Draft Enactment on Cessation of Payments

1. For the purposes of any proceedings before a court (hereinafter called "the court") taken under any of the principal Acts, in which proceedings it is material to aver and prove that a debtor (as hereinafter defined) should be deemed to have ceased to pay his debts or that a cessation of payment by him of his debts should be deemed to have occurred, proof of such averment shall, with respect to the debtors severally hereinafter specified, be sufficiently made upon it being proved that one or more of the events or conditions set out in section 3 to 7 hereof have occurred.

2. (a) An "individual debtor" means, in the case of natural persons, an individual debtor, or where two or more such persons are in partnership with one another, or were so in partnership at a material time, the members of such partnership who are jointly indebted, and words referring to the singular shall, where the context requires, refer to the plural.

(b) a "corporate debtor" means a company incorporated under the relevant principal Act or by statute or by charter, and includes an unregistered company within the meaning of the relevant principal Act, other than an oversea corporate debtor.

(c)/

(c) an "oversea corporate debtor" means an oversea company within the meaning of a relevant principal Act, which is incorporated registered or established in any country outside Great Britain pursuant to the laws of that country, which has at a material time a place of business [registered] in Great Britain pursuant to the provisions of the said principal Act, and such a company shall continue to be an oversea corporate debtor, notwithstanding that, having carried on a business at or from its said place of business, it has ceased to carry on business thereat or therefrom.

3. An individual debtor shall, for the purposes of the laws of England and Wales, be deemed to have ceased to pay his debts if it is proved to the satisfaction of the court that:

(a) he committed or is deemed to have committed one or more of the acts of bankruptcy specified in sections 1(1)(a) or 107 of the Bankruptcy Act 1914, (in this section called "the Act") or in section 21 of the Administration of Justice Act 1965, or in section 4(3) of the Attachment of Earnings Act 1971 or in section 39 (read with Sch.2, para.1) of the Powers of Criminal Courts Act 1973, or any statutes amending the same;

(a) & (b) X

(b)/

(b) he committed a fraudulent or undue preference of one or more of his creditors within the meaning of section 44 of the Act;

(c) he executed any deed or made any agreement in writing or by parol providing for an arrangement, composition or moratorium with his creditors generally or with any class or classes of his creditors;

(d) he declared himself or by his duly authorised servant or agent to three or more of his creditors collectively, or to three or more of his creditors severally within the space of 14 days his inability to pay his debts then due to each of them

provided that it shall be proved to the satisfaction of the court that such inability was believed by the debtor to be permanent and not merely temporary;

(e) he had a receiving order in bankruptcy made against him under the Act whether on his own petition or on the petition of a creditor or creditors;

4. A corporate debtor shall for the purposes of the laws of England and Wales be deemed to have ceased to pay its debts if it is proved to the satisfaction of the Court that:

(a)/

(a) one of the grounds existed for winding it up under section 223 of the Companies Act 1948; (in this section called "the Act");

(b) one of the conditions existed by virtue of which under section 224 of the Act a company is deemed to be unable to pay its debts;

(c) a petition to wind it up on the ground of insolvency was presented pursuant to the Act to a court having jurisdiction so to wind it up;

(d) an extraordinary resolution for its winding up was duly passed by its members within the meaning of section 278(1)(c) of the Act;

(e) a meeting of its creditors was summoned under section 293 of the Act for the purpose of passing a resolution for its voluntary winding up;

(f) it committed a fraudulent preference of one or more of its creditors within the meaning of section 320 of the Act;

(g) it committed a fraudulent conveyance or transfer of its assets or a substantial part of its assets, within the meaning of section 172 of the Law of Property Act 1925;

(h)/

(h) it declared by itself or by its duly authorised servant or agent to three or more of its creditors collectively or to three or more of its creditors severally within the space of 14 days that it was unable to pay its debts then one to each of them

provided that it shall be proved to the satisfaction of the court that such inability was believed by the debtor to be permanent and not merely temporary;

(i) it applied to a court for any order for a scheme under section 206 of the Act, or made any arrangement or composition with its creditors under section 306 of the Act;

(j) it procured or suffered the appointment by one or more of its creditors, ~~or by~~ a court, of a receiver, or a receiver and manager, over its assets or any substantial part or any class or classes of its assets;

(k) it filed or procured to be filed with the Registrar of Companies as required by statute any annual statement of its accounts which disclosed a deficiency of assets to liabilities;

5. (1)/ (dishonour of negotiable instrument)

6. (1) An oversea corporate debtor shall for the purposes of the laws of England and Wales be deemed to have ceased to pay its debts if it be proved to the satisfaction of the court that:

(a) it became the subject in the country where it was registered or incorporated of any bankruptcy, liquidation, insolvency or analogous proceedings or

(b) it was declared or deemed by the laws of that country to have ceased payment of its debts.

(2) Upon such cessation of payments by an oversea corporate debtor being proved, any place of business which it then possessed in the United Kingdom shall itself be deemed, for the purposes of any proceedings by any creditor of such debtor at such place of business, to have ceased to pay the debts due from the debtor thereat.

