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REDRAFT AS AT 11th September 1975

THE UNIFORM LAW

INTRODUCTION

1. By Article 76 of the Convention, each Member State is required to incorporate into its own legislation relating to the forms of bankruptcy proceedings listed in Article 1(a) of the Protocol, such provisions as may be necessary to make its law conform with the six articles of the Uniform Law and with Article 39(1) of the Convention. Such incorporation is to be effected not later than the date on which the Convention comes into force, i.e. on the first day of the sixth month following its ratification by the last Member State to take this step.

2. We understand that the provisions of the Uniform Law, in particular those which invalidate transactions effected within the specified periods of relation-back, are intended to be standard requirements, in the sense that each State must adapt not merely its own statutory provisions which are "less severe", but also those which are "more severe". This standardisation is a necessary consequence of the policy embodied inter alia in Articles 18 and 19(2) of the Convention, which refer to the law of the State of the bankruptcy both the requirements for opening a bankruptcy and, in general, the effects of the bankruptcy. The N-L Report, however, indicates that Member States are required to incorporate into their own legislation the articles of the Uniform Law only to the extent that their legislation does not contain provisions to the same effect, and that they are not necessarily expected to incorporate the exact text of those articles into their own law. The N-L Report refers to the need to respect the different constitutional requirements and legislative traditions of the Member States. We have been assured that no decision has been taken to alter the ruling given in the N-L Report, that Member States will not be obliged to reproduce the texts of the Uniform Laws word for word.

Nevertheless, we have heard suggestions from Continental sources that this policy might be changed. We think this would be unfortunate and would cause unnecessary difficulties for all Member States. If there was a requirement for the texts of the Uniform Laws to be reproduced verbatim into national laws, then they would require very careful and specific re-drafting.

3. The statutory provisions by which each Member State implements its obligation to introduce the Uniform Law will form part of that State's internal law, applicable to all bankruptcies and liquidations, whether or not they are of an international (i.e. a "Community") character. They will replace the comparable provisions of the existing law. The Uniform Law, therefore, is of special importance and its implications require careful consideration.

for what it is about ✓

4. The Convention envisages that Article 39(1) and the provisions of the Uniform Law should form part of national legislation, not only in respect of bankruptcy and liquidation proceedings in the strict sense, but also in respect of certain other analogous proceedings to be specified by individual Member States. In the terms of Article 76(3), these other proceedings are to be listed in Article XIII of the Protocol. On the assumption that "Creditors' Voluntary Winding-up" is scheduled under Article I(b) of the Protocol, it will also require to be listed in Article XIII.

5. In relation to the other forms of bankruptcy proceedings to be listed in Article I)b) of the Protocol, Article 39(1) is to apply, but of the Uniform Law only Articles 3 to 6 and, in either case, only to the extent that those provisions are appropriate to such other proceedings. It will be recalled that these are procedures which, while avoiding formal bankruptcy or liquidation, are designed to secure either the collective distribution of the debtor's estate among his creditors, or, while safeguarding their interests, to enable the debtor to re-establish himself.

6. In considering the effects of the bankruptcy on contracts of sale with reservation of title, we have raised objections to the provisions of Article 39(1). (See paragraph above). If our recommendations are accepted, then no practical purpose would be served by making Article 39 a uniform law. In this case, of course, all references to Article 39 should be deleted from Article 76. However, should it be decided that provisions relating to contracts of sale with reservation of title are to form a part of the Uniform Law, then in our opinion they should apply to all forms of bankruptcy proceedings. Such a law could not be confined in its operation to bankruptcy situations, but must be general in its effect.

7. We accept the provisions of Article 76(4) to the extent that it may not be appropriate to apply to "other bankruptcy proceedings" the rules of relation-back and set-off, etc., contained in Articles 3 to 6 of the Uniform Law. If creditors desire the application of such rules, their remedy, arguably, is to institute formal bankruptcy proceedings.

8. It has been suggested to us that difficulties may arise because Article 76(4) prescribes that the Uniform Laws apply to the specified analogous proceedings only "to the extent that those provisions are capable of applying thereto". This leaves the extent of the application of these provisions entirely unclear. The Uniform Law, moreover, contains numerous references to the opening of the bankruptcy and, to make its operation effective, it would seem essential to indicate an equivalent point of time in analogous proceedings. Not all of us are persuaded that Article 76(4) is satisfactory, but it could be improved to some extent by making its terms more explicit and by making it clear that the Uniform Laws should apply only to the extent permitted by the law governing the particular proceedings.

9. Members of the Working Party of Experts who produced the material on which the N-L Report was based, and from whose deliberations the draft

Convention emerged, put forward, as if on behalf of their own States, a number of reservations with regard to the Uniform Law. It has not been made clear to us whether the making of such specific reservations has at any time become the policy of the States to whom they are attributed, or whether they remain no more than the informed anticipations of the Experts from those States. The inclusion of one reservation (Annex II to the Convention, paragraph (c)) attributed to four out of the then Six States throws doubt on the whole basis of Annex II.

