4

INSOLVENCY LAW REVIEW COMMITTEE

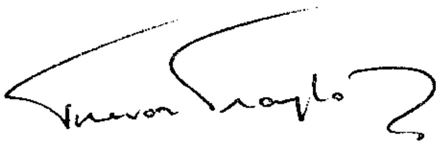
NOTE TO MEMBERS

FINAL REPORT

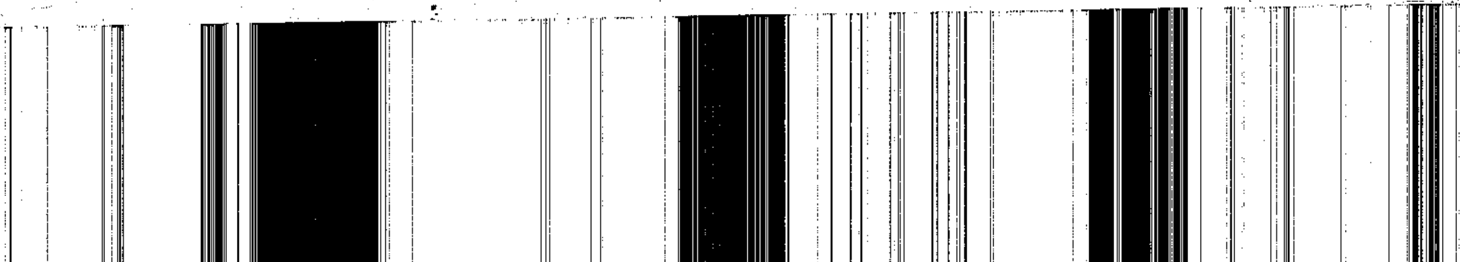
1 Enclosed are two copies of Chapter 5 - "The Initiation of Insolvency Proceedings" which has been prepared by Muir. It is based upon several ILRC's which were considered by the committee at various times, culminating in ILRC 98 which was taken at the 35th meeting.

2 If there are any points of principle which you wish to raise please let me know as a matter of urgency as we must discuss these at the meeting on 17 December.

3 Perhaps you would let me have one copy of the chapter back as soon as convenient with any drafting improvements which you would like to suggest.



T H TRAYLOR
Secretary
19.11.80



CHAPTER 5

THE INITIATION OF INSOLVENCY PRODEEDINGS

1.1. For historical and procedural reasons which have been described earlier in this Report, there exists in the present law and procedure governing the various types of insolvency proceedings - by which is meant, as has already been made clear, every kind of proceeding dealing with the affairs of any insolvent debtor, - a very considerable differentiation between the limited company, i.e. the corporate debtor, and the individual or personal debtor, or partnership of debtors; Similar differences exist in the case of certain insolvency modes of regulating both types of debtor, in particular circumstances. Examples of these differences, and indeed anomalies, have already been given in Chapter 6 above.

1.2. The second of our Terms of Reference reads as follows :

> "(ii) to examine the possibility of formulating a comprehensive insolvency system and the extent to which existing procedures might, with advantage, be harmonised and integrated."

In pursuit of that specific task, we have had to consider with great care, and with the assistance of our Consultees, what are "the existing procedures" in the case of each type of insolvency proceeding, to what extent their differences are significant in their social or legal content, and how far it is not only possible, but indeed necessary, to harmonise and integrate them. A man, Mr. Joseph Green, alone or with his wife, runs a shop or small business as an individual trader

or trading partnership, whose affairs, if and when he or they fail in business, will be administered in bankruptcy by means of a bankruptcy petition, presented against him or them by (almost invariably) an individual creditor; such a petition is heard in camera, without advertisement or publicity, unless and until a Receiving Order is made. If, on the other hand, he, or they, have been trading as a limited company, - having maybe a capital of no more than two one-pound issued shares, and maybe only one director, and that company fails, it is proceeded against by means of a winding-up petition, advertised both centrally and locally, and heard in open court, with the potential participation of as many of the company's creditors as have seen or heard of the advertisement. In our studies of these matters, we have termed the former procedure, that of the present bankruptcy law, the "one-to-one" basis, and the latter, under the present winding-up law, the "collective" basis; we refer to the progress of an insolvency administration from the former stage to the latter as becoming "collectivised". In all our thinking, we have had to remind ourselves, firstly, that the whole purpose of any insolvency administration has always been, from earliest days, the collective realisation and distribution of the debtor's assets among his (or its) creditors generally; but secondly, just as it is the duty of any insolvency code to do justice as between the debtor and his creditors generally, so it must also do justice to the debtor himself, and as between the debtor and society as a whole.

1.3. In our own opinion, as well as under the guidance of the Terms of Reference we have quoted above, we have to examine, to value and where necessary to refashion the manifold existing procedures into one just and logical whole, - an Insolvency Code which applies equally, and so far as practicable

identically, to debtors of every status, as well as to creditors of every status. As we have described above in Chapter , "The Credit World", insolvency must in all cases represent a personal, and also a social, disaster for the debtor, whose ripples and reverberations spread far and wide, both in the personal and in the corporate fields. It was not without reason that those who fashioned the original bankruptcy laws and procedures provided that bankruptcy proceedings, initially by debtor's summons and then by petition, should be heard in private; and very recently, the paramount necessity for this was emphasised by an appellate bankruptcy court.

Damage from allegation of insolvency

1.4. When the Winding-up procedure was devised for the purpose of, in effect, "making limited companies bankrupt", under new and different statutes, which borrowed some portions while discarding other portions of the bankruptcy code, the mode of proceeding was, as we have just described, the presentation of a public and advertised petition for the "bankrupting" of the company. Such advertising, and such public hearing, of the petition was of course in one sense the carrying out of the first of the purposes of insolvency, namely the participation of all creditors in the proceedings; it was however in another sense calculated to bring about the probable destruction of the company as a going concern, albeit at the instance of a single creditor. It must of course be borne in mind in any such analysis and comparison that, until late in the 19th century, trade and business was carried on, to a very large extent, on a personal or partnership basis, whereas the limited company tended to be confined to a substantial extent to enterprises of large proportions. Our Victorian grandfathers were not likely, we think, to have felt much need to concern themselves with the corner shop as a limited company undertaking; they had enough problems dealing with the administration in insolvency of massive trading partnerships, with unlimited, or largely unlimited, liability, whose

litigious misfortunes help to fill the pages of the Law Reports. They have now become limited companies too, and remained so, until the incidence of corporation tax tempted some of them back to the pastures of unlimited liability. With the recent increase in the permissible number of partners in partnerships, and the consequent creation of firms of enormous proportions, for example in the professions of solicitors and accountants, the social, as well as the legal, balance has begun to tilt the other way. Joseph Green Ltd., our corner shopkeeper, will have its failure administered by a winding-up petition, whereas Green, Black, White, Brown & Co., the eminent firm of purveyors of professional services, will have their failure (if it is not disrespectful to contemplate it) administered in the bankruptcy court. Whether that court as at present constituted could still cope with the bankruptcy of such very large partnerships, one may take leave to doubt. On the other hand, such an entity seems hardly suitable litigation-fodder for a public hearing in open court.

1.5. It seems to us, in the light of the foregoing considerations, to be necessary to rethink the whole insolvency procedure, from the point of its initiation onwards, with a view to unifying it into one all-embracing code. In arriving at this decision, we have to come down unequivocally on one side or the other of the two central issues, firstly, is it to operate on the basis of "one-to-one" or "collective", and secondly is it to operate "in camera" (i.e. in Chambers, from which the other creditors and the public are excluded) or in open court? We have decided these questions in favour of the initial process being in all cases on a one-to-one basis, and in all cases being heard initially in Chambers.

1.6. It is upon the foundation of these fundamental

decisions that we have endeavoured to construct our unified system for the initiation of every type of insolvency proceeding, which is described below. It will however not necessarily apply to "voluntary insolvencies", nor to very small cases.

arrangements

The New Procedure

2.1. The term "petition", at present used to describe the initiatory process in both bankruptcy and winding-up, should be replaced by the term "insolvency application", which term we shall employ in what follows, with the "petitioning creditor" being termed "the applicant creditor". The term "debtor" will refer to every type of debtor, whether individual, partnership or corporate, and for convenience we shall refer to all these different debtors as "he" or "his", "it" or "its".

2.2. Although every bankruptcy petition and every winding-up petition has always had to be based on a debt, possessing certain characteristics, no petition has been capable of being presented in bankruptcy, for several centuries past, without the proof by the petitioner of one or more "acts of bankruptcy". In winding-up, however, the prequisites for petitioning have been much simpler and less rigorous, being directed, - as were in essence the acts of bankruptcy - to the establishment of the insolvency of the company, but comprising no more than (a) the non-payment of a debt of a specific sum for a specific time after formal demand, or (b) an unsatisfied execution, or (c) the proof that the company was unable to pay its debts, including where appropriate its contingent or prospective debts or liabilities. The prerequisite in bankruptcy, namely the proof of one or more acts of bankruptcy (of which there are no less than sixteen) has become encrusted with a large amount of case-law,

and the category of acts has steadily enlarged over the centuries. Even as recently as 1973, the invention of "criminal bankruptcy" (discussed in Chapter or Appendix) created a new one, in that the order of a judge of criminal trial caused a convicted person to be treated as if he had committed an act of bankruptcy at that moment. The strictness of proof, which had its origin in what are called the "quasi-criminal" characteristics of bankruptcy, of at least one act of bankruptcy, has often afforded a loophole for an otherwise unmeritorious debtor to escape. Although very many bankruptcies are nowadays founded upon a "bankruptcy notice", which resembles the "statutory notice" in winding-up, even such notices are very strictly construed, and not infrequently trip up the unwary creditor or his solicitor, and they also require to be personally served.

2.3. We therefore propose the total abolition of acts of bankruptcy in relation to bankruptcy proceedings, and to adopt, for all proceedings by way of insolvency application, a simplified version of the present winding-up prerequisites, which are designed to produce a prima facie proof of insolvency, with which the debtor can nevertheless take issue, in the form and manner we describe. We would, however, observe, in anticipation of our later discussion, that the elimination of acts of bankruptcy removes the basic "anchor" of the trustee's title, - the "terminus a quo" from which his title generally commences, and we shall require to provide an alternative system to the "period of relation-back" to the relevant act of bankruptcy as now prescribed by the Bankruptcy Act, and, though to a much lesser extent, in winding-up to the date of presentation of the winding-up petition; this result we propose to achieve by what we later describe as the "claw-back" provisions, by means of

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antecedent

which the administrator of the insolvency administration may apply to set aside antecedent transactions which may be deemed to have been detrimental to the creditors.

2.4. We must therefore ask ourselves, what should be the criteria of that state of insolvency which justifies a creditor in applying for, and the court in ordering, the discipline of insolvency administration. The criteria must not be so severe, as to discourage the enforcement of just debts, nor so lax, as to encourage indignant or malicious creditors, or those merely "on the make", from commencing unjustifiable proceedings, or proceedings founded on unliquidated or unenforceable debts. Our chosen criterion is is <u>the non-payment of any debt</u>, which fulfils one of the three prerequisites outlined below, by a procedure in which the debtor has an adequate opportunity of defending himself against an insolvency order. This to a large extent reproduces the present position in bankruptcy, so far as concerns the case of the non-payment of a bankruptcy notice founded on a <u>judgment debt</u>, and in winding-up, in the case of the non-compliance with a statutory notice in respect of <u>any debt</u>, or the mere non-payment of a <u>judgment debt</u> or, in modern usage, <u>any reasonably undisputed non-judgment debt</u>. But these categories of debts are not exhaustive; justice may demand that a debt should be a permissible foundation for insolvency proceedings, even where it is not yet due and payable, or is otherwise contingent or prospective, the recovery of which when due and payable may be established to be at risk, or - to use a recognised legal term, - "in jeopardy".

2.5. Such a jurisdiction at present hardly exists at all in bankruptcy, except for the case where a still current bill of

exchange becomes immediately payable by virtue of the commission by the acceptor of an act of bankruptcy; in winding-up, however, special provision is made for the founding of a petition on a contingent or prospective debt, but only on terms of first satisfying the Court (in fact, the Registrar) that there is a prima facie case, and of giving security for costs. In our opinion, provided that there are adequate safeguards for the debtor against irresponsibly initiated applications, and against the damage capable of being caused to him or it by an ill-founded ~~petition~~ proceeding, there is no reason, in principle, why contingent or prospective debts should not become the foundation for insolvency applications.

2.6. We therefore propose that the categories of debt which will support the initiation of an insolvency application against any debtor should be the following :

2.7.(1) (a) The first category is <u>a judgment debt</u>, of a minimum amount to be prescribed (the present minima being £200 both in bankruptcy and in winding-up - for the purposes of the statutory notice - on which amounts we shall make suggestions later), and not being subject to a stay of execution. Although prima facie a judgment debtor is not entitled to any notice requiring him to pay a money judgment <u>per se</u>, there are occasional cases where that judgment may have been entered in default of appearance or of attendance of the defendant personally or by solicitors or counsel, which in themselves would justify some notice being given; we further think that the optimism or fallibility of human nature is such as to justify a requirement of the giving in all cases of some notice, viz. of an intention to proceed with an insolvency application, to all defendants.

(b) Such notice will be given by first class post to the debtor at his last known address, if an individual, or to a corporate debtor at its registered office, or, if there is reason to think that that would be an unsatisfactory destination, at its principal place of business, alternatively at the address of a duly constituted agent of the debtor. This notice should briefly indicate to the debtor the consequences of ignoring it. The length of the notice should be 21 days, as for the present "statutory notice" in winding-up. Its despatch should not be a formal prerequisite for the making of the insolvency application, but its absence may be relevant in considering the merits of the debtor if he appears and defends, and as to costs. In this respect, it is to be distinguished from the more formal notice referred to in (2) below, in connection with non-judgment debts.

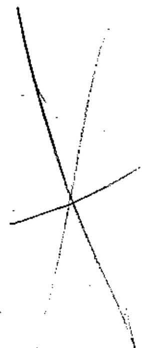
2.8. (2) The second category is a Non-Judgment Debt, of the same minimum amount, and of a reasonably indisputable character, formal notice to pay which has been given to the debtor or to his or its agent by registered post not less than 21 days before the making of the insolvency application. The principle, applied under the present procedure both in bankruptcy and in winding-up, that insolvency proceedings must not be taken on a disputable debt, is in our opinion sound and just, and is recognised in our formulation above. The applicant creditor who relies on this category takes the risk of being found to have unjustifiably proceeded on such a debt, with the serious consequences which we later propose. The Insolvency Court will, like the present courts, in all but exceptional cases, abstain from "trying" a disputable, and disputed, debt.

2.9. There is however a category of debt which falls half-way between a judgment debt which is presently due and payable, and a non-judgment debt, namely a debt which is payable under a judgment at a future date, e.g. a judgment debt, or a part of it, which is payable wholly at a future date, or by instalments. Such a debt is more than "contingent or prospective" (our next category (3)), and each instalment must, when it falls due, fall to be considered as a judgment debt capable of being proceeded upon as such, if it be of the requisite minimum amount. In respect of such a future debt, or such instalment not yet due, we consider that it should be treated as if it fell within (2) above, as an indisputable non-judgment debt.

