40th Agenda
39th Mins
1(5)

INSOLVENCY LAW REVIEW COMMITTEE

FORTIETH MEETING

Meeting to be held in the Conference Room, 2-14 Bunhill Row, on Wednesday, 16 April 1980 at 10.00 am.

A G E N D A

1 Minutes of the meeting of the 18 March.

2 Matters arising.

3 Secretary's report.

4 Reservation of Title (ILRC's 105 and 106).

5 Avoidance of floating charges (ILRC's 79, 75 and 108).

6 Propriety of Floating Charges - Proposals for change (ILRC's 111, 112 and 109).

7 Fixed Charges (ILRC's 22B and 110; see also 4th Mtg minutes, para 43).

8 Distribution of assets in liquidations (ILRC 102).

9 Any other business.

10 Agenda for next meeting (21 May).

Trevor Traylor

T H TRAYLOR
26 March 1980

40th Mtg
16.4.80

INSOLVENCY LAW REVIEW

Minutes of the Fortieth Meeting of the Review Committee on 16 April 1980.

Present:	Sir Kenneth Cork	(Chairman)
	PGH Avis	
	J S Copp	
	AIF Goldman	
	J M Hunter	
	D McNab	
	P J Millett	
	T R Penny	
	C A Taylor	
	T H Traylor	(Secretary)
	E L Reeves	(Assistant Secretary)
In attendance:	J R Endersby	
	D Graham	
	G A Weiss	

1 The Committee met at 10.00 am. The minutes of the thirtyninth meeting held on 18 March were agreed and signed.

MATTERS ARISING

2 The Committee had before it copies of the letter sent to the Secretary of State about the Government's policy on the OR's role in bankruptcy and the Secretary of State's reply. The Committee agreed to take up the offer that a delegation should see Mr Eyre and if necessary after that the Chairman should see the Secretary of State.

3 The question of the final Report was raised and it was decided to re-activate the drafting sub-committee.

SECRETARY'S REPORT

4 The Secretary said that he had received apologies for absence from Mr Drain, Mr Muir Hunter, Mr Walker-Arnott and Mr Jack.

5 Papers circulated since the last meeting had been ILRC 108-112 and notes and comments on the items on the agenda. Papers placed before the Committee at the meeting were the correspondence referred to in para 2 above and a copy of a letter dated 14 September 1977 from the Registrar of Companies on the question of registration of reservation of title.

6 As to panel and group meetings, the Legal Panel were to meet on 18 April, Working Group 1 on 23 April and 1 May, Working Group 2 on 24 April and the Accountants' Panel on 29 April.

RESERVATION OF TITLE

7 The Committee had before it ILRC 105 and 106 together with comments by Mr John Hunter and Mr Millett.

§10. meaning of "ceiling" ✓
§12. "go to court"

8 The Secretary said that the recommendations of the Accountants' Panel were listed in para 24 of ILRC 105. In general they supported the proposals put forward by the Legal Panel in ILRC 59. In particular, they both say that reservation of title should be deemed to be a security interest and that all forms, including extensions over products and mixed goods, should be valid provided they are registered. When distributing the report on 19 February, he had enclosed a note of caution that deeming ROT to be a security interest might require a fundamental change in the Sale of Goods law. This view was supported by the Law Commission in their letter of 4 February 1980. Mr John Hunter had put forward proposals which implement the Committee's provisional decisions, and also take into account the Law Commission's requirement about proceeds of sale. In the package put forward by Mr Millett, one of the proposals was that there should be registration. Mr John Hunter had reservations about the feasibility of registration and felt that the Committee should get the views of the Registrar of Companies. The Secretary had done this in September 1977 and the only thing that the Registrar could offer was that an item be included in the statutory annual return, requiring a company to state if it had or had not entered into such transactions in the year in question.

9 The Committee confirmed its earlier decision that reservation of title should not be outlawed. On the question of tracing beyond goods in their original state, Mr Millett preferred to leave it to the Courts to work out when the goods can be traced under ordinary principles and not define this in legislation; members agreed with this view.

10 The Committee then discussed the question of registration. The Chairman's view was that a diligent creditor should be able to find out that reservation of title was present; in his view all that was necessary was to say that reservation should be void in a liquidation unless there was a simple notice on the public file and that each person who would wish to claim reservation of title would have to ensure that there was a notice covering his transactions as a whole with that buyer. This was generally accepted by a majority of members, who thought that there should be a ceiling and provision for taking the notice off the file. Looking at para 13 of ILRC 105, the majority of members accepted the proposal set out therein. It was stressed that only one notice would be required in respect of all transactions with a supplier of goods but each supplier should be dealt with separately.

