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SECOND DRAFT
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INSOLVENCY LAW REVIEW COMMITTEE

CORK REPORT

PART I CHAPTER 2

THE CREDIT WORLD

(1) Introduction

2.1.1 This Committee has been set up to examine, for the first time for at least a century, the whole of the field of legal and social relationships which is nowadays generally called "insolvency". This term is coming into use ^{as a collective description of those procedures which have} to describe what has previously been called "bankruptcy", that is the ^{administration in} insolvency of individuals ^{and partnerships}, "winding-up", that is the ^{administration in} insolvency of limited companies and corporations, and the specialised forms of administration represented by receiverships ^{under debentures}, deeds of arrangement, and administration orders in the County Court. This new terminology has been introduced to describe the most recent statute, the Insolvency Act, 1976.

2.1.2 Our terms of reference contemplate the desirability of the amalgamation, so far as practicable, of all these categories into one homogeneous statute and the application, so far as may be practicable and also just, of substantially the same principles to every kind of debtor.

2.1.3 In the pursuit of this aim we have had to direct our attention simultaneously to the interests of the debtor, whether individual or corporate, and of his creditors, and of society as a whole.

2.1.4 Not least among our tasks have been to seek to determine how far the interest²⁵ of society should ~~not~~ merely the putting of debtors into insolvency or protecting them from that predicament, but should also significantly direct the ^{manner of} administration of individual cases. If it be right, as we believe, that society should have an important say in these two aspects of insolvency, then it must follow that society ^{should} ~~must~~ pay the price for its participation in what has hitherto been largely private litigation between members of the community. The price demanded is that society provides and pays for the judicial and administrative machinery through which its participation can be effective and fruitful. He who calls the tune must pay the piper. What your Committee seeks to do is to compose the ^{appropriate} tune.

2.1.5 What do we mean by insolvency, and how does such a state of affairs come about? In a "barter society" or a strictly cash economy, no one can become insolvent in the sense that his liabilities exceed his assets, except where by doing an injury to another, - what the lawyers call the commission of a "tort", - he becomes liable to pay a sum of money which does not flow from a promise or other mutual obligation, ^{one or more} entered into between him and ^{another} specific person.

2.1.6 It is only when money obligations are undertaken which are not immediately discharged in full that a person can ^{become subject to} acquire a liability which exceeds or may, when it becomes payable, exceed his present or future assets. This process represents the creation of credit and ^{is} the springboard for

the relationship of debtor and creditor. In the ordinary circumstances of human life the creation of credit involves ^{must} the possibility that the credit may be ^{in the event have to be} misplaced, resulting in an actual debt.

2.1.7 Credit is the lifeblood of our form of economy.

The most significant extenders of credit are banks and other lending institutions, such as finance houses or building societies, ^{and that "half-way house", represented by hire-purchase financiers,} Merchants extend credit to customers, and

customers to merchants. Even the Government itself extends credit by obliging its subjects to act as tax collectors ^{of PAYE and VAT,} and thereby ^{to} becoming ^e indebted to the Government.

2.1.8 Credit is fundamental to all trade, commerce and industry, whether in the shape of short-term, medium-term or long-term facilities, whether secured or unsecured. It is created by the mere buying "on credit" of goods not immediately paid for or which are to be paid for at a future date. More and more are our old every-day cash dealings being replaced by credit transactions, as the proliferation ^{the use of} of credit cards shows. We are all familiar with the needs and demands of the consumer society, where the sometimes derided "buy now, pay later" tag has been the means of improving the lot of the humblest of our fellow citizens, who are thereby enabled to enjoy, particularly in the field of their household goods, an immediate and socially valuable improvement in their living standards.

2.1.9 The overwhelming majority of transactions involving the provision of credit are carried through more or less harmoniously in accordance with the terms of the ^{original} bargain between the parties, to the ultimate satisfaction and profit of all concerned. We, by our terms of reference, are not primarily concerned with the implementation of these successful transactions, even though they may give rise to disputes, for example, with regard to ^{the} quality of the goods supplied or ^{to} their delivery. Our concern is rather with the unsuccessful transactions, when the relationship between a debtor and his, her or its creditors have broken down or collapsed, due to the debtor's insolvency. The debtor finds himself in a situation where he is no longer able to meet his obligations or commitments as they fall due, and the question ^{then} is, what is to be done?