10. We have received numerous criticisms of the proposal to permit any reservations to be made to the provisions of the Uniform Law. It has been suggested to us that if the provisions of the Uniform Law cannot be made generally acceptable to Member States, the failure to achieve agreement must reflect on the validity of the overall approach of the Convention. Reservations already put forward on behalf of the original six Member States are extensive and make substantial inroads on the uniformity of Community bankruptcy law. We are firmly of the opinion that progress towards unification must be hindered by acceptance of the right to make any reservations to the Uniform Law. Moreover, reservations such as that made on behalf of Italy and the Netherlands, not to refer to the date of the cessation of payments, may occasion hardship to individuals, because a transaction which would have been valid by its proper law may be invalidated because, on bankruptcy, matters fall to be dealt with by the laws of another Member State. The reservations listed in Annex II to the draft Convention should be regarded as only of a provisional nature (even if they now represent national policies of individual States) and strenuous efforts should be made to achieve complete agreement to the Uniform Law, or at least a Uniform Law. The concession of any right of reservation must surely nullify the basic desire for uniformity and, in our view, any reservation made to the Uniform Law will seriously weaken the

Convention and can only result in increasing the difficulties of its implementation, both by the courts and by practitioners and liquidators.

11. We strongly recommend that clause 5 of Article 76 should be deleted and that Annex II should be excluded entirely from the final draft of the Convention

Extension of the bankruptcy of companies, firms, etc., to individuals: "associated bankruptcies"

12. Among the rules which must appear in, or be incorporated into, the legislation of Member States, are rules enabling the court which declares the bankruptcy of a company or firm to declare, in specified circumstances, the bankruptcy of persons who have conducted (or rather misconducted) the affairs of that legal entity. Article 1 of the Uniform Law declares that the situations in which such an "associated bankruptcy" may be declared are:

(1) where any person has, whether de jure or de facto, directed or managed the legal entity and has:

(a) surreptitiously carried on activities for his own account under cover of the legal entity; or

(b) wrongfully dealt with the property of the legal entity as if were his own; or

(c) wrongfully carried on a business at a loss for his personal benefit, and

(2) where one or other of those acts has led or contributed to the legal entity's suspension of payments.

We need hardly stress the importance of this requirement of causal connection. Article 1 further declares that in making such a declaration of bankruptcy, the court may determine whether the person concerned must pay all or only a specified part of the legal entity's debts. We would add that the precise ambit and meaning of the specified categories of "misconduct" are not merely

unclear in the current English text, but are equally unclear in the French original (see paragraph below).

13. It may facilitate analysis of Article 1 of the Uniform Law to deal separately with its major implications. These include:

(a) the principle that the bankruptcy of a company may entail the bankruptcy of an associated person;

(b) the extension of this principle to firms and entities other than companies;

(c) the principle that the date of cessation of payments of the associated person should be identical with that of the company; and

(d) the inclusion of certain standard substantive requirements for the declaration of the bankruptcy of an associated bankruptcy.

The bankruptcy of associated persons.

14. Article 1 of the Uniform Law covers much, though not all, of the ground covered by sections 332 and 333 of the 1948 Act and by sections 298 and 299 of the 1960 Act; but none of those sections confers on the court of the winding-up jurisdiction to directly adjudicate personally bankrupt the person found liable thereunder, irrespective of his own personal financial situation. Those sections go no further than to facilitate the enforcement, by personal bankruptcy proceedings, of the liability of delinquent directors and officers by enacting that a declaration of their liability, and an order to repay or otherwise to contribute to the assets, shall be deemed to be a final judgement on which a bankruptcy notice may be founded. It is a matter of concern to all who have submitted comments to us that a director or manager may be made bankrupt when, even taking account of the company's actual or potential claims against him, he may be personally solvent.

15. We have already referred to this problem in our consideration of

Article 11 at paragraphs to . We understand that in addition to the reservations already put forward on behalf of the Federal Republic of Germany and the Netherlands, Denmark also has reservations about the implication of automatic bankruptcy. We repeat our strong conviction that no person ought to be liable to be made bankrupt unless and until a quantified pecuniary claim has been established against him and he has failed to meet it.

Firms and entities other than companies.

16. There are no equivalent provisions to sections 332 and 333 affecting the persons conducting the affairs (whom we will call "managers") of firms or of legal persons other than incorporated companies. However, in principle, if a manager of an incorporated company can be made liable, there is no reason why the manager of a firm which might carry on the same trade should not be under similar liability.

17. It has been suggested to us that the formulation of rules governing the liability of individuals for the debts of a legal entity, is a function of the constitutional law regulating the affairs of that entity; that these criteria are not appropriate matters for the law of bankruptcy at all and are, therefore, not appropriate for inclusion in the present Convention. We do not share this view, but we do consider it essential that those criteria should be precisely stated, since the liability is quasi-penal in its effects. It is not clear from the text of the Convention whether the onus of proof of liability falls on the liquidator (although the N-L Report appears to imply this), nor whether the article is intended to apply simply to the directors or managers acting at the time of the entity's cessation of payments. We understand that both these points have been answered affirmatively in Brussels but consider that the text itself needs clarification.

Cessation of payments of an associated person.

18. Paragraph 2 of Article 1 provides that, where it is necessary to determine the date of cessation of payments of an associated person, that date should be the date of the legal entity's own cessation of payments. This imputation of an artificial date of cessation of payments (whatever that term may mean: see paragraph below) is undesirable, because it introduces an element of retroactivity and may cause hardship to third parties. In our opinion the relevant date should be the date of commencement of the individual's own bankruptcy.

19. We understand that the Brussels Panel have under consideration the deletion of Article 1(2). We recommend that this proposal should be supported. Alternatively, the United Kingdom should itself recommend the deletion of clause 2 on the following grounds:

(a) cessation of payments is in principle an overt act committed by a debtor of which one might have some notice. Such an act by the company might not necessarily involve a cessation of payments by the individual, and persons subsequently affected by his bankruptcy might not have been aware of company's cessation of payments.

