INSOLVENCY LAW REVIEW

Note to Drafting Sub-Committee

INTRODUCTORY

I have prepared a first draft of the introductory to the Report so that you will be aware of its probable contents which, therefore, need not appear in the main body of the Report. It will not be possible to complete many of the blank spaces in it until much later on but, of course, there is no urgency about this.

2 I am trying to lay hands on a number of previous Reports so that we can look at their general pattern. I hope to have a fair number available by the time we first meet.

T H TRAYLOR
11 December 1978

England + Wales
Northern Ireland or N.I.

FIRST DRAFT

CORK REPORT - INTRODUCTORY

/Note by author. Official guidance to secretaries of committees says that to ensure consistency of content there should be an introductory section to the Report containing any or all of the following: terms of reference, date of appointment, membership, circumstances in which the committee was set up, steps taken to gather facts and opinions, number of meetings held, and a brief indication of the layout of the report (including page or paragraph reference to a summary of recommendations). This is of particular importance where it is expected that the Secretary of State will publish the Report and present it to Parliament./

REPORT OF THE INSOLVENCY LAW REVIEW COMMITTEE

The Right Honourable John Smith MP
Secretary of State for Trade

The Committee was appointed by your predecessor /or "by Mr Edmund Dell, MP, then Secretary of State for Trade in the previous administration"/ on 27 January 1977, after he had announced in the House of Commons in answer to a parliamentary question on 25 October 1976, that he was setting up a committee under the chairmanship of Mr K R Cork, FCA, FCIM (now Sir Kenneth Cork, GBE) to carry out a fundamental and exhaustive reappraisal of all aspects of the insolvency laws of England Wales.

2 The announcement of the membership of our Committee was made to the House of Commons by Mr Clinton Davis MP, then Parliamentary Under Secretary of State for Trade on 27 January 1977. The Members of the Committee then appointed were:

Mr PGH Avis
Mr J S Copp
Mr G Drain BA LLB JP
Mr AIF Goldman
Mr MVS Hunter QC
Mr Registrar J M Hunter
Mr P J Millett QC
Mr D McNab

Mr Registrar T R Penny

Mr C A Taylor CB, FCIS

Mr E I Walker-Arnott

Mr T H Traylor MBE of the Insolvency Service, Department of Trade, was appointed Secretary.

3 We were given the following terms of reference:

i. to review the law and practice relating to insolvency, bankruptcy, liquidation and receiverships in England and Wales and to consider what reforms are necessary or desirable;

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;

iii. to suggest possible less formal procedures as alternatives to bankruptcy and company winding up proceedings in appropriate circumstances; and

iv. to make recommendations.

4 It soon became obvious that we had undertaken a massive task and one of great difficulty and we thought it appropriate to invite the following persons to attend our meetings and to give us the benefit of their specialised knowledge:

Mr D Graham QC

Mr J R Endersby

Mr G A Weiss FCA

/Reference to Bob Jack also to go in here when the circumstances of his appointment have been checked plus, possibly, a reference to the Scottish Working Party of which he is Chairman/.
Our special thanks are due to these gentlemen who have attended nearly every meeting of the Committee, served on various panels and sub-committees and given us the benefit of their experience and expert advice.

5 We also thought it expedient to set up three consultative panels of experts drawn respectively from the accountancy, insurance and legal professions. In general terms their tasks have been to analyse the broad decisions of principle arrived at by the Committee, to consider the practicability of the proposals and any resultant problems, and to submit detailed plans for implementation of the proposals. It would not be overstating the position to say that the work of the Committee would have been infinitely more difficult, if not impossible within a reasonable timescale, without the consultative panels to undertake these onerous tasks. We are particularly indebted to these gentlemen whose names are set out in Appendix I.

6 It has been necessary also to set up numerous sub-committees from within the Committee to deal with specific areas. In all there have been [X] sub-committees and it is perhaps worth recording that panel or sub-committee meetings have been held on [X] days, mostly for all-day sessions.

7 We held our first meeting on 25 February 1977 and since then we have held full meetings of the Committee on [X] days. On a further [X] days we received delegations from representative

organisations who attend either at our invitation or at their own request. These meetings have been of considerable value and assistance to us and we are indebted to all those who took part.

8 Partly in response to a consultative letter which we issued in March 1977 and partly in response to specific requests made by the Committee, we have received nearly [X] hundred written submissions, varying from a few words to book length, from individuals, organisations and government departments. A full list of all those whose evidence we have heard or received appears in Appendix 2 and to all of them we desire to express our sincere gratitude. We should like to express our thanks also to the USA and those Commonwealth countries which have supplied us with copies of their own comparable reports and other valuable information about their insolvency codes and practices.

[Note by author: the panels and sub-committees, in particular, have been supplied with a lot of information and I am in frequent communication with these countries].

9 In view of the number and bulk of the written submissions which we have received we have decided not to append these to the Report. However, copies of the memoranda will be made available to the Department.

