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THE CORK REPORT - DRAFT 2.

CHAPTER 3.

SUMMARY

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(2) Brief survey of bankruptcy and insolvency laws to 1883.

(3) The modern bankruptcy system.

(4) Deeds of Arrangement.

(5) The Administration Order procedure.

(6) The winding-up of companies.

(7) The Receiver and Manager.

CHAPTER 3.

HISTORICAL BACKGROUND

(1) General.

3.1.1. No comprehensive statement of insolvency law in England and Wales exists. Instead there is a patchwork of materials dealing with the subject, consisting of legislation such as the Bankruptcy Act, 1914, the Deed of Arrangement Act, 1914, parts of the Companies Act, 1948, and parts of the County Courts Act, 1959; all this has to be supplemented by the principles of common law and equity as illustrated by caselaw and as discussed in the text books.

3.1.2. The framework of the present regime was established during the second half of the 19th century. It has remained intact ever since with no more than a few minor modifications. The Victorian attempts to deal with the subject were manifold; indeed, between the end of the Napoleonic Wars and the end of the century there were well over 50 Acts of Parliament dealing with the subject of insolvency. This concern merely followed a pattern which had been going on for many generations. Each new wave of legislation was usually prompted by some economic crisis or grave business scandal (such as the South Sea Bubble in the early part of the 18th century) or by a desire to mitigate some of the harsher features of the law.

3.1.3. Most of the issues with which we are confronted today have in one form or another been debated in previous centuries. Three examples may? will suffice:

(i) At the beginning of the 17th century Parliament introduced measures, in the shape of the doctrine of reputed ownership, which were aimed at curing problems similar to those created nowadays by the practice of certain suppliers reserving title to goods delivered until payment has been made, i.e. the Romalpa question;

(ii) At the beginning of the 19th century public opinion was greatly disturbed at the harsh treatment received by a large number of insolvent debtors whose affairs were not amenable to the bankruptcy laws;

(iii) At the beginning of the 20th century a departmental committee investigating company law gave close scrutiny to the impact of the floating charge, at that time no more than about 40 years old, upon the prospects of the unsecured creditors of obtaining any dividend in the liquidation of an insolvent company.

3.1.4. The great difference between our present deliberations and all previous discussions of the subject is that we are expressly directed to study the field of insolvency law as a whole, dealing with the corporate as well as the non-corporate debtor together. All previous inquiries have been piecemeal and limited in their ambit.

3.1.5. The roots of insolvency law are embedded deep in our legal, social and economic history. It has always been recognised that the topic is one which touches or might touch on most aspects of commercial law in the sense that there was always a risk that all merchant contracts might at one time or another fall to be investigated by the Bankruptcy Courts. It was indeed claimed, with some justification, in the early part of the 19th century that "the system of the bankrupt law now forms the most extensive and important branch of the

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3.1.7. Seizure of the debtor's assets was initiated by each creditor separately; there was no machinery for any collective form of execution and for sharing the expenses amongst a number of creditors; furthermore, a practical difficulty arose from the fact that there was no machinery for inquiring as to the nature of the debtor's assets. The system had the effect of giving the race for assets to the swift, the rule being "first come, first served".

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3.1.11. With the great expansion of economic activity flowing from the Industrial revolution the principle was increasingly recognised that commerce was built on great credits and that great credits produced great debts. It followed that, owing to the risks arising from these and other circumstances, the most diligent and honorable merchant might be ruined without committing any fault; if he had conducted himself honestly towards his creditors, had made a full disclosure, and delivered up all his property to be divided amongst them, in satisfaction of their debts as far as it would extend, it was regarded as equally reasonable that in such a case his creditors should

> "Release him from a strict and rigid performance of engagements, which, without fraud, and only through the casualties incident to trade, he has been disabled, completely to fulfil."

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(2) A brief survey of Bankruptcy and Insolvency Laws to 1883.

3.2.1. At an early stage the trading community demanded reforms. The first English Bankruptcy Act, upon whose foundations the great edifice of Bankruptcy Law was to be constructed over the next three centuries, was passed in 1542 during the Reign of Henry VIII. It was aimed at the absconding debtor, namely, those persons who -

> "....... craftily obtaining into their hands great substance of other men's goods, do suddenly flee to parts unknown, or keep their houses, not minding to pay or restore to any their creditors, their duties, but at their own wills and pleasures consume debts and the substance obtained by credit of other men, for their own pleasure and delicate living, against all reason, equity and good conscience."

3.2.2. There followed a spate of legislation in 1571, during the Reign of Queen Elizabeth I, which enabled the Lord Chancellor at the suit of a creditor, to order the seizure of the assets of an absconding trader and to provide for the distribution of the proceeds of sale amongst his creditors, "a portion, rate and rate alike, according to the quantity of their debts". This Elizabethan legislation also included provisions for the setting aside of fraudulent conveyances, provisions which in their original form remained vigorously alive and part of our law for over 350 years, being finally replaced in 1925 by a modern but, in some respects, less satisfactory substitute.

3.2.3. This system of equitable distribution of the assets amongst the creditors, in such sharp contrast to the procedures at common law, was confined to traders in the sense above described. Until the 19th century there were no provisions for a trader to apply of his own accord to the Court to be made bankrupt, nor could the non-trader debtor apply for any equivalent relief from the burden of the claims of his creditors generally. In this sense the earlier Bankruptcy Acts were creditor-orientated, showing little concern for the debtor, other than that he should surrender all his property and be punished for any fraud. It was not until 1705 that discharge from bankruptcy in any real sense was made possible. Indeed, as if to make up for this apparent relaxation, the fraudulent trader, who had become bankrupt, faced the death penalty. It is reported that in November 1761 a bankrupt was hanged in Smithfield for concealing part of his effects.

3.2.4. The penal side of the legislation, imposing what is still widely referred to as "the stigma of bankruptcy" seems to have been motivated by desire to maintain acceptable standards of conduct in the commercial community, such as honest and fair dealing and the keeping of adequate books of account from which a true picture of a trader's affairs could be ascertained, by means of disciplinary proceedings against any defaulters. Such defaulters must forfeit the privileges of and incidental to earning their livelihood in commercial society whose structure and fabric had been put at risk by any trader who failed to fulfil his commitments. That society was well aware of the chain reaction and consequences which might ensue when a business collapsed, not only upon the affairs of fellow-traders, but also upon the livelihood of employees or apprentices, as well as their families, who might become a charge upon the poor law. Such dislocation to the system might require more or less severe measures of punishment as a deterrent to other traders.[5]

~~3.2.5. Meanwhile, the plight of non-trader debtors was becoming increasingly more harsh and severe.~~ The Bankruptcy Laws were in large measure used as the medium for carrying out these disciplinary functions.

3.2.5. The upshot of the Bankruptcy Legislation, confined to traders, was that as a matter of law bankruptcy and insolvency were two quite distinct situations, though frequently confused. A person who was insolvent might never become a bankrupt, or indeed be capable of becoming so; and a bankrupt might finally prove to be solvent.

3.2.6. Meanwhile The plight of the non-trader debtor became increasingly more harsh and severe. The inhumanity of the situation whereby a creditor could so easily have his debtor sent to prison, which was described at the end of the 18th century as the English equivalent of the slave trade, was also noted in more enlightened circles for its futility. One author summed up the matter as follows :

> "On the one hand, imprisonment is not always effectual to force payment from an obstinate and fraudulent debtor; while, on the other, he whose insolvency may have arisen only from accident and misfortune, may still be detained in prison by a rigorous creditor, though he has nothing left wherewith to satisfy the debt."

3.2.8. This severity was to some extent mitigated by the establishment in 1813 of a Court for the relief of insolvent debtors. This system, in one shape or another, remained in existence until 1861 when it was abolished; thenceforward non-traders, as well as traders, have been amenable to the Bankruptcy Acts.

3.2.9. The machinery of the insolvent debtors court is, however, not without interest since it is a direct ancestor of what is now known as the Administration Order procedure in the County Court. By the middle of the 19th century it was possible for any person, not being a trader or, if a trader, but owing debts amounting in the whole to less than £300, to present "a petition for protection from process". The debtor annexed to his petition a schedule of his debts and upon the presentation of the petition it was open to the court to give protection to the petitioner from the following :

> "all process whatever, either against his person or his property of every description, which protection shall continue in force, and all process be stayed, until the appearance of the petitioner in court....".

3.2.10. A debtor, in respect of whose affairs an interim order for protection had been made, was given protection not only from process, but also from being detained in prison at the suit of a judgment creditor. If, in due course, it appeared to the court that the debtor had made out a prima facie case for relief, a final order could be made which might involve the vesting of the debtor's property in a trustee, as well as provisions for the discharge of his debts, either in full or partially, from any after-acquired income or earnings. The power to make such a final order, however, could only be exercised where the court was satisfied that the debts of the petitioner had not been contracted by any manner of fraud or breach of trust and an order could also be refused if the debtor, at the time of becoming indebted, was without "reasonable assurance of being able to pay the debts".

3.2.11. The power of the courts to imprison debtors were in any event themselves drastically curtailed by the Debtor Act 1869, though they were not then entirely abolished. It was the almost unanimous opinion of the County Court Judges that the ability to commit judgment debtors to prison should be continued if an order for the non-payment of money was to have any real efficiency. Accordingly, provisions were enacted to enable the Judges to commit to prison a debtor, who had the means to pay, but who was recalcitrant and refused to do so.

3.2.12. Side-by-side with the process of alleviating the position of the non-trading debtor, considerable efforts were also being made throughout the 19th century to reform the Bankruptcy Laws strictly so called. The first attempts were made in 1825 followed, during the next 60 years, by an almost constant re-assessment of the position. The many shifts in policy need only be briefly described. Before 1831 it was the creditors who virtually had the full control over the administration of bankrupt estates. Apart from the abuses to which this gave rise, such as the disposal of assets at a gross undervalue, the system was generally considered to be in a state of chaos and gave rise to general dissatisfaction.

3.2.13. In 1831 the predominant role of the creditors in the administration of bankrupt estates was reduced by the appointment of officers known as Official Assignees who were attached to the London Bankruptcy Court, but not to the Courts in the Provinces. However, this new system was by no means free from corruption and was itself finally abolished in 1869. Nonetheless, the concept of some form of official control over bankrupt estates was re-examined in consequence of the scandals which were associated with the administration of bankrupt estates during the period from 1869 to 1883.