11 On the question of receiver's or liquidator's right to dispose of assets notwithstanding a reservation of title clause, the Committee accepted paras 24 (13) to (15) of ILRC 105, the last word in 24 (14) meaning "obtained".

12 Some members questioned whether it was right for a receiver to sell for less than the invoice price. It was pointed out that apart from goods actually used (which would be paid for at the invoiced price) the receiver could sell as a going concern with the stock at valuation and that was what the supplier would get, or if he could not sell as a going concern he could return the goods. The supplier would be unsecured for any balance if sold as a going concern. This was accepted with Mr Taylor and Mr John Hunter dissenting. Mr Copp remarked that it would be quite wrong if the receiver sold the goods at well below cost, and Mr Weiss replied that the supplier could of course go to court, but it might be necessary to sell below cost in a falling market.

PROPRIETY OF FLOATING CHARGES

13 The Committee had before it ILRC 108, 109, 111 and 112 and comments by members.

14 Mr Millett said that his proposals were part of a package. He was an opponent of the floating charge, but he was convinced by the evidence that it was too late to abolish it. We had no decent "chattel mortgage" system and the floating charge fulfils a necessary function. The trouble was that it sweeps into the security future goods, goods which are not owned by the company at the date when the money was borrowed but were bought later and not paid for. This was a long standing grievance; Mr Justice Buckley in 1905 had pointed out that if a creditor had the audacity to ask for payment and tried to enforce his legal remedies, the debenture-holder could obtain a receiver and close the door against him, taking his money or his goods as part of the security - he had said that this was an injustice. Mr Millett added that he thought that his earlier proposal that future goods not paid for should not come into the security was wrong. What was now being put forward was a package - firstly, preferentials would be greatly reduced which would benefit the debenture-holder; secondly, the receiver would be assisted as regards reservation of title; and thirdly, even creditors with fixed charges should be restricted for 12 months after the appointment of a receiver. As to what should be done about the floating charge, firstly it was being proposed that s.322 should be strengthened (but this would be discussed later) and, secondly, the unsecured creditors should receive a stake (suggested as 10%) in the net realisation made by the receiver, subject to a ceiling so that the unsecured creditors do not do better than the debenture-holder.

15 Mr Avis pointed out that ILRC 108 and 109 did not reveal as much enmity against the floating charge as had been suggested. He thought that giving the unsecured creditors a stake would be to the detriment of the customer as bank lending would be lowered. Some members suggested that this might be a good thing if border-line cases could not borrow money so easily.

16 Mr Taylor supported Mr Millett, saying that in his experience there was a great deal of discontent about the present system.

17 On the suggestion that the unsecured creditors should receive a special stake in the net realisations, members were in favour with Mr Avis dissenting. Mr Millett then explained the examples which had been given in ILRC 111, which provided that the percentage received by the unsecured creditors should not in any event exceed that taken by the debenture-holder. Looking at these he thought that it would be difficult to argue that there would be any major change in the pattern of lending by the banks.

18 The Chairman said that quite often following a receivership the liquidator had no funds. Setting aside a percentage for unsecured creditors would in effect give the liquidator a fund with which to take legal action if necessary. Is this therefore a misleading "sop" to the crs?

19 The Committee generally could not agree with a suggestion that the debenture-holder should only be secured up to say 75% of the amount advanced, the balance being unsecured.

20 With regard to the percentage to apply (para 17 above), it was first agreed by a small majority that the debenture-holder should not rank against the special stake set aside for unsecured creditors for the balance; taking that into account, a figure of 10% was thought to be about right, although some members would have put the figure somewhat higher.

21 It was not thought that a fixed charge holder should also give up 10%, because a fixed charge was on a specific asset or assets and did not cover the whole as did a floating charge. Where a debenture-holder had both fixed and floating charges, the 10% would not apply to recoveries under the fixed charge.

Avis present law re stamping

22 The Committee then considered whether the debenture-holder should register a monetary limit in respect of the sum secured by the floating charge. It was accepted that this would not need to be in the debenture. Mr Endersby thought, that provided the amount so registered could be uplifted or reduced as appropriate, it would be no more than an administrative inconvenience to the banks. It was unanimously agreed that a monetary limit should be registered.

23 The question of debentures in favour of controllers of companies was raised. It was thought to be impracticable to stop this and in any event there would be stringent restrictions on directors in other directions.