10 The width of our terms of reference has made it imperative, in order to keep our enquiry and this Report within manageable bounds, that our recommendations should be to some extent

selective. This we have sought to achieve by limiting our recommendations, wherever it was convenient to do so, to matters of major importance and to general principles. We have not attempted to clothe our recommendations in statutory language because we assume this to be the province of parliamentary draughtsmen; but in certain crucial areas we have put forward a form of words intended to crystallise a change in policy which we advocate.

11 /Possibly a para saying where the summary is or alternatively that "We have not attempted to summarise all our conclusions and recommendations because they are closely related to the context in which they appear and are likely, we think, to be better appreciated if made in the light of that context." My own feeling is that there should be a summary at least of the major recommendations/.

12 /Possibly a para indicating in broad terms the layout of the Report: "This Report is presented in /X/ parts. Part I is..... Part II examines..... All of our recommendations are to be found in Part...../.

13 In referring to the more important statutes in this field, we use a number of abbreviations. These include the following:

'1857 Act'- The Irish Bankrupt and Insolvent Act, 1857;

'1872 Act'- The Bankruptcy (Ireland) Amendment Act, 1872;

'1913 Act'- The Bankruptcy (Scotland) Act, 1913;

'1914 Act'- The Bankruptcy Act, 1914;

'1929 Act'- The Bankruptcy Amendment Act (Northern Ireland), 1929;

'1948 Act'- The Companies Act, 1948.

'1960 Act'- The Companies Act (Northern Ireland), 1960.

/Note - there will be a few more to put in/.

The 1976 Act

14 /Para about any difficulties of sufficient importance to be recorded - none hopefully?/

15 /I'll want to record thanks to my staff and the verbatim reporters/.

16 /Para along the lines "In presenting this Report we would like to emphasise that it represents the unanimous findings of the whole Committee" - or not, as the case may be./

Sir Kenneth Cork (Chairman)
Peter Avis
John Copp
Geoffrey Drain
Alfred Goldman
Muir Hunter
John Hunter
Peter Millett
Duncan McNab
Ritchie Penny
Christopher Taylor
Edward Walker-Arnott

Trevor Traylor (Secretary)

March 1984

4(32)

DRAFT OF I.L.R.C. REPORT

I INTRODUCTION

The Committee was entrusted with the task of covering the whole field of Insolvency Law and, in addition, where appropriate, enforcement procedure. Although at the commencement it was realised that this was a mammoth task, its scope has proved to be immeasurably larger than was originally envisaged. The number of organisations and people who have wished to give both written and oral evidence is very large and the strength and even passion of their views surprised many members of the Committee.

It was soon realised that if the Committee were to wait for evidence to be received and digested before forming views and setting out principles, nothing concrete would materialise for 4 to 5 years and if the time for legislation to be agreed and enacted of at least another two years was added to this then interest would have fallen off and proposals might even be out of date before being enacted.

The Committee has, therefore, decided after over a year of deliberations and having received a considerable amount of written and some oral evidence, that already a general philosophy has been established and that it is now able to set out the general principles which it has in mind within which the law should be revised. It seems from the general tenor of most written submissions received so far that further evidence will reinforce its views and that they are unlikely to be materially changed. It believes also that if the Committee's thinking is made known to the consultees, then time will be saved by those giving evidence not having to emphasize that which has already been accepted. If, however, the Committee's preliminary view or decisions are not acceptable to the consultees, then they will doubtless make this clear in their evidence and obviously the

Committee will bear that in mind in drafting the final Report. On the other hand, if as it is hoped, the evidence overwhelmingly supports the views of the Committee, then this can be included in the Report and will add enormously to the credibility of the recommendations and the likelihood of government arranging the necessary legislation.

In the event, the Committee can only frame the necessary outline legislation after having decided the general principles it believes are the right ones.

It is realised that to make the necessary amendments to existing legislation to remove the present anomalies and draft the outline of legislation necessary to put the new proposals into effect is a major task that can only be carried out by teams of experts working dedicatedly and continuously and even then it will take at least two years. We are fortunate to have as Chairman and members of the panels we have set up, those public spirited people who have the specialist knowledge and dedication to carry out this task.

The Committee therefore intends to concentrate mainly on the new basic principles and on considering oral and written evidence and then passing on its decisions to the working panels and the secretariat who will devise the necessary draft legislation to put them into effect. It will also fall principally on to the secretariat and the panels to consider the necessary revision of the existing legislation where it has proved in practice inadequate or unsuitable.

There is no point in considering the revision of the insolvency laws unless there is a basic philosophy agreed by the Committee which acts as a broad guide and against which all proposals can be tested.

Fortunately, this desired basic philosophy has come through clearly, both from the evidence given and the thinking of the Committee itself.

Insolvency does harm to the community by causing damage to the interests of both business and individuals, creates unemployment and lack of confidence undermining faith in institutions and it causes personal pain and distress to individuals, some of which is unnecessary.