2.1.10 "By what is to be done" ^{basically} we mean [^] four things:

- (i) What is to be done with the assets of the debtor which are necessarily less than his debts?
- (ii) What is to be done with his creditors, ^{- is it to be} "share and share alike", or some other basis of distribution?
- (iii) What is to be done with the debtor or, if the debtor be a company, with its officers ^{managers} and ⁱⁿ other agents?
- (iv) What does society ^{itself} need, and demand, ^{what should it} in these ^{to be done} three potentially conflicting fields?

2.1.11 These problems can and do affect the individual, however humble, at one end of the spectrum, and great corporations at the other. The answers which are given by English law today to these problems do not seem to us, and to many of those ^{whom} we have so fruitfully consulted, to be ^{adequately} addressed to those four areas of concern, but ^{represent} are, by and large, responses to the economic conditions and attitudes prevalent over 100 years ago. During that period, which has seen such fundamental changes ^{the structures of} in our mercantile and human societies, the system has been tinkered with, patched and extended by false analogies, ^{so} as to present today countless anomalies, inconsistencies and inefficiencies. We are convinced that the systems (for they are in reality numerous) no longer work satisfactorily, in the sense that their product does not accord with what we conceive to be the demands of fairness and justice to all in ^{the} a ~~modern~~ society, in which we live ^{today}.

(see ch. 6.)

2.1.12 It seems to us and to our consultees that the time is ripe for a radical new look at the general field of insolvency, so that it may be refashioned to give expression to the needs of our economy and of our society generally, when faced with the insolvency situation of one of its members.

(2) How does the credit world work today?

2.2.1 Following many years of credit restriction, the financial climate in the ^{United Kingdom} ~~U.K.~~ has developed considerably, and a much wider concept of borrowing is now in force both for businesses and individuals. Inflation and overall improved standards of living have been the forces which have impelled lenders to increase facilities of all types, despite the knowledge that such expansion generates greater lending risks, particularly in an atmosphere of fierce competition.

2.2.2 Extensive promotion of the numerous credit facilities that are ^{now} available has generated an unprecedented acceptability of and demand for credit in this country. The relative ease by which credit can now be obtained must, however, ^{be balanced by} ~~necessitate~~ a strict control of personal and business budgeting, if those who avail themselves of such facilities are to avoid over-reaching themselves financially.

2.2.3 The difficulties ^{of} easy credit are further exacerbated by the absence of ^{any} security for the majority of personal credit facilities. We are thus faced with the situation of easily obtainable credit bringing with it the problems of mounting personal indebtedness, coupled with confusion as to the remedies to be employed to control the resulting difficulties ^{of recovery} ~~of the monetary liabilities debts thereby incurred~~

2.2.4 In many respects, the same comments apply to the whole trading community, including both large and small businesses. Competition for lending is severe, and ^{this} sometimes encourages an abrogation by certain lenders of their responsibility in the areas of prudence and the principles of "good lending." In the main, however, lenders in this field seek security for their advances which now often extend into the medium to long-term range.

2.2.5 The taking of security does not ^{of itself} preclude the need for repayment, but ^{it} achieves for the lender a degree of priority in obtaining repayment in the event of a business failure. If there were no security of any kind available to lenders, either the total amount of lending would be less, particularly in the case of smaller or newly established businesses, or there would be larger losses ^{requiring} to be covered by higher costs of financing.

(There to say, ...)

2.2.6 In the case of the Clearing Banks, the need for security is counteracted by the volume and reliability of the financial information that their customers can produce. To some extent a bank's ability to monitor such information regularly during the lifetime of the loan is an acceptable substitute for formal security; but to require such information from small firms would in many cases impose undue burdens on limited administrative resources. The need for security is inevitably greater in the case of the small firms who have modest capital resources and who have not the resources available to produce detailed financial information for the lender to monitor. In such cases, security offers a means of off-setting the greater risk of loss.

2.2.7 Despite the taking of security and the popularity of revolving credit lines, it is vital to a lender's favourable assessment ^{of the borrower's application for an advance} that the borrower has the ability, ^{the} willingness and ^a clear obligation to repay; in the absence of due repayment, it is essential to the whole credit system and to the maintenance of respect for the law and belief in the sanctity of contract, that all those involved should clearly understand that a breach will result in some form of effective sanction being applied.