2.10. (3) Our third category is a contingent or prospective debt, in respect of the prospect of payment of which, as and when (or if and when) it becomes due and payable, the creditor advances reasonable doubts, and alleges his apprehension of "jeopardy". We have already referred, in paragraph 2.5 above, to the existence at present of this ground for petitioning in winding-up, and its vestigial existence in bankruptcy. It is, in our opinion, necessary to provide for the possibility of an insolvency application being founded upon such a debt, while considerably enhancing the penalties on the creditor who relies upon it for any abuse of that right. A formal notice, as under (2) above, would be required to be sent, and a very full "affidavit of merits" as to the alleged jeopardy should be filed. The Insolvency Court should, we think, retain the power to refuse to entertain the application, if dissatisfied as to those merits.

2.11. We are omitting from our examination at this stage those other grounds for the making of an insolvency application

which are not founded on, and commenced for the purposes of enforcing, any debt as such; the averment of the "just and equitable" ground for petitioning in winding-up, even in a petition founded expressly on a debt, appears to us to be either a historical survival, or merely to reflect the Court's equitable jurisdiction to do justice between creditors and to have regard to their wishes (as required by Section 346 of the Companies Act, 1948), - a jurisdiction for which we specifically provide in our later proposals. We equally omit proceedings to wind up a company on that ground for reasons unconnected with the non-payment of a debt, e.g. those brought by aggrieved shareholders. As regards that other special category, namely the procedure whereby the Secretary of State for Trade may petition for the winding-up of a company, under Section 35 of the Companies Act, 1967, on the grounds of "public interest", although such a petition may in fact be founded, inter alia, upon the alleged insolvency of the company, this is not invariably the case, and we regard such proceedings as tending to fall outside our terms of reference; but we shall deal briefly with them in Chapter below.



2.12. The creditor, having satisfied himself and, where necessary, the Insolvency Court as to his entitlement to apply, will then file his Insolvency Application. There exists an admirable rule in the Bankruptcy Courts, and also, though to a lesser extent, in the Winding-Up Courts, that the court (that is to say, the Registrar), is to satisfy itself as to the petition being properly founded and being supported by the necessary evidence, before allowing it to be presented and issued (see Bankruptcy Rule 151 and Winding-Up Rule 33); we would wish to see this rule preserved and where necessary strengthened, having regard to our proposed increase in the facility of making an

insolvency application; in winding-up, it is, of course, mandatory, as to the merits, in the case of petitions founded on contingent or prospective debts, - a procedure which we have preserved.

2.13. The Insolvency Application, when issued out of the Insolvency Court, will name a date, not less than (say) 28 days, ahead, for the hearing, and will warn the debtor that at the hearing, a Protection Order (the term which we propose to substitute for "Receiving Order" and "Winding-Up Order") or a Debts Arrangement Order will be made, unless within a shorter specified time - we would suggest one week earlier than the hearing date, - he gives to the applicant creditor, or to his solicitor, and to the Court, notice of at least one of the following grounds for resisting the making of such an order.

2.14. The grounds referred to will be the following :

(1) If the debt relied on be not a judgment debt, that there is a bona fide defence to the claim;

(2) If the debt be a judgment debt, that there are bona fide grounds for applying to "the court of judgment" to set aside the judgment, on some basis recognised in law, e.g. that it was given by default or without trial;

(3) That there are bona fide grounds for impeaching the debt on account of some substantial illegality or irregularity (not being a mere procedural defect) in the insolvency field;

(4) that there exists a bona fide right of set-off, counterclaim or cross-demand, of a sufficient amount and stated with sufficient particularity;

(5) That the debtor is willing and able to pay the

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applicant's debt, with interest if justly claimable, and costs, either at the first hearing, or within such longer period as the Court should allow. If the sum to be used for such payment is "third-party money", this must be stated, with the name of the provider, and whether the provision be by way of loan, postponed loan or gift.

(Note: The fact that the money is that of a third-party may be very material in the court's consideration of the question whether the applicant creditor should be permitted to receive the sum so paid forthwith: see paragraphs 3.6 to 3.8 below).

The Hearing.

3.1. The hearing will normally, at least in the first instance, be in Chambers. The Court will consider such grounds as the debtor has stated under (1) to (5) above. In the course of its consideration, and at any stage of the hearing or any adjourned hearing, it may order the debtor to file a sworn statement of his affairs, and/or a statement of his means and/or earnings.

3.2. After hearing such evidence and arguments as it thinks just and necessary, the Court may either adjourn the matter, for such reason as it then states, or at that hearing or any adjourned hearing may make one or more of the following orders, or have regard to any of the following matters, in adjudicating upon the application :

(1) Allow the debtor to pay the debt in full ~~or by instalments~~, either -

(a) if the Court is satisfied as to the standing of the applicant creditor and as to his ability to repay

if called upon to do so, to the applicant creditor or his solicitor direct:

(b) on terms that the money be paid into the Insolvency Court for a specified period, not exceeding one month:

Note 1: The Court's leave for such direct payments will not of itself protect the creditor from being called upon to repay, whether the money paid be the debtor's property or third-party money.

Note 2: Such payment-in will not of itself create the sum paid a security for the creditor.

Note 3: An insolvency application shall not be withdrawn or dismissed by consent, except with leave of the Court.

(2) Determine whether the alleged defence to the debt, if it be a non-judgment debt, has merits, and direct how that defence be adjudicated upon: either by a trial in some other appropriate court, or in special cases before the Insolvency Court itself; in the former case, the Court will adjourn, or may dismiss, the application.

(3) In the case of a judgment debt, determine whether the debtor should be granted an adjournment to enable him to apply to the court of judgment;

(4) Adjudicate upon the alleged illegality or irregularity.

(5) Permit any creditor with a suitably qualified debt to be present at any hearing on such terms as the Court thinks fit.

3.3. If the debtor does not satisfy the Court by payment, resulting in the withdrawal or dismissal of the application, the Court will determine whether it should make a Protection Order

or a Debts Arrangement Order (as to which, see Chapter below), or otherwise deal with the debtor's affairs in the interests of his or its creditors generally.

3.4. Implicit in our foregoing analysis and schedule of these proposed powers and procedure of the Insolvency Court are the consideration of, and our attempt to formulate, just, expeditious and practicable answers to, a number of questions which were foreshadowed in our observations in the preceding paragraphs. The procedure is founded upon the current bankruptcy code, in that the proceeding is initially on a "one-to-one basis", as between the applicant creditor and the debtor, although there may be circumstances in which another interested and qualified creditor may be allowed to participate (which is not at present permitted in bankruptcy, while in winding-up all creditors may participate).

3.5. Within that "one-to-one" relationship, the Court may give its blessing to the payment-off of the debt due to the applicant and terminate the proceedings, - subject to what is said below. During the "one-to-one" relationship, there will be no advertisement of the making of the insolvency application, so that the debtor's credit and standing will remain officially unimpaired; the only exception at this stage would be the use of advertisement to serve an evasive debtor, - a rare situation. In this respect also, we maintain the bankruptcy practice, and depart from the winding-up practice.

3.6. We must then consider whether the applicant creditor, who has applied to the Insolvency Court on the basis that the debtor is insolvent, should be allowed to be paid off, to the detriment of the debtor's other creditors (if any), pressing

or not pressing. Should "the diligent creditor" be rewarded for his diligence? To what extent should the Court allow a debtor who has entered the zone of statutory insolvency to be "let loose" again on the community? If payment is to be permitted, must it be in full, or may it be by instalments? What protection should the other creditors receive by way of a right to require the paid creditor, in the event of a subsequent insolvency order being made, to refund the monies he has received? Should there be some form of "claw-back" provision (a term we have borrowed from North America), so as to restore the equality of treatment of all creditors, and if so, for how long should that creditor be vulnerable in this respect? Finally, how should the Court deal with payments-off, in full or by instalments, which are made out of "third party money"?

3.7. Answers to the foregoing questions must be inspired, we believe, by the general philosophy of the legislature, and of the business community and of society generally, of which the legislature is the spokesman. It is the experience of a number of us, and it is in evidence from our consultees, that there is a widespread practice - and in general a socially valuable practice - for insolvency petitions to be paid-off, although the law, procedure and practice of the respective bankruptcy and winding-up courts differ markedly from one another, as - we do not doubt - do different county courts exercising bankruptcy jurisdiction. We have no statistics readily available of the number of petitions in either set of courts which are "paid off", or of how many are so paid off on the one hand out of the debtor's own money, and on the other hand out of third-party money. It is, however, the present law that the bankruptcy court must ask, and must be satisfied, as to the latter point, whereas no such question is required to be put, or is in practice put, in the Winding-Up Court.

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3.8. There is, of course, always the possibility that the alleged third-party money is really that of the debtor himself or itself, which is being passed through other hands or under the table. It seems therefore desirable that the identity of the third party should be disclosed, although that identity might need to be protected from the eyes of other parties. It also makes a substantial difference, in the realms both of insolvency philosophy and of other creditors' rights, whether the third-party money is to represent an outright gift, or alternatively a loan (the effect of which is in no way to improve the debtor's balance sheet position) or a postponed loan, i.e. postponed to the other creditors' claims.

3.9. Having weighed these considerations to the best of our ability, and not without initial substantial differences of view between ourselves, we have finally concluded that it is desirable that insolvency applications should be disposed of by payment, whether in full or by reasonable instalments, so far as this can be seen to be consistent with the interests of other creditors, and that this result should whenever possible be achieved without any advertisement of the application, in consequence of which the standing and viability of the debtor, - and the willingness of a third party to support him or it - might be impaired. It must always be borne in mind that the number of actual insolvency administrations should be reduced as far as possible, inter alia for the saving of court time and fees, and of the parties' litigation costs, and also for reducing the workload on the Official Receivers in Bankruptcy of the Insolvency Service, to the extent that their services may be required in any actual administration, and also to the extent that they themselves will continue in office in the foreseeable future.

3.10. If our proposals are enacted in legislation, and it should be found that a greater facility for payment off of insolvency applications without publicity is being abused, then the discretions which such legislation will have afforded to the court might have to be restricted. Only experience can, we think, demonstrate the correctness of our diagnosis and our proposed treatment.

11/11/80

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INSOLVENCY LAW REVIEW COMMITTEE

Note to Members

FINAL REPORT

Further to my Note of 17 August, enclosed are two copies of Chapter 2 - "The Credit World". You may recall previously receiving the first 12 paragraphs, which were sent out earlier in the year to obtain the views of Members on the style of the draft.

2 I should be grateful if you would kindly let me have one copy back in due course with your views and comments and any proposed amendments thereon.

3 Also enclosed is a snippet from the "Guardian" on a recent release by the OFT.

4 Chapter 3 is on its way.

Trevor Traylor

T H TRAYLOR
Secretary
22.8.79

Half UK population borrowing on credit

Over half the people in Britain used some form of credit in 1977, twice as many as did so only eight years before.

The figures, which appear in a report from the Office of Fair Trading published yesterday, show that the big growth areas have been the newer forms of credit card borrowing like Access and Barclaycard, and store budget accounts.

People who use credit do not know how much about their legal rights, and do not take much trouble to find out about them either.

The survey suggests that seven customers out of ten who take out hire purchase contracts do not read them properly or even read them at all in some cases.

Consumers are equally unconcerned with the interest rate that they were paying. Very few claimed to know if the rate was reasonable, and according to the report, half of Britain's credit card users do not know what they are paying for the money that they borrow.

People are equally ignorant about the difference between various forms of credit available to them.

All the same, most borrowers believed that they have the best deal available for what they wanted.

The only exception are people who had taken out hire purchase, for over half of them believed that they could have done better elsewhere according to the OFT.

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INSOLVENCY LAW REVIEW COMMITTEE

Note to Members

FINAL REPORT

Enclosed are two copies of the first 36 paragraphs of Chapter 5. Originally, this was intended to be a "Philosophy of Insolvency Law", setting out the aims and basic principles of modern insolvency law and practice. The proposal now is that the chapter should be extended to bring out the shortcomings of the present systems when set against such standards, illustrated by criticisms which have been received in written evidence (ie. material originally intended for Chapter 6).

2 Your views, comments and proposed amendments, set out on one copy and returned, will be most appreciated. Proposed drafts for inclusion in sections yet to be prepared (or indeed in any section) will be warmly welcomed.

3 There will now be a short interlude while I take some leave.

Trevor Traylor

T H TRAYLOR
Secretary to the Review Committee
30.8.79

5.14?

FIRST DRAFT
(21.8.79)

THE CORK REPORT

CHAPTER V

5.14?

A PHILOSOPHY FOR INSOLVENCY LAW

General

5.1. What should be the aims of a modern insolvency law? We attach great significance to this question. If an architect is commissioned to design a building, he will require fairly precise instructions regarding its function and size, and, not least, an estimate of the amount available to be spent on the construction of the project and subsequent maintenance costs. His approach to the design of a house will by no means be the same as that for a factory or civic centre. Likewise, the framers of new insolvency procedures must be given some guidelines as to what they are intended to achieve and what public resources are to be earmarked for their carrying out. In this chapter we accordingly discuss the principal criteria which could be adopted for this purpose.

5.2. The survey of existing procedures and their origins has left us with a clear impression that the goals or objectives which the present insolvency laws were intended by their authors to attain have by and large been forgotten. The system has become rigid in its structure and inflexible in its operation; consequently, if any attention is ever paid to the purposes which the system was originally designed to serve, such an exercise leads inexorably to the application of principles originally aimed at grappling with problems of insolvency arising in generations with needs quite different from those of our own; such principles are therefore not necessarily suited to the conditions prevailing today or, to an even greater extent, likely

to prevail in the future.

5.3. Insolvency is not an exact science and does not possess a set of rules valid for all times and circumstances. We are, however, satisfied that it is possible to extract from our own accumulated experience in this country as well as elsewhere certain general principles, as opposed to hard and fast rules, to which an insolvency law should strive to give effect. We are conscious that much of the discussion below is directed to the ideal or perfect situation and that, indeed, the full implementation of some of the principles might frustrate or impede the working out of others. In a subject which is concerned, as insolvency undoubtedly is, with the interplay of a multitude of commercial and social relationships, we believe that it is our duty to seek to resolve these conflicts by the application of practical yardsticks and that we shall accordingly be in fact concerned, in the final analysis, much, if not more so, with the art of what is possible than what is believed to be the ideal.

5.4. As has already appeared, our terms of reference and one of our specific aims has been to consider the possibility of unifying or at least harmonising the various existing codes of insolvency. In considering the proper form of an insolvency code we think it necessary, so far as practicable, to treat all debtors, be they individuals, partnerships or corporations, under the common description of debtor. When, therefore in what follows we speak of "the debtor" and his estate, we shall mean every kind of debtor, whatever form his or its personality takes.