Therefore, what is required is an insolvency system which does the least possible harm to the community and at the same time endeavours to limit the number of companies and individuals who become insolvent by a mixture of penalties and requirements that act as an adequate deterrent.

This system must be as simple as is possible and must fit in with the E.E.C. insolvency system with which we must comply and which is being negotiated with the other partners in Brussels at this moment.

II FLOATING CHARGES AND RECEIVERS

The first matter the Committee considered in detail was the position of Receivers under Floating Charges, and this brought up immediately the question whether Floating Charges, which are peculiar to U.K. Law and which do not look like being adopted in most other countries, should themselves continue.

Certain Members of the Committee had a feeling that the Floating Charge gave a priority to the Banker or other lender over Unsecured Creditors, which indeed is its purpose but that therefore it is unfair. However, the general evidence which has been received is that the Floating Charge is a necessary part of the financing of industry in this Country and that there is no real desire for it to be discontinued.

On the other hand, it was felt (probably correctly) that in the past Receivers appointed under Floating Charges had considered their main duty was to the Debenture Holder and not to the Company as a whole although they were expressed to be the company's agent, and this was also felt to be unfair. It was not the Floating Charge which was wrong, but the fact that the Floating Charge gave the Bank the right to appoint a Receiver, who then had the complete and unfettered conduct of the realisation of the assets in his hands, and if he was looking only to the realisation of the Debenture Holder's money and had no regard to the other people involved in the Company then the result was unfavourable to the community at large.

It was therefore felt that a Receiver should have responsibility not only to the Debenture Holder, but to the workforce, the general community and the other Creditors, Secured or Unsecured. As a result it is intended that the

Receiver, possibly renamed "Administrator" (see para III overleaf), should in future have a different role to that in the past and not only should he have greater responsibility to the other creditors, but it must be seen that he has appropriate powers. Nevertheless, of course, the proper priorities for repayment must be recognised.

The Committee's recommendations, therefore, are that these wider responsibilities to the other classes of creditors should be put into practice by a meeting of Creditors being called within three months of the Receiver's appointment, at which meeting the Creditors will have the right to appoint a Committee, to which the Receiver must report and if the Committee at any time feels that the Receiver is not conducting the Receivership properly, then it will have the power to apply to the Court for rectification. This could happen if for instance it were found that the Receiver was taking a short cut in the realisation to satisfy the Debenture Holder whereas the business could be continued and sold as a going concern for a better sum.

Some difficulties have been experienced in the past, when a Receiver has been appointed, and there is a liquidation, the Liquidator will have no real power, as he has no money, and therefore a Receiver should be able to take proceedings which are at the moment only open to a Liquidator.

For instance, if there have been preferences of Creditors, then the Receiver will be able to take action to reclaim the money involved and if he should think it right that the Company should be wound up, then he should have the right to petition the Courts accordingly.

The Receiver's responsibility to other classes of Creditors must not extend just to consultation and information and he may need to be prevented from advising

Indeed, the whole "compartmentalisation" of the realisation of assets should be discontinued, and the Receiver, and indeed the Liquidator, should do his duty for all the Creditors. Therefore he should not be subject to criticism where there is only in the first instance enough money to pay the Preferential Creditors, and he uses the funds available to take a proper legal action, which would in fact be of benefit only to the Unsecured Creditors, and further when he has enough money for the Unsecured Creditors, if there is still proper action he should take then he must be permitted to use the funds available to recover monies, which would then go to Shareholders. The problem is that in conducting the litigation he would be risking the funds of a different class with prior rights, but it is considered that nevertheless the Company must be looked at as a whole.

If one is to ensure that the Receiver is not the creature of the Debenture Holder and/or the Company, then there must be provisions to limit those persons who can be Receiver.

The Committee feels that the Auditor of the Company should not be eligible to be appointed its Receiver; nor should the Debenture Holder himself; nor any of the Officers of his Company; nor should any Officer or employee of the debtor Company be appointed Receiver. In any event the Receiver must be a member of a recognised professional body with its own code of conduct and ethics, and with the right kind of experience and independence to carry out a successful Receivership.

III RESCUE OPERATIONS WITHOUT FLOATING CHARGES

It has been found in the past that where a Company has not given a Floating Charge, it has been impossible to obtain a breathing space, ~~while avenues of rescue are explored~~.

It is therefore intended that there should be power for the Directors, Creditors, Shareholders, and indeed the Departments of Trade or Industry, to apply to the Court for the appointment of an Administrator, who would have identical powers to those of a Receiver for a limited period. He would be able to make decisions in his own right to protect the assets, and indeed, if the Court so wishes, continue in every way as a Receiver under a Floating Charge. The length of time for which he would be appointed would depend on the circumstances and would be fixed by the Court.

IV RETENTION OF TITLE

Inevitably the recent widespread increase in the use by suppliers of goods of retention of title clauses especially after the Romalpa judgement has given the Committee cause for much concern and has been the subject of much evidence.