(b) it might impose greater hardship on persons with whom the debtor has transactions, by relating-back too far;

(c) if the relation-back period went back too far, it might be that transactions by the individual would cease to be impeachable under Article 4 of the Uniform Law;

20. We have had lengthy discussions about the inclusion of the word 'surreptitiously' in clause 1(a), and of the word 'wrongfully' in clauses 1(b) and 1(c). We have come to the conclusion that these words are unnecessary and indeed, that their inclusion could cause difficulties. We are thinking in particular of the problems which have arisen from time to time by the inclusion of the word 'intent' in Section 332 of the 1948 Act.

If a person carries on business on his own account under cover of a firm or company, and fails to distinguish between his own business and property, and those of the firm, then his actions must be open to question, particularly if they have contributed to the collapse of the firm or company. The word 'surreptitiously' is unnecessary. Similarly, if he has misused the company's property, or carried on its business at a loss for his personal benefit, his actions are clearly wrongful and the word itself is therefore unnecessary. These criteria appear to derive from the French juristic approach and the necessity to catch "clandestine traders" and bring them within the French bankruptcy code, applicable only to "traders".

21. We have noted that the Brussels Panel are considering an amended version of Article 1(1). To some extent this re-draft is an improvement, but it does not deal with all the problems which we have raised. The sense of our proposals is that:

1. where a person has utilised the name or assets of a company, firm or entity to carry on business for his personal advantage rather than that of the company, firm or entity, and where that person's conduct of the business has led or contributed to the bankruptcy of the company, the court may declare that person liable to pay all or such part of the debts of that company, firm or entity as it (the court) thinks fit.

2. where any person has been found liable to pay the whole or any part of the debts of a company, firm or entity under paragraph 1 of this Article, or on other grounds has been found liable to pay compensation to a company, firm or entity which has been declared bankrupt, and fails to do so, that person may himself be declared bankrupt.

22. Article 2 of the Uniform Law declares that any person who, whether de jure or de facto, and whether openly or secretly, has managed a legal

entity which has been declared bankrupt may himself be declared bankrupt where, by reason of his management, he has been ordered either to compensate the legal entity or to bear the whole or part of its liabilities, and he has failed to discharge that debt. This provision in itself seems unexceptionable, indeed so obvious as hardly requiring to be stated. It would appear to have been included, however, to ensure the extension of bankruptcy to the managers of companies in those countries where non-traders in principle may not be declared bankrupt. If Article 1 of the Uniform Law is re-drafted in the sense outlined in the preceding paragraph, then we see no necessity for Article 2.

Proof of spouse's claim to property.

23. We have discussed the provisions of Article 3 of the Uniform Law in our consideration of the effects of the bankruptcy in relation to the debtor, at paragraphs to . Article 3, in itself, is acceptable in its present terms.

Periods of relation-back ("periode suspecte).

Preliminary.

24. Article 4 of the Uniform Law is intended to standardise the categories of antecedent transactions which may be attacked in consequence of a bankruptcy, and to standardise the periods during which this effect of the bankruptcy may operate or "relate-back". This term has been adopted from English bankruptcy law as a convenient equivalent for the French expression "période suspecte", which is the period, starting with a "cessation des paiements" (actual, notional or imputed) within which transactions can be attacked as prejudicial to the general body of creditors. The English translation of the Convention employs the term "suspect period". It is remarked in the N-L Report that:

"The real importance of the Uniform Law lies not so much in the unification

of the basic rules relating to the suspect period (since it is largely the same acts which are affected in different systems), as in the unification of the time limits which were very different at the outset".

Cessation of Payments.

25. It is apparent that the concept of "cessation of payments" is crucial to the scheme of Article 4. It is clear, too, that the Uniform Law, as drafted, will not work as its authors intend, unless the concept is defined in a uniform way in the laws of all Contracting States. It is not a matter on which, in our view, any reservations could be accepted (though these are sought at present on behalf of the Netherlands and Italy) because it would lead to a risk of transactions assumed to be valid, notwithstanding the contingency of the bankruptcy of one of the parties, being subsequently declared invalid by virtue of a Community bankruptcy. But cessation of payments is a concept unknown to the legal systems of the United Kingdom and, for this reason, before considering the merits of Article 4 of the Uniform Law, it seems important to consider its meaning and implications. The date of cessation of payments is not necessarily the date when the debtor in fact suspended payments. In France, Belgium and Luxembourg, that date is fixed by the court by reference not merely to the time when he did in fact suspend payment, but also to the time when he ought to have suspended payment, or when he was otherwise conducting himself in a manner prejudicial to his creditors. In Germany, the date is fixed not at the commencement of the bankruptcy but as the occasion arises in judicial proceedings, so that it is theoretically possible for different dates to be selected. The concept is unknown in the law of the Netherlands.

26. Under s.1(1)(h) of the 1914 Act, an act of bankruptcy is committed "If the debtor gives notice to any of his creditors that he has suspended, or that he is about to suspend, payment of his debts". This requires an act

of the debtor or his duly authorised agent, which must be proved as a question of fact, to have been a notice which a reasonable businessman would treat as such. No equivalent provision exists in the Companies Acts with respect to an insolvent company; but the calling by the company of a meeting of its creditors to consider its insolvent liquidation has been held to amount either to a declaration of inability to pay, or as a notice of suspension or intended suspension of payment; see Re Eros Films Ltd (1963) Ch.565, and may also be relied upon to invalidate an execution completed after and with notice of the calling of such a meeting. (1948 Act, sections 325 and 326).

