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ILRC 64

INSOLVENCY LAW REVIEW COMMITTEE

THE PRINCIPLES OF INSOLVENCY LAW

(Comments from consultees summarised by the Secretary)

1. This paper contains summaries of the written evidence which has been submitted to date in response to the consultative letter of March 1977. Consultees were asked to what extent had the socially accepted principles changed since the present legislation was enacted; were all the changes acceptable and were any further changes desirable.

2. I would suggest that what we want to achieve is an integrated and comprehensive insolvency system that will suit the greatest possible variety of situations, deal adequately with the protection of consumer and small debtors, safeguard the integrity of the credit system, foster creditor interest in insolvency administration and generally adjust equitably and fairly the financial arrangements between creditors and insolvent debtors in the overall context of the public interest.

3. Mr J H Farrar (C15) pointed out that the present bankruptcy legislation was based largely on the BA 1883 which, apparently, had not been popular when first introduced. Deeds of composition and arrangement were very popular at that time which led to a suggestion in 1884 that "The Bankruptcy of the country is being worked outside the Bankruptcy Act".

4. Mr Farrar quotes an anonymous reviewer of a Bankruptcy textbook in 1885, "The legal pendulum is ever oscillating in bankruptcy between a laissez-faire policy in which everything is left to a body of creditors too often careless and apathetic, and an officialism which is irksome alike both to debtors and creditors. The present Bankruptcy Act is an extreme illustration of the latter, and this, combined with an illiberal scale of remuneration to practitioners and an increased scale of fees to officials, has rendered the Act unpopular in working". Mr Farrar sees this period as the beginning of the encroachment of the public interest into what had traditionally been an area of private law dealing with private interests. There was increased state intervention into the administration of the system, mainly because creditors could not be trusted to run the show themselves. Even so, both the 1883 and 1914 Acts still left the system very creditor oriented. By comparison, the winding up provisions have been much laxer in their treatment of management of insolvent companies.

5. In more recent times the social nature of credit has drastically changed. Many more people are home-owners with mortgages; much use is made of cheque cards, credit cards and the like, and people are regularly encouraged to use them and to take out bank loans. There is a proliferation of credit facilities and also a proliferation of limited liability business concerns. There are new

methods of doing business and financing, changing concepts of morality and work, increased taxation, tax avoidance schemes, the advent of the credit card economy and an increasing incidence of white collar crime.

6. Mr Farrar suggests that the complexities of the credit system can be intimidating for poorer consumers, who easily get into difficulty, and the availability of advice to the lower income group is very limited. As a result they get a feeling of hopelessness and adopt an ostrich-like attitude to ignore problems, hoping they will go away. He thinks we should follow the trend in some other countries towards assistance for consumer debtors by counselling facilities and less formal insolvency procedures.

7. Mr Farrar points to an increase in the proportion of secured to unsecured debts both in respect of individual traders and trading companies. There has been growing criticism of the way secured and preferential creditors scoop the pool. This, plus the harsh realities of recession, has influenced the modern trend towards safeguarding or salvaging viable business enterprises. Finally, Mr Farrar says that the rigours of the economic climate over the last 5 years have highlighted the inflexibility of our procedures in providing for moratoria.

8. The British Chambers of Commerce (C28) take the view that the law leans too heavily in favour of the debtor. In particular, they want more stringent rules for dealing with delinquent directors of failed companies.

9. The Sheffield Chamber of Commerce (C36) consider procedures should be simplified and harmonised, since both bankruptcy and company winding up have the same objects.

10. The Finance Houses Association (C41) and The Equipment Leasing Association (C58) feel the balance has swung too far in favour of protecting the insolvent. They feel that greater regard should be paid to the principle that it is in the public interest that persons should honour their contracts and pay their debts. Creditors should be given more protection against the fraudulent and the reckless. In most major insolvencies, the small man suffers most. Finally, they point out that modern statutes tend to be obscurely drafted.

11. The Association of Certified Accountants (C46) say that all too often the interests of creditors are not best served by the cumbersome administrative machinery, and debtors are often subjected to unnecessary hardship. The current economic climate has shown that factors beyond the debtor's control can cause his insolvency, so he should not necessarily be subjected to the stigma of bankruptcy.

12. The Institute of Professional Civil Servants (C57) say that it was not anticipated at its inception, that the BA 1914 would have much application outside the leading community, apart from a few highly paid and skilled craftsmen, for whom the Act specified provided retention of tools of trade. It was not foreseen that non-traders would be able to obtain credit in excess of £50. The present day harsh treatment of non-traders is viewed with distaste. The

economic system of the country depends upon the availability of credit generally; therefore insolvency law should be seen to discourage both the fraudulent and careless. Many debtors were incompetent rather than criminal; therefore greater flexibility was required so that draconian measures were used only in the worst cases.

13. The British Bankers' Association (C59) stress that more consideration should be given to creditors losing as a result of the improvident or fraudulent activities of individuals or companies. Any protection given to the debtor should be balanced by more stringent requirements for him to meet his indebtedness.

14. The City of London Solicitors' Company (C61) say that, in general, the same rules should apply to insolvent individuals and companies. The element of vengeance should be removed except where the debtor has committed fraud or other criminal offences. Creditors should be treated fairly, but where there is a reasonable chance of recovery (of the business) there should be machinery available to deal with it, even if creditors might not be paid in full. Persons or companies whose financial affairs were such that there was no possibility of recovery should be eliminated from commercial life, at least temporarily in the case of individuals.