2.2.8 The Clearing Banks, in whose hands the vast majority of business lending is placed, observe a variety of prudential constraints in order to ensure their ^{own} ability to meet their obligations to depositors at all times. Not only are they obliged to comply with ^{central} monetary and credit controls in line with ^{national} economic policy objectives, but they must also, at all times, ensure that they are always able duly to repay their depositors ^{on demand}. This obligation requires the banks to adhere to appropriate standards of liquidity and capital adequacy. ^{of capital} If a bank fails to meet these requirements, it loses the confidence of its depositors and its ability to continue to trade. The most important constraints, therefore, are self-imposed and would apply

even in the absence of control from without. ^{Since} As the banks are an integral feature of the U.K.'s ^{of the United Kingdom and of its} economy and of monetary policies, any reduction of confidence in the banking system through the banks' abrogation of traditional lending principles and ^{any} relaxation of credit repayment and security requirements would have serious repercussions for the British economy as a whole. We see here the clearest demonstration of the direct and ~~distal~~ link between each and every credit transaction, ~~and the one hand,~~ and the ~~health of~~ ^{financial health of society as a whole, on the other.}

2.2.9 A sound banking and financial system is essential for the prosperity of the ^{nation} country; it facilitates the exchange of goods and services and enables the ^{nation} country to make the most efficient use of its human and material resources. Likewise, the provision of credit for trade and industry stimulates production and encourages enterprise as well as tidging individuals and businesses over difficult economic times. ^{These factors} in turn must be matched by an acceptance by all involved that the sanctity of contract is fundamental to the existence of business relations, and that unless businessmen ^{maintain} have a sense of financial responsibility, trading will cease and the economy collapse.

2.2.10 The legislature has it in its power to restrict the enforceability of credit transactions ^{which are} regarded as unfair, ^{so as} to ensure that members of the public are not deceived into taking credit ^{which} they cannot afford or do not ^{really} need. ^{Any} Such a remedy for this alleged evil should not detract from the enforceability of valid contracts ^{and a} or proper respect for them.

2.2.11 Having set the scene of a society confronted with an abundance of credit facilities, we should also perhaps accept that society should not attempt to absolve itself from ^{any} blame and responsibility for the plight of the insolvent debtor. In the main, debts are incurred through

the voluntary granting of credit, and there can be no doubt, as we have seen, that the social climate today, with its emphasis on the acquisition of goods and the use of leisure services, is geared to ^{exert} constant pressure on individuals to borrow, with too little thought ^{being} given to the borrower's ability to make a financially rational decision.

2.2.12 For society in general, the fact that more than 600 private individuals not concerned with trade as an occupation can find themselves embroiled in one year in the ultimate stage of the insolvency process is a collective disaster, at least as great as the sum of the individual misfortunes. The insolvent debtor and his dependants can become a charge upon the State in terms of ^{the} financial and material assistance required to maintain the minimum standard of living which society undertakes to provide. Exposure to the processes of the insolvency law can reduce the dynamic forces which motivate the human resources of the community, and undue effort and attention tends to be diverted from more productive activities to resolving the aftermath of financial collapse.

2.2.13 The business of lending and borrowing dates from the very beginning of social intercourse, and consumer credit can be traced almost from the separation of the consumer function from that of the producer, which began to take place in the Middle Ages. ^{so far as European societies are concerned} ^{in the British Isles}

date and source of statistics

2.2.14 In the present century, we have witnessed a rapid expansion from the most basic forms of consumer credit in the form of pawnbroking, ^{"tally-men"} and money-lending to instalment credit offered by retailers and the massive development into the area of hire-purchase. We have lived through a sudden surge ~~of~~ ^{in the} demand for motor cars, which has spilled over into the market for all kinds of consumer goods. ~~All of which~~ ^{such transactions} require personal finance over periods of two and three years, which ~~are~~ ^{almost invariably} beyond the capacity of retailers ^{themselves} to provide, and as a result we have seen the development of the large-scale finance houses. ⁱⁿ ~~Of~~ recent years, we have seen the establishment of "in-house finance" schemes by manufacturers themselves facilitating the sale of their own products, ^{another} ~~and a~~ very important field of credit supply today, both in terms of the volume of business ^{done,} and the insolvency problems which arise therefrom, is that provided by the many mail-order houses which have grown up over the past twenty years.

For a considerable period, the Clearing Banks

2.2.15 ~~The banks~~ preserved a certain aloofness towards direct involvement in consumer finance until the mid to late 1950's, when the introduction of such schemes as "personal loans" and the acquisition by banks of ^{holdings} interests in finance companies signalled a further element in the growth of sources of

personal finance freely available to consumers. *We may trace the mushrooming of finance hire purchase finance, finance-houses and even the ill-starred "secondary banking" to the reluctance of the Clearing Banks to involve themselves in those fields of*

2.2.16 Since the mid-1960's, we have ^{experienced} the mercurial growth of the credit-card business in its various forms which yet again has vastly expanded the range of credit available to almost all and sundry. The individual ^{confronted} is thus faced today with a bewildering array of avenues of insolvency with little overall control, apart from his own ^{personal honesty and prudence} innate sense of survival.