3.2.14. The effect of the Bankruptcy Act of 1869 was that the debtor and his creditors were the only parties concerned in a bankruptcy. This system had been introduced at the insistence of the commercial community but, in practice, it proved to be a disaster and failed to obtain public confidence. It was said that bankruptcy had become entirely a matter of private concern and had degenerated into a scramble between the debtor and his advisers - often his confederates - on the one hand, and the creditors on the other. The public interest was entirely ignored. Particular abuses stemmed from the fact that it was all too easy for a minority of creditors to control and manipulate the administration of an estate in their own interests to the prejudice of the majority of creditors. The chorus of condemnation for the system became more intense with a series of cases where the assets in the estate had been misappropriated by the trustee.

(3) <u>The modern bankruptcy system</u>.

3.3.1. The Bankruptcy Act, 1883, was the direct response to and a reaction away from recent public dissatisfaction with the administration of bankrupts' estates. The guidelines which the new Act followed must be understood in this light. On moving the second reading of the Bill, Mr. Joseph Chamberlain, the President of the Board of Trade, referred to the principles of bankruptcy law as follows :

> "Every good bankruptcy law must have in view two main, and at the same time, distinct objects. Those objects were:
>
> <u>First</u> the honest administration of bankrupts estates, with a view to the fair and speedy distribution of the assets among the creditors whose property they were;
>
> <u>Secondly</u>, following the idea that prevention is better than cure, to do something to improve the general tone of commercial morality, to promote honest trading, and to lessen the number of failures.
>
> In other words, Parliament had to endeavour, as far as possible, to ~~detect~~ protect the salvage and to diminish the number of wrecks."

3.3.2. Apart from stamping out abuses in relation to the realisation and distribution of the assets, which it was alleged had favoured "that class of the community which lived by preying upon bankrupt estates at the expense of creditors

and debtors
alike", the provisions of the new Act were designed to ensure that an impartial and independent examination into the causes of each bankruptcy should be undertaken, as well as the conduct of each bankrupt. Previously, any such investigation had bee perfunctory and inadequate; since the burden of carrying it out was thrown upon the creditors they had been obliged to undertake "a public duty at their private charge". Finally, the Act was intended to deal more severely with the punishment of misconduct which previously, however grievous, had been altogether inadequate, being handled, not by responsible public authorities, but by the creditors themselves who, in many cases, "might be interested in hushing up questions which they were expected to investigate or who, at any rate, might not be willing to throw good money after bad".

3.3.3. Accordingly, an essential feature of the thought processes underlying the Bankruptcy Act, 1883, is that, although insolvency is not necessarily a crime, yet it indicates a state of things which require public explanation and inquiry. Although bankruptcy might occur in circumstances beyond the debtor's control or by unavoidable misfortune, or without any misconduct on his part, nonetheless it was considered that such persons ought to be the first to desire and claim a full inquiry into the circumstances of their cases "in order that they might go again into the world acquitted, by the verdict of a competent court, of anything which would cast a stigma upon their character".

3.3.4. The public official by whom the investigative process would be carried out was to be the Official Receiver who would act under the directions of a responsible Government Department namely the Board of Trade, giving rise to responsibility to

Parliament. The cost of administering the new system was to be met from several sources:

(i) A fee of £5 was to be levied on each bankruptcy petition, (as had been the case under the old law;

(ii) A small percentage would be payable upon the assets collected;

(iii) The interest on the amounts which, instead of being kept in the hands of trustees as previously, would be paid to the Bank of England.

3.3.5. The machinery for dealing with bankruptcy matters created by the Act of 1883 is essentially that in force today and will be described in detail in a later chapter. An essential new principle to which it gave effect was to recognise that bankruptcy is a matter which, indirectly, if not directly, affects the community at large. The Act accordingly provided that in <u>all</u> proceedings under it, whether they terminated in bankruptcy proper, or in a composition or scheme of arrangement, the debtor should have his affairs investigated and reported upon by the Official Receiver and should undergo a public examination, that was a "turnstyle through which every insolvent debtor must pass". Whether he would be allowed to enter into a composition or to obtain a discharge would depend on the result of those investigations into his previous conduct.

3.3.6. / Further paragraphs will bring the position up to date, including the Insolvency Act, 1976 /

(4) <u>Deeds of Arrangement</u>

3.4.1. / A brief history of this system will be given, emphasising that it involves a voluntary arrangement between a debtor and his creditors, as opposed to the compulsory nature of court proceedings. It enabled the creditors, with the consent of the debtor, to run his business, e.g. through a letter of licence. The Act of 1887 was a natural concomitant of the Bankruptcy Act, 1883, The Deed of Arrangement Act, 1914, introduced a note of court control over Deeds of Arrangement. The Deed of Arrangement is in effect a method whereby a debtor can contract out of the public inquiry system of the 1883 Act./

(5) <u>The Administration Order procedure.</u>

3.5.1. The Act of 1883 expressly provided for one important category of cases where the insolvent debtor would be dealt with otherwise than under the strict provisions of that Act. By Section 122 of the Act of 1883, where a judgment had been obtained in a County Court and the Debtor was unable to pay the amount forthwith, and alleged that his whole indebtedness amounted to a sum not exceeding £50, inclusive of the debt for which the judgment was obtained, the County Court was given power to make an order providing for the administration of his estate, and for the payment of his debts by instalments or otherwise, and either in full or to such extent as to the County Court under the circumstances of the case appeared practicable, and subject to any condition as to his future earnings or income which the Court might think just.

3.5.2. A separate set of rules, quite distinct from the Bankruptcy Rules themselves, was introduced to deal with the Administration Order procedure. The Administration Order Rules were published separately, partly because they related to all County Courts (unlike the Bankruptcy Rules), whether such courts had bankruptcy jurisdiction or not, and partly

because they affected "the very poor" and it was felt desirable that the persons they affected should be able to obtain them as cheaply as possible.

3.5.3. With the introduction of the Administration Order procedure, it was hoped that resort to imprisonment to secure payment of small debts would be much rarer and a loose discretion would be vested in the County Court Judge to arrange for the relief of the small debtor by reasonable composition.

3.5.4. Some indication as to the social purpose which the Administration Order procedure was intended to serve is shown by the fact that the court was enjoined, in determining whether the debtor should pay his debts in full or to any less extent, to take into consideration not only the circumstances under which the indebtedness was incurred and whether there had been any fraud on his part, but also whether the debtor had been guilty of "idleness, improvidence, gambling or intemperance".

3.5.5. Provisions relating to administration orders were contained in the Bankruptcy Act, 1914, but by the County Courts Act, 1934, they were transferred to the latter Act, though the ceiling for the jurisdiction was continued at £50, as it had been fixed in 1883. With the decline in the value of money, this meant that the procedure became more and more obsolete, with the result that the affairs of the "very poor" where insolvent became increasingly, if collective proceedings were required, to be dealt with under the more severe provisions of the Bankruptcy Act. To this extent the purpose of the 1883 Act was being frustrated. The ceiling for the jurisdiction was increased by the Administration of Justice Act, 1965, to £300, with power to increase by appropriate statutory instrument as occasion requires. The ceiling since 1977 has been £2,000. [The effect of the Insolvency Act 1976.]

(6) Winding-Up of Companies.

3.6.1. / The material is now available to give a brief account of the growth of the winding-up system particularly in the second half of the 19th century, leading to the introduction, as late as 1929, of a specifically creditors voluntary liquidation; until then the interests of the creditors were only grudgingly recognised in a voluntary liquidation; the alternatives were a compulsory liquidation (which the creditors could bring about), a voluntary liquidation (which was the sole responsibility of the shareholders), or a hybrid in the shape of a voluntary liquidation under the supervision of the court.

3.6.2. Prior to the 19th century Reforms the system was really one of "great unincorporated partnerships" carrying out extensive business and industrial activities. The absence of any highly developed doctrine of limited liability of shareholders meant that a creditor would bring proceedings against one shareholder, leaving him to do his best to obtain contribution from as many of his fellows as possible.

3.6.3. The Official Receiver system of investigation was introduced into compulsory liquidations in 1890. Insofar as it was ever intended that the system should be conducted on the analogy of the bankruptcy system, with a public examination in all cases, this was soon frustrated by decisions of the Court of Appeal and the House of Lords in 1892 and 1896, confining the public examination to cases where the Official Receiver could establish a prima facie case of fraud. /

(7) The Receiver and Manager

3.7.1. / The floating charge over future assets was devised in the 1860's and giving the blessing of the Court of Appeal in a case in 1870. Its impact on creditors was soon realised and the Crown retaliated by the forerunner of Section 94 introduced in 1898.

3.7.2. The Departmental Committee reporting in 1906 has a great deal to say about the propriety of the floating charge. The majority took the view that it had become an integral part of company finance and could not be abolished. There was, however, a note of dissent.

3.7.3. The upshot was the introduction of the forerunner of Section 322, with a relation-back period of 3 months, by the increased by subsequent Acts.

3.7.4. The history under sub-section (6) above will deal with the introduction of the fraudulent trading provisions in 1929. Something will be said about the reforms in 1948 and 1976./

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3.2.4. The penal side of the legislation, imposing what is still widely referred to as "the stigma of bankruptcy" seems to have been motivated by desire to maintain acceptable standards of conduct in the commercial community, such as honest and fair dealing and the keeping of adequate books of account from which a true picture of a trader's affairs could be ascertained, by means of disciplinary proceedings against any defaulters. Such defaulters must forfeit the privileges of and incidental to earning their livelihood in commercial society whose structure and fabric had been put at risk by any trader who failed to fulfil his commitments. That society was well aware of the chain reaction and consequences which might ensue when a business collapsed, not only upon the affairs of fellow-traders, but also upon the livelihood of employees or apprentices, as well as their families, who might become a charge upon the poor law. Such dislocation to the system might require more or less severe measures of punishment as a deterrent to other traders.

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3.2.5. The upshot of the Bankruptcy Legislation, confined to traders, was that as a matter of law bankruptcy and insolvency were two quite distinct situations, though frequently confused. A person who was insolvent might never become a bankrupt, or indeed be capable of becoming so; and a bankrupt might finally prove to be solvent.

3.2.6. Meanwhile The plight of the non-trader debtor became increasingly more harsh and severe. The inhumanity of the situation whereby a creditor could so easily have his debtor sent to prison, which was described at the end of the 18th century as the English equivalent of the slave trade, was also noted in more enlightened circles for its futility. One author summed up the matter as follows :

> "On the one hand, imprisonment is not always effectual to force payment from an obstinate and fraudulent debtor; while, on the other, he whose insolvency may have arisen only from accident and misfortune, may still be detained in prison by a rigorous creditor, though he has nothing left wherewith to satisfy the debt."

