where you are giving the creditor a 'share' of the ownership of the security."

16. The debtors argue that the purpose of s.103(2) is to ensure that there is a "floor" to the value of the security, which is its market value. It is to ensure that a debtor does not attribute a value to the security which is less than the market value, thereby acquiring equity in the property without the consent of the creditor. It is submitted that this concern does not arise where the debtor, in addition to reducing the repayable amount of the loan below market value, is transferring an equity to the secured creditor which has a positive value.

17. The debtors submit that a debt for equity proposal involving a reduction below market value may make eminent commercial sense for the secured creditor, and offers the following example: -

> "44. For example, if the secured mortgage debt was €50,000 (for example, an older borrower who had paid down their mortgage but was now retired and in arrears) and a Debtor owned a house worth €500,000 then clearly there would be a possibility of a good equity swap being done. For example, if the debtor was happy to give up 50% ownership in exchange for remaining in the property then they could pay (in effect) €250,000 of equity to reduce/discharge €50,000 of debt. This swap on its face (commercially) would hardly be unfair to a creditor and would appear to be overly generous from a Debtor. That said, applying section 103(2) an issue would still arise (the principal sum would be reduced to €0). Indeed, the same issue would arise if the example debtor above gave the full €450,000 of equity in the property in exchange/reduction of the €50,000 debt".

18. Counsel urged that the court adopt a purposive approach to the construction of the Act as regards the relationship between s.102(6) and s.103(2). It was submitted that

the Act "must be interpreted in such a way as to achieve a logical purpose", and cited dicta of Gilligan J in *Boyne v. Dublin Bus* [2008] 1 IR 92:

> "…Indeed, in any question of statutory interpretation the court is bound to have in mind the purpose of a statutory rule or the mischief at which it is directed, so far as such purpose or mischief can be ascertained. That is not to say, of course, that the court can simply give effect to that purpose, but where the court has to make a judgment about the proper meaning of a statute it is likely to want to consider whether it can by the process of interpretation give effect to its purpose or the mischief to which the statute is directed." [para. 39]

19. It was further submitted that: -

> "65. In the debt for equity swap scenario the Act, to achieve a logical purpose, must be read that section 102(6)(f) is an exception to the rule in 103(2) or that section 103(2) is not a true reduction.
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> 66. By way of clarity, it appears (on one reading) that section 103(2) is an unintended de facto veto of every debt for equity case, and inhibits any 115A for any debt for equity case."

The EBS position

20. It would be fair to say that, whereas counsel for the debtors sought to distinguish the decision in *Low*e, counsel for EBS urged the court to adopt it and follow its logic, notwithstanding that it dealt with a situation involving negative equity. It was submitted that the interaction between s.102(6)(f) and s.103(2) was perfectly clear; the Oireachtas had decided that s.102(6)(f) was "subject to" s.103. If the proposal was to reduce the amount of the secured debt to an amount below the agreed valuation, the PIA could only include such a term if the secured creditor agreed to it. It was submitted that there

was nothing ambiguous in s.103(2); a debt for equity proposal would be in accordance with the Act, but only if the secured creditor agreed to it.

21. Counsel referred to the following provisions of part IV of the PIA which set out how the debt for equity swap is to be effected: -

> "2.1.2 Pursuant to S.102(6)(f) of the Act, the mortgage loan balance will be reduced from €210,887.58 to €31,633.14 on the coming into effect of this PIA. The reduction in mortgage debt represents an 85% reduction in the current mortgage loan balance as established in the proof of debt process. In exchange for this 85% reduction in the mortgage loan balance provided for in this PIA, the debtors will grant EBS DAC an 85% share of the equity in their PPR being the property subject of EBS DAC's security.
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> 2.1.3 This grant to EBS DAC of an 85% share of the ownership in the debtors' family home will be by way of an irrevocable option given to EBS DAC to acquire a 85% share in the debtors' PPR for the nominal sum of €1.00 at the time EBS DAC exercises its option. This irrevocable option can be exercised by EBS DAC in two events:
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> (a) The sale of the PPR, or
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> (b) On the death of the longer surviving co-borrower *i.e.* from the estate of the longer surviving co-borrower…
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> 2.1.9 The debt for equity option is subject to any future event of default, either as per the Personal Insolvency Acts, the terms of the loan facility, and/or bankruptcy. If there is such a default, the option becomes exercisable and the debt for equity option may be revoked and the underlying debt (subject to the debt for equity option and subject to payments made) will become due and owing."