7. (Scotland)

8. (Northern Ireland)

9. Where a debtor has ceased to pay his or its debts by virtue of more than one of the acts or events hereinbefore specified in relation/

relation to such a debtor, he or it shall be deemed to have ceased to pay his or its debts on, and his or its cessation of payments shall be deemed to relate back to, the earliest of the said acts or events, being not earlier in point of time than [ ] months before his subsequent bankruptcy or its subsequent winding up.

9. The foregoing provisions shall not affect any of the laws of the United Kingdom prescribing the conditions pursuant to which a bankruptcy petition or a winding up petition can be presented against a debtor by a creditor.

10. The principal Acts herein referred to are the Bankruptcy Acts 1914-1926, the Deeds of Arrangement Act 1914, the Bankruptcy (Scotland) Acts 1913- , the Bankruptcy and Insolvency Act 1857, the Companies Acts 1948-1967, and the Companies (Northern Ireland) Act.

CONSULTATIVE PAPER

CESSATION OF PAYMENTS

Proposed passage for insertion in Section 7

In place of present draft paragraph 7.16 (a)

7.16 (a) The Committee has recently learned that a detailed study is being conducted by the Working Party of Experts at Brussels into the possibility of devising a uniform definition of the concept of the cessation of payments, for the purposes of operating the Uniform Law. The Committee assumes that such a definition, if agreed upon, would in due course be inserted into the Convention by way of amendment to the present draft, and that the Contracting States would be obliged to incorporate it into their national insolvency laws, in the same manner as the Uniform Law itself and Article 39.

7.16 (b) The Committee is without information as to the progress of that study of a possible definition; we feel, however, that it is of importance to canvass the views of readers as to the possible nature and extent of such a definition of cessation of payments, which might enable the U.K. to make a valuable contribution to the formulation of such a definition as would command widespread acceptance. The Committee accordingly proposes, as a basis for discussion the following definition of "cessation of payments", which might prove to be acceptable to the other States and be capable of being incorporated, mutatis mutandis, in the national insolvency laws of each State, and also into the insolvency codes of each part of the U.K.

"1. Cessation of payments shall be constituted

(a) by any failure on the part of a debtor to pay his debts in the ordinary course of business or as they fall due; or

(b) by the debtor committing or suffering an act or acts demonstrating his insolvency;

Unless it be proved that such failure to pay or such insolvency was temporary rather than permanent;

2. In determining whether the debtor has ceased payment within the meaning of clause 1 (a) or (b), a court may, without prejudice to the generality of those clauses, have regard inter alia to the fact that the debtor has committed or suffered one or more of the following acts or events :

/ Here would be set out a list of specific acts or events, to be agreed, such as dishonouring a bill of exchange, suffering an execution over (in Scotland, diligence upon) one's goods, giving notice of suspension of payments, or calling a meeting of creditors, etc; these examples list are, of course, not exhaustive but merely illustrative /

7.16 (c) What would be sought for in devising such a definition of cessation of payments, capable of being adopted by all the E.E.C. States, would be a reasonably accurate mode

of recognising and defining (often though not invariably in retrospect) those situations relating to a debtor which have become generally accepted in the insolvency field as conferring rights on the general body of the debtor's creditors to challenge the validity of his actions and dealings in the period preceding his bankruptcy.

7.16 (d) The views of readers are invited on this suggested definition, and as to those acts or events to which express reference should be made therein.

State right of preferential claim against local-based assets (whether in the wider Convention form or in the more restricted form suggested by the Committee at para.5 above) may cause concern by reason of its novelty and possible complexity. The revolutionary conferment on creditors for fiscal and quasi-fiscal debts of a right of proof across frontiers, even though it be on an unsecured basis, may seem likely to diminish the funds available for other unsecured creditors. There is, of course, also involved a certain sacrifice of "national" jurisdiction, both in relation to the forum for obtaining the bankruptcy of debtors whose commercial activities have been in part carried on in the U.K., although their centre of administration (and therefore the exclusive court for making them bankrupt) lies in another State, and in relation to the exclusion of certain disputes within the bankruptcy from adjudication by the court of the bankruptcy.

8.9 The Committee wish to stress the point that, in their view, this Convention must be founded upon an attitude of mutual trust in the integrity and efficiency of bankruptcy courts and administrations of Member States.

8.10 Readers, and the business, financial and leg communities in each part of the U.K. from which they are drawn, will wish to weigh up for themselves the advantage and disadvantages which have been briefly summarised abo

and have been displayed in greater detail in the preceding sections, together with such other advantages or disadvantages as may occur to the individual reader, and thereafter to strike their own balance. They will then form the best conclusions which they can, and it is hoped that they will communicate them, together with their reasons, to the Committee. From those reasons and these conclusions, it will be the duty of the Committee, as soon as practicable, to present to Her Majesty's Government the advice called for in the Committee's terms of reference, set out in paragraph 1.1 above, which is now urgently required by the Secretary of State for Trade.