27. In Scotland under the Act of 1696 c5, which strikes at voluntary preferences, the "suspect period" (though this term is not a term of art in Scots law) is calculated from a point in time six months before the debtor becomes a "notour bankrupt". In terms of sections 5 and 6 of the 1913 Act, Notour bankruptcy is now constituted either:

(a) by sequestration, or by the issuing of an adjudication of bankruptcy or the granting of a receiving order in England or Ireland; or

(b) by insolvency, concurring with certain facts which publicly demonstrate the debtor's inability to pay his debts as they become due, such as a duly executed charge for payment, where a charge is necessary, followed by the expiry of the days of charge without payment.

28. Although neither the concept of an act of bankruptcy in English or Northern Irish law, nor that of notour bankruptcy in Scots law, are precisely analogous to the continental concept of cessation of payments, we consider that there is a common core of meaning in all three concepts and that it would not be impracticable to reach agreement upon a definition of the concept of cessation of payments for the purposes of the Convention. We understand

* The Scottish Law Commission has recommended the abolition of the term, and its replacement by "practical insolvency"; see Report.

that a detailed study is being conducted by the Brussels Panel into the possibility of devising a uniform definition of the concept of the cessation of payments, for the purposes of operating the Uniform Law. We assume that such a definition would in due course be inserted into the Convention by way of amendment to the present draft, and that Member States would be obliged to incorporate it into their national insolvency laws, in the same manner as the Uniform Law itself. A uniform definition is essential to the equitable application of some of the provisions of the Uniform Law, unless their terms are radically amended. What would be sought for in devising such a definition, capable of being adopted by all Member 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.

29. It has been suggested to us, and this view has some support in the Committee, that the references to Cessation of Payments in the clauses of Article 4 are inappropriate and that, instead, there should be introduced some reference to the insolvency of the debtor at the time of the transaction. The Committee as a whole, however, do not support this proposal, which it is thought would be unacceptable to several Member States and would involve the substantial redrafting of these clauses.

30. In our Consultative Paper we issued a proposed definition of cessation of payments as a basis for discussion. The definition received some support, though, perhaps not unnaturally, there was strong support for something similar to our acts of bankruptcy, and also support for universal adoption of the definition of notour bankruptcy.

31. We put forward the following definition of cessation of payments which

might prove acceptable to the other Member States as a uniform law, capable of being incorporated in their national insolvency laws, and also in the insolvency codes of each part of the United Kingdom:

1. Cessation of payments shall be constituted

   (a) by the ~~patent~~ manifest 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 a debtor committing or suffering an act or acts demonstrating his insolvency;

2. In determining whether cessation of payments has been established, regard shall be paid to all the circumstances, including 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 are, of course, not exhaustive but merely illustrative).

32. We appreciate that a uniform definition of cessation of payments will present difficulties to Member States who do not wish to introduce the concept into their national laws; but after a full discussion, we are satisfied that a uniform definition having absolute clarity should be the ultimate aim. [If this is not immediately possible, we recommend that a clause should be put in the Convention to the effect that the cessation of payments should have the meaning attributed to it by the law of the State of the bankruptcy.] ? Sec.

a clear and uniform definition should be sought

Acts lacking consideration or lacking adequate consideration.

33. Article 4A declares to be void as against the general body of creditors,

meaning given in context of English law.

when effected less than one year before the opening of the bankruptcy, every gratuitous transfer of moveable or immoveable property and every other gift or donation whatever its form, and it provides that the granting of a dowry shall be deemed to be a gift or a donation. ~~The Article~~ that paragraph, however, excludes "ordinary presents" and "gifts or dispositions made in fulfilment of a moral obligation", to the extent that they are "not unusual", having regard to the circumstances." The article further strikes at transactions, other than those depending upon the outcome of an uncertain event, where the obligations undertaken by the bankrupt substantially exceed in value those of the other contracting party.

34. So far as concerns the transactions of personal bankrupts, in England and Wales, section 42 of the 1914 Act and, in Northern Ireland, section 12 of the 1929 Act, in general terms invalidate all "voluntary settlements or transfers" of property, which cover every kind of gift other than those made in consideration of marriage, both (a) absolutely as to those made within two years before the first available act of bankruptcy, and (b) as to those made within ten years, unless the beneficiaries can prove that the bankrupt was solvent at the time of the transaction without the aid of the property disposed of. A contract whereby the bankrupt had assumed disproportionate obligations would usually fall within the scope of these sections of the Acts.

35. In Scotland, "gratuitous alienations" may be invalidated by common law and statutory rules. These differ from the Uniform Law in that:

(a) with one exception, no period of relation-back is specified. The exception relates to donations between spouses where the period is one year prior to the sequestration of the donor;

(b) where there is [~~consideration and~~ contemplation of] no knowledge of the debtor's bankruptcy, gifts in consideration of marriage and (subject to (a) above) even reasonable post-nuptial settlements are protected; and

(c) it is of the essence that the granter should have been insolvent at the time of the alienation, though in some cases this may be presumed from insolvency at the date of the challenge.