"Debtor" or "Insolvent"

5.5. We feel that there is a sound basis for this approach, for the material form of "the debtor" may be dictated as much by history, tax advantage or legal protection as by any other considerations, and those differences should not obscure the essential unity of the relationship between the debtor, the creditors and society.

5.6. The aims of a good modern insolvency law should be as follows:-

(a) To recognise that the world in which we live, create wealth or render services is a system founded on credit, and that such a system requires, as a correlative, an insolvency procedure to cope with its casualties.

(b) To diagnose and treat an actual or potential insolvency situation at an early rather than a late stage in its existence.

(c) To relieve and protect the insolvent, on the one hand, from the demands of his creditors and, on the other, to prevent conflicts between individual creditors over the fate of the insolvent, his estate and affairs, whilst at the same time not neglecting the rights which the insolvent and his family can, notwithstanding the former's insolvency, legitimately expect to continue to enjoy.

(d) To realise those assets which should properly be considered as the estate of the insolvent, with the minimum of delay and expense.

(e) To distribute the proceeds of such realisations amongst the creditors in a fair and equitable manner.

(f) To ensure that the processes of realisation and distribution are administered in an honest and competent manner.

(g) To ascertain the cause of the insolvent's failure and, if and insofar as his conduct merits criticism or even punishment, to decide what measures, if any, require to be taken against him or his associates.

(h) To recognise that the effects of insolvency are not limited to the private interests of the ~~debtor~~ insolvent on the one hand and his creditors on the other, but that society as a whole is vitally affected, not only by the fact of the insolvency itself but at every stage in the outcome of the subsequent processes, and to ensure accordingly that these public interests are at all times recognised and adequately safeguarded.

(i) To devise a framework of law for the governing of insolvency matters which commands universal respect and observance, is seen to produce practical solutions to financial and commercial problems, is simple and easily understood, is free from anomalies and inconsistencies, is capable of being administered efficiently and economically, and yet, is sufficiently flexible to adapt to and deal with the rapidly changing conditions of our modern world.

(j) To ensure due recognition and respect for English insolvency proceedings abroad.

5.7. If these are accepted as a fair statement of a good modern insolvency law, then it must follow that the multifarious statutory procedures which now form our present law should be radically revised and combined to achieve such aims. In our view the time has long since passed from piecemeal and patchwork tinkering with this vital sector of the lives of each one of us.

5.8. The Casualties of the Credit World. Considerable attention has recently been given to the whole nature and structure of the credit industry and the services it provides, e.g. by the Crowther Committee on Consumer Credit and the Wilson Committee on the role of the City. On the other hand, scarcely any detailed study or analysis has been carried out ~~about~~ what happens when the credit relationship breaks down, and that breakdown is of such proportions that an insolvency situation occurs. It is obvious that the repercussions will be of infinite variety and complexity; not only will the personal characteristics and financial circumstances of the individual debtor be ~~of concern~~, but equally relevant may be the impact of the situation upon the affairs of ~~the~~ creditor to the extent that he is able or ~~not~~ to withstand the inevitable delay in the recovery of his debts or to absorb its loss to whatever extent may be necessary in his business or life, without any or any appreciable catastrophe to himself.

5.9. A sharp distinction for present purposes exists between the private individual, who usually, but not always, is to be found in trouble because he has over-extended himself in the credit world; such a person has not normally engaged in any form of business or commercial activity: ~~Conversely~~ the other main category of ~~debtor~~ is ~~the debtor~~ who, either on his own account or in partnership with another, has been ~~so~~ engaged, as will nearly always have been the position of the corporate debtor. The problems faced by ~~each one usually are~~, speaking broadly, widely different, both in the extent of their financial implications and social consequences.

5.10. The Consumer ~~Debtor.~~ The consumer ~~debtor~~ faced with insolvency or, under the present system, even with the harsher regime of bankruptcy, cannot escape the fact that there will be

some disruption to his family life, a degree of intrusion into the privacy of his home and, indeed, as we shall see, some peril to his right to retain that very home, subject to the reforms introduced by the Insolvency Act, 1976. Such a debtor, if bankrupt, must undergo a public examination and, at any rate in the provinces, the hearing is likely to receive some publicity in the local press. If the debtor manages to retain any employment, he can be expected, given a normal degree of sensitivity, to feel some humiliation amongst his family and colleagues; if he loses his livelihood or job, then obviously his bitterness and that of his family will rankle. Whatever the true nature and causes of the insolvency, it is more likely than not, in our present society, that his condition will be recorded somehow with a credit agency to his prejudice in terms of being able to obtain credit or work in the future.

5.11. **The Commercial Debtor.** The failure of a trading entity will give rise to a multitude of problems for the entrepreneurs (not merely the Board of Directors but in many cases the shareholders also) as well as those concerned with its daily operations, such as employees and suppliers. The size of the enterprise will clearly have considerable bearing on the type of repercussions which will follow any given failure, but we are all familiar with the modern concept of the "sit-in" by workers who are determined that their jobs shall not be lost. This is a phenomenon which can drastically diminish, if not annihilate, the value of a company's stock, plant and goodwill to the evident disadvantage of its creditors.

5.12. We believe that a concern for the livelihood and wellbeing of those dependent upon an enterprise which might be the lifeblood of a whole town or region, to be a legitimate factor to which a

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modern law of insolvency must have regard. The chain reaction consequent upon any given failure can potentially be so disastrous to creditors, employees and the community that it must not be overlooked. Our present insolvency laws do not even pay lip-service to this concept.

5.13. The existing machinery for dealing with insolvency matters and the problems created by the casualties of the credit world have, like so many of our institutions, grown up almost haphazardly, and they lack any overall plan or general coherence. We are convinced that, not-withstanding the many separate virtues which the present system undoubtedly has, ~~that~~ each piece of machinery, looked at in the aggregate, fails by a long way to achieve so many of the fundamental aims of a good insolvency law described above that nothing less than a radical re-structuring of the procedures will suffice if insolvency situations in the future are to be efficiently dealt with in a manner, by prevailing requirements, recognised to be fair and just.

5.14. The more unscrupulous debtor, however, may be better prepared to handle the insolvency situation because he has taken some precautions against such an event, for example, by putting assets beyond the reach of his creditors in the manner we consider later; not surprisingly, such a debtor is frequently known to look upon his bankruptcy with a certain cynicism.

? wrong place

5.15. <u>The early diagnosis and appropriate treatment of an insolvency situation.</u>

The precise point at which a debtor becomes insolvent, in the sense that he is unable to pay his debts as they fall due, is extremely difficult to determine. Yet it is a matter of immense significance and the pivot upon which so much else turns. The existence of insolvency means that decisions have to be taken which will radically affect the debtor himself, his creditors as well as the public at large and which it may not be easy to reconcile:

(a) For the debtor the time has been reached when he must consider whether it is proper for him to incur any further credit without notifying his creditors of the truth regarding his situation; if he is engaged in business, he may genuinely believe that by obtaining further credit his affairs can be restored to a normal basis; if he is a private individual, he may be constrained to obtain credit as an essential adjunct of the everyday life of himself and his family.

(b) For the creditor, his concern is to recover his debt as swiftly as possible and, once the debtor is known to be insolvent, the individual creditor may well find himself in a state of conflict or competition with fellow creditors who are likewise looking for payment.

(c) For society in general, it is a matter for concern that a debtor, once he is recognised to be in a state of insolvency, should not be exposed unnecessarily to the demands of individual creditors, but that some order should be introduced into what might otherwise decline into a chaotic situation.

5.16. The ~~debtor~~ ~~indebted~~ person indebted should, at any rate in theory, always be the first to know that he is insolvent. He should be in possession of sufficient material from which to judge that his affairs are on the decline and that his situation as regards his creditors has progressed to one of insolvency. So far as a ~~debtor~~ he fails to appreciate his position and to wake up to the need to take proper steps to deal with it, he is prejudicing not only himself but~~, in particular,~~ the generality of his creditors. To the extent that ~~the Debtor~~ he has been engaged in trade, then clearly any such failure is likely to be accompanied with more gravity, due to the likelihood that his activities will be of larger scale and scope.

5.17. All too frequently ~~debtors~~ insolvents will try to delude themselves as to the real truth of their position and its implications. They resort to euphemisms, such as that they are suffering from "cash flow problems"; they resort to delaying tactics such as putting forward unjustified complaints regarding the quality of goods supplied or work done; they embark upon a strategy of putting off the evil day by offering to pay by instalments or making round figure payments on account. Occasionally they ~~may~~ go into hiding, or generally give the impression that their affairs have reached such a pitch as to have "got it on top of them." They can even suffer a paralysis of perception and judgment, which is sometimes described as "bankruptcy neurosis".

"Sunshine and clouds" 5.22

5.17A. In the absence of a direct admission by him ~~the debtor~~ of his insolvency, for example, by convening a meeting of his creditors, individual creditors are left to infer that an insolvency situation has been reached either from outward signs of ~~the debtor's~~ his conduct or by causing him to act in such a way that, in the eyes of the law, he is to be treated as legally insolvent. At this ~~point~~ moment of his insolvency, there clearly arises a conflict between the desire of each ~~the~~ individual creditor to obtain as much as he can for himself from what remains of the ~~debtor's~~ assets of the insolvent and the need, on the other hand,

to protect the interests of all creditors, of whom the individual creditor is but one.

5.18. The reconciliation of these potentially conflicting interests, namely, the private needs of the ~~debtor~~ insolvent and his family, the legitimate aspirations of individual creditors, the demands of the general body of his creditors (secured and unsecured alike) as well as of society in general, has been at the forefront of our deliberations. We soon became convinced that the present balance is no longer satisfactory; our aim is to devise a fresh approach more consonant with the requirements of the credit world as it is likely to exist ~~at~~ in the period up to the end of the present century.

5.19. A good illustration of how the present balance is unsatisfactory can be seen in the divergent approaches under the law and practice as it exists today with regard to the proper moment for the ~~debtor~~ insolvent to take his creditors into his confidence and disclose his true position to them.

5.20. The present law, under the Bankruptcy Act, is that ~~a debtor~~ person indebted who is engaged in trade, has a perfect right, as long as he is "solvent", to determine that he will go on with a business, although it may be making losses. He may trust that, before he becomes insolvent, matters will change, and he will again be in a condition of prosperity. The moment he becomes insolvent, however, then he is no longer going on at his own risk in case of failure; he is going on at the risk of his creditors, in case things do not mend, ~~and~~ as he hopes they will. ~~and The law is~~ The present law on this point is – and rightly so, we believe – that a man has no right to do that: ~~see~~ In Re Stainton (1887) 4 Morr. 242, ~~where~~, (at p.251), Cave J., a great bankruptcy judge, ~~went on to say as follows~~ said this:

"The moment things have got to such a pitch that he cannot pay 20s. in the £, but he nevertheless thinks that if he goes on he may be able to retrieve his position, in my opinion he ought to call his creditors together, and leave

them, who will have to bear the loss in case his calculations are wrong, to determine whether that course of going on shall be proceeded with or not."

5.21. The position under the Companies Acts, as we shall see later in this Report, is to the effect that a company is not bound to stop trading merely because it is in difficulties and unable to pay its debts as they fall due, at all events so long as there is a reasonable prospect of the position of the company being retrieved.

5.22. A balance has to be drawn between "the sunshine syndrome" i.e. the right for an honest and prudent businessman, who is prepared to work hard, to continue to trade out of his difficulties if he can genuinely see a light at the end of the tunnel, and the corresponding obligation of a trader to put up the shutters when, by continuing to trade, he will be doing so at the expense of his creditors and in disregard of factors which reasonable businessman would perceive.

5.23. The link between these two situations, namely, the right to go on and the obligation to stop, is the state of the trader's books of account. If they are adequately maintained, they will usually be an adequate guide, at any moment of time, as to the proper course of conduct. In all insolvencies of substance, a crucial element leading to the collapse is the wilful failure of the debtor to have kept proper books of account or a refusal on his part to believe what they reveal or he is told about them.

5.24. In this respect the accountant has a major role to play. The prudent trader, faced with financial difficulties, will not stand idly by in a state of paralysis and await events to overwhelm him; he will, in accordance with modern practice, call in an

insolvency expert to advise regarding the position and future of the undertaking, if necessary with a view to calling together his creditors and arranging a moratorium. In the more significant cases, it has usually been the accountant's report concerning the insolvent's affairs and possible remedies which has helped to diagnose the causes of the imminent failure and to enable a rescue plan to be devised likely to command widespread support among the creditors. It is not unknown for a trading company, or its bank, to request or require such an investigation to be carried out. These, we acknowledge, are the cases where some prudence has been exercised on the part of the insolvent, who is often found in the event not to have been wholly insolvent, in the sense that he or his company is quite beyond rescue and must go into bankruptcy or liquidation. We have been obliged to concern ourselves not only with those cases but much more with the true "failures" of the credit world, i.e. those who are not, *ex hypothesi*, prudent, or who are not adequately advised or who do not take any such advice until it is too late.

5.25. Our thesis is that it is better for all concerned if these insolvents can be encouraged to face their creditors at an earlier stage than is now normal or, if they for whatever reason are unwilling to put themselves of their own accord into the hands of their creditors, then there should be as few obstacles as possible in the way of creditors themselves being able to procure the debtor's affairs to be administered on a collective basis for the benefit of all interested parties.

5.26. Although, as we have seen, machinery does at present exist to enable the debtor to take the initiative and to put himself in the hands of his creditors, it is not in our view sufficiently simple or cheap for it to be generally used or, at any rate, to be used in good time. This is particularly the case with regard to the individual insolvent.

5.27. In contra-distinction to the position of a limited company, which finds itself insolvent and where the company can itself take the initiative, either by asking for the appointment of a receiver and manager (if appropriate), or by taking steps to go into creditors' voluntary liquidation, or presenting a petition to the courts to be wound up compulsorily, the position with regard to the individual debtor is by no means so straightforward. At the comparatively humble and uncomplicated level of the consumer-debtor, the machinery of "the Administration Order", which might well be suited to deal with his affairs, cannot be invoked by him voluntarily; he must wait until a judgment creditor has obtained a judgment against him and have applied for such an order to be made. It is true that such a debtor is at liberty to present his own petition in bankruptcy for a receiving order, followed by his adjudication, but in practice the size of the deposit (£50) he is obliged to find, is a deterrent to the use of the bankruptcy procedure. Furthermore, if the debtor were to reflect about the use of such machinery, he might be extremely reluctant to invoke it, if he considered the immediate consequences which would befall him.

5.28. In our view it is far from satisfactory the debtor, who genuinely may need to be protected from his creditors, should feel inhibited from applying to the court for relief on considerations of costs and; more particularly, it is wrong that he should be obliged to choose a mode of administration of his affairs, namely in bankruptcy, which (a) may be entirely unsuited to deal with the type of problems which his affairs present and (b) which he can put in motion, in practice, without any deliberation by the court itself as to whether it is prepared to have the machinery of bankruptcy brought into operation in the case of that particular debtor.