3.2.9. This severity was to some extent mitigated by the establishment in 1813 of a Court for the relief of insolvent debtors. This system, in one shape or another, remained in existence until 1861 when it was abolished; thenceforward non-traders, as well as traders, have been amenable to the Bankruptcy Acts.

3.2.8. The machinery of the insolvent debtors court is, however, not without interest since it is a direct ancestor of what is now known as the Administration Order procedure in the County Court. By the middle of the 19th century it was possible for any person, not being a trader or, if a trader, but owing debts amounting in the whole to less than £300, to present "a petition for protection from process". The debtor annexed to his petition a schedule of his debts and upon the presentation of the petition it was open to the court to give protection to the petitioner from the following :

> "all process whatever, either against his person or his property of every description, which protection shall continue in force, and all process be stayed, until the appearance of the petitioner in court....".

3.2.9. A debtor, in respect of whose affairs an interim order for protection had been made, was given protection not only from process, but also from being detained in prison at the suit of a judgment creditor. If, in due course, it appeared to the court that the debtor had made out a prima facie case for relief, a final order could be made which might involve the vesting of the debtor's property in a trustee, as well as provisions for the discharge of his debts, either in full or partially, from any after-acquired income or earnings. The power to make such a final order, however, could only be exercised where the court was satisfied that the debts of the petitioner had not been contracted by any manner of fraud or breach of trust and an order could also be refused if the debtor, at the time of becoming indebted, was without "reasonable assurance of being able to pay the debts".

3.2.10. The power of the courts to imprison debtors were in any event themselves drastically curtailed by the Debtor Act 1869, though they were not then entirely abolished. It was the almost unanimous opinion of the County Court Judges that the ability to commit judgment debtors to prison should be continued if an order for the non-payment of money was to have any real efficiency. Accordingly, provisions were enacted to enable the Judges to commit to prison a debtor, who had the means to pay, but who was recalcitrant and refused to do so.

3.2.11. Side-by-side with the process of alleviating the position of the non-trading debtor, considerable efforts were also being made throughout the 19th century to reform the Bankruptcy Laws strictly so called. The first attempts were made in 1825 followed, during the next 60 years, by an almost constant re-assessment of the position. The many shifts in policy need only be briefly described. Before 1831 it was the creditors who virtually had the full control over the administration of bankrupt estates. Apart from the abuses to which this gave rise, such as the disposal of assets at a gross undervalue, the system was generally considered to be in a state of chaos and gave rise to general dissatisfaction.

3.2.13. In 1831 the predominant role of the creditors in the administration of bankrupt estates was reduced by the appointment of officers known as Official Assignees who were attached to the London Bankruptcy Court, but not to the Courts in the Provinces. However, this new system was by no means free from corruption and was itself finally abolished in 1869. Nonetheless, the concept of some form of official control over bankrupt estates was re-examined in consequence of the scandals which were associated with the administration of bankrupt estates during the period from 1869 to 1883.

3.2.14. The effect of the Bankruptcy Act of 1869 was that the debtor and his creditors were the only parties concerned in a bankruptcy. This system had been introduced at the insistence of the commercial community but, in practice, it proved to be a disaster and failed to obtain public confidence. It was said that bankruptcy had become entirely a matter of private concern and had degenerated into a scramble between the debtor and his advisers - often his confederates - on the one hand, and the creditors on the other. The public interest was entirely ignored. Particular abuses stemmed from the fact that it was all too easy for a minority of creditors to control and manipulate the administration of an estate in their own interests to the prejudice of the majority of creditors. The chorus of condemnation for the system became more intense with a series of cases where the assets in the estate had been misappropriated by the trustee.

(3) <u>The modern bankruptcy system</u>.

3.3.1. The Bankruptcy Act, 1883, was the direct response to and a reaction away from recent public dissatisfaction with the administration of bankrupts' estates. The guidelines which the new Act followed must be understood in this light. On moving the second reading of the Bill, Mr. Joseph Chamberlain the President of the Board of Trade, referred to the principles of bankruptcy law as follows :

> "Every good bankruptcy law must have in view two main, and at the same time, distinct objects. Those objects were:
>
> <u>First</u> the honest administration of bankrupts estates, with a view to the fair and speedy distribution of the assets among the creditors whose property they were;
>
> <u>Secondly</u>, following the idea that prevention is better than cure, to do something to improve the general tone of commercial morality, to promote honest trading, and to lessen the number of failures.
>
> In other words, Parliament had to endeavour, as far as possible, to ~~detect~~ protect the salvage and to diminish the number of wrecks."

3.3.2. Apart from stamping out abuses in relation to the realisation and distribution of the assets, which it was alleged had favoured "that class of the community which lived by preying upon bankrupt estates at the expense of creditors

and debtors

alike", the provisions of the new Act were designed to ensure that an impartial and independent examination into the causes of each bankruptcy should be undertaken, as well as the conduct of each bankrupt. Previously, any such investigation had bee perfunctory and inadequate; since the burden of carrying it out was thrown upon the creditors they had been obliged to undertake "a public duty at their private charge". Finally, the Act was intended to deal more severely with the punishment of misconduct which previously, however grievous, had been altogether inadequate, being handled, not by responsible public authorities, but by the creditors themselves who, in many cases, "might be interested in hushing up questions which they were expected to investigate or who, at any rate, might not be willing to throw good money after bad".

3.3.3. Accordingly, an essential feature of the thought processes underlying the Bankruptcy Act, 1883, is that, although insolvency is not necessarily a crime, yet it indicates a state of things which require public explanation and inquiry. Although bankruptcy might occur in circumstances beyond the debtor's control or by unavoidable misfortune, or without any misconduct on his part, nonetheless it was considered that such persons ought to be the first to desire and claim a full inquiry into the circumstances of their cases "in order that they might go again into the world acquitted, by the verdict of a competent court, of anything which would cast a stigma upon their character".

3.3.4. The public official by whom the investigative process would be carried out was to be the Official Receiver who would act under the directions of a responsible Government Department namely the Board of Trade, giving rise to responsibility to

Parliament. The cost of administering the new system was to be met from several sources:

(i) A fee of £5 was to be levied on each bankruptcy petition, as had been the case under the old law;

(ii) A small percentage would be payable upon the assets collected;

(iii) The interest on the amounts which, instead of being kept in the hands of trustees as previously, would be paid to the Bank of England.

3.3.5. The machinery for dealing with bankruptcy matters created by the Act of 1883 is essentially that in force today and will be described in detail in a later chapter. An essential new principle to which it gave effect was to recognise that bankruptcy is a matter which, indirectly, if not directly, affects the community at large. The Act accordingly provided that in <u>all</u> proceedings under it, whether they terminated in bankruptcy proper, or in a composition or scheme of arrangement, the debtor should have his affairs investigated and reported upon by the Official Receiver and should undergo a public examination, that was a "turnstyle through which every insolvent debtor must pass". Whether he would be allowed to enter into a composition or to obtain a discharge would depend on the result of those investigations into his previous conduct.

3.3.6. ∠ Further paragraphs will bring the position up to date, including the Insolvency Act, 1976 /

(4) <u>Deeds of Arrangement</u>

3.4.1. ∠ A brief history of this system will be given, emphasising that it involves a voluntary arrangement between a debtor and his creditors, as opposed to the compulsory nature of court proceedings. It enabled the creditors, with the consent of the debtor, to run his business, e.g. through a letter of licence. The Act of 1887 was a natural concomitant of the Bankruptcy Act, 1883. The Deed of Arrangement Act, 1914, introduced a note of court control over Deeds of Arrangement. The Deed of Arrangement is in effect a method whereby a debtor can contract out of the public inquiry system of the 1883 Act./

(5) The Administration Order procedure.

3.5.1. The Act of 1883 expressly provided for one important category of cases where the insolvent debtor would be dealt with otherwise than under the strict provisions of that Act. By Section 122 of the Act of 1883, where a judgment had been obtained in a County Court and the Debtor was unable to pay the amount forthwith, and alleged that his whole indebtedness amounted to a sum not exceeding £50, inclusive of the debt for which the judgment was obtained, the County Court was given power to make an order providing for the administration of his estate, and for the payment of his debts by instalments or otherwise, and either in full or to such extent as to the County Court under the circumstances of the case appeared practicable, and subject to any condition as to his future earnings or income which the Court might think just.

3.5.2. A separate set of rules, quite distinct from the Bankruptcy Rules themselves, was introduced to deal with the Administration Order procedure. The Administration Order Rules were published separately, partly because they related to all County Courts (unlike the Bankruptcy Rules), whether such courts had bankruptcy jurisdiction or not, and partly

because they affected "the very poor" and it was felt desirable that the persons they affected should be able to obtain them as cheaply as possible.

3.5.3. With the introduction of the Administration Order procedure, it was hoped that resort to imprisonment to secure payment of small debts would be much rarer and a loose discretion would be vested in the County Court Judge to arrange for the relief of the small debtor by reasonable composition.

3.5.4. Some indication as to the social purpose which the Administration Order procedure was intended to serve is shown by the fact that the court was enjoined, in determining whether the debtor should pay his debts in full or to any less extent, to take into consideration not only the circumstances under which the indebtedness was incurred and whether there had been any fraud on his part, but also whether the debtor had been guilty of "idleness, improvidence, gambling or intemperance".

3.5.5. Provisions relating to administration orders were contained in the Bankruptcy Act, 1914, but by the County Courts Act, 1934, they were transferred to the latter Act, though the ceiling for the jurisdiction was continued at £50, as it had been fixed in 1883. With the decline in the value of money, this meant that the procedure became more and more obsolete, with the result that the affairs of the "very poor" where insolvent became increasingly, if collective proceedings were required, to be dealt with under the more severe provisions of the Bankruptcy Act. To this extent the purpose of the 1883 Act was being frustrated. The ceiling for the jurisdiction was increased by the Administration of Justice Act, 1965, to £300, with power to increase by appropriate statutory instrument as occasion requires. The ceiling since 1977 has been £2,000. [The effect of the Insolvency Act 1976.]

(6) <u>Winding-Up of Companies</u>.

3.6.1. ⁄ The material is now available to give a brief account of the growth of the winding-up system particularly in the second half of the 19th century, leading to the introduction, as late as 1929, of a specifically creditors voluntary liquidation; until then the interests of the creditors were only grudgingly recognised in a voluntary liquidation; the alternatives were a compulsory liquidation (which the creditors could bring about), a voluntary liquidation (which was the sole responsibility of the shareholders), or a hybrid in the shape of a voluntary liquidation under the supervision of the court.