The use of these clauses has perhaps been the answer of suppliers to what they think to be the ever increasing encroachment of both Preferential Creditors and Secured Creditors on the funds available for distribution in an insolvency and whilst it can probably be understood in that light it has carried with it a number of consequences which might not be foreseen on superficial consideration. The principal difficulty which has concerned the Committee is the problem which widespread use of Romalpa clauses has placed in the way of attempts by Receivers

and Liquidators to carry on businesses with a view to their sale as a going concern to the ultimate benefit of all Creditors and of the community. The recommendations of Paragraphs II and III are designed to make this easier, and obviously the same object must be borne in mind in deciding in how to deal with this situation. Many Consultees would like us to outlaw these clauses completely, but whilst other security rights remain we think it unlikely that a recommendation to this effect would succeed. However, it is felt that some way must be found to deal with the uncertainties which Romalpa clauses create which would seem at present to give their beneficiaries rights not only to take possession of goods delivered to businesses but also to follow through into other goods that have been manufactured and to proceeds of sale; and it is not difficult to see how this can quickly tear any business apart.

We have also been impressed by some evidence to the effect that businesses which are extensively subject to Romalpa clauses from their suppliers may be finding difficulty in getting paid by their customers who want to be satisfied before paying that they are getting proper title to the goods they are buying. This problem may itself lead to greater danger of insolvency right down the line of trade and we are led to believe that reliance on these clauses in sales contracts may well already be decreasing.

In order to try to achieve a fair balance between firstly Secured and Preferential Creditors, secondly suppliers seeking to maintain Romalpa type clauses and thirdly Unsecured Creditors at large it will be recommended that all Romalpa type clauses must be registered so that Creditors and others making appropriate searches can find that they exist. It is also proposed that in the event of insolvency such clauses shall only be valid to the extent that the original goods supplied are still in the debtor's possession, are identifiable and have not changed their nature. Thus the benefits of the clauses would be lost as soon as the goods are used in processes of manufacture or the like or when they have been

sold in the ordinary course of business.

V THE INDIVIDUAL DEBTOR

One of the problems at the moment in dealing with individuals, is that there is no real alternative to Bankruptcy. It seems generally agreed that other debt enforcement procedures are unsatisfactory especially in the case of the small individual debtor who owes money to more than one Creditor.

There are a large number of people, who through ignorance, stupidity or just muddle-headedness, drift into insolvency, really involving only a small number of creditors. They then face the full panoply of bankruptcy albeit somewhat improved by the Insolvency Act 1976 and all the restrictions imposed on the Bankrupt who has done real harm to the community.

Also, those people who have been unlucky, and neither reckless nor criminal, again are forced through the same system.

It is therefore the Committee's wish to see that there are alternative methods of dealing with individuals which are practical and which do not require reference to the Courts to the same extent as at present. On the other hand, bankruptcy has been used as a method of debt enforcement because it has been found in practice that it is the most successful. Any new system brought in must therefore not be used as a method whereby a debtor can avoid his obligations. It is recognised that if a system is made too severe, the debtor will carry on trading or incurring debts so as to try to avoid it, thus creating more chaos and getting himself or herself more and more into difficulties.

It is therefore felt that there should be three separate routes for the insolvent individual.

(a) Simple Administration Orders for the consumer type debtor, or the very small one man trader.

(b) A strengthened form of the present Deed of Arrangement.

(c) Full Bankruptcy.

(a) Where the liabilities are small and where the debtor's conduct has been reasonable, he should be allowed to be relieved of his liabilities as quickly as possible, and be allowed to start afresh, without any continuing penalty. The procedure will remain under the control of the Court which will undertake the distributions to Creditors.

(b) The other route for an individual will apply where the liabilities are greater, but his conduct has not been either reckless or criminal and the insolvency has been caused by the vicissitudes of trading, or merely incompetence. Under the strengthened form of Deed, the Trustee would have many powers which can presently be exercised only by a Trustee in Bankruptcy but the Trustee would of course be under the control of the Court in using those functions in the same way as the Court has a measure of control over a Liquidator in a voluntary winding-up. It is however, envisaged that once a Deed Trustee is given the same powers as a Bankruptcy Trustee there is no longer any need for the absolute right of a creditor to insist on full bankruptcy and whereas a creditor will still of course be able to apply to the Court for a Receiving Order, the Court would have power to have regard to the majority view and not only to the petitioning creditor. Quite clearly, however, a substantial majority would have to agree.

On the other hand, under this arrangement, the debtor would not be liable to

the personal restrictions, such as on incurring credit and trading which would be reserved for formal Bankruptcy.

(c) Full Bankruptcy would then only be reserved for the really bad cases where such quasi-penal features as public examinations and continuing disabilities for a period to be determined by the Court are thought to be necessary. It is suggested that all second failures should automatically come within this category except in very exceptional circumstances.