5.29. To a considerable extent similar criticisms can be levelled at the procedure whereby a creditor takes the initiative for obtaining

a bankruptcy administration. Not only is the deposit (~~at present~~ now ~~£200~~ £90) a deterrent, but equally he is entitled, almost as of right, to a receiving order, not only against what might be the wishes of other creditors but even ~~if~~ where the paraphernalia of bankruptcy ~~are~~ may be really quite inappropriate to the affairs of the particular ~~debtor~~ insolvent.

5.30. In our view it is socially important ~~desirable, if not considerably more so,~~ that adequate machinery should be available to the individual debtor whereby he can ~~to~~ put himself in the hands of his creditors with the minimum of delay and that the final choice regarding the mode of administration should not be irrevocably taken until the court has before it a reasonable amount of information to decide what is best to be done in the particular case. We intend to recommend that considerable procedural changes should be made to give effect to this philosophy. These will, in general terms, take the shape of proposals for a radical re-structuring of the Administration Order procedure and for the introduction of a new system whereby an insolvent ~~debtor~~ seeking relief will, in an appropriate case, ask in the first place for ~~what~~ we propose to call a "Protection Order" to be made against him, as a preliminary to a decision by the court as to how best his affairs should ultimately be wound up. We also shall make recommendations for a new and simplified system for judicially establishing the fact of insolvency, involving the abolition of the present system of "acts of bankruptcy", and for assimilating, so far as practicable, the position and treatment of individual insolvents ~~debtors~~ and corporate insolvents ~~debtors~~ with regard to this crucial aspect of insolvency law.

5.31. ~~Concerning~~ <u>The relief of the debtor and the rights of his creditors</u>.

Once the processes of insolvency have been launched - and properly launched - against an insolvent ~~debtor~~, he is no longer entirely the master of his own fate or fortune, such as it is. A new regime

has either at his own request or at the request of a creditor, been superimposed upon his affairs, namely, the administration of his assets, usually by an independent person, for the benefit of his creditors and, in the event of a surplus, ultimately for himself. But the debtor does not necessarily obtain the considerable advantage of immediate relief from the claims of his creditors at no corresponding price to himself; that price will vary with the circumstances of each case.

5.32. Insofar as the debtor obtains relief from the claims of his creditors and is his property no longer exposed to being seised by them in or towards satisfaction of their claims, this involves an interference with their ordinary civil remedies. All the creditors are equally the victims of the insolvency situation and, if the rights of each and every one of them are to be restrained and subject to interference by force of law, then they have some legitimate expectation that their fellow creditors will not, once the insolvency situation has supervened, be treated more favourably than themselves.

5.33. Under the present law there is considerable disparity between the rights and remedies of creditors against the property of their debtor, depending upon the accident of the form taken by the insolvency proceedings. The ability of one creditor to steal a march over his colleagues is stronger where the insolvency proceedings take the form of the convening of a creditors meeting for voluntary winding-up as opposed to the presentation of a petition to the court for the compulsory winding-up of the company. The proliferation of remedies open to creditors, e.g. the levy of execution or the taking of garnishee proceedings by a judgment creditor, rights of distress available to certain creditors such as the landlord or the Inland Revenue, not to speak of the remedies

to secured creditors, leads to uncertainty, and confusion and can penalise the more indulgent creditor. It is our aim to seek to eliminate as many of these inconsistencies as possible so that one creditor, once insolvency proceedings have supervened, cannot readily obtain an undue advantage over his ~~colleagues~~. the general body of creditors.

5.34. Whilst removing the insolvent ~~debtor~~ from the pressures of his creditors and ensuring that such assets as remain to him are not, after the threshold of insolvency proceedings has been passed, unfairly exploited to the prejudice of the general body of creditors, it is nonetheless for consideration whether, and upon what terms, if any, the debtor himself should still be entitled to enjoy any part of those assets and, if so, for how long. This is essentially a matter which arises in the case of the individual insolvent ~~debtor~~ and, in practice, relates to what is far and away in the majority of such cases the only asset of any real substance, namely, the insolvent's ~~debtor's~~ home. As matrimonial law develops, it must increasingly be recognised that not only has the insolvent ~~debtor~~ himself a proprietorial interest in this asset but, as it is the home of the members of his family, they also have rights in it which must be taken into consideration. The extent to which the enjoyment by the insolvent ~~debtor~~ as well as by his family of their home should not be impaired by the event of insolvency proceedings is a matter of prime social concern, and is one to which we have given considerable thought.

5.35. The assets available for creditors.

Not only are creditors of an insolvent ~~debtor~~ whose affairs are being administered in insolvency restricted with regard to their civil remedies against him, being confined to lodging their claims in that administration; but they are also, in the nature of things, further disadvantaged by the delay which must inevitably occur whilst the estate is being realised and a dividend paid. Such delay is clearly an injustice to the creditor, and is aggravated to the extent

that the dividend falls short of payment in full, together with an appropriate rate of interest. We consider that expedition and despatch in the dealing with the estate of insolvents should be given high priority.

5.36. The question next to be considered is what are, or should be, the assets available for distribution amongst the creditors. In this field, the position under the present law differs significantly between the provisions of personal bankruptcy and those of company winding-up.

5.37. [Further sections will include:

(1) Equality is equity

(2) The investigatory role in insolvency proceedings

(3) The protection of society from the activities of delinquent debtors and directors.

(4) The simplification of insolvency law and practice.]

5.38 [At the next re-draft, Chapter 5 will also reflect the principal complaints received from consultees as listed in the attached paper.]

Written Evidence - Many Areas of Concern

1 Problems for consumer-creditors when mail order companies go into liquidation (C12 and others. See also Kayford case).

2 Numerous views on Retention of Title, for and against, depending upon business, etc, of the witness.

3 There should be more extensive use of the C C Administration Order, coupled with development of the Enforcement Officer and counselling facilities. It should be used also for small businesses (C15 (Farrar), C23, C25, etc).

4 The accountability of a receiver requires attention as their actions affect all creditors (C15, C23, C24, etc).

5 Fraudulent trading needs strengthening and clarification of the rules.

6 More extensive use should be made of Public Examinations in company winding-up. Directors should be treated in a similar manner as individual bankrupts and be liable to similar disabilities.

7 The proliferation of Government preferential rights (many consultees).

8 Law leans too heavily in favour of debtor who is able to continue trading while insolvent or emerge from wreckage of one company and trade immediately under the protection of another limited company (several consultees).

9 Problems related to groups of companies and the liability of the holding company.

10 Bankrupts trading in the spouse's name.

11 The Deed of Arrangement needs to be updated (C31, C35, C39, etc).

12 Problems of sub-contractors in the construction industry, vis-a-vis retention moneys.

13 Unsecured creditors should be able to appoint a receiver (C33).

14 OR's Service should be expanded to cope with investigation, especially where fraud is suspected (C36, C116).

15 Insolvency provisions and rules, especially those related to bankruptcy, should be drafted in modern language (C38, C41, etc).

16 Fraudulent preferences, etc, need thorough overhaul (C40, etc).

17 Many calls for harmonisation of the systems and of procedures.

18 Many complaints about delinquent directors, mismanagement, etc.

19 A number are against the newly-introduced automatic discharge of bankrupts.

20 Several want C C Administration Orders to be available for application by creditors (C42, etc).

21 A number ask for restrictions on who may act as receiver, trustee or liquidator.

22 Several requests for a simplified procedure for "small" bankruptcies and liquidations (DTI, etc).

23 Bankruptcy disabilities and offences require simplification (several).

24 Acts of Bankruptcy are archaic and should be abolished (several).

25 The majority of debtors are incompetent rather than criminal; thought should be given to the creation of a more flexible system so that draconian measures are applied only in the worse cases (C57).

26 Protection afforded to the debtor should be balanced by more stringent requirements for him to enact his indebtedness - more consideration should be given to creditors (C59).

27 Existing debt collecting procedures are not adequate; the threat of bankruptcy or liquidation is in many cases the only effective means of enforcement (C59, etc).

28 Several organisations feel that they should join the preferential bandwaggon.

29 Complaints about set-off between Government departments. Also, the law of set-off should be clarified.

30 Exempt property in a bankruptcy needs bringing up to date; a fresh look should be given to the position of the matrimonial home.

31 Reputed ownership should be abolished.

32 The various forms of committees of creditors, their powers, duties, etc, should be harmonised (C151).

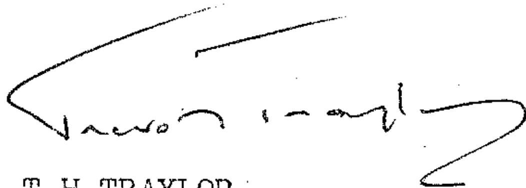
INSOLVENCY LAW REVIEW COMMITTEE

NOTE TO MEMBERS

It was agreed, during the afternoon session of yesterday's meeting, that the meeting fixed for 25 June should be cancelled. This will enable members to concentrate on the draft chapters/sections which they have undertaken to prepare for inclusion in Part 2 of the Report.

It was further agreed that the meetings fixed for 13 and 27 July should start at 9.30 am.

Items for consideration at the meeting on 13 July should reach me not later than 25 June. The general view was that if Part 2 is to be completed within a reasonable time, most of the preliminary preparation of drafts would have to be completed by the end of this month.



T H TRAYLOR
Secretary
9.6.81

Times Mon 8th June 1981

habits have changed and these news for coffee drinkers.

Robin Young on opportunities offered by the Companies Bill

Making life harder for cheats

Now that the flow of legislation designed to protect consumers has virtually ceased, consumer organizations are disappointed that the Government has not taken the opportunity afforded by its Companies Bill, which goes into committee in the Commons tomorrow, to help them in some important respects.

What has upset the consumer lobby most about the Bill is the Government's determination to abolish the Registry of Small Business Names. The Consumers' Association, the National Consumer Council and the National Federation of Consumer Groups are united in a campaign to save the registry and have recruited to their cause such diverse supporters as the Newspaper Proprietors Association, the confederation of British Industry, the Press Council and the Institute of Trading Standards Administration.

No one claims that the register, which originated in 1916, is perfect. The principle behind it is that anybody carrying on a business in something other than their own name should register the particulars, so that the public may know with whom they are dealing.

Enforcement is admittedly at something of a low ebb. Many cowboy and fly-by-night operations are not registered. Some traders of the sort most likely to bilk the public find it convenient to have a clutch of undisclosed aliases.

The register has nonetheless been a useful starting point for aggrieved customers and investigative journalists alike, intent on exposing the activities of rogue traders. Banks tend to insist that small businesses with which they deal register as they are legally required; and the register while not reliable or complete, has by no means ceased to function.

The Government intends to abolish it to save money. The register's defenders say that it should be made effective and self-supporting, first by increasing the registration and search fees, which have remained unchanged since 1916.

The Government, instead, will require fuller disclosure of the details of proprietorship on business stationery, letterheads and so on. The chances of tracking down the dishonest minority by such means are distinctly remote.

In the Lords committee stage the Government was actually defeated on the issue, thanks to the stalwart interventions of consumer champions such as Lady Elliott of Harewood and others. To the confoundment of the consumer lobby the Government then put the whips on in the Lords (almost unheard of) and reversed the decision on report.

It remains to be seen whether there are any on the Conservative benches in the Commons who will speak up for the public's right to know which individual or company is trading and under what name.

There is another matter on which the Government even at this late stage might make amends. Section 188 of the Companies Act 1948 empowers a court winding up a company or convicting directors of fraud to ban the individuals concerned from holding any other directorship for five years. There has to be misconduct, fraud or other criminal offence involved.

The Government (to its credit) is extending this power to magistrates' courts, where most such cases are now likely to be prosecuted. At the same time crown courts and the Chancery division of the High Court will be allowed to extend their bans to 15 years. But the basic rule of the Companies Act — that it applies only to cases involving misconduct or crime — remains.

Under section nine of the Insolvency Act 1976, the same sort of ban can be imposed on anyone who has been a director of two limited companies which have gone into liquidation due to insolvency within five years of each other, if he was entirely or largely to blame for at least one of the failures since October, 1977.

The Insolvency Act is unhelpfully silent about who should enforce this provision, so it is left to the Department of Trade. In fact since the Act was passed only two directors, both in the same case, have been banned from holding further directorships because of repeated insolvencies.

Yet it is a notorious scandal in many trades (building, double glazing, central heating, car sales among them) that when one company goes out of business owing people money, the directors carry on in the same line of business via another company they have set up, perhaps to go insolvent again with more creditors unsatisfied on each occasion.

Repeatedly on Mr Roger Cook's radio programme, *Checkpoint*, on Miss Esther Rantzen's *That's Life* on television, in the columns of *Private Eye* and elsewhere, cases are reported of companies bilking their customers — companies whose directors have been doing the same for years via a succession of companies which have, in turn, each gone bankrupt.

A business insolvency can be worse for the customers than the owners, who are protected by limited liability.

So what can be done in a situation so clearly unsatisfactory to consumers? Would the Government perhaps consent to an amendment to its present Bill which would say that on the failure of a company owing to insolvency within five years of another involving the same director or directors those individuals should be automatically disqualified for five years from holding any more directorships, unless they can satisfy the Department of Trade or a court that they should qualify for dispensation?

Such an amendment will, almost certainly, be presented in committee. Unless the Government can bring themselves to accept something of this form, we must await the report of the Cork Committee on insolvency with inevitable delay before legislation can ensue.

Some directors will have bankrupted a lot more companies, and lost their customers a lot more money, before that.

Draw attention to ?LRC6 in so far included here & in Ch. 6.

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THE CORK REPORT

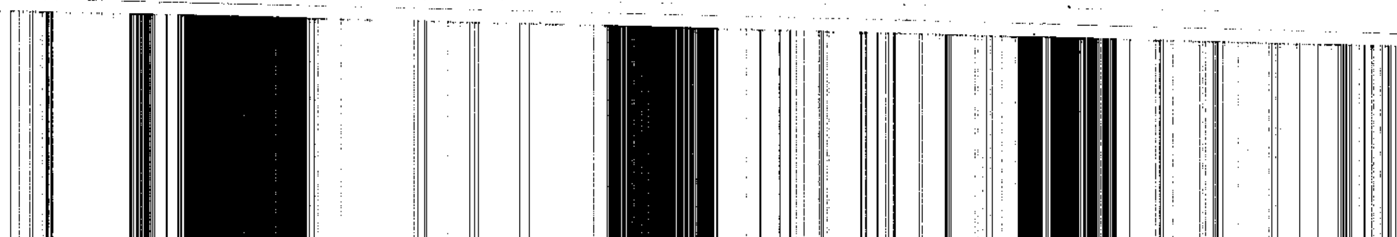
CHAPTER V

A PHILOSOPHY FOR INSOLVENCY LAW

General

5.1. What should be the aim of a modern insolvency law? We attach great significance to this question. If an architect is commissioned to design a building, he will require fairly precise instructions regarding its function and size, and not least, an estimate of the amount available to be spent on the construction of the project and subsequent maintenance costs. His approach to the design of a house will by no means be the same as that for a factory or civic centre. Likewise the framers of new insolvency procedures must be given some guidelines as to what they are intended to achieve and what public resources are to be earmarked for their carrying out. In this chapter we accordingly discuss the principal criteria which could be adopted for this purpose.