3.6.2. Prior to the 19th century Reforms the system was really one of "great unincorporated partnerships" carrying out extensive business and industrial activities. The absence of any highly developed doctrine of limited liability of shareholders meant that a creditor would bring proceedings against one shareholder, leaving him to do his best to obtain contribution from as many of his fellows as possible.

3.6.3. The Official Receiver system of investigation was introduced into compulsory liquidations in 1890. Insofar as it was ever intended that the system should be conducted on the analogy of the bankruptcy system, with a public examination in all cases, this was soon frustrated by decisions of the Court of Appeal and the House of Lords in 1892 and 1896, confining the public examination to cases where the Official Receiver could establish a prima facie case of fraud. ⁄

(7) The Receiver and Manager

3.7.1. / The floating charge over future assets was devised in the 1860's and giving the blessing of the Court of Appeal in a case in 1870. Its impact on creditors was soon realised and the Crown retaliated by the forerunner of Section 94 introduced in 1898.

3.7.2. The Departmental Committee reporting in 1906 has a great deal to say about the propriety of the floating charge. The majority took the view that it had become an integral part of company finance and could not be abolished. There was, however, a note of dissent.

3.7.3. The upshot was the introduction of the forerunner of Section 322, with a relation-back period of 3 months, by the increased by subsequent Acts.

3.7.4. The history under sub-section (6) above will deal with the introduction of the fraudulent trading provisions in 1929. Something will be said about the reforms in 1948 and 1976./

3

INSOLVENCY LAW REVIEW COMMITTEE

Note to Members

FINAL REPORT

1 Enclosed is the next helping: 2 copies of Chapter 3 giving the historical background to insolvency law and practice. The return of one copy, giving your comments and suggested amendments would be appreciated. Of particular assistance would be suggestions concerning the matters in square brackets, ie. from paragraph 3.3.6 onwards.

2 Chapter 4 is in the pipeline.

T H Traylor

T H TRAYLOR
Secretary to the Committee
8.79

amended 8/9/79

(22.8.79)

MW

THE CORK REPORT - DRAFT 2.

CHAPTER 3.

SUMMARY

(1) General

(2) Brief survey of bankruptcy and insolvency laws to 1883.

(3) The modern bankruptcy system.

(4) Deeds of Arrangement.

(5) The Administration Order procedure.

(6) The winding-up of companies.

(7) The Receiver and Manager.

(8) The Insolvency Service [when drafted]

CHAPTER 3.

HISTORICAL BACKGROUND

(1) General.

3.1.1. No comprehensive statement of insolvency law in England and Wales exists. Instead, there is a patchwork of materials dealing with the subject, consisting of legislation such as the Bankruptcy Act, 1914, the Deeds of Arrangement Act, 1914, parts of the Companies Act, 1948, and parts of the County Courts Act, 1959; all this has to be supplemented by the principles of common law and equity, as illustrated by caselaw and as discussed in the text books.

3.1.2. The framework of the present regime was established during the second half of the 19th century. It has remained intact ever since, with no more than a few minor modifications. The Victorian attempts to deal with the subject were manifold; indeed, between the end of the Napoleonic Wars and the end of the century there were well over 50 Acts of Parliament dealing with the subject of insolvency. This concern merely followed a pattern which had been going on for many generations. Each new wave of legislation was usually prompted by some economic crisis or grave business scandal (such as the South Sea Bubble in the early part of the 18th century), or by a desire to mitigate some of the harsher features of the law.

failure of the banks and railway corps.

3.1.3. Most of the issues with which we are confronted today have in one form or another been debated in previous centuries. Three examples will suffice:

(i) At the beginning of the 17th century, Parliament introduced measures, in the shape of the doctrine of "reputed ownership", which were aimed at curing problems similar to those created nowadays by the practice of certain suppliers reserving title to goods delivered until payment has been made, i.e. the Romalpa ~~question;~~ doctrine;

(ii) At the beginning of the 19th century, public opinion was greatly disturbed at the harsh treatment received by a large number of insolvent debtors whose affairs, because they were not "traders", were not amenable to the bankruptcy laws; or

Date? name.

(iii) At the beginning of the 20th century, a Departmental Committee investigating company law gave close scrutiny to the impact of the floating charge, at that time no more than about 40 years old, upon the prospects of the unsecured creditors of obtaining any dividend in the liquidation of an insolvent company, whose assets were so charged.

3.1.4. The great difference between our present deliberations and all previous discussions of the subject is that we are expressly directed to study the field of insolvency law as a whole, dealing with the corporate debtor as well as with the non-corporate debtor ~~together~~. All previous inquiries have been piecemeal and limited in their ambit.

3.1.5. The roots of insolvency law are embedded deep in our legal, social and economic history. It has always been recognised that the topic is one which touches or might touch on most aspects of commercial law, in the sense that there was always a risk that all merchants' contracts might at one time or another fall to be investigated by the Bankruptcy Courts. It was indeed claimed, with some justification, in the early part of the 19th century, that "the system of the bankrupt law now forms the most extensive and important branch of the

or mercantile

Source.

mercantile law of the United Kingdom."

3.1.6. The old common law, stretching back to mediaeval times, was stark and uncompromising, making the position of the debtor extremely unenviable. A sharp distinction was drawn between the two principal remedies which were open to creditors: a creditor could either seize the body of his debtor or could seize the effects of his debtor, but he could not pursue both remedies ~~could not be pursued~~ at the same time; moreoever, if the body of the debtor was taken in execution, it was not possible thereafter to resort to his effects.

3.1.7. Seizure of the debtor's assets was initiated by each creditor separately; there was no machinery for any collective form of execution ~~and~~ or for sharing the expenses amongst a number of creditors; furthermore, a practical difficulty arose from the fact that there was no machinery for inquiring as to the nature of the debtor's assets, nor were all his assets subject to seizure by way of common law execution. The system had the effect of giving the race for assets to the swift, the rule being "first come, first served".

3.1.8. The alternative remedy was that the debtor should be summarily arrested and thrown into prison, there to be detained at the pleasure of the creditor. In this sense, insolvency was in fact regarded as an offence, very little, if at all, less criminal than a felony, and a right to subject his debtor to a prolonged imprisonment seems to have been almost regarded as one of the natural rights of the creditor.

3.1.9. An important and far-reaching distinction was commonly made between the position of traders, i.e. persons employed in merchandising or the buying and selling of ~~in the~~ goods, including money, i.e. the business of banking, on the one hand, and non-traders such as those in employment or engaged in a profession or, indeed, landowners and farmers, on the other. Non-traders were not expected to obtain ~~acquire~~, nor to have occasion to give, extensive credit. Their principal asset was likely to consist of immoveable property, and, as that expression implies, this was regarded as being "stationary". The capital of such a non-trader was regarded as being "known, visible and permanent". If, therefore, he were to take steps to put himself beyond the reach of his creditors, it was to be expected that he would be unable to make away with his assets.

3.1.10. The position of the trader was quite different. It was appreciated that the nature of his activities was such that he needed to give and to receive credit, and that his capital might largely consist of moveable property of the type "generally unknown, always uncertain, and perpetually fluctuating".

3.1.11. With the great expansion of economic activity flowing from the Industrial Revolution, the principle was increasingly recognised that commerce was built on great credits, and that great credits produced great debts. It followed that, owing to the risks arising from these and other circumstances, the most diligent and honourable merchant might be ruined without personally committing any fault; if he had conducted himself honestly towards his creditors, had made a full disclosure, and had delivered up all his property to be divided amongst them, in satisfaction of their debts as far as it would extend, it was regarded as equally reasonable that in such a case his creditors should

> "Release him from a strict and rigid performance of engagements, which, without fraud, and only through the casualties incident to trade, he has been disabled, completely to fulfil."

?

3.1.12. There, in a nutshell, are the main issues facing this Committee. How best can a distinction be drawn between the different types of debtors, ranging, at one end of the spectrum, from the large trading corporation, whose collapse might affect the livelihood of many thousands of people, all the way through to the other end of the spectrum, where a consumer in the domestic sphere finds himself in financial difficulties and is deserving of compassion and help more than anything else? How, then, are the dishonest to be punished and the innocent to be rehabilitated and, whether they are culpable or not, how best are their assets to be distributed amongst their creditors, and what proportion, if any, of their future income should be applied in satisfaction of their debts?

(2) A brief survey of Bankruptcy and Insolvency Laws to 1883.

3.2.1. At an early stage, the trading community demanded reforms. The first English Bankruptcy Act, upon whose foundations the great edifice of Bankruptcy Law was to be constructed over the next three centuries, was passed in 1542 during the reign of Henry VIII. It was aimed at the absconding debtor, namely, those persons who -

> "....... craftily obtaining into their hands great substance of other men's goods, do suddenly flee to parts unknown, or keep their houses, not minding to pay or restore to any their creditors, their duties, but at their own wills and pleasures consume debts and the substance obtained by credit of other men, for their own pleasure and delicate living, against all reason, equity and good conscience."

3.2.2. There ~~followed~~ ensued a spate of legislation beginning in 1571, during the reign of Queen Elizabeth I, which enabled the Lord Chancellor, at the suit of a creditor, to order the seizure of the assets of an absconding trader and to provide for the distribution of the proceeds of sale amongst his creditors, "a portion, rate and rate alike, according to the quantity of their debts". This Elizabethan legislation also included provisions for the setting aside of fraudulent conveyances, provisions which in their original form remained vigorously alive and part of our law for over 350 years, being finally replaced in 1925 by a modern but, in some respects, a less satisfactory substitute.

3.2.3. This system of equitable distribution of the assets amongst the creditors, in such sharp contrast to the procedures at common law, was confined to "traders" in the sense above described. Until the 19th century, there were no provisions for a trader to apply of his own accord to the Court to be made bankrupt, nor could the non-trader debtor apply for any equivalent relief from the burden of the claims of his creditors generally. In this sense, the earlier Bankruptcy Acts were creditor-orientated, showing little concern for the debtor, other than that he should surrender all his property and be punished for any fraud. It was not until 1705 that discharge from bankruptcy in any real sense was made possible. Indeed, as if to make up for this apparent relaxation, the fraudulent trader, who had become bankrupt, faced the death penalty. It is reported that in November 1761 a bankrupt was hanged in Smithfield for concealing part of his effects.

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legal title

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married women 1935

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3.2.13. In 1831, the predominant role of the creditors in the administration of bankrupt estates was reduced by the appointment of officers known as Official Assignees who were attached to the London Bankruptcy Court, but not to the Courts in the Provinces. However, this new system was also by no means free from corruption, and was itself finally abolished in 1869. Nonetheless, the concept of some form of official control over bankrupt estates was re-examined in consequence of the scandals which were associated with the administration of bankrupt estates during the period from 1869 to 1883.