Provisions would be made to prosecute the debtor where it is appropriate and not only should this prosecution be able to be brought easily, but the trading community should know the penalties which people are likely to incur if they commit a criminal bankruptcy offence and indeed the acts which are criminal must be clearly set out.

Above are the general guidelines on which the new proposals will be framed. They can be summarised simply as making the route easy and cheap for those who are innocent and unlucky and very difficult for those who are reckless or criminal.

It is also intended to co-ordinate the insolvency of individuals and companies wherever possible so that almost identical procedures can operate in both cases which will make them more simply understood by creditors and the general public. Thus for instance, it is considered that as a result of this revised procedure it would be necessary both for bankruptcy petitions and for proposed deeds to be advertised in the same way as winding-up petitions and company creditors' meetings are advertised now. It is recognised that advertisements can have a more disastrous effect on individuals and their families than advertisements of company petitions and it is therefore proposed that there should be a short delay before a bankruptcy petition is advertised so as to give the debtor an opportunity to

apply to the Court for a stay if he can show a valid reason.

It would be still possible both for the debtor wishing to be relieved of his immediate problems or for a creditor to apply to the Court and the Court will then be able to decide into which of the suggested categories a particular case should fall. This should not of course prevent a debtor from initiating the Deed Procedure should he so wish.

VI VOLUNTARY LIQUIDATION

Whilst certain detailed aspects of voluntary liquidations will need to be harmonized with other procedures and the powers of liquidators in certain circumstances need to be strengthened, these are matters for liquidation procedures as a whole and it is felt that generally the system of voluntary liquidation works well.

VII COMPULSORY LIQUIDATIONS

Here again it is not thought that the basic concept needs fundamental changes. Detailed aspects may need to be harmonized with other procedures, and there are a number of other features of insolvency laws and procedures generally which will be dealt with under their separate subject headings.

VIII OPENING OF INSOLVENCY PROCEDURES

In order to create greater certainty and also to comply with the likely contents of the eventual E.E.C. Bankruptcy Convention, it has been found necessary to define evidence on which petitions by creditors for the opening of insolvency proceedings can be founded. For practical purposes this constitutes evidence of cessation of payment by the debtor.

This date of the cessation of payment which can be used for petitions is also of importance in voluntary insolvency proceedings both of companies and of individuals because it will be the date to which Liquidators' and Trustees' powers will relate back. There will therefore be circumstances in which the Court will have to determine the date of cessation of payments even if it does not have to do so merely for the opening of the proceedings, such as for instance when a debtor files his own petition or the new voluntary procedure outlined in para. V (b) above, or a company voluntarily enters into liquidation.

From Muir Hunter

The following circumstances will provide the appropriate evidence (here reproduce appropriate parts of new I.L.R.C. coming from Muir Hunter Committee when ready).

It is also necessary to clarify the position of companies and of individuals between the date of cessation defined above (whether they are alleged in a bankruptcy or winding-up petition, or whether they are fixed by the Court at a later date) and the actual commencement of the insolvency proceeding by the appointment of a Liquidator or Trustee. Present legislation and case law are considered to be unsatisfactory, especially in regard to the restrictions they impose on the operation of banking accounts which may cause businesses to grind to a halt. In the case of compulsory liquidations for instance Section 227 of the Companies Act 1948 gives the Court a discretionary power to sanction dispositions of property but constant reference back to the Court is cumbersome and expensive. There are often very long delays between the presentation of the petition and even a first Court hearing let alone subsequent adjournments before a final order is made; those intervals are especially long during Court vacations when it is exceedingly difficult to get a quick hearing before a Judge or Registrar.

Next for a larger & better equipped Co'y Mtg Ct. or General Insolvency Ct.

Whilst it is most desirable, and as already mentioned may indeed be necessary for the purposes of the E.E.C. Convention, to extend the period and strengthen the powers for relation back and also to introduce this concept into other procedures such as voluntary liquidations and the new form of Deed, where it is not presently known, it is at the same time essential to protect bona-fide transactions in the ordinary course of business which do no harm and indeed are likely to be of benefit to creditors. Uncertainty of the effect of transactions is something which should always be avoided and while it will obviously be necessary to legislate against the disposal of assets during what is perhaps the most vulnerable time, one must be careful not to do unnecessary damage.

It is also considered desirable (although this is perhaps more a matter of practice than of law) that it should be easier than it is at present to obtain from the Court the appointment of a provisional Liquidator pending the hearing of a winding-up petition. This should not be confused with the proposals for the appointment of an Administrator under paragraph III since they would apply only when a business needs to be rescued. There are also, however, other instances where it is desirable that an independent person should take charge of the company's affairs urgently, and protect its assets. Whilst presentation of a winding-up petition by no means always leads to the making of a winding-up order, circumstances can nevertheless arise, and are not difficult to visualize, where such protection is necessary. At present it is difficult to obtain appropriate Orders from the Court, and even when an Order is made, the Official Receiver is nearly always appointed, although this is not mandatory under the existing law. It is thought that if the appointment of a provisional Liquidator is made easier, there will be more cases where it might be appropriate for someone other than the Official Receiver to be appointed, and this should be made clear.