5.2. The survey of existing procedures and their origins has left us with a clear impression that the goals or objectives which the present insolvency laws were intended by their authors to attain have by and large been forgotten. The system has become rigid in its structure and inflexible in its operation; consequently if any attention is ever paid to the purposes which the system was originally designed to serve, such an exercise leads inexorably to the application of principles aimed at grappling with problems of insolvency arising in a generation with needs quite different from those of our own; such principles are therefore not necessarily suited to the conditions prevailing today or, even moreso, likely



(j) To ensure due recognition and respect for English insolvency proceedings abroad.

5.7. If these are accepted as a fair statement of a good modern insolvency law, then it must follow that the multifarious statutory procedures which now form our present law should be radically revised and combined to achieve such aims. In our view the time has long since passed for piecemeal and patchwork tinkering with this vital sector of the lives of each one of us.

5.8. **The casualties of the credit world.**

Although considerable attention has recently been given to the whole nature and structure of the credit industry and the services it provides, e.g. by the Crowther Committee on Consumer Credit and the Wilson Committee on the Role of the City, scarcely any work has been done to describe and understand what happens, in any particular circumstances, when there is a breakdown of the credit relationship of such dimensions that an insolvency situation occurs. It is obvious that the repercussions will be of infinite variety and complexity, depending not only on the personal circumstances of the individual debtor, but also upon the affairs of his creditor to the extent that he is in a position to cope with the inevitable delay in the recovery of his debt or to absorb the loss of the whole or virtually the whole of the debt.

The consumer debtor

5.9. Let us take a few examples. The consumer debtor faced with insolvency or, under the present system, with bankruptcy, must face the fact that there will be some disruption to his family life and even a degree of intrusion into the privacy of his home; if he manages to remain in employment, he can be expected, given a normal degree of sensitivity, to feel some humiliation amongst his family and colleagues. The more unscrupulous debtor, however, may be better prepared to handle the situation because he has, for example, taken some precautions against such an event by "salting away" assets in one manner or another which we will comsider later; such a debtor, we regret to say, may even look upon his bankruptcy with a certain cynical eye.

The commercial debtor

5.10. The failure of a large trading entity will give rise to a multitude of problems for the proprietors and those concerned

with its daily operations, such as employees and suppliers. We are all familiar with the modern concept of the "sit-in" by workers who are determined not to lose their jobs. A concern for the livelihood and wellbeing of a whole industry or region is, in our view, a legitimate factor to which a modern law of insolvency must have regard.

5.11. Our present machinery for dealing with insolvency matters, has, like so many of our institutions, grown up almost haphazardly, and it lacks any overall plan or general coherence. We are convinced that, notwithstanding the many virtues which it undoubtedly has, that it fails by a long way to achieve so many of the fundamental aims for a good insolvency law to which we have referred that nothing less than a radical re-structuring of the procedures will do if insolvency situations in the future are to be efficiently dealt with in a manner, judged by prevailing requirements, to be fair and just.

5.12. The diagnosis and early treatment of an insolvency situation.

The debtor is himself invariably the first to know that he is insolvent but, all too often, he will try to delude himself as to the truth or its implications; telltale signs indicate his real state of mind: demands from creditors are ignored or are met with delaying tactics, such as complaints as to the quality of goods supplied or work done; he refers euphemistically to having "a cash flow problem"; He may even go abroad or generally give the impression that his affairs are beginning to get on top of him.

5.13. From these signs it is possible for outsiders, such as his creditors, to infer that they have an insolvency situation on their hands. Immediately each creditor is faced with what

for him is the crucial question, namely, how best can he recover what is due from the debtor? The longer the situation is allowed to go on unregulated, the greater the chance for the debtor to play one creditor off against another, to dispose of such assets as he still possesses to the prejudice of the general body of his creditors, and so to conduct his affairs that it becomes increasingly difficult to tidy them up in a speedy and satisfactory way.

5.14. The practice and procedure of our present law is not well suited to achieve those ends.

5.8. The Casualties of the Credit World. Considerable attention has recently been given to the whole nature and structure of the credit industry and the services it provides, e.g. by the Crowther Committee on Consumer Credit and the Wilson Committee on the role of the City. On the other hand, scarcely any detailed study or analysis has been carried out about what happens when the credit relationship breaks down and that breakdwon is of such proportions that an insolvency situation occurs. It is obvious that the repercussions will be of infinite variety and complexity; not only will the personal characteristics and financial circumstances of the individual debtor be of concern, but equally relevant may be the impact of the situation upon the affairs of the creditor to the extent that he is able or not to withstand the inevitable delay in the recovery of his debts or to absorb its loss to whatever extent may be necessary in his business or life without any or any appreciable catastrophe to himself.

5.9. A sharp distinction for present purposes exists between the private individual, who usually, but not always, is to be found in trouble because he has over-extended himself in the credit world; such a person has not normally engaged in any form of business or commercial activity. Conversely, the other main category of debtor is the debtor who, either on his own account or in partnership with another, or as a corporation has been so engaged, as will nearly always have been the position of the corporate debtor. The problems faced by each one usually are, speaking broadly, widely different both in the extent of their financial implications and their social consequences.

5.10. The Consumer Debtor. The consumer debtor faced with insolvency or, under the present system, even with the harsher regime of bankruptcy, cannot escape the fact that there will be

some disruption to his family life, a degree of intrusion into the privacy of his home and, indeed, as we shall see, some considerable peril to his right to retain that very home. Subject to the reforms introduced by the Insolvency Act, 1976, such a debtor, if bankrupt, must undergo a public examination and, at any rate in the provinces, the hearing is likely to receive some publicity in the local press. If the debtor manages to retain any employment, he can be expected, given a normal degree of sensitivity, to feel some humiliation amongst his family and colleagues; if he loses his livelihood or job, then obviously his bitterness and that of his family will rankle. Whatever the true nature and causes of the insolvency, it is more likely than not, in our present society, that his condition will be recorded somehow with a credit agency to his prejudice in terms of being able to obtain credit or ~~work~~ even employment in the future.

5.1. The more unscrupulous debtor, however, may be better prepared to handle the insolvency situation because he has taken some precautions against such an event, for example, by putting assets beyond the reach of his creditors in the manner we consider later; not surprisingly, such a debtor is frequently known to look upon his bankruptcy with a certain cynicism.

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5.12. <u>The Commercial Debtor.</u> The failure of a trading entity will give rise to a multitude of problems for the entrepreneurs (not merely the Board of Directors but in many cases the shareholders also) as well as those concerned with its daily operations, such as employees and suppliers. The size of the enterprise will clearly have considerable bearing on the type of repercussions which will follow any given failure, but we are all familiar with the modern concept of the "sit-in" by workers who are determined that their jobs shall not be lost. This is a phenomenon which can drastically diminish, if not annihilate, the value of a company's stock, plant and goodwill to the evident disadvantage of its creditors.

5.13. We believe that a concern for the livelihood and wellbeing of those dependent upon an enterprise which might be the lifeblood of a whole town or region, to be a legitimate factor to which a m

modern law of insolvency must have regard. The chain reaction consequent upon any given failure can potentially be so disastrous to creditors, employees and the community that it must not be overlooked. Our present insolvency laws do not even pay lip service to this concept.

5.14. The existing machinery for dealing with insolvency matters and the problems created by the casualties of the credit world have, like so many of our institutions, grown up almost haphazardly and they lack any overall plan or general coherence. We are convinced that, not withstanding the many virtues the system undoubtedly has, that each piece of machinery looked a the aggregate fails by a long way to achieve so many of the fundamental aims of a good insolvency law described above nothing less than a radical re-structuring of the procedu insolvency situations in the future are to be er, by prevailing requirements, rec

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CHAPTER 5. INITIATION

2nd Draft
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1. Introduction

1. Our terms of reference require us, inter alia, "to examine the possibility of formulating a comprehensive insolvency system and the extent to which existing procedures might, with advantage, be harmonised and integrated".

2. Nowhere in our present law of insolvency are there to be found greater or more profound differences between the bankruptcy code applicable to individuals on the one hand and the winding up code applicable to companies on the other, than in their different requirements for the initiation of insolvency proceedings. These are by no means limited to those attributable to the differences between individual debtors on the one hand and corporate creditors on the other; and accordingly it ought to be possible to eliminate the discrepancies and to formulate a unified system. But the differences are not slight or superficial; they are fundamental. The act of bankruptcy, for example, which constitutes the very cornerstone of the bankruptcy code, has no part at all in the winding up code. In seeking to

devise a uniform procedure to replace the present codes, we have been faced with fundamental questions concerning the nature and purpose of insolvency proceedings.

3. The principal differences between the two codes under the existing law may be summarised as follows:

(i) In bankruptcy, the petitioning creditor must allege that the debtor has committed an "act of bankruptcy". This may, and usually does, consist of the debtor's failure to comply with a "bankruptcy notice", requiring him to pay a judgment debt due to the petitioning creditor; but it is not so limited. An act of bankruptcy, once committed by a debtor, remains available to all his creditors for a period of three months, during which time any of them may found a bankruptcy petition upon it. In essence therefore, the petitioning creditor complains, not of the debtor's failure to pay a debt due to him, but of the debtor's insolvency. In company winding up the reverse is true. The concept of the act of bankruptcy is unknown. The petitioning creditor is required formally to allege that the company is insolvent and unable to pay its debts as they fall due; but the only evidence to support the allegation almost invariably consists merely of the company's failure to pay

a debt presently due to the petitioning creditor.

(ii) A bankruptcy petition is not advertised; the proceedings are anonymous and are heard in ~~commerce~~ camera; and other creditors are not permitted to attend. The proceedings are thus conducted entirely on a "one-to-one" basis as if they constituted private litigation between the parties. A winding up petition, in contrast, must be publicly advertised after the expiry of seven days from the date of service; the advertisement constitutes an invitation to all the creditors of the company to attend at the hearing of the petition in order to support or oppose the making of a winding up order; and the hearing is in public. The proceedings are thus conducted on a collective basis.

(iii) Although bankruptcy proceedings are conducted as private litigation between the parties, the Court must bear in mind that the debtor has committed an act of bankruptcy which is available to other creditors, and that he is to be treated as an insolvent person. He will therefore normally not be permitted to obtain the dismissal of the petition by paying off the

petitioning creditor's debt out of his own money; although he will normally be permitted to do so out of money provided by a third party. In practice, the source of the money is necessarily the subject of only superficial inquiry. In company winding up, in contrast, the company has an absolute right to have the petition dismissed, provided that it satisfies the claims of the petitioning creditor, whether or not out of its own assets, before the petition has been advertised. Once the petition has been advertised, on the other hand, the company no longer has the right to have it dismissed by satisfying only the claims of the petitioning creditor; any other creditor may apply to be substituted as petitioner and may seek to have the company wound up on the original petition as amended.

(iv) Once an individual debtor is adjudicated bankrupt, his insolvency is treated as having commenced on the date on which he committed the act of bankruptcy on which the petition was founded. In company winding up, this concept is unknown; once a winding up order is made against a company, its insolvency is treated as having commenced on the date on which the petition was presented.

4. In seeking to devise a uniform procedure, therefore, we have been faced with the following questions:-

(i) what should be the nature of the applicant's complaint? Should he be required to allege that the debtor is or was at some past date insolvent; or merely that he has failed to pay a debt presently due to the applicant?

(ii) should the application be advertised, so that the proceedings may be conducted on a collective basis in the presence of the other creditors; or should they be conducted, like ordinary litigation, on a one-to-one basis?

(iii) should the debtor be permitted to have the proceedings dismissed by paying the debt due to the applicant, and if so on what terms? Or should the other creditors be entitled to intervene?

(iv) should an insolvency order be based on the debtor's insolvency, or on his failure to pay a debt presently due to the applicant?

(v) should some date prior to the initiation

of proceedings be identified as the date on which the debtor became insolvent, with a view to setting aside all subsequent transactions?

5. Underlying these questions is a more fundamental one: whether insolvency proceedings ought to be regarded exclusively as a collective remedy sought by one creditor for the benefit of all; or whether, and if so to what extent, they may also properly be regarded as a form of execution sought by a creditor whose primary aim is simply to obtain payment of the debt due to him. Allied to this is another question of fundamental policy: whether the diligent creditor who is active to recover the debt due to him ought to be allowed to retain the fruits of his diligence; or whether his attempts to gain priority over other, less diligent, creditors in the event of the debtor's insolvency, should be frustrated.

6. These are questions which have faced us again and again in the course of our deliberations. Our attitude to them has influenced many of the recommendations which are to be found in later Chapters of this Report. We are convinced of two matters. First, we are satisfied that the present

processes of execution are so inadequate that bankruptcy and winding up are increasingly resorted to as the only effective means of enforcing money judgments. In these circumstances, it is unrealistic to place obstacles in the way of the debtor's payment of the debt due to the applicant, and unfair to the diligent creditor to deprive him of the payment which it was his object to obtain. Secondly, we believe that all attempts to identify a particular point of time prior to the commencement of proceedings as the moment when the debtor became insolvent should be abandoned.

7. We have designed our proposals for a unified system with these principles in mind. At the outset, we intend the proceedings to be strictly on a "one-to-one" basis, with no advertisement and no publicity, and with every encouragement to the debtor to obtain the dismissal of the proceedings by paying off the applicant. If he fails to do so then the application will be advertised and the proceedings will be continued on a collective basis in the presence of all those creditors who wish to attend. Only from this moment, when the proceedings become "collectivised", will the debtor fall to be regarded as an insolvent. This moment, which is of crucial importance to many of our recommendations both in this and other

Chapters of this Report, will be that of the making of a "Protection Order".

2. Acts of bankruptcy

8. We propose the complete abolition of the whole concept of the act of bankruptcy. Under the present law, there are no less than sixteen different acts of bankruptcy, or seventeen if the notional act of bankruptcy introduced by the Powers of Criminal Courts Act 1973 is included. Most of them are obsolete or obsolescent; their abolition will greatly simplify and modernise the law of bankruptcy. With the exception of the debtor's failure to comply with a bankruptcy notice, none of them was needed in order to enable a creditor to present a bankruptcy petition in a proper case. Every creditor who wishes to initiate insolvency proceedings against a debtor must allege and prove that he is a creditor and, except in the cases of future and contingent debts, this involves alleging and proving that the debtor has failed to pay a debt presently due to the applicant and not bona fide disputed on

reasonable grounds. Such failure on the part of a corporate debtor has always been sufficient to justify the conclusion that the debtor is insolvent and ought to be wound up. Special provision is required for the comparatively rare case of the contingent or prospective creditor, but subject thereto no other evidence of insolvency is needed. We have reached the conclusion that these principles, modified in accordance with our recommendations, are appropriate for individual as well as corporate debtors.