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Crown by statute, to recover debts due to itself from its subjects for tax and other public obligations, by means of the executive power, a power later extended by statute to minicipal rates and taxes in one form or another, and, secondly, from a desire to ensure that the employees of a bankrupt employer are not left unprovided for by reason of the non-payment of arrears of wages outstanding when their employment ceased.

5.6. The preferential debts codes, in their present-day forms, as established by the Bankruptcy Acts and the Companies Acts of the U.K., are based upon two fundamental premises -

(1) that the Crown no longer possesses, in insolvency, any rights of direct recovery from its debtors, by prerogative or other executive action, although it still enjoys certain privileges over other creditors;

(2) that all creditors on whom statutory rights of preference are conferred, including the Crown, rank pari passu with one another for priority payment out of the assets, with the exception of the landlord entitled to distrain for limited arrears of rent who may be relegated to a second-stage or postponed preferential status, as against preferential creditors in the strict sense.

5.7. Those Crown privileges are (a) that in respect of taxes, although entitled to rank preferentially for only one year's tax (in respect of each category of tax), the Crown may select for its preferential claim the "best year's" arrears out of the six years preceding the bankruptcy or the winding-up;*1 (b) that if any assessment to tax be made on the insolvent taxpayer, even if "arbitrary" (i.e. based on estimated assessments) has become final under the statutory tax code before the bankruptcy or winding-up, it cannot be challenged or re-opened by the trustee in bankruptcy or the liquidator as a matter of right, but only as a matter of administrative concession, differing in this respect from almost all other debts provable in insolvency;*2 and (c) that the Crown can still enforce certain judgments for tax debts by means of committal to prison for non-payment.*3

5.8. As might be expected, the insolvency codes of the other States of the E.E.C. demonstrate many of the same characteristics as those of the U.K.; but certain fundamental

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*1 Re. Pratt. Inland Revenue v. Phillips (1951) Ch. 225; (England); Lord Advocate v. Purvis Industries Ltd. (1958) S.C. 336 (Scotland).

*2 See Williams on Bankruptcy (18th Edn.) pp.185-6; Palmer's Company Precedents (18th Edn.) Vol.II, pp.392-3.

*3 Debtors Act, 1869, S.5.

State right of preferential claim against local-based assets (whether in the wider Convention form or in the more restricted form suggested by the Committee at para.5 above) may cause concern by reason of its novelty and possible complexity. The revolutionary conferment on creditors for fiscal and quasi-fiscal debts of a right of proof across frontiers, even though it be on an unsecured basis, may seem likely to diminish the funds available for other unsecured creditors. There is, of course, also involved a certain sacrifice of "national" jurisdiction, both in relation to the forum for obtaining the bankruptcy of debtors whose commercial activities have been in part carried on in the U.K., although their centre of administration (and therefore the exclusive court for making them bankrupt) lies in another State, and in relation to the exclusion of certain disputes within the bankruptcy from adjudication by the court of the bankruptcy.

8.00 ~~It is, in the Committee's opinion,~~ The Committee, their readers, and for the business, financial and legal communities of the U.K. from which their readers are drawn, as a whole, and in each of the component parts of the Kingdom, will wish to weigh up for themselves the advantages and disadvantages which have been briefly summarised above, and have been displayed in greater detail in the preceding sections, together with such other advantages or disadvantages as may occur to the individual reader, and thereafter to strike their own balance. They ~~should~~ will then form the best conclusions which they can, and

communicate them, together with their reasons, to the Committee. From those reasons and those conclusions, which the Committee must, as soon as practicable, present to Her Majesty's Government the advice called for in the Committee's terms of reference set out in paragraph 1.1 above, which is now urgently required by the Secretary of State for Trade.

~~8.10~~ The Committee, ~~having already studied the Convention exhaustively for over 12 months, feel entitled to conclude by suggesting to their readers a principle which may help to guide their approach to the Convention, regarded as a whole.~~ This Convention ~~(like any other judicial and commercial treaty, but perhaps in this case to a higher degree)~~ must ~~surely~~ be founded upon an attitude of mutual trust ~~between each of the signatory~~ States ~~(and their respective nationals)~~ in the integrity and diligence of their ~~respective~~ courts and administrative ~~systems. By signing and ratifying such~~ a Convention, the U.K. would be undertaking to its fellow Member States and to their nationals, to afford them the justest, fairest and most efficient administration of their rights in the U.K., whether those rights be individual or collective. They would in return be entitled to expect to receive from those States and their nationals a like degree of justice, fairness ~~and efficiency.~~

8.11 There does not seem to the Committee to be any prospect, as at this date and at this stage of the E.E.C.'s

development, of envisaging, let alone of drafting, a wholly new and different system for inter-E.E.C. insolvency administration (a system which all seem to agree to be in some form essential). But the long-established and highly experienced insolvency administrators of the U.K. (whom the Committee understand to be much admired in other States) and the communities which they serve, have surely much to contribute to the proper fashioning of this new, and potentially valuable, judicial and economic instrument. It is as a vital foundation for the negotiation by the U.K. of its participation in that instrument that the views of the readers are so much needed, and are now urgently awaited by the Committee and by Her Majesty's Government.