IX PREFERENTIAL CREDITORS

There has been a wealth of evidence to the Committee about the rights and wrongs of certain classes of creditors continuing to enjoy preferential rights. The general tendency of this evidence has been in favour of restricting preferential claims, particularly those of the Crown, except from those bodies who think that for one reason or another they themselves should come into the preferential class.

In particular, it has been suggested that "consumer creditors", (that is those people who have paid in advance to a shop or manufacturer, or a mail order company for goods they do not receive) should get priority. While obviously we have sympathy for these people perhaps the strongest practical objection would be that in a particular situation where the problem arises the number of preferential claims would then be so great that their priority rights would probably not be worth very much.

While these people, when paying their money, may not have realised that they were accepting a commercial risk, this cannot be regarded as sufficient reason. In recent years compensation or guarantee funds have been established in some trades under Government auspices and this would seem to be the only way in which this particular evil could be cured.

It must also be recognised that the priority of the wage earner, which was at one time very important, really means little these days because of the rights he has been given in other social legislation so that if he loses as a result of an insolvency he is in fact paid out of Government Funds and it is the Government who then stand in his shoes. On the other hand it is argued that the Government introduced this legislation in the knowledge that they would acquire the workers' rights.

It is also recognised that it is unrealistic to think that workers continue in their employment if they remain unpaid for up to 4 months - the maximum period allowed at present in the Bankruptcy and Companies Acts. Their rights in liquidation (but not at present in bankruptcy) are however acquired by other parties, usually banks, who advance monies for the specific purpose of paying wages. This is regarded by some as an invaluable way in which help can be given to try to save a business, but others consider it merely as a means whereby the evil moment of admission of insolvency is put off to the ultimate detriment of all concerned.

The Committee has at present come down in favour of the view that preferential rights should be abolished altogether except for two classes:-

(a) what might be regarded as quasi-trust funds, such as monies collected or deducted by companies from others as PAYE or VAT or the like, but even then those rights should be restricted as applying only to monies that became due after the last reasonable date when the appropriate authority should have collected its dues.

(b) employees' claims for wages and salaries.

X DUTIES & RESPONSIBILITIES OF DIRECTORS

It is generally considered that it is at present far too easy for Directors to escape responsibility where the companies they control have continued to operate at a time when they were quite obviously insolvent and when there was no real prospect of that situation being redeemed. Whilst admittedly one must be careful not to be too much influenced in judging the conduct of Directors with the benefit of hindsight there is, nevertheless, a general consensus of opinion that the present state of the law is unsatisfactory. The main section of the Companies Act dealing with fraudulent trading is Section 332 which provides that 'if in the course of the winding-up of the company it appears that any business

of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for fraudulent purpose, the Court may, if it thinks proper so to do, declare that any persons who were knowing parties to the carrying on of the business in manner aforesaid shall be personally responsible without limitation of liability for all or any of the debts or other liabilities of the company as the Court may direct'.

It must be recorded here that proceedings under this Section are taken only very rarely because it has been held by the Courts that for instance the terms 'defraud' and 'fraudulent purpose' must'connote actual dishonesty involving according to current notions of fair trading amongst commercial men real moral blame', and again 'in my judgement there is nothing wrong in the fact that Directors incur credit at a time when to their knowledge the Company is not able to meet all its liabilities as they fall due. What is manifestly wrong is if Directors allow a Company to incur credit at a time when the business is being carried on in such circumstances that it is clear the Company will never be able to satisfy its creditors. However, there is nothing to say that Directors who genuinely believe that the clouds will roll away and the sunshine of prosperity will shine upon them again and disperse the fog of their depression are not entitled to incur credit to help them to get over the bad time'.

It is debatable whether the second quotation should be a fair statement of any revised law, but one must recognise that so long as it exists it becomes almost impossible for a Liquidator to discharge the onus of proof of showing actual dishonesty.

It is therefore suggested that when it can be proved by a Liquidator that credit actually was incurred at a time when the company was insolvent this should be prima facie evidence of fraudulent trading and that thereafter the burden of

showing that there was not actual fraud should shift to the Director or other persons against whom the accusation is made; if they can show that they acted honestly they will presumably be excused.

There would still be a borderline of cases where Directors would say that they did not know the true position, either because it was not disclosed to them by others or because they were too incompetent to understand figures. It is possible that in the latter case a Court might refrain from making an order burdening those people with personal liability for the Company's debts but at least the Court should have power to disqualify such persons from ever becoming Directors of companies again. If they have used their own incompetence in an attempt to mitigate a more serious claim there would seem to be no reason why this should not be accepted as a valid reason for not allowing the privilege of limited liability.