3.2.14. The effect of the Bankruptcy Act of 1869 was that the debtor and his creditors were the only parties concerned in a bankruptcy. This system had been introduced at the insistence of the commercial community, but, in practice, it proved to be a disaster and failed to obtain public confidence. It was said that bankruptcy had become entirely a matter of private concern and had degenerated into a scramble between the debtor and his advisers - often his confederates - on the one hand, and the creditors on the other. The public interest was entirely ignored. Particular abuses stemmed from the fact that it was all too easy for a minority of creditors to control and manipulate the administration of an estate in their own interests to the prejudice of the majority of creditors. The chorus of condemnation for the system became more intense with a series of cases where the assets in the estate had been misappropriated by the trustee himself.

(3) The modern bankruptcy system.

3.3.1. The Bankruptcy Act, 1883, was the direct response to, and a reaction away from, ~~recent~~ current public dissatisfaction with the administration of bankrupts' estates. The guidelines which the new Act followed must be understood in this light. On moving in the House of Commons the second reading of the Bill, Mr. Joseph Chamberlain, the President of the Board of Trade, referred to the principles of bankruptcy law as follows :

Source.

> "Every good bankruptcy law must have in view two main, and at the same time, distinct objects.
> Those objects were:
> First, the honest administration of bankrupts' estates, with a view to the fair and speedy distribution of the assets among the creditors whose property they were;
> Secondly, following the idea that prevention is better than cure, to do something to improve the general tone of commercial morality, to promote honest trading, and to lessen the number of failures.
> In other words, Parliament had to endeavour, as far as possible, to protect the salvage and to diminish the number of wrecks."

3.3.2. Apart from stamping out abuses in relation to the realisation and distribution of the assets, which it was alleged had favoured "that class of the community which lived by preying upon bankrupt estates at the expense of creditors

and debtors
alike", the provisions of the new Act were designed to ensure that an impartial and independent examination into the causes of each bankruptcy should be undertaken, as well as the conduct of each bankrupt. Previously, any such investigation had bee perfunctory and inadequate; since the burden of carrying it out was thrown upon the creditors, they had been obliged to undertake "a public duty at their private charge". Finally, the Act was intended to deal more severely with the punishment of misconduct which previously, however grievous, had been altogether inadequate in severity, being handled, not by responsible public authorities, but by the creditors themselves who, in many cases, "might be interested in hushing up questions which they were expected to investigate or who, at any rate, might not be willing to throw good money after bad".

3.3.3. Accordingly, an essential feature of the thought processes underlying the Bankruptcy Act, 1883, is that, although insolvency is not necessarily a crime, yet it indicates a state of things which require public explanation and inquiry. Although bankruptcy might occur in circumstances beyond the debtor's control or by unavoidable misfortune, or without any misconduct on his part, nonetheless it was considered that such persons ought to be the first to desire and claim a full inquiry into the circumstances of their cases, "in order that they might go again out ? into the world acquitted, by the verdict of a competent court, of anything which would cast a stigma upon their character".

3.3.4. The public official by whom the investigative process would be carried out was to be "the Official Receiver" who would act under the directions of a responsible Government Department, namely the Board of Trade, giving rise to responsibility to

Parliament. The cost of administering the new system was to be met from several sources:

(i) A fee of £5 was to be levied on each bankruptcy petition, (?) as had been the case under the old law;

(ii) A small percentage would be payable upon the assets collected;

(iii) The interest on the amounts realised which, instead of being kept in the hands of the trustees as previously, would ? be paid in to the Bank of England.

3.3.5. The machinery for dealing with bankruptcy matters created by the Act of 1883 is essentially that still in force today and will be described in detail in a later chapter. An essential new principle to which it gave effect was to recognise that bankruptcy is a matter which, indirectly, if not indeed directly, affects the community at large. The Act accordingly provided that in all proceedings under it, whether they terminated in bankruptcy proper, or in a composition or scheme of arrangement, the debtor should have his affairs investigated and reported upon by the Official Receiver and and under the supervision of the Court of Bankruptcy should undergo a public examination; that was a "turnstyle through which every insolvent debtor must pass". Whether he would be allowed to enter into a composition or to obtain a discharge would depend on the result of those investigations into his previous conduct.

3.3.6. / Further paragraphs will bring the position up to date, including the Insolvency Act, 1976 /

(4) Deeds of Arrangement

3.4.1. / A brief history of this system will be given, emphasising that it involves a voluntary arrangement, by way of contrast, between a debtor and his creditors, as opposed to the compulsory nature of court proceedings. *inter alia* It enabled the creditors, with the consent of the debtor, to run his business, e.g. through a letter of licence. The Act of 1887 was a natural concomitant of the Bankruptcy Act, 1883. The Deeds of Arrangement Act, 1914, introduced a ~~note~~ *element* of court control over Deeds of Arrangement. The Deed of Arrangement is in effect a method whereby a debtor can contract out of the public inquiry system of the 1883 Act./

designed to effect equality of treatment and to suppress abuse of the system

(5) <u>The Administration Order procedure.</u>

3.5.1. The Act of 1883 expressly provided for one important category of cases where the insolvent debtor would be dealt with otherwise than under the strict provisions of that Act. By Section 122 of the Act of 1883, where a judgment had been obtained in a County Court and the Debtor was unable to pay the amount forthwith, and alleged that his whole indebtedness amounted to a sum not exceeding £50, inclusive of the debt for which the judgment was obtained, the County Court was given power to make an order providing for the administration of his estate, and for the payment of his debts by instalments or otherwise, and either in full or to such extent as to the County Court under the circumstances of the case appeared practicable, and subject to any condition as to his future earnings or income which the Court might think just.

3.5.2. A separate set of rules, quite distinct from the Bankruptcy Rules themselves, was introduced to deal with the Administration Order procedure. The Administration Order Rules were published separately, partly because they related to all County Courts (unlike the Bankruptcy Rules), whether such courts had bankruptcy jurisdiction or not, and partly

because they affected "the very poor" and it was felt desirable that the persons they affected should be able to obtain them as cheaply as possible.

Is this text consistent with 3.2.10 re imprisonment for [illegible]

3.5.3. With the introduction of the Administration Order procedure, it was hoped that resort to imprisonment to secure payment of small debts would be much rarer, and a loose discretion would be vested in the County Court Judge to arrange for the relief of the small debtor by reasonable composition.

3.5.4. Some indication as to the social purpose which the Administration Order procedure was intended to serve is shown by the fact that the court was enjoined, in determining whether the debtor should pay his debts in full or to any less extent, to take into consideration not only the circumstances under which the indebtedness was incurred and whether there had been any fraud on his part, but also whether the debtor had been guilty of "idleness, improvidence, gambling or intemperance".

3.5.5. Provisions relating to administration orders were contained in the Bankruptcy Act, 1914, but by the County Courts Act, 1934, they were transferred to the jurisdiction conferred by the latter Act, though the ceiling for the jurisdiction was continued at £50, as it had been fixed in 1883. With the decline in the value of money, this meant that the procedure became more and more obsolete, with the result that the affairs of the "very poor" where insolvent became increasingly, if collective proceedings were required, to be dealt with under the more severe provisions of the Bankruptcy Act. To this extent the purpose of the 1883 Act was being frustrated. The ceiling for the jurisdiction was increased by the Administration of Justice Act, 1965, to £300, with power to increase by appropriate statutory instrument, as occasion required. The ceiling since 1977 has been £2,000. [The effect of the Insolvency Act 1976.]

(6) Winding-Up of Companies.

3.6.1. / The material is now available to give a brief account of the growth of the winding-up system, particularly in the second half of the 19th century, leading to the introduction, as late as 1929, of a specifically creditors' voluntary liquidation; until then the interests of the creditors were only grudgingly recognised in a voluntary liquidation; the alternatives were a compulsory liquidation (which the creditors could bring about), a voluntary liquidation (which was the sole responsibility of the shareholders), or a hybrid in the shape of a voluntary liquidation under the supervision of the court.

3.6.2. Prior to the 19th century reforms the system was really one of "great unincorporated partnerships" carrying ~~out~~ on extensive business and industrial activities. The absence of any highly developed doctrine of limited liability of shareholders meant that a creditor would bring proceedings against one shareholder, leaving him to do his best to obtain contribution from as many of his fellows as possible.

3.6.3. The Official Receiver system of investigation was introduced into compulsory liquidations in 1890. Insofar as it was ever intended that the system should be conducted on the analogy of the bankruptcy system, with a public examination in all cases, this was soon frustrated by decisions of the Court of Appeal and the House of Lords in 1892 and 1896, confining the public examination to cases where the Official Receiver could establish a prima facie case of fraud._/

[illegible] the Act.

(7) The Receiver and Manager

3.7.1. [The floating charge over future assets was devised in the 1860's and first giv~~ing~~en the blessing of the Court of Appeal in a case in 1870. Its impact on creditors was soon realised, and the Crown retaliated by enacting the forerunner of the present Section 94, introduced as section of in 1898.

the approval

3.7.2. The Departmental Committee reporting in 1906 ha~~s~~d a great deal to say about the propriety of the floating charge. The majority took the view that it had become an integral part of company finance and could not be abolished. There was, however, a note of dissent. (its nature?)

3.7.3. The upshot was the introduction of the forerunner of Section 322, with a relation-back period of 3 months by the 1908 Act, increased by subsequent Acts to 6 months in 1929 and to 12 months in 1948. That is one of the most significant changes on the time scale that you can see.

3.7.4. The history under sub-section (6) will deal with the introduction of the fraudulent trading provisions in 1929. Something will be said about the reforms in 1948 and 1976.]

DRAFT REPORT: For inclusion in Part I, Chapter 3

History of Bankruptcy

1 Bankruptcy legislation in England has a long history, originating during the reign of Henry VIII in an attempt to control fraud and in order to secure an equitable distribution of the assets of an insolvent debtor. The Statute of Bankrupts, 1542 observed that "divers and sundry persons, craftily obtaining into their hands great substance of other men's goods, do suddenly flee to parts unknown, or keep their houses, not minding to pay or to restore to any their creditors their debts and duties, but at their own wills and pleasures consume the substance obtained by credit of other men for their own pleasure and delicate living, against all reason, equity and good conscience."

2 The early bankruptcy laws applied only to traders; non-traders continued to be subject to the ordinary law of debtor and creditor until 1813 when there began a series of Acts for the "Relief of Insolvent Debtors". These statutes were designed to protect debtors who were not guilty of fraud or negligence and to secure an equitable distribution of their assets among their creditors. In 1861, the law of bankruptcy was extended to include non-traders and in 1869, a consolidating Act was passed embracing most of the substantive practices and law of bankruptcy now in force.