20.x.79.

differences between those States' codes and the U.K. codes, are to be noted, namely :

(1) (a) In most of the States, preferential debts do not share the same equal rank of preference, but enjoy different degrees of rankings;

(b) there is also a greater variety of debts enjoying preferences than in the U.K.;

(2) State debts and "social obligations" are generally regarded in other States as enjoying special privileges and protection on grounds of "public policy" ("ordre public"), or "social policy" ("ordre social"), ~~which confer on them a quasi-constitutional status,~~ which ~~is not accorded recognition~~ in the U.K. (see para.5. below).

(3) Some States still possess certain prerogative or executive powers for recovering the debtor's indebtedness to the State of a fiscal or quasi-fiscal nature ~~(i.e. payable to the State or its organs by compulsion of law),~~ irrespective of the incidence of his bankruptcy or its liquidation, considerably exceeding any privileges enjoyed by the Crown in the U.K. (see para.5.7. above);

(4) In some States, preferential debts may constitute prior charges on the securities held by secured creditors whereas the ~~only such prior~~ "charges" enjoyed by preferential creditors in the U.K. ~~are~~ confined to the case where a floating charge is realised by the

appointment of a receiver and manager (see para.5.11 below).

(5) The concept of subrogation to the preferential rights of creditors, conferred by the U.K. winding-up codes (see paras. 5.4. ~~above~~ and 5. below) does not appear ~~not~~ to exist in ~~the~~ other States.

5.8A. The Committee is aware of the strong feelings current among the business community in the U.K. against all, or at lease most, preferential debts and even more against any extension thereof. It understands that such sentiments are echoed in all the other States, and that it is not impossible to foresee an eventual diminution, if not ~~the~~ abolition, of preferential rights, ~~or alternatively a harmonisation of preferences between all the States, which would considerably assist in the solution of some of the problems considered in this Section; particularly~~ In any event, it would seem to be essential to reduce or eliminate the different rankings of preferences within States, which are likely to present peculiar problems of administration. The Convention however must not prevent from any encourage an increase in scale or a multiplication in number of such preferences.

5.9. ~~It is~~ the policy of the Convention, ~~so far as possible, not to~~ will not of itself interfere with the basic internal bankruptcy laws of each State (~~see para. above~~); ~~accordingly~~, the internal preferential debts code of each State will remain ~~substantially unchanged~~. The Convention's provisions would take effect principally in four areas :

(1) any creditor entitled under the laws of his own

5.15. Neither the Report nor the Convention refer to or legislate for the case of the subrogated creditor for wages advances described in the preceding paragraph as an important aspect of the U.K. winding-up code, and it is not clear whether the debt claimed by such a subrogated creditor would be construed as "a debt arising out of a contract of employment" within the meaning of Article 17(8), considered below. We draw this omission to the attention of readers and invite their views.

5.15. By Article 17(8), disputes relating to debts generally are subjected to the exclusive jurisdiction of the courts of the State of the bankruptcy; but certain excepted classes of debts, namely, fiscal and quasi-fiscal debts, social security debts and the debts arising out of contracts of employment considered in para.5.15 above, are excluded from that universal jurisdiction, in relation to which Article 17(8) provies: "the courts or authorities normally having jurisdiction shall determine the existence and the amount of the debt and the extent of such preferential rights as it may enjoy". These exceptions to that universal jurisdiction itself founded on the twin principles of unity and universality referred to at para. above, appear to the Committee to give rise to a number of questions.

5.16. In a U.K. bankruptcy or winding-up, the trustee or liquidator has the general duty of determining, subject to the directions and the adjudications of the Courts exercising bankruptcy or winding-up jurisdiction those very questions regarding the existence, the amount and the preferential status of debts. In cases where the debt has been established

prior to the bankruptcy or winding-up order, by the judgment of a court of competent jurisdiction, the trustee or liquidator will in general be bound by that judgment, (though not if it was a judgment by consent, or one vitiated by collusion or fraud). It is also true that he may not be able, as a matter of right, to disturb a finalised tax assessment (see para 5. above). But in all other cases, i.e. of unadjudicated debts, he has the right and duty to adjudicate upon them, subject to his decision being approved by the court. Furthermore, that court has also the jurisdiction to determine in any disputed case, whether and to what extent the debt, if and when established enjoys preferential status. Such statutory rights of preference are, in U.K. insolvency law to be strictly construed, and are not to be extended by implication or analogy, because they are calculated to prejudice the general body of creditors.*1.

5.17. ~~The effect of~~ Article 17(8) cited above, would produces in the case of the U.K., an anomalous situation, not merely in relation to the preferential status of a debt but even to the existence and amount of the debt. Under U.K. law, once a bankruptcy or winding-up has occurred "the courts or authorities normally having jurisdiction to determine" the foregoing questions are the bankruptcy and winding-up courts themselves; the only "authorities" which can be envisaged as

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*1 Re. Baker, ex parte Eastbourne Waterworks Co. (1954) 1 W.L.R. 1144.

relevant in the U.K. are the Inland Revenue or other quasi-judicial tribunals, but they have jurisdiction, at best, to determine the existence and amount of the debt, but not its preferential status, if any.