The Committee has also received much evidence in support of the proposition that wherever a company has failed the Directors should be disqualified from being Directors of other companies unless they can get relief from the Courts. It is thought by the Committee that this is perhaps excessively harsh but there is no doubt that disqualification must be made considerably easier than even the new provisions of Section 9 of the Insolvency Act 1976.

The Committee has also examined the position of Directors' responsibilities under criminal law. There are, of course, some companies which are set up with the deliberate intention to defraud the community whether the victims be trade suppliers or members of the public paying money, and these are relatively easy to deal with. In these cases civil proceedings are rarely worthwhile because the people concerned are unlikely to have much in the way of personal assets but a revised form of criminal bankruptcy may well be a useful weapon at the Court's disposal.

In more sophisticated frauds the position is very different.

Liquidators in voluntary liquidations are under a duty to report to the Director of Public Prosecutions (or in Scotland to the Lord Advocate) if it appears to them in the course of the winding-up that any past or present officer or member of the company has been guilty of an offence for which he is criminally liable. In compulsory liquidations the responsibility for investigating possible criminal offences remains with the Official Receiver. In both cases there is often frustrations because many cases reported under these provisions are not taken up. Liquidators additionally have to face up to the very real problem, that when a prosecution is undertaken, civil proceedings based on the same or allied circumstances are inevitably delayed and the persons charged perhaps not unnaturally spend money which in justice ought to go to creditors on their criminal defence.

It is therefore suggested that legislation should be introduced whereby civil and criminal proceedings could be consolidated and a Court would have power to make appropriate orders under each heading. Since inevitably the burden of proof in criminal proceedings is greater it would not of course follow that criminal proceedings will always be taken side by side with civil actions, but it is felt strongly that where there is cause for both, the civil remedies ought not to have to take second place.

XI CRIMINAL BANKRUPTCY

(This subject must be dealt with but I know very little about it and therefore do not feel competent at this stage to make any observations).

Philosophy

XI FRAUDULENT PREFERENCES

The present legislation is contained in Section 44 of the Bankruptcy Act 1914 which is introduced into Liquidation law by Section 320 of the Companies Act 1948. This Section deems fraudulent and void against the Trustee (or Liquidator) every payment, transfer of property or obligation incurred by a person (or Company) unable to pay his debts as they become due and made in favour of a creditor with a view to giving such creditor or surety or guarantor for the debt due to such creditor a preference over others. The payment or other transaction attack must have been made within six months of the presentation of the Bankruptcy or Winding Up Petition.

Whilst it is now generally agreed that the use of the word "fraudulent" in this context is misleading, since actual fraud need not be shown, there is, nevertheless, very real difficulty in the present legislation because it is necessary to show that the preference was a voluntary act on the part of the debtor. Contrary to the law in most E.E.C. and other countries, a creditor in this country is entitled to take any lawful steps to be paid even when the debtor is clearly insolvent and it is sufficient answer to a claim under these sections that pressure was exercised by the creditor. It is obvious that when a business starts to run into difficulties and payments slow down, creditors begin to get worried and talk to the debtor and it is not a very far step from this to demonstrate pressure, which need not go so far as, for instance, a positive step such as trying to levy execution. It is also not sufficient for the Liquidator or Trustee to show that the pressure ought not to have influenced the debtor because he was in any case so demonstrably insolvent that another creditor was certain to push him into Bankruptcy or Liquidation anyhow, so that in practical terms he had nothing to fear from the creditor whom he paid.

Further considerable problems arise in practice in the case of company bank overdrafts guaranteed by the Directors, where steps are frequently taken to pay

off the bank in order to procure a release of the guarantee. If during the time that the overdraft was reduced or extinguished, no creditor at all was paid, the position is perhaps easier but one is so often met with the answer "what else could I have done with the money, except pay it into the Bank", and it becomes difficult to establish a preference successfully when at least some creditors are getting paid.

It is therefore suggested that a Liquidator or Trustee should be entitled to avoid a preference and seek repayment from the creditor when he can show as a fact that the creditor was preferred over others without having to demonstrate any motive.

Even if it were thought that this is too harsh for the full period of six months, it should at least apply as from the date determined as that of cessation of payment if that was not the date when business ceased altogether.

XII OTHER AVOIDANCE PROVISIONS AND POWERS OF LIQUIDATORS

(a) Much dissatisfaction is caused by the present operation of Section 322 of the 1948 Companies Act which provides that a floating charge on the undertaking of a company created within 12 months of the commencement of the winding-up shall be invalid unless it is proved that the company was solvent immediately after the creation of the charge except to the extent of any cash paid to the company at the time of or subsequently to the creation of and in consideration for the charge.

Firstly, it is recommended that this provision should also be extended to fixed charges which at present can only be attacked as fraudulent preferences, as dealt with in paragraph XI above.