9. The elimination of the doctrine of the act of bankruptcy, however, is not merely a question of modernising and simplifying the grounds upon which a creditor may initiate insolvency proceedings. It represents a fundamental change in the law of bankruptcy with far-reaching consequences. No creditor will be able, or need, to rely on the debtor's failure to satisfy some other creditor's claim; no creditor demanding and receiving payment of a debt lawfully due to him will be concerned whether the debtor is able to meet his other liabilities: for the concept of the "available act of bankruptcy" will disappear. If a Protection Order is made, it will have immediate effect, but there will be no "relation back", either to the date on which the application was made, or to

any earlier date; the debtor's insolvency will be treated as commencing on the date on which the Protection Order is made.

3. <u>Grounds on which an insolvency application may be made</u>

10. We propose that in future the sole ground upon which the Court may make an Insolvency Order in respect of a debtor, whether individual or corporate, and the sole ground upon which an application for such an Order may be made by a creditor, will be that the debtor is insolvent and unable to pay his or its debts. Where the application is made by a creditor, the debtor will be deemed to be insolvent and unable to pay his or its debts:-

(a) Where the applicant is a judgment creditor to whom the debtor is indebted in a sum in respect of a judgment debt of not less than the prescribed amount, not being the subject of a stay of execution, and the debtor has failed to pay the same; or

(b) Where the applicant is a creditor to whom

the debtor is indebted in a sum of not less than the prescribed amount, being a debt presently due and payable and not known to be bona fide disputed by the debtor on reasonable grounds, and the debtor has failed to pay the same after service upon the debtor or the debtor's agent not less than 21 days before the making of the insolvency application of a formal demand in writing for payment; or

(c) Where the applicant is a contingent or prospective creditor to whom the debtor is or may become indebted in a sum of not less than the prescribed amount, being a debt not yet presently due and payable, and it is proved to the satisfaction of the Court that the debtor's liabilities, including contingent and prospective liabilities, exceed the debtor's assets.

11. A judgment debtor is not entitled to any notice requiring him to pay a money judgment, and accordingly we do not propose that the service of a formal demand for payment should be a pre-condition for the making of an insolvency application founded upon a judgment debt. Where, however, judgment has been entered in default, and in other similar cases, it would often be prudent and commercially

sensible to serve a notice requiring payment before making an insolvency application. Failure to serve an adequate notice in an appropriate case should, in our view, be a matter to be taken into consideration by the Court at the hearing, particularly on any question as to costs.

12. Where the debt in which the application is founded is not a judgment debt, we propose that the service of a formal written demand for payment should be an essential requirement. Service should be effected personally or by recorded delivery letter. The notice should indicate briefly the possible consequences of ignoring it. Its purpose is to give the debtor an opportunity either to pay the debt or to deny any liability to do so, with reasons. We are firmly of the view that the present rule, that insolvency proceedings must not be brought on a disputed debt, should be retained. The Insolvency Court is not the proper forum for trying a disputed debt. An applicant who relies on such a debt will risk having his application dismissed with costs and, in appropriate cases, an inquiry as to damages.

4. The new unified procedure

(1) Creditors' applications

13. We propose that the following procedure should be adopted in the case of every application by a creditor, whether the debtor be an individual or a company:-

(i) the creditor will file in the appropriate Insolvency Court a simple form of Insolvency Application, which will replace the present petition;

(ii) the Application will contain the names and addresses of the creditor and the debtor, and will set out the details of the debt on which it is founded and the grounds upon which it is alleged that the debtor is insolvent;

(iii) the Application will be supported by a formal Affidavit sworn by the applicant or a duly authorised officer of the applicant verifying the facts stated in the Application;

(iv) court officials will no longer be required to satisfy themselves that the Application is properly founded and supported by the necessary evidence before allowing it to be

filed and issued, though in a proper case where the Application is clearly defective (for example where the debt on which it is founded is below the prescribed minimum) they will continue to have power to reject it;

(v) the Court will immediately fix a date for the first hearing of the Application not less than [14] nor more than [21] days after the filing of the Application;

(vi) a sealed copy of the Application endorsed with the date of the first hearing will be issued to the applicant by the Court and served by the applicant upon the debtor or the debtor's agent. Service must be effected not less than [10] clear days before the date fixed for the first hearing, and may be effected personally or by recorded delivery service at the debtor's last-known place of residence (if an individual) or registered office (if a company) or place of business (if a trader whether individual or corporate);

(vii) the copy of the Application served on the debtor should be endorsed with a notice

informing him that at the hearing a Protection Order may be made, unless before the date of the hearing the debtor either (a) pays the debt stated in the Application in full together with a specified sum in respect of costs or (b) files a defence to the Application setting out fully the debtor's grounds for disputing it;

(viii) the notice endorsed on the Application should also contain the information that the debtor may, in lieu of a defence, file a simple form of admission of insolvency and request an immediate Protection Order, on receipt of which the Court will forthwith make the Order, vacate the date fixed for the hearing, and notify the applicant creditor.

2. Debtors' applications

14. We are firmly of the view that, where appropriate, debtors should be encouraged to file their own applications, and that the process should

be as simple, swift and cheap as can be devised. It is also essential in the case of the corporate debtor that the procedure should be the same as the procedure by which the appointment of an Administrator may be obtained (see Chapter). Accordingly, we propose that in future the unified procedure outlined below should be adopted and should replace the several codes now in force.

15. (a) Individual debtors

(i) the debtor will complete and sign a short statement acknowledging his insolvency, listing his principal creditors and the amounts believed to be due to them, describing his principal assets, and requesting the making of an immediate Protection Order. The statement should also contain a short explanation of the grounds upon which a Debts Arrangement Order is considered to be inappropriate. The statement need not be supported by an affidavit verifying it;

(ii) the debtor will cause a copy of the statement to be delivered to the appropriate Insolvency Court;

(iii) on receipt of the statement, the Court will make an immediate Protection Order.

16. (b) Corporate debtors

(i) the board of directors of the debtor company will formally resolve that the company is insolvent and (unless it is proposed to seek an Administration Order) that is expedient that a Protection Order be made, and (in any case) that the appropriate meetings of members and creditors be convened;

(ii) the resolution will also state whether the board propose to recommend a compulsory winding up, a voluntary liquidation of assets, or the making of an Administration Order;

(iii) the resolution may but, except where it is proposed to seek an Administration Order, need not nominate as Administrator some person qualified to act as such;

(iv) the board will cause to be delivered to the appropriate Insolvency Court a certified copy of the resolution together with a letter signed by the proposed Administrator (if any) expressing his willingness to accept the appointment;

(v) on receipt of the certified copy of

the resolution the Court will (unless an Administration Order is sought) make a Protection Order and appoint as Provisional Administrator the person nominated by the board or, if none has been nominated, the Official Receiver;

(vi) the Provisional Administrator will proceed to convene the necessary meetings of members and contributories.

17. It is a ~~conditional~~ cardinal principle of the system we propose that in every case, whether the debtor be an individual or a company, and whatever the character of the process which will ultimately ensue, the first step will be to obtain a Protection Order and the appointment of a Provisional Administrator. It will be his responsibility to convene the necessary meetings, at which the type of insolvency process to be adopted will be decided. In the meantime the Protection Order will mark the commencment of the insolvency, and by freezing the position will afford the debtor the necessary measure of protection while the creditors are notified of the position.

18. It follows that the present system of creditors' voluntary winding up, in which the Court normally plays no part at all, and in which the commencement of the liquidation is the date of the

members' resolution, will be replaced by a new system in which the Court will make a Protection Order, and in which the commencement of the liquidation will precede the convening of the appropriate meetings. It is to be expected that our proposal to involve the Court, however slightly, will arouse some ill-informed criticism, but we regard it as indispensable. In an attempt to allay anxiety, we stress the following:-

(i) the decision to initiate some form of insolvency process will remain, as at present, that of the board of directors;

(ii) the decision whether the company should be wound up and if so in what manner will remain, as at present, for the members and creditors to make;

(iii) the involvement of the Court will be minimal, being limited to the making of a formal Protection Order and the confirmation of the company's nominee as Provisional Administrator;

(iv) the Official Receiver will play no part except where the board fail to nominate a proposed Administrator;

[(v) it would be inconsistent to require a

Court Order for the appointment of an Administrator where the company was seeking to be placed in Administration, but to dispense with the requirement of a Court Order where the company was seeking the more serious process of liquidation.]

19. We have received a considerable body of evidence critical of the present law applicable to creditors' voluntary winding up, and in particular of the position during the period which must elapse between the convening of the necessary meetings and the passage of the resolution to wind up which, under the present law, marks the commencement of the liquidation. During this period, while the directors remain in control, the company's assets and the interests of the creditors are most inadequately protected. Many of our proposals, particularly those dealing with securities and uncompleted executions, will make the problem worse, not better, if the present procedure for placing a company in creditors' voluntary winding up remains unaltered. We are in no doubt that, if our other proposals are accepted, it is essential that notice to the creditors of the company's insolvency should follow, and not precede, the commencement of the insolvency and the appointment of a Provisional Administrator. We also believe that,

if our proposals are adopted, they will meet the many criticisms of the present procedure which have been made to us.

CHAPTER 5

The assets available for creditors.

5.1. Before we consider the question "what should be done with the debtor's assets?", we must consider, what are, or should be, the assets available for distribution among his creditors. In this field, the position under the present law differs significantly between the provisions of personal bankruptcy and those of company winding-up.

5.2. The assets presently "available" under each kind of insolvency fall into three ~~categories:~~ classes:

Class (1): These are the ~~The~~ assets (subject to the Exceptions stated below) which are actually in the debtor's possession when he becomes bankrupt, or, if a company when it is wound up, and which are his property; these include not only physical or "tangible" assets, land, factories, houses, plant, material and "goods" generally, but also "intangible" assets such as book debts (due in the course of trade), other debts, rents, royalties, patents and other rights to receive or recover money, including rights of action to enforce claims to money or to recover damages.

Exceptions (a) Of the assets of this description, some, though physically in the debtor's possession and ostensibly his property, no longer "belong" to him, for he has mortgaged or charged them to other persons, or has sold or otherwise disposed of them without delivering them or (if they are intangible) without conveying the legal title;

(b) Other such assets, in the form of tangible assets, (which we will call "goods") such as plant, raw materials, semi-finished or finished goods, and in the form of intangible assets ~~which~~ such as book debts, although in the debtor's possession and ostensibly his property, have not yet begun to "belong" to him; this arises where the goods have been acquired by the debtor

either under a contract of sale under which he will not become the "owner" of the goods until those goods have been paid for or all the goods supplied to him by that seller have been paid for, (this doctrine is called "reservation of title", or sometimes "the Romalpa doctrine" and is considered in Chapter below). Where this arises, the proceeds of sale of the goods in the shape of money, received (and still traceable) or to be received by the debtor from his customers may be claimable by the vendor. There is an exception to this Exception, in respect of the doctrine of "reputed ownership", applicable only in personal bankruptcy and considered below.

(c) The debtor may also be in possession and ostensibly the owner of goods leased to him, or being bought by him under hire purchase or conditional sale agreements, under which the debtor or his trustee in liquidation has no rights of property in them, or only those restricted rights of property, in accordance with the relevant provisions of the Consumer Credit Act, 1974 and of the Bills of Sale Acts 1878 - 1882.

Class (2) These are the assets which, although not in the debtor's possession and not his property when he becomes bankrupt or, (if a company) is wound up, were his property at an earlier date, and have been either disposed of by him, or seized by one or more of his creditors since that date. Under the existing law, some of such transactions, either of disposal or of seizure may be set aside on the application of the trustee in bankruptcy or the liquidator, so that the value of those assets can be recovered for the benefit of the debtor's creditors.

That earlier date varies widely as between bankruptcy and winding-up, and according to the different classes of transaction affected. It may be the date of the presentation of the petition (for bankruptcy or for winding-up), or it may be a still earlier

date, such as the commission of an "act of bankruptcy", or a date when the debtor was plainly insolvent. These periods, running back from the date of the bankruptcy or the winding up, to some earlier date, during which past transactions affecting the debtor's property may be sought to be set aside, are called "periods of relation back", ~~and~~ the Committee has given close consideration to the principles involved in the "relation back" concept, and they are dealt with in Chapter below.

CHAPTER 5

The assets available for creditors.

5.1. Before we consider the question "what should be done with the debtor's assets?", we must consider, what are, or should be, the assets available for distribution among his creditors. In this field, the position under the present law differs significantly between the provisions of personal bankruptcy and those of company winding-up.

5.2. The assets presently "available" under each kind of insolvency fall into three classes:

Class (1): These are "present" assets (subject to the Exceptions stated below) which are actually in the debtor's possession when he becomes bankrupt, or, (if a company) when it is wound up, and which are his property; these include not only physical or "tangible" assets,-land, factories, houses, plant, material and "goods" generally,-but also "intangible" assets such as book debts (due in the course of trade), other debts, rents, royalties, patents and other rights to receive or recover money, including rights of action to enforce claims to money or to recover damages.

Exceptions: (a) Of the assets of this description, some, though physically in the debtor's possession and ostensibly his property, no longer "belong" to him, for he has mortgaged or charged them to other persons, or has sold or otherwise disposed of them without delivering them or (if they are intangible) without conveying the legal title;

(b) Other such assets, in the form of tangible assets, (which we will call "goods") such as plant, raw materials, semi-finished or finished goods, and in the form of intangible assets such as book debts, although in the debtor's possession and ostensibly his property, have not yet begun to "belong" to him; this arises where the goods have been acquired by the debtor

either under a contract of sale under which he will not become the "owner" of the goods until those goods have been paid for, or all the goods supplied to him by that seller have been paid for, (this doctrine is called "reservation of title", or sometimes "the Romalpa doctrine" and is considered in Chapter below). Where this arises, the proceeds of sale of the goods in the shape of money/ received (and still traceable) or to be received by the debtor from his customers may be claimable by the vendor. There is an Exception to this Exception, in respect of the doctrine of "reputed ownership", applicable only in personal bankruptcy and considered below.

(c) The debtor may also be in possession and ostensibly the owner of goods leased to him, or being bought by him under hire purchase or conditional sale agreements, under which the debtor or his trustee in liquidation has no rights of property in them, or only those restricted rights of property, in accordance with the relevant provisions of the Consumer Credit Act, 1974 and of the Bills of Sale Acts 1878 - 1882.

<u>Class (2)</u> These are "past" assets which, although not in the debtor's possession and not his property when he becomes bankrupt or, (if a company) is wound up, were his property at an earlier date, and have been either disposed of by him, or seized by one or more of his creditors since that date. Under the existing law, some of such transactions, either of disposal or of seizure, may be set aside on the application of the trustee in bankruptcy or the liquidator, so that the value of those assets can be recovered for the benefit of the debtor's creditors.

That earlier date varies widely as between bankruptcy and winding-up, and according to the different classes of transaction affected. It may be the date of the presentation of the petition (for bankruptcy or for winding-up), or it may be a still earlier

date, such as the commission of an "act of bankruptcy", or a date when the debtor was plainly insolvent. These periods, running back from the date of the bankruptcy or the winding up, to some earlier date, during which past transactions affecting the debtor's property may be sought to be set aside, are called "periods of relation back"; ~~and~~ the Committee has given close consideration to the principles involved in the "relation back" concept, and they are dealt with in Chapter below.

CHAPTER .