5.18. Where, however, a bankruptcy has been declared in another State, within which bankruptcy there are preferential creditors in the U.K., the question will arise by what "courts or authorities normally having jurisdiction", those questions are to be determined. It would seem that in order to comply with the policy of Article 17(8), the U.K. would need to establish courts or authorities capable of determining, from the point of view of U.K. preferential creditors of the Article 17(8) classes, the matters thereby left to their decision. The views of readers are invited on what form that such "courts or authorities" should take, and as to the nature and extent of the right of representation before them by or on behalf of the foreign interested person including ~~trustee or~~ trustee or liquidator.

5.19. If the existence, amount and preferential status of those classes of debts, when owed by the debtor in or to other States, are to be conclusively determined by the appropriate courts or authorities in those States, then questions would seem to arise as to the mode of submission of proofs of debt (called, in Article 30, "claims") in respect of those classes of debts in a U.K. bankruptcy. Such "claims" are, by Article 30(1), capable at present of being lodged by creditors informally in writing, stating the amount of the

debt and whether or not it is preferential or secured. It would, however, appear necessary, that a debt of the classes which are specially justiciable under Article 17(8) should be the subject of a more formal proof, so as to disclose the creditor's special preferential rights as claimed by him, and to assist the liquidator in dealing with it. It may also be observed that under Article 30(2), creditors residing in a State other than the State of the bankruptcy may dispute other creditors' claims, again informally in writing. It is not indicated whether it is contemplated that creditors (as opposed to the trustee or liquidator) may be entitled to make themselves parties to the proceedings relating to disputed debts under Article 17(8), which would be a procedure not available at present in U.K. law except with the leave of the Court.

5.20. Over and above the procedural question of the mode and place of adjudication of the excepted classes of debts referred to in Article 17(8), there is the more fundamental question of the right of preferential creditors, having exhausted such local rights of recovery against assets as they may enjoy, to come into the "foreign" bankruptcy or winding-up, e.g. in the U.K., to claim for the balance. This applies in particular to the case of fiscal and quasi-fiscal debts, which, though not enjoying the right of multi-State preferential recoveries, can prove as unsecured creditors for their unsatisfied balances (Article 42(1)). The same rule appears to apply to social security debts

(Article 42(2)). It has been suggested to the Committee that such debts, (which may be very large) should in some way be moderated in their impact on the general body of creditors, which would necessitate an amendment to the Convention, e.g. by imposing on such creditors a duty to elect between local recovery on the one hand and proof in the "foreign" bankruptcy on the other.

5.21. On the footing that there will continue to exist, within the E.E.C. or some of its States, and under the Convention, a system of locally-enforceable preferential debts, enforceable against the locally-based assets of a bankrupt made bankrupt in another State, the question arises as to how this system is to be administered by the liquidator in practice. It is plain that, in implementing the requirements of Articles 40 to 46, he will need to establish and maintain, in respect of each State wherein assets of the bankrupt are located, a "local assets-pool" (French "sous-masse") for the purpose of making appropriate distributions therefrom to those creditors who are established as having enforceable rights against it. But neither the Convention, nor the Report, envisages or requires the setting up of "sub-liquidations", or the appointment of "sub-liquidators". There is, however, power, under Article 28, to appoint more than one liquidator (one or more of whom may be qualified under the laws of a State other than the State of the bankruptcy), and for the liquidator or liquidators to employ agents to assist him, also drawn from that class.

5.22. Thus far the Committee has sought to present the general pattern of the Convention's policy towards preferential debts in relation to its modus operandi rather than to its social justifications. It is however now necessary to examine the social basis for the proposed multi-State preferential claim, intended to be afforded to all preferential creditors other than for fiscal and quasi-fiscal debts, in relation to the existing U.K. law.

5.23. As already explained, the present position under the U.K. insolvency codes is that all creditors, wherever situate or resident, are entitled to prove as creditors in any bankruptcy or winding-up, so long as their debts are not per se excluded from proof, under the general law. Subject to a creditor establishing his rights to be admitted to proof, he can then claim such preferential status as the U.K. codes confer on a debt of that class, e.g. an unpaid employee in a foreign country is entitled in the U.K. bankruptcy or winding-up of his U.K.-based employer to prove preferentially for his wages, and a person (wherever situate) would be entitled to prove by subrogation (in the winding-up) for moneys advanced to pay wages to such employee.

5.24. Four possible attitudes can be postulated for the U.K. to adopt under the Convention :

(1) to adhere to its existing law, namely that preferential creditors should continue to claim in bankruptcy or in liquidation here; but if they

PREFERENTIAL AND SECURED DEBTS

5.1. All insolvency codes, while founded on the general principle of rateable distribution of the insolvent's assets among his creditors, make to a greater or less extent two principal exceptions, with respect to secured debts and to preferential debts.