36. So far as concerns insolvent companies, a company has no general power to make gifts of its assets or any other dispositions without consideration or for a substantially inadequate consideration. Such transactions will usually be void as against the company and its creditors by the application of the doctrine of ultra vires: the occasions in which they might be valid as implementing a moral obligation must be extremely rare.

37. In considering the provisions of Article 4 of the Uniform Law, it should be borne in mind that they envisage that, in addition, the law of each Member State will contain rules based on the Paulian action which strike at acts, whenever carried out, effected with a view to "defrauding" creditors. These rules, moreover, do not necessarily mean that all past transactions, whenever entered into, may be re-opened. In the laws of the original Six, the alienees of property may be protected by rules of positive prescription, analogous to the Scottish rule of positive prescription which protects a person who has possessed land on a prima facie valid title for a period of ten years. It is also clear that apart from the reservations referred to above, the provisions of the Uniform Law are a compromise between different approaches prevailing in the laws of the Six. We have come to the conclusion that, viewed in this light, Article 4(A) would be acceptable subject to certain safeguards. It should be made clear that benefits under the "Married Women's Policies of Assurance" Acts should continue to be protected. There would also require to be provision for the protection of third party bona fide purchasers of alienated property. In England a purchaser for value from the donee under a voluntary settlement who has no notice of an act of bankruptcy on the part of the settlor, obtains a good title as against the

settlor's trustee in bankruptcy. In Scotland, the purchaser for the value will not be required to restore the property although the seller is liable for the price.

38. As compared with Section 42 of the Bankruptcy Act 1914, which provides for the avoidance of certain settlements made by the bankrupt within two years of the date of the settlement, the period of one year specified in Article 4(A) of the Convention seems relatively short. In Scotland, whether under the common law or under the Act of 1621, c. 18, there is no time-limit for the cutting down of gratuitous alienations, but insolvency at the time of the gift must be established or be inferred. It is understood, however, that it has been agreed by the Brussels Panel that this period should be extended to two years. This proposal is supported by the Committee, though Mr Anton would allow the donee to establish as a defence that the debtor was solvent at the time of the gift.

Payment of debts not yet due.

39. Article 4B(1)(a) of the Uniform Law declares to be void, as against the general body of creditors, payments in advance of debts not yet fallen due made by the bankrupt after the date of cessation of payments and within six months of the opening of the bankruptcy. This rule resembles the doctrine of "fraudulent preference" in the legal systems of the United Kingdom. It differs, however, from the present law of England wherein an intention to prefer the creditor in question must be proven; also there in no requirement to show that the payment was made after a specific date of cessation of payments, but only that it was made within six months before the presentation of the petition. To some extent, however, these differences cancel each other out because, under the system proposed in the Convention, in transactions effected after the date of cessation of payments, an intention on the part of the bankrupt to prefer a creditor may be readily inferred. However, we feel that the clause could with advantage be amended so as not to strike down

bona fide transactions taking place after the cessation of payments, which may in fact be beneficial to the debtor and perhaps to his creditors. As it stands at present the clause invalidates all payments absolutely.

The performance of contractual obligations in an unusual manner.

40. Article 4B(1)(b) and (c) of the Uniform Law invalidate transactions entered into by the bankrupt after the cessation of payments and less than one year before the bankruptcy was opened, whereby a payment which was due was discharged, or a contractual obligation fulfilled, in an unusual way. There is no rule precisely to the same effect in the laws of the United Kingdom, but in all of its legal systems an abnormal mode of discharging an obligation might well be construed as a ~~badge of~~ fact fraud, from which an intention to prefer might be inferred. Fraudulent preferences, of course, are invalid if effected within the six months preceding the filing of the petition in England or Northern Ireland or preceding notour bankruptcy in Scotland. Since this provision of the Convention takes effect only after the cessation of payments, it is prima facie less wide ranging in its effect than the corresponding provisions of English or Scots law and is considerably less certain in its incidence. Assuming that settlement in an unusual manner is regarded as evidence from which an intention to prefer may be inferred, and that it is this latter which invalidates the transaction, then we do not find the clauses objectionable. But we do feel that they could be clarified, and we also think that it should be made clear that the inference may be rebutted. As it stands there appears to be no room to rebut the inference, which could plainly cause injustice in some cases.

Securities for prior debts.

41. Article 4B(2) of the Uniform Law declares to be invalid, as against the general body of creditors, securities over the assets of the debtor whether created by contract, by operation of the law or by court order, if created

during the year preceding the opening of the bankruptcy and after the cessation of payments. Exceptions are made in respect of statutory charges over the debtor's assets implied in favour of wards or of public authorities. There is no comparable rule in English or Northern Irish law, and such a security would be invalid only if it were shown to be a fraudulent preference or, in the case of a company, the transaction comprised the creation of a floating charge at a time when the company was insolvent. Nor is there any similar rule in Scots law and, while such a security might be struck at as a fraudulent preference, charges created in implement of a preceding obligation do not come within the category. We think this clause should specify that securities or charges granted under prior subsisting obligations would not be invalidated. The burden of showing the antecedent obligation or consideration should be on the creditor and not on the liquidator. While a substantial change in United Kingdom laws is involved, we think it is one which is acceptable, provided there is a uniform definition of cessation of payments.

Transactions voidable at the court's discretion.

42. Apart from the four cases discussed above where transactions are expressed to be absolutely void as against the general body of creditors, there are two other situations where the court may declare a transaction to be void as against those creditors.