Secondly it is considered that the interpretation of the words "any cash

paid to the company at the time of or subsequently to the creation" have been interpreted by the Court on too narrow a basis. It means in practice that a floating charge given to a bank is beyond attack as soon as the company has paid into its account in the ordinary course of business a sum of money equal to the overdraft existing at the time the charge was created, quits irrespective of the fact that an equal sum of money may have been drawn out of the account during the same period. In other words, there is no need for any effective increase in the total of the overdraft forthe floating charge to excape this clause. The Committee consider that this is nothing other than an anomaly which should be rectified, so that the charge becomes valid only to the extent that the lending was actually increased.

(b) It is considered that Section 95 of the 1948 Companies Act be amended so as to require registration of charges over all forms of assets of a company, failing which they should be void against a Liquidator. At present, no registration is required over for instance stocks and shares, including shares in subsidiaries and it is thereby found that the safeguards to creditors which the disclosure provisions of Section 95 are presumably intended to give, are not sufficiently wide.

(c) It is found in practice that Liquidations often disclose abuses as a result of which creditors or shareholders have suffered, but which have not themselves created damage to the company and accordingly, the Liquidator has no power to attack them and seek remedies.

Examples of this are the reduction in the number of the company's shareholders below the statutory minimum which give creditors certain rights against Directors and Officers, but those rights are not vested in the Liquidator and also the manipulation of the price of a company's shares on the Stock Exchange through the dissemination of wrongful information.

It is recommended that a Liquidator should have the right, with the sanction of the Committee of Inspection or the Court, to take any proceedings based on discoveries made by the Liquidator in the exercise of his functions which would be for the benefit of the company, its creditors or its shareholders.

XIII GROUPS OF COMPANIES

Another area in which there has been much evidence, and a good deal of it conflicting, relates to the position of groups of companies in cases where one or more, but not necessarily the whole group, get into difficulties.

There appear to be two distinct problems, the first relating to the habit within some groups of companies giving guarantees in respect of certain of its others liabilities, particularly to the banks. The second problem relates to the extent of the responsibility of parent companies for the activities and liabilities of their subsidiaries.

Where cross-guarantees within groups are given, these are only disclosed on the public file where they are supported by charges, registerable under the provisions of Section 95 of the 1948 Act, and of course even the guarantees whether or not supported by security, should be disclosed as contingent liabilities in companies' audited accounts. The practical difficulty however, lies in the fact that mere disclosure of the existence of the guarantee, whether or not supported by a charge, gives no indication to anyone as to the total amount which could be called upon or even less the chances of the guarantee actually being called. It has sometimes been found by suppliers that they have been quite happily giving credit to a company on the basis of healthy-looking balance sheets and satisfactory status reports, but suddenly, owing to the failure of another company in the group, a Receiver is appointed under a floating charge containing a guarantee and with little,if any, lending to the company itself and the ordinary creditors get

nothing. Whilst undoubtedly the freedom to give such cross-guarantees and cross-charges must be maintained, it is recommended that accounts should show the maximum amount of the contingent liability at the balance sheet date and also the name of the company or companies forthe benefit of which it is given, so that someone sufficiently diligent, such as one of the many Trade Protection Societies would be able to undertake appropriate searches so as at least to get some idea of the true state of affairs.

The position of parent companies and their Boards vis a vis subsidiaries also causes much difficulty. Some evidence has suggested that parent companies should always be responsible for the debts of their subsidiaries, but many powerful cases have been made against this proposition. It has been represented for instance that long term lenders who are locked into a company, would be seriously prejudiced by a sudden fundamental change of this kind in the law, and also that it would inhibit new ventures within groups. Additionally, it has been pointed out that extending such responsibilities to subsidiaries abroad would cause very special problems. Whilst there may well be some compulsory extension of such responsibility, both of parent companies and of their Directors, under the E.E.C. Bankruptcy Convention, it must be recognised that there are countries and situations where a complete extension of such responsibility could be abused.

Whilst there clearly are situations where Holding Companies ought to be made responsible for their subsidiaries' debts because of the way in which these have been incurred, the matter is perhaps best looked at from the point of view of the responsibilities of Directors, whether they be Directors de jure or de facto. In various parts of the 1948 Act, the expressions "Director" and "Officer" are specifically defined as including "any person in accordance with whose directions or instructions the Directors of the company are accustomed to act". In the opinion of the Committee, this definition should be applied in considering the responsibilities of Holding Companies and their Boards and the definition quoted above should perhaps be extended to include bodies corporate.

There are undoubtedly many occasions where persons are appointed to Boards of subsidiaries, more for the purpose of giving them status within their organisation than because of their capabilities as Directors, and the Parent Company and its Board maintains very close control. In those cases, it is not only hard on the subsidiary companies' Directors if they were to carry sole responsibility, but this would be of little practical significance because their personal assets which could be attacked, would probably be nothing compared to the funds of the Holding Company. It is therefore suggested that the criterion of actual control and direction be adopted so that where a Holding Company really exercises day to day control, it should carry responsibility in the same way as the Directors of the subsidiary, but not otherwise.