5.2. In the case of secured debts, i.e. debts secured on the whole or part of the property of the bankrupt, these are in general not interfered with by the bankruptcy, so long as the creation of the security was not in itself a fraud upon or otherwise invalid as against the creditors; but there are exceptions to this general rule, some of which are discussed below in paras.

5.3. As for preferential debts, the categories of debts to which preference is at the present time accorded by United Kingdom law may be summarised as follows :

(1) taxes (maximum one year's arrears, but the "best year" can be selected);

(2) rates (not exceeding "last year's" arrears);

(3) P.A.Y.E., V.A.T., and analogous imposts (not exceeding "last year's" arrears);

(4) unpaid employees' wages (maximum of 4 months' arrears of remuneration, not exceeding £200 in all per person, and holiday pay);

(5) sundry other pecuniary obligations to public bodies which have power to levy charges for public purposes.

5.4. In the field of preferential debts, the bankruptcy code and the company winding-up code of the United Kingdom are substantially identical in their provisions, save for one important provision, which is to be found in the latter but not in the former, namely the subrogation of persons who have advanced monies to the Company for the payment of wages to its employees; such persons are subrogated in the winding-up of the company to the same preferential rights which the employees would have enjoyed if they had remained unpaid.*

5.5. In the case of preferential debts, these qualify as such, and are made recoverable in priority to ordinary unsecured creditors, on grounds of public policy, in order either to benefit the public revenue or to fulfil other social objectives. Historically, the preferential debts system derives in the United Kingdom firstly, so far as concerns England and Northern Ireland from the Crown's prerogative power, and so far as concerns Scotland, from power conferred on the

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*See s.319(4) of the Companies Act, 1948 (for England and Scotland) and s. of the Companies (Northern Ireland) Act ; the former section, so far as material, reads:

"Where any payment has been made (to an employee) on account of wages or salary ..... or on account of holiday remuneration out of money advanced by some person for that purpose, the person by whom the money was advanced shall in a winding-up have a right of priority in the amount by which the sum in respect of which (the employee) ..... would have been entitled to priority has been diminished by reason of the payment having been made."

Crown by statute, to recover debts due to itself from its subjects for tax and other public obligations, by means of the executive power, a power later extended by statute to municipal rates and taxes in one form or another, and, secondly, from a desire to ensure that the employees of a bankrupt employer are not left unprovided for by reason of the non-payment of arrears of wages outstanding when their employment ceased.

5.6. The preferential debts codes, in their present-~~day~~ forms, as established by the Bankruptcy Acts and the Companies Acts of the U.K., are based upon two fundamental premises -

(1) that the Crown no longer possesses, in insolvency, any rights of direct recovery from its debtors, by prerogative or other executive action, although it still enjoys certain privileges over other creditors;

(2) that all creditors on whom statutory rights of preference are conferred, including the Crown, rank pari passu with one another for priority payment out of the assets, with the exception of the landlord entitled to distrain for limited arrears of rent who may be relegated to a second-stage or postponed preferential status, as against preferential creditors in the strict sense.

5.7. Those Crown privileges are (a) that in respect of taxes, although entitled to rank preferentially for only one year's tax (in respect of each category of tax), the Crown may select for its preferential claim the "best year's" arrears out of the six years preceding the bankruptcy or the winding-up;*1 (b) that if any assessment to tax be made on the insolvent taxpayer, even if "arbitrary" (i.e. based on estimated assessments) has become final under the statutory tax code before the bankruptcy or winding-up, it cannot be challenged or re-opened by the trustee in bankruptcy or the liquidator as a matter of right, but only as a matter of administrative concession, differing in this respect from almost all other debts provable in insolvency;*2 and (c) that the Crown can still enforce certain judgments for tax debts by means of committal to prison for non-payment.*3

5.8. As might be expected, the insolvency codes of the other States of the E.E.C. demonstrate many of the same characteristics as those of the U.K.; but certain fundamental

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*1 Re. Pratt, Inland Revenue v. Phillips (1951) Ch. 225; (England); Lord Advocate v. Purvis Industries Ltd. (1958) S.C. 336 (Scotland).

*2 See Williams on Bankruptcy (18th Edn.) pp.185-6; Palmer's Company Precedents (18th Edn.) Vol.II, pp.392-3.

*3 Debtors Act, 1869, S.5; Administration of Justice Act 1970, s.11, Sch.4.

differences between those States' codes and the U.K. codes, are to be noted, namely :

(1) (a) In most of the States, preferential debts do not share the same equal rank of preference, but enjoy different degrees of rankings;

(b) there is also a greater variety of debts enjoying preferences than in the U.K.;

(2) State debts and "social obligations" are generally regarded in other States as enjoying special privileges and protection on grounds of "public policy" ("ordre public"), or "social policy" ("ordre social"), which confer on them a quasi-constitutional status, which is not accorded recognition in the U.K. (see para.5 below).