3 The Act of 1869, however, provided what was essentially a creditors' administration and private trustees took the place of the official assignee. The abuses of creditors' administration

led to the Act of 1883 which separated the judicial and administrative functions, transferring the latter to the Board of Trade, under an Inspector General in Bankruptcy, with functions to control the appointment and work of trustees in bankruptcy.

4 The Bankruptcy Act 1883 remains the basis of modern bankruptcy administration and since that date, three Committees have submitted reports recommending amendments to the legislation.

5 The first Committee appointed in April 1906 by the Rt. Hon. David Lloyd- George, then President of the Board of Trade, presented its report in April 1908 (Report of the Departmental Committee on Bankruptcy Law Amendment) [Cmnd 4068] after carrying out a comprehensive review of the relevant Acts. The Bankruptcy Act, 1914 and the Deeds of Arrangement Act, 1914 were then enacted, consolidating and amending the earlier Bankruptcy and Deeds of Arrangement Acts.

6 It is perhaps interesting to note some of the problem areas which were specifically mentioned in the terms of reference of a committee some seventy years ago:

(a) the adequacy of provisions for investigation into the conduct of an insolvent debtor or bankrupt, and for the imposition of punishment or disabilities;

(b) the effectiveness of measures to check improper and reckless trading;

(c) the requirement for a more immediate realisation of a bankrupt's estate;

(d) after acquired property and the need to protect persons who have become creditors of the bankrupt since his bankruptcy;

(e) more stringent requirements for discharge; and

(f) more effective control of voluntary arrangements between insolvent debtors and their creditors.

7 It is true that over the years the attitude of society has mellowed, recognising for example, the humanity and advantage of a bankrupt being released from his liabilities and given an opportunity to re-establish himself with as little delay as possible. Nevertheless, we have found that most, if not all of the problems which were referred to in 1906 remain matters of concern today.

8 The second Committee was set up in June 1924 with limited terms of reference, and it reported in January 1925 (Report of the Bankruptcy Committee 1924-25) [Cmnd 2326]. The committee's attention was drawn mainly to the provisions for the discovery and punishment of offences in the Bankruptcy Act, 1914, although it did consider and report on a number of other topics. The Bankruptcy (Amendment) Act, 1926 was then enacted.

9 Again, it is interesting to note some of the matters which the second committee considered were of sufficient concern to merit inclusion in what was only a twenty page report:

(a) the heavy losses resulting from fraudulent trading and "long firm frauds";

(b) the surprising extent to which credit is given without adequate enquiries first being made;

(c) the failure by debtors to keep adequate trading records;

(d) the tendency to treat bankruptcy offences as being of a less serious character than they in truth are;

(e) the requirement for automatic discharge provisions;

(f) after acquired property and the rights of persons who became creditors after a debtor's bankruptcy; and

(g) the difficulty of proving the intention of a debtor to prefer (fraudulent preference).

10 The third Committee under the Chairmanship of His Honour Judge John Basil Blagden, was appointed in October 1955 "to consider and report what amendments are desirable in (i) the Bankruptcy Acts 1914 and 1926, more particularly in regard to the provisions relating to the discharge of bankrupts, and (ii) the Deeds of Arrangement Act 1914". That committee reported in May 1957 (Report of the Committee on Bankruptcy Law and Deeds of Arrangement Law Amendment) [Cmnd 221] that apart from the matter of discharge the basic structure of the bankruptcy law was generally sound and well suited to its purpose.

11 The Blagden Committee put forward a number of proposed amendments which they said were "designed to remove as far as possible administrative difficulties and inequalities, some of which have been inherent in a system of law which has to serve a two-fold purpose, on the one hand of protecting a bankrupt from anything in the nature of persecution by his creditors, and on the other, protecting creditors from the dishonest or fraudulent financial dealings of their debtor."

12 Successive governments have never found parliamentary time to enact what have been described as the relatively minor amendments suggested, and no amending legislation has resulted from the Blagden Report. The law relating to bankruptcy is still enacted largely in the Bankruptcy Act, 1914 and the Bankruptcy

(Amendment) Act, 1926. Minor changes have, however, resulted from the provisions of other Acts such as the Companies Act 1947, and the Powers of Criminal Courts Act, 1973 which permits the Director of Public Prosecutions to seek a Criminal Bankruptcy Order at the time of conviction in larger cases of fraud and theft. This has enabled him in suitable cases to petition in bankruptcy so that, as far as maybe, ill-gotten gains can be recovered and distributed to those who suffered loss by the fraud or theft. There has been legislation to give greater security to the employees of insolvent employers. More recently the Insolvency Act, 1976 was enacte primarily to implement the more important recommendations of a Review Team which in 1972 had reported on the management of the Insolvency Service. The main provisions of the 1976 Act increased the monetary limits relating to bankruptcy and winding-up, amended the rules relating to proof of debts and to public examinations, and introduced an automatic discharge procedure for bankrupts.

<u>The objectives of bankruptcy</u>

13 The Bankruptcy Acts exist for the following purposes:

(a) to regulate the affairs of insolvent debtors, including partnerships and the estates of insolvent debtors, providing efficient machinery whereby a debtor or his creditors may secure the transfer of the debtor's assets to an impartial person for realisation and distribution amongst the creditors;

(b) to adjudicate fairly between the creditors by providing for the protection of security and other rights and preferences and ensuring that the general body of creditors share the available estate rateably amongst themselves;

(c) to provide relief to the debtor from harassment by his creditors;

(d) to enable a bankrupt who has made a full disclosure of his affairs to obtain, with the minimum of humiliation and delay, a discharge of his liabilities and the opportunity to make a fresh start; and

(e) to discover and punish the dishonest or fraudulent debtor.

Bankruptcy procedure

14 Bankruptcy applies only to individuals and partnerships; it does not apply to companies incorporated under the Companies Act 1948 which are subject to the winding up provisions of the Companies Acts. This is not so in many other countries; the bankruptcy laws of the Continental Members of the EEC, Canada and the USA (but not Australia) apply both to physical and legal persons.

15 All bankruptcy proceedings start with a petition to the Court which may be presented by a creditor or creditors jointly, by the debtor himself, or by the legal representative of the estate of a deceased insolvent. In the case of a creditor's petition the Court will require proof that the debt or debts are not less than £200, that the debtor has committed an "act of bankruptcy" and that he is a person subject to the Bankruptcy Acts. The Court may make a receiving order against the debtor, but not adjudicate him bankrupt at that stage unless he consents.

16 A petition by the debtor himself must state that he is unable to pay his debts. The Court may make a receiving order against the debtor and at the same time an order of adjudication declaring him bankrupt.

17 Under a receiving order the Official Receiver becomes the receiver of the debtor's property. At this stage his duties are to take custody of and protect the debtor's estate, interview the debtor to enquire into his financial affairs, and to call a meeting of the creditors.

18 The creditors' meeting considers any proposal by the debtor for settling his debts either in full or by way of composition or scheme of arrangement. In the absence of acceptable proposals the creditors may decide to ask the Court to adjudge the debtor bankrupt and to appoint a person of their choice as trustee of his estate.

19 The debtor is declared bankrupt by an order of adjudication which operates to divest him of all his property and to vest it in the trustee. The trustee is then in a position to realise the assets as to distribute the proceeds among the creditors in accordance with the priorities laid down in the 1914 Act. The remedies which are normally available to creditors are extinguished and their remaining right is to prove their claims in the bankruptcy.

20 Apart from its proprietary effects, adjudication involves several unpleasant and limiting constraints and consequences for the bankrupt which are designed to ensure his co-operation in the administration of his estate, to prevent him participating in many aspects of public life, and from engaging in activities involving a high degree of trust. He may not obtain credit for £50 or over without disclosing his status, nor may he trade in a name other than that under which he was adjudicated without disclosing that name. He may not, without the leave of the Court, act as a director of a company or be concerned directly or indirectly with a company's management. He is disqualified from being elected

to or sitting in either House of Parliament. He cannot be elected to or act as a member of a local authority. He cannot act as a Justice of the Peace, hold a solicitor's practising certificate or act as a trustee in bankruptcy or of a trust estate.

21 The Official Receiver has a statutory duty to investigate the manner in which the debtor has conducted his business and to report to the Court whether the debtor may have committed a misdemeanour under the Bankruptcy Acts. This involves interviews with the debtor, examination of books of account and relevant papers and correspondence with those with whom he has had financial dealings. Until recently, a public examination of the debtor was held in open court to complete the examination of the debtor as to his conduct, dealings and property, and to set down the evidence and the circumstances leading up to and resulting in the failure. Under the Insolvency Act 1976 the Court may, upon application by the Official Receiver, make an order dispensing with the public examination of the debtor.

22 At any time after he has been adjudicated bankrupt, but not before conclusion of his public examination if not dispensed with, the bankrupt may apply for his discharge from bankruptcy. The effect of a discharge order is to release the bankrupt from all debts which were provable in the bankruptcy save for a limited number of exceptions and to free him from virtually all of the restrictions and disqualifications of a bankrupt. The discharge must be sought by the debtor himself. However, if the Court is so minded, it may make an order which will give the bankrupt an automatic discharge upon the fifth anniversary of his adjudication. If no such order has been made, the Court is

required to review the position after five years have elapsed since adjudication.

T H TRAYLOR

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INSOLVENCY LAW REVIEW

Development of English Bankruptcy Law

1. The strict law of debtor and creditor - whereby a debtor's assets were sold to pay his creditors and he was imprisoned if his debts could not be paid in full, or where a creditor could seize and hold his debtor's land as security - was adequate for primitive states of society. But it was inadequate either to deal with fraud or to ensure an equitable distribution of an insolvent debtor's assets. It often resulted in a scramble by creditors under writs of execution. Accordingly some system of administration became essential, initially for traders, and bankruptcy enactments were introduced, running side by side with the ordinary law of debtor and creditor.

2. There have been some 40 Bankruptcy Acts since the Statute of Bankrupts 1543, which was aimed at the fraudulent debtor and which cited certain acts of bankruptcy which are still extant today, in particular, those relating to the absence or departure of a debtor or to his keeping house.

3. Subsequent Bankruptcy Acts became more sophisticated and, at times, more severe, as endeavours were made to block loopholes in the law. The earliest Acts were creditor-orientated and showed little concern for the debtor, other than that he should surrender all of his property and be punished for any fraud. It was not until 1705 that discharge from bankruptcy was made possible. At the same time, as if to make up for this apparent relaxation, the fraudulent debtor faced the death penalty.