THE INITIATION OF INSOLVENCY PROCEEDINGS

1.1. For historical and procedural reasons which have been described earlier in this Report, there exists in the present law and procedure governing the various types of insolvency proceedings - by which is meant, as has already been made clear, every kind of proceeding dealing with the affairs of any insolvent debtor, - a very considerable differentiation between the limited company, i.e. the corporate debtor, and the individual or personal debtor, or partnership of debtors; Similar differences exist in the case of certain insolvency modes of regulating both types of debtor, in particular circumstances. Examples of these differences, and indeed anomalies, have already been given in Chapter above.

1.2. The second of our Terms of Reference reads as follows: "(ii) to examine the possibility of formulating a comprehensive insolvency system and the extent to which existing procedures might, with advantage, be harmonised and integrated." In pursuit of that specific task we have had to consider with great care, and with the assistance of our Consultees, what are "the existing procedures" in the case of each type of insolvency proceeding, to what extent their differences are significant in their social or legal content, and how far it is not only possible, but indeed necessary, to harmonise and integrate them. We may illustrate this problem by the simplest examples. A man, Mr Joseph Green, alone or with his wife, runs a shop or small business as an individual trader or trading partnership, whose affairs, if and when he or they fail in business, will be administered in bankruptcy by means of a bankruptcy petition, presented against him or them by (almost invariably) an individual creditor; such a petition is heard in camera, without advertisement or publicity, unless and until a Receiving Order is made. If, on the other hand, he, or they, have been trading as a limited company, - having maybe a capital of no more than two one-pound issued shares, and maybe only one director, and that company fails, it is proceeded against

by means of a winding-up petition, advertised both centrally and locally, and heard in open court, with the potential participation of as many of the company's creditors as have seen or heard of the advertisement. In our studies of these matters, we have termed the former procedure, that of the present bankruptcy law, the "one-to-one" basis, and the latter, under the present winding-up law, the "collective" basis; we refer to the progress of an insolvency administration from the former stage to the latter as becoming "collectivised". In all our thinking, we have had to remind ourselves firstly, that the whole purpose of any insolvency administration has always been, from earliest days, the collective realisation and distribution of the debtor's assets among his (or its) creditors generally; secondly, but just as it is the duty of any insolvency code to do justice as between the debtor and his creditors generally, so it must also do justice to the debtor himself, and as between the debtor and society as a whole.

1.3. In our own opinion, as well as under the guidance of the Term of Reference we have quoted above, we have to examine, to value and where necessary to refashion the manifold existing procedures into one just and logical whole, - an Insolvency Code which applies equally, and so far as practicable, identically, to debtors of every status, as well as to creditors of every status. As we have described above in Chapter , "The Credit World", insolvency must in all cases represent a personal, and also a social, disaster for the debtor, whose ripples and reverberations spread far and wide, both in the personal and in the corporate fields. It was not without reason that those who fashioned the original bankruptcy laws and procedures provided that bankruptcy proceedings, initially by debtors summons and then by petition, should be heard in private; and very recently, the paramount necessity for this was emphasised by an appellate bankruptcy court.

1.4. When the winding-up procedure was devised for the purpose of, in effect, "making limited companies bankrupt", under new and different statutes, which borrowed some portions while discarding others,

portions, of the bankruptcy code, the mode of proceeding was, as we have just described, the presentation of a public and advertised petition for the "bankrupting" of the company. Such advertising, and such public hearing, of the petition was of course in one sense the carrying out of the first of the purposes of insolvency, namely the participation of all creditors in the proceeding; it was however in another sense calculated to bring about the probable destruction of the company as a going concern, albeit at the instance of a single creditor. It must of course be borne in mind in any such analysis and comparison that, until late in the 19th century, trade and business was carried on, to a very large extent, on a personal or partnership basis, whereas the limited company tended to be confined to a substantial extent to the enterprises of large proportions. Our Victorian grandfathers were not likely, we think, to have felt much need to concern themselves with the corner shop as a limited company undertaking; they had enough problems dealing with the administration in insolvency of massive trading partnerships, with unlimited, or largely unlimited liability, whose litigious misfortunes help to fill the pages of the Law Reports. They have now become limited companies too, or remained so, until the incidence of corporation tax tempted some of them back to the pastures of unlimited liability. With the recent increase in the permissible number of partners in partnerships, and the consequent creation of firms of enormous proprtions, for example in the professions of solicitors and accountants, the social, as well as the legal, balance has begun to tilt the other way. Joseph Green Ltd. our corner shopkeeper, will have its failure administered by a winding-up petition, whereas Green, Black, White, Brown & Co., the eminent firm of purveyors of professional services, will (if it is not disrespectful to contemplate it) have their failure administered in the bankruptcy court. Whether that court as at present constituted could still cope with the bankruptcy of such very large partnerships, one may take leave to doubt. On the other hand, such an entity

seems hardly suitable litigation-fodder for a public hearing in open court.

1.5. It seems to us, in the light of the foregoing considerations, to be necessary to rethink the whole insolvency procedure, from the point of the initiation onwards, with a view to unifying it into one ~~ubiquitous~~ all-embracing code. In arriving at this decision, we have to come down unequivocally on one side or the other of the two ~~see-saws,~~ central issues, firstly is it to operate on the basis of "one-to-one" or "collective", and secondly is it to operate "in camera" (i.e. in Chambers, from which the other creditors and the public are excluded) or in open court. We have decided these questions in favour of the initial process being in all cases on a one-to-one basis, and in all cases being heard initially in Chambers, ~~(which terms where the numbers of persons participating are too great, the Court "sitting as in Chambers".~~

1.6. It is ~~upon this foundation of principle~~ upon the foundation of these fundamental decisions that we have endeavoured to ~~devise~~ construct our unified system for the initiation of every type of insolvency proceeding, which is described below. It will however not necessarily apply to "voluntary insolvencies", nor to very small cases.

The New Procedure

2.1. The term "petition", ~~as~~ at present used to describe the initiatory process in both bankruptcy and winding-up, ~~will~~ should be replaced by the term "insolvency application", which term we shall employ in what follows, with the "petitioning creditor" being termed "the applicant creditor". The term "debtor" will refer to every type of debtor whether individual, partnership or corporate, and for convenience we shall refer to all these different debtors ~~all~~ as "he" or "his", "it" or "its".

2.2. Although every bankruptcy ~~and~~ petition and every winding-up petition has always had to be based on a debt, ~~having~~ possessing certain characteristics, no petition ~~could be~~ has been capable of being presented in bankruptcy, for several centuries past, without the proof by the petitioner of one or more "acts of bankruptcy". In winding-up, however, the prerequisites

for petioing were much simpler and less rigorous, being directed, - as were acts of bankruptcy - to establishing the insolvency of the company, but comprising no more than (a) the non-payment of a debt of a specific sum for a specific time after formal demand, (b) an unsatisfied execution, or proof that the company was unable to pay its debts, including where appropriate its contingent or prospective debts, or liabilities. The prerequisites in bankruptcy, of proof of an act of bankruptcy (of which there are no less than thirteen) have become encrusted with a large amount of case-law, and have seen an increase over the centuries. Even as recently as 1973, when the invention of "criminal bankruptcy" (discussed in Chapter or Appendix) necessitated an order of a criminal judge causing a convicted person to be treated as if he (or she) had committed an act of bankruptcy at that moment. The strictness of proof of at least one act of bankruptcy has often been a loophole for an otherwise unmeritorious debtor to escape - which had its origin in what are called the "quasi-criminal" characteristics of bankruptcy +. Although very many bankruptcies are nowadays founded upon "bankruptcy notices", which resemble the "statutory notices" in winding-up, they are much more strictly construed, and not infrequently trip up the unwary creditor or his solicitor, and also necessitate personal service.

2.3 We have therefore decided to propose the abolition of acts of bankruptcy in relation to bankruptcy proceedings, and to adopt, for all proceedings by way of insolvency application a simplified version of the present winding-up prerequisites, which like the latter - are designed to produce a prima facie proof of insolvency, with which the debtor can take issue, in the form we describe. We would observe, in anticipation of our later discussion that the elimination of acts of bankruptcy removes the basic "anchor" of the trustee's title, the "terminus a quo" from his title generally commences, and we shall require to provide

an alternative system to the "period of relation-back" to the act of bankruptcy ~~now applying under~~ the Bankruptcy Act, and, to a much lesser extent, in winding-up to the date of presentation of the winding-up petition; this result we propose to achieve by what we ~~shall~~ later ~~be~~ describing as the "claw-back" provisions, which ~~are to entitle~~ the administrator of the insolvency administration to set aside antecedent transactions which may be deemed to have been detrimental to the creditors.

2.4. What ~~therefore~~ should be the criterion of that state of insolvency which justifies a creditor in applying/and the court in ~~applying~~ the discipline of insolvency administration? ~~It is plain that~~ the criterion must not be ~~too~~ severe, as as to discourage the enforcement of just debts, nor ~~too~~ lax, ~~so~~ as to encourage indignant malicious ~~or~~ merely "on the make" ~~creditors~~ from commencing unjustifiable proceedings, or proceedings on unliquidated or unenforceable debts. Our ~~choice~~ is ~~for~~ the non-payment of any debt, which fulfils one of three prerequisites outlined below, ~~in circumstances in which, and by a procedure by which~~ the debtor has an adequate opportunity of defending himself against an insolvency order. ~~In substance,~~ this to a large extent reproduces the present position in bankruptcy, ~~in~~ the case of the non-payment of a bankruptcy notice founded on a judgment debt , and in winding-up, in the case of the non-compliance with a statutory notice in respect of any debt, or the mere non-payment of a judgment debt or, in modern usage, any reasonably undisputed non-judgment debt. But these categories of debts are not exhaustive; justice may demand that a debt should be a permissible foundation for insolvency proceedings, even where it is not yet due and payable, or is otherwise contingent or prospective, the recovery of which when due and payable may be established to be at risk, or - to use a recognised legal term, - "in jeopardy".

2.5. Such a jurisdiction hardly exists at all in bankruptcy,

except where a still current bill of exchange becomes immediately payable by virtue of the commission by the acceptor of an act of bankruptcy; in winding-up, special provision is made for the founding of a petition on a contingent or prospective debt, but only on terms of satisfying the Court (in fact, the Registrar) that there is a prima facie case, and of giving security for costs. In our opinion, provided that there are adequate safeguards for the debtor against irresponsibly initiated applications, and against the damage capable of being caused by ~~advertising~~ an ill-founded petition, where is no reason why contingent or prospective debts should not in principle become the foundation for insolvency applications.

2.6. We therefore propose that the categories of debt which will support the initiation of an insolvency application against any debtor should be the following:

(1) (a) A judgment debt, of a minimum amount to be prescribed (the present minima being both in bankruptcy and in winding-up - for the purposes of the statutory notice - ~~£200~~, on which amounts we shall make suggestions later) and not subject to a stay of execution. Although prima facie a judgment debtor is not entitled to any notice requiring him to pay ~~the~~ judgment *per se*, there are cases where judgment has been entered ~~by~~ default of appearance or attendance of the defendant personally or by solicitors or counsel, which in themselves would justify some notice being given; we further think that the optimism or fallibility of human nature is such as to justify a requirement of the giving of ~~such~~ notice, viz. of an intention to proceed with an insolvency application, to all defendants, ~~without qualification.~~

(b) Such notice will be given by first class post to the debtor at his last known address, if an individual, or

to a corporate debtor at its registered office, or if there is reason to think that that would be an unsatisfactory destination, at its principal place of business, alternatively to the address of the duly constituted agent of the debtor. This notice will briefly indicate to the debtor the consequences of ignoring it. The length of the notice should be 21 days, as for the present "statutory notice" in winding-up. Its despatch should not be a prerequisite for the making of the insolvency application, but its absence may be relevant in considering the merits of the debtor if he appears and defends. In this respect, it is to be distinguished from the more formal notice referred to in (2), connection with non-judgment debts.

2.8. (2) A Non-Judgment Debt, of the same minimum amount, and of a reasonably indisputable character, formal notice to pay which has been given to the debtor or his or its agent not less than 21 days before the making of the insolvency application, by registered post. The principle, applied under the present procedure both in bankruptcy and in winding-up, that insolvency proceedings must not be taken on a disputable debt, is in our opinion sound and just, and this is recognised by our formulation above. The applicant creditor takes the risk of being found to have proceeded on such a debt, with the more serious consequences than we later propose. The Insolvency Court, like the present courts, will in all but the most exceptional cases, abstain from "trying" a disputable, and disputed debt.

2.9. A debt which falls half-way between a judgment debt which is presently due and payable, and a Non-judgment, is a debt payable under a judgment at a future date, e.g. a judgment or part of it, which is payable at a future date, by instalments. In such a case, it is more than "contingent or prospective" (our next category), and each instalment must, when it falls due, fall to be considered as a judgment debt capable of being proceeded upon, if it be of the requisite minimum amount. In respect of such debt, or such

instalment not yet due, we consider that it should be treated as if it fell within (2) above, as an indisputable non-judgment debt.

2.10. (3) A contingent or prospective debt, in respect of the prospect of payment of which, as and when (or if and when) it becomes due and payable, the creditor advances reasonable grounds for his apprehension of "jeopardy". We have already referred in paragraph 2.5 above, to the existence of this ground for petitioning in winding-up, and its vestigial existence in bankruptcy. It is, in our opinion, necessary to provide for the possibility of an insolvency application being founded upon such a debt, while considerably enhancing the penalties on the creditor for any abuse of that right. A formal notice, as under (2) above, would be required to be sent, and a very full "affidavit of merits" as to the alleged jeopardy should be filed. The Insolvency Court should, we think, retain the power to refuse to entertain the application if dissatisfied as to those merits.

2.11. We are omitting from our examination at this stage the grounds for the making of an insolvency application which are not founded on, and commenced for the purposes of enforcing, a debt; the "just and equitable" ground for petitioning in winding-up, even in a petition founded expressly on a debt, appears to us to be either a historical survival, or to reflect the Court's equitable jurisdiction to do justice between creditors and to have regard to their wishes (as required by section 346 of the Companies Act, 1948), - a jurisdiction for which we specifically provide in our later proposals. We equally omit the present proceedings to wind up a company on that ground for reasons unconnected with the non-payment of a debt, e.g. those brought by aggrieved shareholders. As regards the other separate category, namely the procedure whereby the Secretary of State for Trade may petition for the winding-up of a company, under section 35 of the Companies Act, 1967, on the grounds of "public interest", although such a petition may in fact be founded, *inter alia*, upon the

alleged insolvency of the company, this is not invariably the case, and we regard such proceedings as ~~very nearly~~ tending to falling outside our terms of reference; but we shall deal briefly with them in Chapter below.