43. The first situation, which is specified in Article 4(C) of the Uniform Law, is where a person enters into a transaction with the bankrupt during the year preceding the bankruptcy and after his cessation of payments. Such a transaction may be declared invalid under Article 4(C)(1) where:

(a) the person in question knew of the cessation of payments; and

(b) the transaction was prejudicial to the general body of creditors.

Article 4(C)(1) has no precise analogue in the bankruptcy systems of the United Kingdom. It appears to confer a wide discretion on the court, for

the exercise of which it prescribed no guidelines. The article places at some risk anyone who contracts with the debtor after knowledge of his cessation of payments, and might be a barrier to the negotiation of measures to secure the future viability of the debtor's business. It is to be contrasted with the protection afforded to persons dealing with the bankrupt under section 46 of the Bankruptcy Act, 1914, which provides some protection to banks since they may, in the ordinary course of business or otherwise bona fide, pay monies directly to a person subsequently adjudged bankrupt, or someone claiming by assignment from him (which does not include the payee of the cheque). The payment must be made before the date of the Receiving Order and without notice of the presentation of a petition. (This is a sensible provision since it enables the debtor to try to pay off his creditors to avert presentation of such a petition.)

44. We are troubled by the phrase "knew of the cessation of payments". The meaning of the French text, literally, is that the recipient had knowledge of the cessation of payments. It has been suggested to us that an English judge would construe clause C(1) strictly as meaning that the recipient must have known of the circumstances. We think this would impose an unnecessarily heavy burden of proof, and it should be sufficient that the recipient knew or ought to have known of the cessation of payments.

45. We note that similar difficulties arise in Article 4C(2), below which requires proof that the person concerned knew of the cessation of payments at a particular time, and in Article 5(4) of the Uniform Law, which provides that set-off shall not be allowed if the transfer was made after the transferee had knowledge of the cessation of payments. We think that in all three cases, it should be open to the court to impute knowledge to the person concerned in appropriate circumstances. We have noted that in dealing with the effects of the bankruptcy against third parties, Article 26(2) of the Convention requires proof that at the

time of a transaction "the third party knew or ought reasonably to have known of the bankruptcy". We recommend that a similar expression should be used in Articles 4C(1), 4C(2) and 5(4) of the Uniform Law.

46. We consider that the principle of Article 4C(1) is acceptable in the context of cessation of payments. We would stress, however, that the condition (or the event) of cessation of payments must comprise sufficiently recognisable events in ~~the mind of~~ a businessman, knowledge of which can fairly be attributed to persons whose transactions with a debtor may be invalidated by such knowledge.

47. Under Article 4(C)(2), similar rules to those in clause C(1) are prescribed for transactions with negotiable instruments, subject to protection being given to the payees of cheques, the indorsers of a promissory note (other than the first indorser), and the holders in due course of bills of exchange. The N-L Report indicates that this clause will enable action to be taken on behalf of the general body of creditors against a person who has derived profit from putting a bill of exchange into circulation after the cessation of payments, knowing the state of affairs of the person against whom it is drawn. It does seem, however, that the clause as drafted would remove the safeguards of section 46 of the 1914 Act, so far as creditors are concerned. It would seem that cheques may be met, not only for the bankrupt personally, but also for third parties, notwithstanding that a petition had been presented and even that the bank had knowledge of such petition. The debtor could therefore continue to issue cheques until shortly before the date of the Receiving Order, knowing that they would be met upon presentation and that the liquidator would have to claim repayment from the payees. There is no requirement that a bank should act in the ordinary course of business or otherwise bona fide in paying such cheques.

48. We accept that it is desirable to afford special protection to banks to

enable personal debtors or debtor companies to continue to operate banking accounts after the date of cessation of payments. We are concerned, however, that Article 4C(2) as drafted may protect persons other than bankers. In our Consulative Paper we pointed out that this article raised technical questions on which the advice of bankers and others was sought. Little comment was received, however, and we consider that the Department should seek further and specific advice as to the impact of this provision.

49. The second situation, specified in Article 4D of the Uniform Law, is where a security right conferred by contract has been presented for registration more than 15 days after the date of the transaction creating the security. We assume that the registration referred to in this article includes all cases where registration is required to complete the security rights, including the registration of rights relating to land in the Land Charges Registries of England and Wales and in the General Register of Sasines in Scotland. Where this situation arises during the year preceding the bankruptcy and after the date of cessation of payments, the security may be declared void as against the general body of creditors. The N-L Report indicates that this is intended to be a discretionary power and that, in exercising it, the court may enquire into the reasons for the delay in registration.

50. The principle embodied in Article 4D is recognised in the statute law of the United Kingdom, in particular under sections 95 and 106A of the 1948 Act and section 93 of the 1960 Act. We note, however, that those sections are mandatory rather than discretionary; that the period for registration is 21 days (although the court has power to extend the period) and that this period is extended where the charge has been created abroad. No such comparable position exists in bankruptcy, and acceptance of this clause will require its introduction into United Kingdom bankruptcy law. We think that it is inappropriate to confer a discretion without giving guidelines, and that in

general, the position should be as certain as possible, both for commercial reasons and for the simpler handling of problems. We think the certainty given by sections 95 and 106A of the 1948 Act should not be lost. We can see no justification for limiting the operation of this clause to the period following the cessation of payments and we think that the period of 15 days, allowed for registration, is too short.