4. The 1571 Act set out the acts of bankruptcy with more precision and extended powers to examine debtors; that of 1604 dealt with the fraudulent conveyance of land, the preamble to the Act referring to "frauds and deceits daily increasing among people engaged in buying and selling". It also decreed that a debtor found guilty of perjury during his examination should stand in a

/pillory

pillory for 2 hours with his ear nailed to the pillory. Release was effected by cutting off the ear.

5. During the next 20 years, there was an increasing number of bankruptcies and an increase in fraudulent avoidance of the bankruptcy code. To assist in counteracting such practices the Act of 1624 extended the ear-cropping punishment to any debtor unable to give a reasonable explanation for his state of bankruptcy. It also introduced the reputed ownership doctrine which, with little alteration, has remained a part of the bankruptcy code.

6. The Act of 1705 introduced "set-off" and in 1721, debts payable at a future date became provable. The next few years saw an increase in a system of long fir fraud: the 1732 Act referred to "evil minded persons who had bought upon trust and credit large quantities of merchandise, and sold or pawned the goods for less than their value, thereby raising ready money" and who had then disappeared. This Act imposed the death penalty for the failure of a bankrupt to submit to examination; it also introduced the first anti-gambling legislation into the bankruptcy code. 1825 saw the first Deeds of Arrangment Act, and 1831 the introduction of an Official Assignee and a special court for bankruptcy proceedings.

7. Throughout this period, the bankruptcy code was confined to traders. However, in 1813 there began a series of acts, known as the Relief of Insolvent Debtors Acts, designed to modernise the old, harsh law of debtor and creditor, to protect debtors who were not guilty of fraud or negligence and to allow for the equitable distribution of their estates. The next logical step - to extend bankruptcy law to non-traders - was enacted in 1861.

8. All of these and subsequent Bankruptcy Acts were designed to re-adjust legislation to changing social conditions and to the sentiments of the commercial community. One of the main characteristics of the later Acts was an oscillation between private and official administration, with first one, and then the other predominating. Creditors' control was brought back into favour by the 1869 Act

/but

but, in the light of much abuse, the Act of 1883 reverted to official administration introducing the OR's service to secure an independant and impartial examination into the circumstances of each case. At the same time it sought to retain some of the advantages of creditor control, by allowing for the consultation of creditors' wishes as far as possible. The 1883 Act also took on a disciplinary character, recognising for the first time that the trading methods and conduct of a debtor concerned the interests and welfare of the whole trading community and the State. Thus, a large number of its provisions were designed to achieve a high standard of commercial morality.

9. The 1883 Act remains the basis of current bankruptcy law, though a comprehensive review was carried out from 1906 to 1908, which resulted in the consolidating and amending Act of 1914. Another committee looked at the penal sections of the 1914 Act during 1924/25 and the Bankruptcy (Amendment) Act, 1926 followed. Finally, the Blagden Committee was appointed in 1955 to advise on any necessary amendments, particularly in regard to discharge procedure and to Deeds of Arrangement. In their Report in May, 1957 the Committee said, inter alia, "We are satisfied that the basic structure of the bankruptcy law, apart from that relating to discharge, is generally sound and well suited to its purpose."

The need for change

10. It would be complacent to assume, 20 years later, that the Blagden view still held good. In recent years there has been a vast expansion of consumer credit, tied in with mass production and mass consumption. Business methods have changed as have methods of financing, particularly secured financing. There has been a proliferation of limited liability corporations and an increasing incidence of fraud, tax avoidance and other misdemeanours within the business community.

11. The principles underlying the bankruptcy code were framed when goods were in short supply, and did not depreciate substantially when passing from a debtor to his creditors. Today, such store is set by a new article as compared to a used one, that goods in the hands of a trustee in bankruptcy have only a fraction of the value they had while in the hands of the debtor. This is

/particularly

particularly true of consumer bankruptcies, of which there has been a substantial increase due, partly, to the high pressure salesmanship of consumer oriented industries, and to the buy now - pay later concept.

12. During the development stages of the present Bankruptcy Act there was far less credit and it was only available after careful consideration. Consideration should not be given to the plight of the consumer or wage-earner debtor whose difficulties often result from the continual encouragement to make greater use of consumer credit. Consumer credit legislation is being modernised following the Crowther Report and perhaps thought should be given to a wider extension of methods other than bankruptcy for dealing with the majority of consumer debtors. In general there are few, if any, free assets in consumer bankruptcies and therefore bankruptcy proceedings are of little practical value. There are obvious advantages to all concerned if the debtor can come to an arrangement with his creditors, provided he has a measure of protection from all of his creditors. It may be that further research should look at ways in which the system can function so as to rehabilitate the small debtor.

13. There is today much less stigma attaching to bankruptcy than in the past. Reasons for this include a general laxity in paying debts, a diminution of the responsibility of the individual and a more readily acceptance of bankruptcy as a solution to financial problems. This may be a contributory cause of the increasing number of undischarged bankrupts in recent years. It might be no bad thing if the stigma of bankruptcy was revived, by reserving the state of bankruptcy for such as persistent or fraudulent debtors.

14. There have been substantial changes regarding secured creditors. Originally, most creditors were unsecured and the amount owed under security was usually only a small part of the total liabilities. For this reason, perhaps, bankruptcy and winding-up legislation has not interfered to any great extent with the rights of secured creditors. Over the years there has been an increase in the secured debts of most commercial debtors. In the case of companies, in particular, this often results in the realisation of the debtor's

/assets

assets, at least initially, by way of receivership. In the case of consumer debtors, hire purchase and credit sale agreements, together with property charged by way of security, result in repossessions and sales outside of the bankruptcy process. It is for consideration that some of the controls and protection afforded by the winding-up and bankruptcy codes should be available, if only to give a measure of confidence to the ordinary unsecured creditor.

Companies

15. Since the Limited Liability Act, 1855, various Companies Acts have included winding-up provisions. The current Acts deal extensively with both the voluntary and compulsory winding-up of companies and with the appointment of liquidators and committees of inspection. In particular fields, such as preferential rights of creditors, the bankruptcy and winding-up codes are virtually identical. It is possible that a much greater degree of harmonisation between the two codes is desirable. At the same time, there has been criticism that, in dealing with the insolvency of companies, too much reliance is placed upon bankruptcy rules which were evolved in the 19th Century.

16. In practice, there is little apparent difference between an individual in business in his own right, and an individual operating through a limited company of which he is the beneficial owner of all of its shares. But there is a very real difference following insolvency; the bankrupt loses all his property which is not exempt from seizure, and is subjected to the disqualifications resulting from adjudication; the company director, all too often, is quickly in business again, through a new company. A great deal has been done in recent years to "pierce the corporate veil", but there is much to commend a system which treats all business failures by the same set of rules.

The EEC

17. The entry of the UK into the EEC has added a further factor to be considered in reaching a decision on the scope of changes in insolvency law and practice to be introduced. Any new legislation should be designed to assist the process of harmonisation. Note should be taken of the concepts underlying

/directives

directives and conventions, whether accepted or in draft, so far issued by the EEC Commission.

18. There may be advantages in looking at the insolvency laws of other EEC States, especially in cases where the law has been modernised. In Belgium and Luxembourg, where bankruptcy applies only to traders, and in France and Italy, where it applies mainly to traders, companies are subject to the law of bankruptcy in the same way as are individuals. In France, the usual procedure is "règlement judiciaire" (a form of arrangement) which aims at preserving the debtor's business and, when the administration is complete, restoring it to him. The alternative is "liquidation des biens" whereby an insolvent estate is wound up for distribution among the creditors. The adjudication of a person as a bankrupt (faillite) is a proceeding quite separate from the winding-up of his affairs; it entails penalties and the loss of rights, in particular, an incapacity to direct or manage a commercial undertaking either as a sole trader or in the form of a company. "Faillite" is reserved for individuals - be they sole traders, business partners or the directors and managers of companies - who have committed certain specified acts to the detriment of the creditors.

Acts of Bankruptcy

19. Traditionally, the conduct of a debtor and not financial embarrassment was the essential element for opening bankruptcy proceedings. Bankruptcy started with an act by the debtor, such as departing abroad. As bankruptcy was largely criminal or quasi-criminal in character, it was felt that a debtor should not be forced into bankruptcy unless he had done something to merit such treatment. Over the years, the element of culpability became secondary and the mere fact that the debtor had committed some act, not necessarily culpable became the essence of bankruptcy. The aim of modern law should be radically different. It should seek to regulate the economic situation that arises out of the debtor's financial condition.

/20.

20. It has been suggested that "acts of bankruptcy" are nothing but the reflexes of an insolvent person, and that the failure to found bankruptcy upon the fact of insolvency has resulted in a weakening of bankruptcy law in the field of equity between creditors. The necessity to prove an act of bankruptcy may delay proceedings until the debtor has become more deeply in debt, to the detriment of creditors, who will receive less.

21. Acts of bankruptcy do not apply to corporations. Moreover, a judgment creditor of an individual may serve a notice to pay upon him, failure to comply constituting an act of bankruptcy. Prior to the latest insolvency legislation in Canada, which abolished acts of bankruptcy, the one most frequently used by a petitioning creditor provided that "a debtor commits an act of bankruptcy ... if he ceases to meet his liabilities generally as they become due". It may be that prima facie presumptions that a debtor has ceased to pay his debts generally as they fall due should be adequate upon which to found a "bankruptcy" petition, throwing the burden of proof upon the debtor.

Conclusion

22. Blagden was verystrongly of the opinion that any new Acts should take the form of comprehensive Acts and not of amending Acts; that amendment of the original Acts in accordance with recommendations then put forward, would inevitably lead to considerable confusion and to difficulty in ascertaining the law. With the additional pointers to a possible need for major changes, this is an even more powerful requirement today.

23. If new and comprehensive Acts are envisaged, then it would seem prudent to examine in depth the extent to which both bankruptcy and winding-up laws require to be modernised and the extent to which they might, with advantage, be harmonised. As regards previous examinations into winding-up legislation, both Cohen and Jenkins had such wide remits into the whole ambit of company law, that the major parts of their enquiries and recommendations were outside the areas of insolvency and winding-up.

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INSOLVENCY LAW REVIEW

DRAFT REPORT: For inclusion in Part I, Chapter 3

pt. I

History of Bankruptcy

1 Bankruptcy legislation in England has a long history, originating during the reign of Henry VIII in an attempt to control fraud and in order to secure an equitable distribution of the assets of an insolvent debtor. The Statute of Bankrupts, 1542 observed that "divers and sundry persons, craftily obtaining into their hands great substance of other men's goods, do suddenly flee to parts unknown, or keep their houses, not minding to pay or to restore to any their creditors their debts and duties, but at their own wills and pleasures consume the substance obtained by credit of other men for their own pleasure and delicate living, against all reason, equity and good conscience."