*repetition?
21.85*

and the protection afforded by the operation of the

Consumer Credit Act of 1974, when finally and completely brought into force. ^{It is perhaps regrettable that, so far as we are aware, our public educational system provides for no training in this important aspect of life, the handling of credit.}

2.2.17 Whilst the opportunities for contracting debt have become

more numerous and varied, the law governing insolvency has been surprisingly static, perhaps reflecting ^{a sense of the need present need} the desire for substantive reform, rather than ^{for a further} tinkering with existing laws which could only lead to more confusion and difficulty.

full title?

2.2.18 As we shall see later, the "Blagden Committee" which reported

in 1957 ^{pronounced itself} was satisfied with the basic structure of the bankruptcy laws ^(which were ^{of course} the sole concern); but the rapid expansion in consumer spending and credit and the considerable overall changes in the social and economic structure of society has ^{in our opinion} rendered the updating of the present old laws ^{now absolutely essential;} ^{initial and} more necessary and certain most useful ^{initial} steps have already been taken in the terms of the Insolvency Act of 1976, which amend ^{some of} the provisions of the 1914 Act, ^{and} bringing them more into line with the liberal social climate in which we now live.

2.2.19 Bearing in mind the responsibility which devolves on society

for the present state of affairs in ^{all} the areas of insolvency, we should ^{apply ourselves initially} look to attempting to ensure a fair distribution of a debtor's assets among his creditors, and whilst revised legislation must punish the dishonest ^{debtor} insolvent who attempts to take ^{an anti-social} advantage of the system, it must at the same time embody a system of law which enables the honest but unfortunate, and in many cases bewildered borrowers, overstretched and ill-informed, to extract themselves from hopeless debt

situations which they ^{can} never put right. We should not lose sight of the fact that in many instances the debtor, recognising his difficulties and his duty to society, may well have started the whole legal process ^{of} petitioning for his own bankruptcy as ^{what is really} an appeal for help.

2.2.20 The costs to all those involved in bankruptcy are considerable, and there are immense and far-reaching problems associated with the whole social process which cannot be ^{easily} quantified, ~~in any~~ way.

2.2.21 The economic and social implications are such, therefore, that we must endeavour to provide a background which gives the creditor the confidence to lend, whilst at the same time does not deter the potential debtor from making a reasonable decision to borrow.

2.2.22 The foregoing material shows that society, and through society the legislature, has ^{at} all times ^{a duty} in this field to maintain a just balance between the creditor on the one hand and the debtor on the other; ^{this} a balance, as we have endeavoured to show in other parts of this report, ^{which has} shifted first one way and then the other over the centuries. But it must be borne in mind throughout that it is the creditor, be he large or small, who possesses the capital ^{which}, in the aggregate, is the capital of society as a whole, ^{to} which the debtor seeks access for purposes beneficial initially to himself, secondly to the creditor in providing him with a market for his capital and, ultimately, ^{to} ~~for~~ society as a whole.

2.2.23 These intricate relationships need to be policed with a combination of ^{firmness, fairness and} benevolence and fairness, so that the readiness to lend is balanced by a reasonable ground for borrowing, and that those who offend against the ground rules, whether they be unconscionable creditors or unconscionable debtors, are suitably restrained and made to conform to the standards which society has ^{thought} thought fit to lay down from time to time.

(3) Statistics

update
2.3.1 Figures produced by the Department of Trade for 1977, the first full year since the Insolvency Act ^{in bankruptcy} of 1976, reveal that 4,095 Receiving Orders were made. The estimated liabilities in these failures amount to £105M and the estimated value of the assets £16M.

2.3.2 Under the heading of "Employees, No Occupation and Unemployed", there were 623 Receiving Orders with liabilities of £4.7M and assets of £1.2M.

fraction outside Counties?
2.3.3 Of the total of just over 4,000 Receiving Orders in 1977, 2,867 were administered as "summary cases", that is to say, ^{the} under the 1976 Act, ^{the} cases in which estimated assets were less than £4,000 each. At the end of the process, out of every £1 of net assets realised in cases where the Official Receiver was Trustee, 53.1p was accounted for by administrative expenses, 16.3p was paid to preferential creditors, and 30.6p distributed to unsecured creditors.

[1978 or 1979 statistics will be substituted when available]

how many tax notes Gov. Dept?