(3) Some States still possess certain prerogative or executive powers for recovering the debtor's indebtedness to the State of a fiscal or quasi-fiscal nature (i.e. payable to the State or its organs by compulsion of law), irrespective of the incidence of his bankruptcy or its liquidation, considerably exceeding any privileges enjoyed by the Crown in the U.K. (see para.5.7. above);

(4) In some States, preferential debts may constitute prior charges on the securities held by secured creditors, whereas the only such prior charges enjoyed by preferential creditors in the U.K. are confined to the case where a floating charge is realised by the

State to preferential treatment is to be entitled (whether his own State is "the State of the bankruptcy" or not) to enforce his preferential rights against the assets of the bankrupt situate within their own State, notwithstanding the "universal vesting" of all the assets in the liquidator: e.g. a preferential French creditor in a U.K. bankruptcy could enforce, against any assets in France, the preferential rights conferred on him by the French bankruptcy law according to the ranking of his preference under that law.

(2) any creditor in any State,(other than a creditor for a debt of a fiscal or quasi-fiscal character), is to be entitled to enforce, against any assets situate in a State other than his own, such preferential rights (if any) as are conferred on creditors of the same class as himself by that State: e.g. an unpaid Italian employee in a U.K.bankruptcy could enforce against any assets situate in Germany such preferential rights as are conferred by the German bankruptcy law upon an unpaid German employee of the same class.

(3) all creditors wherever situate are to be entitled to prove as creditors in the bankruptcy wherever declared, for such preferential rights of dividend as are conferred on creditors by the bankruptcy laws of the State of the bankruptcy.

(4) creditors in respect of fiscal and quasi-fiscal debts are not to be entitled to enjoy any rights of preferential recovery or dividend in any State other than the State to which, or within which, those debts are owed. But any balances of such debts, which such creditors have not succeeded in recovering by the use of their prerogative or executive rights of recovery in their own State, will rank for proof in the bankruptcy, if in another State, but only as unsecured creditors (Article 42(1) and (2)).

5.10. The system contemplated by paragraph 5.9(4), above, represents a fundamental change in currently accepted private international law in this field, namely, that the Courts of one State do not enforce the fiscal or quasi-fiscal obligations of another State by process against the debtor or his property within their jurisdiction, whether directly by action in its courts or indirectly through a trustee in bankruptcy or a liquidator. In the case of the U.K., this rule applies even where the foreign State is a Dominion or other member of the British Commonwealth, and it also applies between E.E.C. Member States.*1 But under the Convention provision, summarised in paragraph 5.9 (4) above, in the U.K. banrkutpcy of a U.K. debtor, for example, sums owed by the debtor in

*1 See, e.g. Government of India v. Taylor (1955) A.C. 491; Buchanan v. McVey (Sup.Ct. of Eire), ibid, 516 n. Metal Industries (Salvage) Limited v. S.T. Harle (Owners) (1962) S.L.T. 124.

respect of French income tax (or the balance owing after the exhaustion of French-located assets by French Revenue recoveries) could be proved for as an unsecured debt in the U.K. bankruptcy; the same would be true of the U.K. bankruptcy of another State's national whose centre of administration was in the U.K.; similarly, sums due by a U.K. debtor in respect of U.K. income tax could be proved for by the U.K. Treasury as an unsecured debt if the debtor were made bankrupt in Germany, although, of course, in this case the U.K. would have had no means of exercising any direct rights of recovery against the debtor's assets in the U.K.

5.11. There is one exception to the statement that the Crown and other preferential creditors in the U.K. do not possess direct remedies against the assets of a debtor, namely that already referred to in para 5.8(4). Where a company has granted a floating charge over its assets registered (in England) under s.95 and (in Scotland) under s.106A et seq. of the Companies Act, 1948, (as amended by the Companies (Floating Charges) Scotland Act, 1961) or under the comparable Northern Irish Act, then by virtue of the provisions of ss.94 of the 1948 Act (for England) and of s.19 of the Companies (Floating Charges and Receivers) (Scotland) Act, 1972 (for Scotland) and of the comparable Northern Irish Acts, where a receiver is appointed under such a floating charge and the company is not in winding-up, the first monies recovered by him out of the assets bound by the charge (after defraying his charges, etc.) are to be applied in paying those debts which

would be preferential in an insolvent winding-up. A similar prior charge over the assets is created in the case of an actual winding-up; but such a privilege could, under the present U.K. codes, only apply to a winding-up under the U.K. Companies Acts, and not to a foreign winding-up. No comparable prior charge for preferential debts exists in relation to the assets of personal bankrupts in the U.K.

5.12. As has been indicated above (para. 5.9), it is the policy of the Convention that all creditors entitled to preference (other than in respect of fiscal or quasi-fiscal debts), should be entitled to claim such preferential rights as are conferred on creditors of that preferential class in each State, subject only to the prerequisite that there are some assets of the bankrupt located in that State. ~~Before we examine the mechanism by which these rights are to be enforced~~, The Report appears to assume (see e.g. pp. et seq.) that the ~~predominant~~ chief or principal creditor of this type will in practice be the unpaid employee, to such extent that he is a preferential creditor in respect of his arrears of wages, accrued holiday remuneration, or redundancy (or severance) pay.