2.12 The creditor, having satisfied himself and, where necessary, the Insolvency ~~Court~~ Court as to his entitlement to apply, will then file his Insolvency Application. There exists a ~~most~~ admirable rule ~~practice~~ in the Bankruptcy Courts, and also, ~~we believe~~ though to a lesser extent, in the Winding-Up Courts, that the court ~~xxxxxxxxxxxxxxxxxx~~ (that is to say, the Registrar) is to satisfy itself as to the petition being properly founded and being supported by the necessary evidence, before allowing ~~the petition~~ it to be presented and issued (see Bankruptcy Rule 151 and Winding-Up Rule 33); ~~which~~ we would wish to see this rule preserved and where necessary strengthened, having regard to our proposed increase in the facility of making an insolvency application; in winding-up, it is of course mandatory, as to the merits, in the case of petitions founded on contingent or propspective debts, - a procedure which we have preserved.

2.13. The Insolvency Application, when issued out of the Insolvency Court, will name a date, not less than (say) 28 days ahead for the hearing, ~~(a period which in the London Courts appears to result in practice)~~; and will warn the debtor that at the hearing, a Protection Order (that term which we propose to ~~being our proposed~~ substitute for "Receiving Order" and "Winding-Up Order") or a Debts Arrangement Order will be made, unless within a shorter specified time - we would suggest one week ~~earlier~~ than the hearing date, he gives to the applicant creditor, or to his solicitor, and to the Court, notice of at least one ~~(or more than one)~~ of the following grounds for resisting the making of such an order.

2.14. The grounds ~~there~~ referred to will be the following:

(1) If the debt relied on be not a judgment debt, that there is a bona fide defence to the claim ~~for that debt~~;

(2) If the debt be a judgment debt, that there are bona fide grounds for applying to "the court of judgment" to set aside the judgment, on some recognised basis in law, e.g. that it was given by default or without trial;

(3) that there are bona fide grounds for impeaching the debt on account of some substantial illegality or irregularity (not being a mere procedural defect) in the insolvency field;

(4) that there exists a bona fide right of set-off, counterclaim or cross-demand, of a sufficient amount and stated with sufficient particularity;

(5) that the debtor is willing and able to pay the applicant's debt, with interest if justly claimable, and costs, either at the first hearing, or within such longer period as the Court should allow. If the sum to be used for such payment is "third party money," this must be stated, with the name of the provider, and whether the provision be by way of loan, postponed loan or gift.

(Note: The fact that the money is that of a third party may be very material in the court's consideration of the the question whether the applicant creditor should be permitted to receive the sum so paid forthwith: see paragraphs 3.6 to 3.8, below;)

The Hearing

3.1. The hearing will normally, at least in the first instance, be in Chambers. The Court will consider such grounds as the debtor has stated under (1) to (5) above. In the course of its consideration, and at any stage of the hearing or any adjourned hearing, it may order the debtor to file a sworn statement of his affairs, and/or a statement of his means and/or earnings.

3.2. After hearing such evidence and arguments as it thinks just and necessary, the Court may either adjourn the matter, for such reason as it then states, or at that hearing or any adjourned hearing

may make one or more of the following orders, or have regard to any of the following matters, in adjudicating upon the application:

(1) Allow the debtor to pay the debt in full, or by instalments either

(a) if the Court is satisfied as to the standing of the applicant creditor and as to his ability to repay if called upon to do so, to the applicant creditor or his solicitor direct:

(Notes: 1 Such a direct payment will not of itself protect the creditor from being called upon to repay, whether the money paid be the debtor's property or third party money)

(b) on terms that the money be paid into the Insolvency Court for a specified period, not exceeding one month:

Note: 2 Such payment in will not of itself create the sum paid as a security for the creditor

Note 3: An application shall not be withdrawn or dismissed by consent except with leave of the Court

(2) Determine whether the alleged defence to the debt, if it be a non-judgment debt, has merits, and direct how that defence be adjudicated upon; either by a trial in some other appropriate court, or in special cases before the Insolvency Court itself; in the former case, the Court will adjourn, or may dismiss, the application;

(3) In the case of a judgment debt, determine whether the debtor should be granted an adjournment to enable him to apply to the court of judgment;

(4) Adjudicate upon the alleged illegality or irregularity;

(5) Permit any creditor with a suitably qualified debt to be present at any hearing on such terms as the Courts thinks fit;

3.3. If the debtor does not satisfy the Court by payment, resulting in the withdrawal or dismissal of the application, the Court will determine whether it should make a Protection Order or a Debts Arrangement Order (as to which, see Chapter below), or otherwise deal with the debtor's affairs in the interests of his or its creditors generally.

3.4. Implicit in the foregoing analysis and schedule of the proposed

3.9. Having ~~carefully~~ weighed the ~~various~~ considerations to the best of our ability, and not without initial substantial differences of view between ourselves, we have finally concluded that it is desirable that insolvency applications should be disposed of by payment, whether in full or by reasonable instalments, so far as can be ~~established~~ to be consistent with the interests of other creditors, and that this result should be achieved without any advertisement of the application, ~~whereby~~ the standing and viability of the debtor, - and the willingness of a third party to support him - might be impaired. It must ~~be~~ always borne in mind that the number of actual insolvency administrations should be reduced as far as possible, inter alia for the ~~reduction~~ of court time and fees, and of the parties' litigation costs, and ~~for~~ ~~the~~ reduction ~~of~~ the workload on the Official Receivers in Bankruptcy of the Insolvency Services, to the extent that their services may be required in any actual administration, and to the extent that they themselves will continue in office in the foreseeable future.

3.10. If our proposals are enacted in legislation, and it ~~be~~ found that a greater facility for payment off without publicity is being abused, then the discretions which such legislation will have afforded to the court might have to be restricted. Only experience can, we think, demonstrate the correctness of our diagnosis and our proposed treatment.

INSOLVENCY LAW REVIEW COMMITTEE

INITIATION OF INSOLVENCY PROCEEDINGS

1 A summary of a proposed procedure for the initiation of insolvency proceedings of an involuntary character is attached. The proposals, to which members of the sub-committee are generally agreed, emanate from discussions with Peter Millett and Ritchie Penny in connection with their respective papers and subsequent further consideration by the sub-committee.

2 The summary is presented in skeleton form with amplifying remarks where necessary.

3 In addition to approving the general principles the Committee is invited to deal with a number of specific questions set out in paragraph 8.

9 July 1979

INITIATION OF INSOLVENCY PROCEEDINGS

1 The procedure has no direct application to "voluntary" insolvency, nor to small cases intended to fall within the proposed Debts Arrangement Order.

2 The form of the initiatory procedure is for convenience still called a "petition".

Note: It is an appeal to the Court to administer the estate generally and "petition" would seem to be the most appropriate term.

3 The procedure is intended to apply both to individual debtors and to corporate debtors.

4 "Acts of bankruptcy" will disappear, as will those grounds for presenting a winding-up petition other than for non-payment of a debt. In so far as those earlier "grounds" in either code remain relevant, they will apply only to the rare case of contingent or prospective debts.

Note: Chris Taylor has some reservations; also, further thought will need to be given to "just and equitable" grounds for winding up in the public interest, used by the Department.

5 The sole ground for presenting a petition will become the non-payment of a debt that is due and payable.

6 The debt, the non-payment of which justifies the presentation of a petition, will fall into one of the following categories:- (it will also need to be of the minimum specified amount, which might possibly vary as between individual and corporate debtors).

(1) a non-judgment debt, of a reasonably undisputable type, notice to pay which, of a minimum specified length, had been duly given to the debtor or his agent;

(2) a judgment debt, in respect of which no such notice need be given; save that it might be desirable to require service of a copy of the judgment as entered, in cases where it had been pronounced by default, or in the absence of the defendant or his solicitor or counsel;

(3) a contingent or prospective debt, which satisfies the criteria later discussed.

Notes: (i) It will be necessary to ensure that an instalment which is due is regarded as a debt.

(ii) Some concern has been expressed for the debtor who has disappeared, but notice will have been sent to him or his agent at the last known address.

(iii) Some members felt that having got a judgment (6(2)) nothing further need be done prior to filing an insolvency petition but the majority favoured a letter being sent to the debtor's last known address warning him of the consequences of non-payment of the judgment debt.

(iv) If the debtor does not respond to the notice (6(1)) or the letter (6(2)), this may be taken in account by the Court in the incidence of costs.

(v) 6(3) has been left for further consideration.

7 The petition, as served on the debtor, will appoint a day for hearing reasonably in advance, and will warn the debtor that a Protection Order will be made, unless within a shorter specified time, he gives notice to the petitioning creditor and to the Court for one of the following:-

(1) a defence to the petition debt, if it be not a judgment debt;

(2) grounds for applying to the Court of judgment to set aside the judgment debt, if by default or without trial;

(3) grounds for impeaching either class of debt on grounds of illegality or irregularity;

(4) the existence of a set-off, counterclaim or cross-demand of an appropriate amount;

(5) willingness and ability to pay, in a very short time, the debt, interest and costs; this should indicate whether the payment is to be made out of the debtor's own funds, or out of third party monies.

<u>Notes</u>:(i) Examples of a defence in 7(1) might be that the debtor did not receive notice of the demand to pay, or that the credit period for the goods had not expired.

(ii) On 7(2) it is felt that consideration of such matters should be removed from the Insolvency Court and be dealt with by the Court of judgment.

(iii) The period acceptable in 7(5) must be very short to prevent abuse.

8 At the hearing, which will, at least in the first instance, be in Chambers, the Court will either:

(1) Allow the debtor to pay the debt to the petitioning creditor, either
(a) forthwith and absolutely, or
(b) on terms that the money be paid into Court for a specified period;

(2) Try out the alleged defence to the petition debt, if a non-judgment debt,

<u>or</u> adjourn or dismiss the petition pending the trial of the dispute as to the debt in another, more appropriate, court;

(3) Give or refuse leave to the debtor for an adjournment to enable him to apply to the court of judgment to set aside a judgment debt;

(4) Consider any alleged grounds of illegality or irregularity (not being a mere procedural defect); or

(5) If the debtor does not satisfy the Court by payment, or as to the existence of any other substantial ground for resisting or dismissing the petition, the Court will make a Protection Order or a Debts Arrangement Order.

<u>Note</u>: Much thought has been given to a number of problems in connection with 8(1) and it is felt that these are matters upon which the Committee should make a decision:

<u>Question 1</u> Should a petition invariably be dismissed if third party money is tendered in payment? It is thought that the answer is in the affirmative, but it is doubtful whether the fact that it is third party money will always be certain.

<u>Question 2</u> Should the debtor be allowed to pay off a petition out of his own money? This is supported by some members on the basis that the debtor should be free to deal with any other creditors as they and he see fit.

<u>Question 3</u> Should a creditor, so paid "in preference to" the debtor's other creditors, be entitled to keep the money for himself?

<u>Question 4</u> If "relation-back" is abolished, in the case of the individual debtor back to the act of bankruptcy, then what (if any) relation-back should be continued back to the date of the presentation of the petition?

<u>Question 5</u> Can a duty (and if so, of what type) be imposed on the Court, or what right can be afforded to the Court, to refuse to allow payment-off of the debt by a plainly insolvent debtor? Should the Court be left with a general discretion?

<u>Question 6</u> Can the protection of other creditors (if there be any who are relevant) be ensured by:
the payment of money into Court (see 8 (1) (b) above)?

<u>or</u> by a provision invalidating such a payment over a specified, not-too-long, period, in the event of a subsequent Protection Order being made, - analogous with a "fraudulent preference"?

9 Upon the making of a Protection Order, the Official Receiver will be brought into the case, which will probably, though not invariably, be advertised, with a view to the most efficient discovery of the debtor's affairs and his debts.

10 It will be noted that no "proof of insolvency" or "proof of cessation of payments" is called for. Such proof is afforded by the non-payment of the petition debt relied upon.

11 No advertisement will be made of the petition until after the Protection Order, unless required by way of substituted service. The withholding of advertisement will prevent injury to the debtor's credit.

12 The danger of the abuse of the procedure by the petitioning creditor, eg. by reliance on a genuinely disputed debt, will be restrained by statutory penalties by way of damages and costs for "unjustified presentation".

13 It will be seen that this procedure commences and continues, until a Protection Order is made, on a "one-to-one" basis, and not collectively. However, it may be necessary to envisage a multi-creditor hearing, if during the hearing of the first petition, a further petition is presented by another creditor (or creditors). The present procedure is not to hear more than one petition at a time, nor to allow other creditors into the hearing.

14 The question of contingent or prospective debts, (see 6 (3) above), is difficult. It is unknown in bankruptcy, except in the case of a still current bill of exchange, and rare in winding-up. The present statutory precautions, requiring the Court to investigate in the latter case if the petition shows a prima facie case, should be maintained.

INSOLVENCY LAW REVIEW COMMITTEE

Note to Members

Herewith the agenda for the meeting on 25 June. Peter Avis has very kindly made arrangements for the Committee to meet in Scottish Life House, 36 Poultry, a buffet lunch will be served and the conference accommodation will be available for the whole of the day. A location card is enclosed to assist you in locating the building. Please take the second lift on the ground floor of Scottish Life House to the 5th Floor where there is a reception desk and cloakroom. You will then be conducted to the conference room on the 4th Floor.

The main items on the agenda are very largely those which were originally intended for the May meeting. The associated papers were sent out with the agenda for that meeting on 22 April and "briefs" for the items were sent out on 13 May. Perhaps you will kindly give my office a call if you are unable to locate any of these papers. Two additional items have been included:- "Partnership Bankruptcy" and "Public Utilities". Neither should take up much of the Committee's time.

The following papers are also enclosed:-

(a) Letter dated 15 May from Peter Avis giving his comments; in particular, referring to two matters which he wishes to discuss arising from the meeting on 16 April.

(b) Comments from Peter Avis on item 9 (minimum paid up capital).

(c) Letter dated 12 May from John Hunter commenting on items 5, 6 and 7.

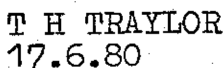
(d) Comments from Gerry on Criminal Bankruptcy (item 6).

(e) Extract from FT 2/6/80 which includes a reference to the ILRC and to our possible views on criminal bankruptcy.

(f) ILRC 120 Partnership Bankruptcy.

(g) ILRC 121 Public Utilities.

(h) ILRC 122 Written Evidence on Public Utilities.



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17.6.80

INSOLVENCY LAW REVIEW COMMITTEE

Note to Members

Attached is the agenda for the meeting on 21 May, together with the following papers:-

(a) Minutes of the last meeting.

(b) Para 9 of Mr J Hunter's note of 27/11/79.

(c) Clause 175 of the Canadian Bill.

(d) SS.57 and 58 of the New Zealand Insolvency Act, 1967.

(e) ILRC 113 - Committees of Creditors - report by the Accountants' Panel.

(f) ILRC 114 - Criminal Bankruptcy - report by Mr Muir Hunter.

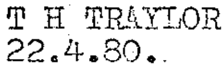
(g) ILRC 115 - Committees of Creditors - written evidence.

(h) ILRC 116 - Minimum paid-up capital - written evidence.

(i) ILRC 117 - Compulsory Bonding - report by the Accountants' Panel.

(j) ILRC 118 - The Authority and Personal Liability of a Receiver under Contracts and Leases (Report by the Legal Panel).

(k) DT5 - Memorandum from the Department on Criminal Bankruptcy.



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