15. The TUC (C74) say that insolvency law needs to be brought into line with Redundancy legislation and the Employment Protection Act, to improve the security of workers affected by insolvency and bankruptcy. In particular, solutions are required to the disruptive effects on employment prospects and productivity. Company liquidations reduce employment opportunity; often the insolvency is due to misjudgement and managerial inadequacy. In such cases the clear object should be to seek ways, perhaps by financial or managerial reconstruction, by which viability could be restored and employment secured.

16. The Birmingham Settlement Money Advice Centre (C82) say that it is inappropriate that the loss of virtually all of his assets should apply to a non-trading debtor; unless a good and sufficient case is made out, such as criminal lack of care, fraudulent use of monies or misrepresentation in obtaining loans or good on credit.

17. The Institute of Chartered Secretaries and Administrators (C83) think the law should be directed towards preventing insolvency rather than the propping up of unprofitable businesses, by ensuring that steps are taken in good time to avoid defaults on creditors.

18. The Insolvency Practitioners' Association (C106) say that the major requirement is the harmonisation of insolvency procedures, coupled with a substantial reduction in the level of formality.

19. They call for restriction in the proliferation of government preferences and set-off.

20. They say that the law regulating fraudulent activities has failed. The definition of fraudulent trading is too strictly drawn, so that credit can be obtained and misused recklessly without a proper safeguard for all those who advance the credit.

21. The National Association of Trade Protection Societies (C113) say that there is insufficient distinction between the treatment of unfortunate debtors, and the reckless and irresponsible. They want more stringent obligations on directors of limited liability companies with personal liability falling on those who are irresponsible. They also call for a review of preferences.

JUNE 1978

INSOLVENCY LAW REVIEW

DRAFTING SUB-COMMITTEE - Note to Muir Hunter and David Graham

THE PRINCIPLES OF INSOLVENCY LAW - WRITTEN EVIDENCE

1 Written evidence which has been received since the preparation of ILRC 64 (copy attached) appears to contain no proposals about the principles of insolvency law. However, I have had a run through all the written evidence and here follow some amplifying remarks to ILRC 64.

2 John Farrar (C15) has been summarised extensively in ILRC 64. He also suggests that a person overburdened with debts or harassed by creditors may be the source of much social evil, and quotes from the Canadian Report. "The tensions built up in harassed individuals and families frequently contribute to family breakdown, mental illness, crime and economic dependency". He says this problem must be coped with expeditiously but, in the case of small debtors, without the expense and formality of full bankruptcy which, in such cases, is of little practical value as a means of collective execution. He supports more extensive use of administration orders coupled with the development of Enforcement Offices and debt counselling as recommended by the Page Committee, plus the encouragement of moratoria and compositions. Advantages will be (a) avoidance of the stigma of bankruptcy, (b) an increase in the likelihood of creditors being paid and (c) generally cheaper than bankruptcy.

3 Finally, Farrar points to the need for an Insolvency Court, attached to QBD (his item 13).

4 R B M Knight (C17) feels that the protection given to the owner/proprietor/director of a private limited company is no longer appropriate because it fails to recognise the element of personal responsibility. Secondly, in the case of companies generally and public companies in particular there is growing public recognition of the responsibility to employees and the community in addition to the shareholders. In general, he feels that the law does not impose a sufficient duty on owners/proprietors and directors to act at an early stage of knowledge of insolvency.

5 The Trade Indemnity Company Ltd (C23) think that there is less stigma attaching to insolvency than in the past and that the costs involved in attempting to collect indebtedness tend to favour the debtor unduly.

6 The Investment Protection Committee of the British Insurance Association (C24) say that as a general principle, any changes in the law or practice of Insolvency should not affect rights conferred on either party under existing contracts or in the manner in which these rights may now be enforced.

7 The Retail Consortium (C38) say that the two principles of rehabilitation and an even hand to be preserved between creditors, although simple concepts in themselves, have resulted in much complexity in the law. In the result the ordinary creditor is unable to know his rights fully or precisely without recourse to professional aid. The insolvency law needs to be updated and simplified and written in a language understood by those engaged in commerce for whom the rules are there to serve.

8 The Finance Houses Association (C41) think that we must be unique in Western Europe in having separate systems of insolvency administration for individuals and corporations. They point to the greater convenience of a unified procedure and codified statute covering all forms of insolvency.

9 There are some errors in para 12 of ILRC 64; in line 3 the IPCS (C57) were referring to the "trading community". Lines 4/5 should read "specifically provided for the retention of tools of trade".

10 The Midland Bank (C64) say that as a general principle it seems right that the financial activities of an insolvent debtor, either individual or company, should be brought to a halt, his assets realised as quickly and as profitably as is reasonably possible, and his liabilities discharged as speedily and as equitably, having regard to the priorities of those liabilities, as circumstances permit. In addition, insolvency law should provide for certain particular circumstances. Firstly, for at least a certain substantial specified period, the debtor should not be able to borrow or obtain credit without disclosing his previous insolvency to his prospective creditor. Secondly, the individual debtor, or directors if a company, should be liable to criminal penalties if the insolvency resulted from business imprudence. Thirdly, where the insolvency is marginal, it should be possible for the debtor's business to continue under supervision, if this will benefit the creditors. Fourthly, where no criminal offence is involved and all the creditors so agree, it should be possible for the insolvency to be dealt with in a substantially informal manner. The Midland Bank is of the view that the present law does not adequately cater for their third and fourth points.

11 The Society of Conservative Lawyers (C92) have based their written evidence on the following postulates:-

(a) the Scheme of Arrangement must be reinforced and alternative vehicles of recovery considered;

(b) the unsecured creditor must be conceded more extensive rights than he presently has in receivership and liquidation;

(c) the exhorbitant expense of receiverships and liquidations must be reduced; and

(d) limitation should be imposed both on the form and privileges of incorporation.

T H TRAYLOR
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