22. It was submitted that para. 2.1.3 did not signify a grant of equity, but rather an "irrevocable option" to acquire equity in certain circumstances. Counsel in fact queried whether it could be properly regarded as a debt for equity swap at all. The provisions left complete uncertainty as to when the property might be sold and the option exercised, and as to the value of the property at that time. It was being suggested that the secured creditor should have risk imposed on him by an order under s. 115A (9) in substitution for its current certainty as to its rights.

23. Counsel submitted that the "core issue contemplated by the PIP's appeal (a debt for equity proposal absent the creditor's consent)" had already been determined in *Lowe*. In that case, McDonald J, under the heading "Is the consent of the secured creditor required?", reviewed the terms of s.103 and concluded that the protection afforded to secured creditors by ss. 103(1) and (2) was mandatory rather than directory:-

> "27. To my mind… 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."

24. Importantly, McDonald J was of the view that the share of the 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" [para. 37]. The court went on to find that,

given the language of s.102(6) and in particular the words "subject to sections 103 to 105", it was not possible "…to construe s.102(6)(f) as overriding or in any way taking precedence over the requirements of s.103(2)" [para. 38].

25. As regards the relationship between s.103(2) and s.115A, McDonald J had this to say:

> "…[T]he 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)." [para. 40]

Conclusions

26. It is important to note that s.102(6) is a permissive section, which sets out a range of possible strategies of which a PIP may avail in dealing with a secured debt. The PIP will consider the appropriate course, and a secured creditor has the right under s.98(1)(a) and s.102(1) to express a view as to how its security might be treated.

27. If the PIP chooses an option pursuant to s.102(6)(f), she does so in the knowledge that this option is "subject to" s.103, and that the market value of the security cannot be reduced below the statutory floor without agreement of the secured creditor.

As McDonald J points out, the "equity" cannot be regarded as part of the value of the security, as it is what is being offered in return for the reduction in that value.

28. It follows therefore that it does not matter whether the equity being offered by the PIP is positive or negative. The subsections are not in any way obscure or ambiguous. On the contrary, they suggest an intention to provide assurance to a secured creditor that its security cannot be reduced below market value without its consent. The only inference to be drawn is that a PIP is perfectly entitled to propose a debt for equity solution in accordance with s.102(6)(f) which envisages the value of security being reduced below the agreed or s.105 value; however, she cannot do so without the agreement of the secured creditor. There is nothing in the wording of the subsections to indicate that the Oireachtas intended s.102(6)(f) to be an exception to the rule in s.103(2), or that s.103(2) "is not a true reduction". The literal interpretation of ss. 102 and 103 is not absurd; neither does it appear to me that their terms fail to reflect the plain intention of the Oireachtas. On the contrary, it seems to me that s.103 sets out a measure of protection for the secured creditor which the PIP's proposal, in the absence of agreement, clearly contravenes.

29. Counsel for the PIP points out that s.115A was enacted in the Personal Insolvency (Amendment) Act 2015, *i.e.* after the enactment in the parent Act of s.102 and s.103. He suggests that, if the objecting creditor's position is correct, s.103(2) is "an unintended *de facto* veto of every debt for equity case…", in that the court would have no jurisdiction to review under s.115A a refusal by the secured creditor to agree a debt for equity proposal. It may be that a secured creditor does indeed have a "*de facto* veto"; however, it is not for this Court to express a view that this was "unintended" in circumstances in which the protection afforded by s.103 to secured creditors is clear. In the absence of ambiguity or absurdity I cannot infer that the Oireachtas overlooked

the effect of s.102 and s.103 on s.115A(9) applications; it does not follow, in my view, that the Oireachtas must have intended that a refusal by a secured creditor to agree to a debt for equity swap could be the subject of review by the court pursuant to an application under s.115A(9), but for some unaccountable reason failed to give effect to this intention.

30. Where one can identify circumstances – such as in the example proffered by the PIP in para. 17 above – in which a debt for equity swap involving positive equity might make good commercial sense from the point of view of the secured creditor, that creditor can readily agree to the proposal. The Act simply states that, in the absence of an agreement, this particular solution cannot be imposed by the court on the creditor pursuant to s.115A (9). If this state of affairs is to change, in my view amending legislation will be required, and I echo and endorse the words of McDonald J at para. 48 of *Lowe*: -

> "…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".

Orders

31. It follows from the foregoing that the answer to the issue as formulated by the parties is in the affirmative; the proposed PIA does offend against the provisions of s.103(2), and the PIP's application under s.115A cannot succeed. There will therefore be an order dismissing the appeal, and an order affirming the order of the Circuit Court (Her Honour Judge Mary O'Malley Costello) of 25th February 2021 dismissing the

application under s.115A. If any other order is required, the parties have liberty to apply within seven days of delivery of this judgment, failing which the order will be made without further reference to the parties.