2 The early bankruptcy laws applied only to traders; non-traders continued to be subject to the ordinary law of debtor and creditor until 1813 when there began a series of Acts for the "Relief of Insolvent Debtors". These statutes were designed to protect debtors who were not guilty of fraud or negligence and to secure an equitable distribution of their assets among their creditors. In 1861, the law of bankruptcy was extended to include non-traders and in 1869, a consolidating Act was passed embracing most of the substantive practices and law of bankruptcy now in force.

insert history of joint stock Corps - 1854?

3 The Act of 1869, however, provided what was essentially a creditors' administration and private trustees took the place of the official assignee. The abuses of creditors' administration

led to the Act of 1883 which separated the judicial and administrative functions, transferring the latter to the Board of Trade, under an Inspector General in Bankruptcy, with functions to control the appointment and work of trustees in bankruptcy.

4 The Bankruptcy Act 1883 remains the basis of modern bankruptcy administration and since that date, three Committees have submitted reports recommending amendments to the legislation.

5 The first Committee appointed in April 1906 by the Rt. Hon. David Lloyd- George, then President of the Board of Trade, presented its report in April 1908 (Report of the Departmental Committee on Bankruptcy Law Amendment) [Cmnd 4068] after carrying out a comprehensive review of the relevant Acts. The Bankruptcy Act, 1914 and the Deeds of Arrangement Act, 1914 were then enacted, consolidating and amending the earlier Bankruptcy and Deeds of Arrangement Acts.

Muir Mackenzie

6 It is perhaps interesting to note some of the problem areas which were specifically mentioned in the terms of reference of a committee some seventy years ago:

(a) the adequacy of provisions for investigation into the conduct of an insolvent debtor or bankrupt, and for the imposition of punishment or disabilities;

(b) the effectiveness of measures to check improper and reckless trading;

(c) the requirement for a more immediate realisation of a bankrupt's estate;

(d) after-acquired property and the need to protect persons who have become creditors of the bankrupt since his bankruptcy;

(e) more stringent requirements for discharge; and

(f) more effective control of voluntary arrangements between insolvent debtors and their creditors.

7 It is true that over the years the attitude of society has mellowed, recognising for example, the humanity and advantage of a bankrupt being released from his liabilities and given an opportunity to re-establish himself with as little delay as possible. Nevertheless, we have found that most, if not all of the problems which were referred to in 1906 remain matters of concern today.

8 The second Committee was set up in June 1924 with limited terms of reference, and it reported in January 1925 (Report of the Bankruptcy Committee 1924-25) [Cmnd 2326]. The committee's attention was drawn mainly to the provisions for the discovery and punishment of offences in the Bankruptcy Act, 1914, although it did consider and report on a number of other topics. The Bankruptcy (Amendment) Act, 1926 was then enacted.

9 Again, it is interesting to note some of the matters which the second committee considered were of sufficient concern to merit inclusion in what was only a twenty page report:

(a) the heavy losses resulting from fraudulent trading and "long firm frauds";

(b) the surprising extent to which credit is given without adequate enquiries first being made;

(c) the failure by debtors to keep adequate trading records;

(d) the tendency to treat bankruptcy offences as being of a less serious character than they in truth are;

(e) the requirement for automatic discharge provisions;

(f) after acquired property and the rights of persons who became creditors after a debtor's bankruptcy; and

(g) the difficulty of proving the intention of a debtor to prefer (fraudulent preference).

10 The third Committee under the Chairmanship of His Honour Judge John Basil Blagden, was appointed in October 1955 "to consider and report what amendments are desirable in (i) the Bankruptcy Acts 1914 and 1926, more particularly in regard to the provisions relating to the discharge of bankrupts, and (ii) the Deeds of Arrangement Act 1914". That committee reported in May 1957 (Report of the Committee on Bankruptcy Law and Deeds of Arrangement Law Amendment) /Cmnd 221/ that apart from the matter of discharge the basic structure of the bankruptcy law was generally sound and well suited to its purpose.

11 The Blagden Committee put forward a number of proposed amendments which they said were "designed to remove as far as possible administrative difficulties and inequalities, some of which have been inherent in a system of law which has to serve a two-fold purpose, on the one hand of protecting a bankrupt from anything in the nature of persecution by his creditors, and on the other, protecting creditors from the dishonest or fraudulent financial dealings of their debtor."

12 Successive governments have never found parliamentary time to enact what have been described as the relatively minor amendments suggested, and no amending legislation has resulted from the Blagden Report. The law relating to bankruptcy is still enacted largely in the Bankruptcy Act, 1914 and the Bankruptcy

(Amendment) Act, 1926. Minor changes have, however, resulted from the provisions of other Acts such as the Companies Act 1947, and the Powers of Criminal Courts Act, 1973 which permits the Director of Public Prosecutions to seek a Criminal Bankruptcy Order at the time of conviction in larger cases of fraud and theft. This has enabled him in suitable cases to petition in bankruptcy so that, as far as maybe, ill-gotten gains can be recovered and distributed to those who suffered loss by the fraud or theft. There has been legislation to give greater security to the employees of insolvent employers. More recently the Insolvency Act, 1976 was enacte primarily to implement the more important recommendations of a Review Team which in 1972 had reported on the management of the Insolvency Service. The main provisions of the 1976 Act increased the monetary limits relating to bankruptcy and winding-up, amended the rules relating to proof of debts and to public examinations, and introduced an automatic discharge procedure for bankrupts.

not so stated in Parliament

The objectives of bankruptcy insolvency admin.

All the statutes consid. in T.T.p.1 et seq

Pt III The non-trader 13 rescued by the 1861/1869 Acts and controlled by the Debtors Act 69

The Bankruptcy Acts in its present form ~~exist~~ for the some or all of the following purposes:

(a) to regulate the affairs of insolvent debtors, including partnerships and the estates of insolvent debtors, providing efficient machinery whereby a debtor or his creditors may secure the transfer of the debtor's assets to an impartial person for realisation and distribution amongst the creditors;

Chapter 11

(b) to adjudicate fairly between the creditors by providing for the protection of security and other rights and preferences and ensuring that the general body of creditors share the available estate rateably amongst themselves;

Justice Report on Bankruptcy for purposes

(c) to provide relief to the debtor from harassment by his creditors;

(d) to enable a bankrupt who has made a full disclosure of his affairs to obtain, with the minimum of humiliation and delay, a discharge of his liabilities and the opportunity to make a fresh start; and

(e) to discover and punish the dishonest or fraudulent debtor, or its agents or associate.

(1) Do they perform these purposes adequately in each Dept. and (2) are these other aims and purposes which they should perform. See infra

Bankruptcy procedure Sep. chapter

14 Bankruptcy applies only to individuals and partnerships; it does not apply to companies incorporated under the Companies Act 1948 which are subject to the winding up provisions of the Companies Acts. This is not so in many other countries; the bankruptcy laws of the Continental Members of the EEC, Canada and the USA (but not Australia) apply both to physical and legal persons.

15 All bankruptcy proceedings start with a petition to the Court which may be presented by a creditor or creditors jointly, by the debtor himself, or by the legal representative of the estate of a deceased insolvent. In the case of a creditor's petition the Court will require proof that the debt or debts are not less than £200, that the debtor has committed an "act of bankruptcy" and that he is a person subject to the Bankruptcy Acts. The Court may make a receiving order against the debtor, but not adjudicate him bankrupt at that stage unless he consents.

16 A petition by the debtor himself must state that he is unable to pay his debts. The Court may make a receiving order against the debtor and at the same time an order of adjudication declaring him bankrupt.

17 Under a receiving order the Official Receiver becomes the receiver of the debtor's property. At this stage his duties are to take custody of and protect the debtor's estate, interview the debtor to enquire into his financial affairs, and to call a meeting of the creditors.

18 The creditors' meeting considers any proposal by the debtor for settling his debts either in full or by way of composition or scheme of arrangement. In the absence of acceptable proposals the creditors may decide to ask the Court to adjudge the debtor bankrupt and to appoint a person of their choice as trustee of his estate.

19 The debtor is declared bankrupt by an order of adjudication which operates to divest him of all his property and to vest it in the trustee. The trustee is then in a position to realise the assets as to distribute the proceeds among the creditors in accordance with the priorities laid down in the 1914 Act. The remedies which are normally available to creditors are extinguished and their remaining right is to prove their claims in the bankruptcy.

20 Apart from its proprietary effects, adjudication involves several unpleasant and limiting constraints and consequences for the bankrupt which are designed to ensure his co-operation in the administration of his estate, to prevent him participating in many aspects of public life, and from engaging in activities involving a high degree of trust. He may not obtain credit for £50 or over without disclosing his status, nor may he trade in a name other than that under which he was adjudicated without disclosing that name. He may not, without the leave of the Court, act as a director of a company or be concerned directly or indirectly with a company's management. He is disqualified from being elected

to or sitting in either House of Parliament. He cannot be elected to or act as a member of a local authority. He cannot act as a Justice of the Peace, hold a solicitor's practising certificate or act as a trustee in bankruptcy or of a trust estate.

21 The Official Receiver has a statutory duty to investigate the manner in which the debtor has conducted his business and to report to the Court whether the debtor may have committed a misdemeanour under the Bankruptcy Acts. This involves interviews with the debtor, examination of books of account and relevant papers and correspondence with those with whom he has had financial dealings. Until recently, a public examination of the debtor was held in open court to complete the examination of the debtor as to his conduct, dealings and property, and to set down the evidence and the circumstances leading up to and resulting in the failure. Under the Insolvency Act 1976 the Court may, upon application by the Official Receiver, make an order dispensing with the public examination of the debtor.

22 At any time after he has been adjudicated bankrupt, but not before conclusion of his public examination if not dispensed with, the bankrupt may apply for his discharge from bankruptcy. The effect of a discharge order is to release the bankrupt from all debts which were provable in the bankruptcy save for a limited number of exceptions and to free him from virtually all of the restrictions and disqualifications of a bankrupt. The discharge must be sought by the debtor himself. However, if the Court is so minded, it may make an order which will give the bankrupt an automatic discharge upon the fifth anniversary of his adjudication. If no such order has been made, the Court is

required to review the position after five years have elapsed since adjudication.

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Description of W/up procedure

and other systems.

How many debtors in each categories

statistics under each category at its end.

At end of Chapter, aggregate all "debtors" dealt with by the system.

Objectives