51. We recommend that the period of grace for the registration of securities should be 21 days, that the period of relation-back should be unlimited and that there should be no discretion to validate in the event of failure to register ~~a security~~ in due time, ~~subject to any extension by the court~~ ~~cases where the debtor company was insolvent at the time~~

The Paulian Action.

52. Article 35 of the Convention and Article 4F of the Uniform Law envisage the retention in the laws of Member States of the "Paulian action". This action was available in Roman Law to a creditor where (a) the debtor had impoverished himself to the detriment of his creditors, and (b) he did so in the knowledge that he was insolvent or would be made so by the act. Its effect was to annul the transaction challenged and to restore the property to the general body of creditors. It was incorporated into the French Civil Code by Article 1167, which declares that the creditors "may also, in their personal name, attack transactions of the debtor in fraud of their rights". As interpreted by the French courts, this article covers every species of transaction, whether done with or without valuable consideration, which creates or aggravates the debtor's state of insolvency. It may include not merely a fraudulent transfer but a failure to accept a succession or gift. Though the text refers to the "fraud" of the debtor, it is not necessary in every cast to establish actual fraud. When the debtor knows that a transaction into which he is entering will make him insolvent or increase his insolvency, he is presumed to intend to injure his creditors. The nature of the action implies

that the creditor seeking to set the transaction aside had prior rights which the transaction prejudiced. The action is directed against the person who profited by the debtor's act and not against the debtor himself. When that person received the debtor's property as a gift, he is liable to restore the property, whether or not he was aware of the debtor's fraud. Where he gave valuable consideration, he is liable only where he was aware of the debtor's fraud. Where the property has been transferred by that person to another person, the former is liable in damages. The latter is liable to restore the property only when he received it as a gift or was himself acting in bad faith.

53. There are analogues to the Paulian action in the legal systems of the United Kingdom. The Scots Act of 1621 c. 18, still in force, which strikes at gratuitous alienations and preferences in fraud of creditors, was modelled on the Paulian action, and the preamble refers to the intention "to follow and practice the good and commendable laws, civil and canon, made against fraudful alienations in prejudice of creditors". In England, the Acts of Elizabeth I impeaching fraudulent conveyances and purchases, now largely reproduced in sections 172 and 173 of the Law of Property Act, 1925, have a similar purpose; but the requirement of proof of fraudulent or at least a dishonest intention renders it narrower in scope than, for example, Article 1167 of the French Civil Code. These provisions of the 1925 Act give individual rights, which anyone can enforce to set aside fraudulent purchases. However, it has been held that the right to take such proceedings against a bankrupt is vested in the trustee, and this would seem to be in line with the intention in Article 4F.

54. In general we do not foresee any difficulty resulting from the introductio of Article 4F, but we suggest that it could, with advantage, be amended to " ..... the liquidator alone, unless with the leave of the court ..... ".

? Floating Charges. X

55. Jurisdiction in actions to set aside acts done by the debtor in fraud of his creditors is exclusively conceded by Article 17(3) to the courts of the State of the bankruptcy, and the law of that State is applicable by virtue of Article 35(2). Unless, therefore, there is a measure of harmonisation of the principles adopted by Contracting States in setting aside transactions not covered by a specific period of relation-back, there is a serious risk of prejudice to persons who might have had reason to believe that a transaction entered into by them with a person who later becomes bankrupt was legally unassailable. In this respect, too, the Convention, despite the terms of Articles 75 and 76, will operate retrospectively.

56. A special problem arises in the context of floating charges which, though an important security device in the legal systems of the United Kingdom, are in substance unknown to those of other Member States, although something comparable is understood to exist in Germany. Section 322 of the 1948 Act, the Scottish 1961 Act and section 290 of the 1960 Act provide that, where a company is being wound-up, a floating charge created within the previous 12 months shall, unless it is proved that immediately after the creation of the charge the company was solvent, be invalid, except to the amount of the cash paid then or thereafter to the company and interest thereon. There was some doubt, however, whether this provision superseded the Scottish rules relating to fraudulent preferences, which may be challenged without limitation as to date. The Companies (Floating Charges and Receivers) (Scotland) Act 1972 removes this doubt by adding a new subsection to section 322; "(3) where a company is being wound-up in Scotland, a floating charge over all or any part of its property shall not be held to be an alienation or preference voidable by statute (other than the provisions of this Act) or at common law on the ground of insolvency or notour bankruptcy".

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* reference to my proposed amendments

It may be, however, that some Community systems would regard certain floating charges as alienations or preferences voidable by virtue of the Paulian action. Where, therefore, a foreign court finds that the centre of administration of a United Kingdom company is situated within its own territory and opens bankruptcy proceedings in relation to the company there, it might hold that a floating charge, even in relation to the company's assets in the United Kingdom, is invalid under the Paulian action as a fraudulent preference.

57. We recognise the great importance of floating charges to the commercial community in the United Kingdom, and we would consider it undesirable if the Convention in any way prejudiced their validity. We recommend that a special provision should be included in the Convention (not in the Uniform Law) to afford them, and the powers of receivers and managers appointed under them, recognition throughout the Community. The provisions of the Uniform Law should then expressly include them as a security for the purposes of the law. To achieve acceptance of the United Kingdom form of floating charge within the Community, we envisage that a number of concessions, and/or protective provisions for the benefit of non-U.K. creditors within the Community, will need to be made, such as compulsory registration, invalidity within a period of relation back (as under section 322, 1948 Act) and the prior rights of local preferential creditors; but we consider that these would be worth conceding for the obtaining of recognition of the floating charge.

my note

58. In this connection, we should observe that there is currently in preparation by the EC Commission a draft Directive on the Recognition of Non-Possessory Liens, the text, of which and in particular the footnotes thereto, ~~of which~~ seem to go a long way towards preparing the ground for such recognition.