5.13. However, no statistics are available to the Committee as to the number and size of such claims anticipated within other States and it would be helpful to obtain these. It may, however, be noted that in relation to redundancy ~~or severance pay~~ payments (potentially a very large item), under the U.K. insolvency codes, redundancy ~~pay is a~~ payments are claims vested in the employee himself as against his employer; but should

his employer become insolvent, he can recover from the ~~appropriate department of~~ State, which is then subrogated to the employee's rights in the employer's bankruptcy* ~~(see Redundancy Payments Act, 1965, s.6)~~, but does not at present enjoy~~ing~~ a preferential status. But it is understood that ~~severance pay~~ redundancy payments (or their equivalent) in certain Member States are a preferential debt, ei either of the employee or of the State ~~and that there may be a tendency for such rights to be extended, e.g. in Germany.~~ In the U.K., however, employees' accrued holiday remuneration may amount to substantial preferential debts in the aggregate.

5.14. A special feature exists in the U.K. winding-up code, however, in that as already described (see para.5.4. above) an extensive right of preferential claim by subrogation is conferred in respect of advances made for the payment of wages (under s.319(4) of the Companies Act, 1948, cited ante, para.5.3.). This right, although enacted in general terms, appears to be enjoyed almost exclusively by the bankers of companies, to whom credit for the payment of wages is extended, generally on a special "wages account", which account conserves the maximum preferential employee's right to four months' pay, not exceeding £200 and holiday remuneration, for which the bankers (if they have paid those sums) are entitled to claim preferentially in the winding-up. These sums may be of very significant size in the aggregate, and with the possible exception of the Revenue, may constitute one of the largest individual debts, and the largest preferential debt, in a U.K. winding-up.

* Redundancy Payments Act 1965, s.6.

recover any sum from the same debtor in a "foreign" State they must bring it into account.

(2) to adhere to its existing law relating to proof of debts and distribution, but agree to a preferential creditor being entitled to elect whether to prove as such or to exercise his rights of recovery from assets situate in another state.

(2) to adhere to its existing law, but ~~agree to~~ permit a preferential creditor exercising his preferential rights, not only to prove as such in the bankruptcy or winding-up (regardless as to which is the State of the bankruptcy) but also to recover as a preferential creditor against the assets of the debtor situate in any other State or States, to the extent (if at all) that their laws permit him to do so, subject to some formula limiting the totality of his receipts.

(4) to adhere to its existing law, but ~~agree to~~ permit a preferential creditor additionally to exercise such preferential rights as are accorded to him by the law of his own State, only, subject to some formula limiting the totality of his receipts.

5. The justification which has been presented to the Committee for the course they propose above is that every preferential creditor, and especially an employee-creditor, may be entitled to feel that the assets of the debtor in his State should be charged first with payment of the preferential

debts owed in that State ~~(this is an aspect of what is known in the E.E.C. as "ordre sociale")~~, and only thereafter should the balance of those assets be available to "foreigners". But the Committee, though recognising the moral and constitutional force of that argument, while ~~confined to~~ presented on a "one-State relationship," do not feel ~~in any way~~ moved to ~~accord~~ agree such an anomalous preferential right ~~to~~ claimed be exerciseable ~~by~~ in a creditor in other States, (i.e. other than ~~the~~ his own State) ~~of the creditor,~~ except, of course, in the State of the bankruptcy and subject to its laws. The views of readers are invited.

5. The Committee, while inviting readers' views on the generality of the problems presented above, would wish to indicate its own provisional view, which is mainly founded on proposition (B) in these terms :

(1) A preferential creditor shall be entitled to the preference allowed to him by the law of his own State, out of the assets available to him in that State, as a member of that class of preferential creditors (i.e. ~~that~~ his class may rank against such assets lower than other classes, such as fiscal debts);

(2) If (a) those assets are insufficient to satisfy his claim, or (b) the pecuniary limit on his claim as such preferential creditor in his own State is lower than the limit prescribed by the laws of the State of the bankruptcy, then he may claim preferentially in the bankruptcy for any shortfall

under (a), to the extent that his total recoveries will not exceed the maximum sum recoverable in the bankruptcy, or under (b) up to an amount equal to the limit imposed by the laws of the State of the bankruptcy.

development, of envisaging, let a
new and different system for inter-E.E.
administration (a system which all seem to agree
some form essential). But the long-established and highly experienced insolvency administrators of the U.K. (whom the Committee understand to be much admired in other States) and the communities which they serve, have surely much to contribute to the proper fashioning of this new, and potentially valuable, judicial and economic instrument. It is as a vital foundation for the negotiation by the U.K. of its participation in that instrument that the views of the readers are so much needed, and are now urgently awaited by the Committee and by Her Majesty's Government.

20.x.74.