Set-off.

59. The bankruptcy laws of the United Kingdom seek to ensure that in bankruptcy, the creditor must set-off against any sum he claims from the

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bankrupt's estate any sum that he owes, so that no more than the balance of the account is claimed against him, or proved for by him. In England, this is a statutory obligation under section 31 of the 1914 Act. In Scotland, where the doctrine is termed "compensation", there is no analogous statutory provision in the 1913 Act, but common law rules, tenuously based on a Scots Act of 1592, apply. In Northern Ireland, section 251 of the 1857 Act contains provisions governing set-off of mutual debts and credits similar to, but not identical with, section 31 of the 1914 Act. The bankruptcy principles in this field are imported entire into the winding-up code by sections 316 and 317 of the 1948 Act (and sections of the 1960 Act). The problem presented by applying section 31 of the Bankruptcy Act (which refers to notice of an act of Bankruptcy) to the winding-up of a company has already been noted at paragraph above.

has it?

60. Article 76 of the Convention requires Member States to incorporate in their law Article 5 of the Uniform Law, which must be applied in Convention bankruptcies by virtue of Article 35. We assume that Article 5 is not intended to constitute a comprehensive set of rules on set-off or compensation; rather that it assumes the existence of such rules in Member States, and seeks to harmonise those rules where they differ as to the effects of bankruptcy. This assumption is inferred from the N-L Report which indicates that the internal laws of the six original Member States all have rules of set-off, but there is disagreement on the basic principles. In some systems, no set-off is admissible after the adjudication of bankruptcy; a debtor to the bankrupt must pay all that he owes and be subject to the law of dividend as a creditor. Other systems allow set-off, provided the claims and debts are in the same account, or if they result from the same contract. The provisions of Article 5 are stated to represent a compromise between German, Dutch and Italian law.

61. Clause 1 declares that the intervention of bankruptcy proceedings shall

not prevent set-off, provided the creditor's claim and the debt to be set-off existed in the same estate at the date when the bankruptcy was opened. Consequently, set-off resulting from the acquisition of a claim or debt subsequent to the bankruptcy is excluded. Clause 1 also provides that a claim for damages for breach of contract may be set-off, even if the breach did not occur or was not established until after the declaration of bankruptcy. Clause 2 requires set-off to be allowed though the debts are, or one of them is, future, or ~~are~~ not expressed in money, or ~~are~~ expressed in foreign currency. Clause 3, however, excludes taking into account contingent debts or debts subject to a suspensive condition - and presumably for this reason the Federal Republic of Germany, whose internal law requires such debts to be taken into account, has reserved in Annex II the right to continue to allow contingent debts to be set-off, to such extent as it may decide in bankruptcies opened in Germany. Article 5(4) excludes set-off in favour of the transferee of any claim or debt transferred subsequent to the transferee's acquiring knowledge of the bankrupt's cessation of payments. The same rule applies to the transfer of negotiable instruments payable to bearer or to order.

62. If, contrary to the view expressed above, Article 5 is intended to constitute a comprehensive set of rules relating to set-off or compensation in bankruptcy, the Article is thought to be seriously deficient. It does not deal with the special aspects of set-off in deposit or bailment, in agency and partnership situations, in relation to co-contractors jointly and severally liable, in relation to guarantors or cautioners, or where there has been specific appropriation. It, on the other hand, Article 5 is intended to introduce only such uniformity as should permit of the application in bankruptcies affecting creditors in different Member States of the law of the State of bankruptcy, it presents fewer difficulties, and we see no objection to acceptance of clauses 1 and 2.

63. The N-L Report refers to the differences between the laws of Member States on the admission of set-off in respect of contingent debts. Clause 3 of Article 5 is clearly contrary to both English and Scots law, though it is uncertain whether a contingent liability can be the subject of set-off in Northern Ireland. It has been represented to us that the provisions of clause 3 could produce problems for banks in dealing with performance bonds. It has also been suggested that the rule could operate inequitably in relation to persons subsidiarily liable on bills of exchange, if it is assumed that such liabilities are contingent debts. On the other hand we understand that the set-off of contingent debts causes administrative difficulties in liquidations, and often involve appeals to the courts. On balance, therefore, we favour acceptance of clause 3 of Article 5.

64. Article 5(4) is less restrictive than English law because it only relates to the transfer or assignment of a claim or debt, effected after the cessation of payments, and the negotiation of certain negotiable instruments, whereas section 31 of the 1914 Act is of wider operation. Despite this, we consider that if Article 5 as a whole is to be accepted, clause 4 may be accepted.

65. Although Mr Anton considers that, even in its application in bankruptcy situations, Article 5 is deficient in its present terms and requires re-consideration, the other members of the Committee agree that the broad scheme of the article is acceptable. We all agree that if Article 5 is included in the Uniform Law, its provisions should be mandatory.

Contracts of sale with reservation of title.

66. Article 6 of the Uniform Law provides that in the case of sale with reservation of title, the bankruptcy of the seller subsequent to delivery does not entitle the liquidator to elect to discontinue the contract.

The purchaser could therefore continue his payments and acquire a title to the property at the end of the agreed period. We approve of this approach and we recommend that Article 6 should be accepted.