AVOIDANCE OF FLOATING CHARGES

24 The Committee had before it ILRC 75, 79, 92 and 108.

25 The Secretary said that there had been a preliminary discussion on ILRC 79 at the twentieth meeting. Mr Avis had found the proposals unacceptable and his views were set out in ILRC 75. Both Mr Goldman and Mr Millett were strongly in favour of preventing the debenture-holder "washing" the overdraft.

PA reopen

26 On the latter point, Mr Taylor referred the Committee to the views expressed by the Senate of the Inns of Court and the Bar and the Law Society (C145) in ILRC 108 and the Institute of Credit Management (C108) in ILRC 109. The Chairman did not think that anything practical could be done about the problem as the banks would get round it. It was noted however that Mr Millett had made a proposal in ILRC 79 (Section B.1(ii)) and the Committee accepted this in sofar as it secured a current account.

27 On the question of extending s.322 from 12 months to 2 years, the Committee could see no justification for this, but accepted that there should be an extension to 2 years as suggested by the National Association of Trade Protection Societies where the debenture-holder was a director or officer of the company as he would have a more direct concern in the operation of the company; it was agreed that this should also include shareholders.

28 On the point raised by CCAB in ILRC 108 (who said that "cash" had come to include "moneys worth") it was agreed that this should mean real money.

FIXED CHARGES

29 The Committee had before it ILRC 22B and 110.

30 The suggestion that s.322 should be extended to fixed charges was not accepted. Both Mr Goldman and Mr Millett thought it

unreasonable to say that a creditor who went to judgment and was paid should keep his money, but a more amenable creditor who accepted a fixed charge should lose it.

31 The Secretary said that Mr John Hunter in his letter of 3 April had referred to the Secretary's note on the Charging Orders Act 1979 and to various paras in the Law Commission's Working Paper and Report. The question was whether or not the Committee felt that Act to be adequate. Mr Penny said that there would be a charging order nisi with notice given to the owner of the land and this would become absolute if the owner did not object. The new Act placed an obligation on the court to see that other creditors were not prejudiced and this did answer most of the criticisms levelled against charging orders. It was agreed that the Committee should say that they had no wish to change the Act.

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32 It was noted that it had already been agreed that enforcement of a fixed charge should be restricted for 12 months after the appointment of a receiver, unless there was leave of the court; this was confirmed.

33 As to other suggestions about powers of receivers under LPA 1925 being inadequate, it was felt that these had nothing to do with insolvency.

DISTRIBUTION OF ASSETS IN LIQUIDATIONS

34 The Committee had before it ILRC 102.

35 The Chairman pointed out that the Committee had provisionally decided in September 1978 that:-

(1) the primary duty of the liquidator was to realise assets to the best advantage and then pay out the proceeds in the proper priorities,

(2) any creditor or shareholder who objected should have the right to apply to the court, and

(3) the law needed clarifying and perhaps the word "forthwith" should be deleted from s.319 (as regards paying the preferential creditors).

The Legal Panel had considered these proposals and could see no objections.

36 The Committee confirmed the decisions and remitted the matter to the drafting sub-committee.

NEXT MEETING

37 The Committee would meet next at 10.00 am on Wednesday, 21 May.

38 The agenda would be:-

Committees of Creditors
Compulsory Bonding
Criminal Bankruptcy
Agency of the Receiver
Minimum paid-up capital for companies.

As regards the last item, while it was appreciated that the capital structure of a company was not a matter for the Committee, it was felt that we should give a view on insolvency due to trading with inadequate capital. Members were invited to send in their views on these items in the usual way.

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INSOLVENCY LAW REVIEW COMMITTEE

Note to Members

BRIEFS FOR MEETING ON 16 APRIL 1980

The following papers are enclosed:-

1. Letter dated 3 April from John Hunter with:-

   (a) Para 8 of his note dated 27 November 1979 concerning Voidable Securities;

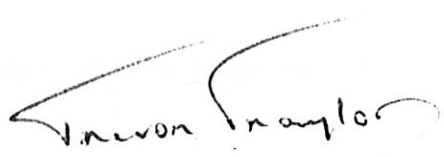
   (b) My note dated 27 February concerning the Charging Orders Act, 1979;

   (c) Paras 16 and 17 of the Law Commission Working Paper on Charging Orders on Land;

   (d) Paras 30, 31 and 34 of the Law Commission's Report on Charging Orders; and

   (e) Para 9 of John's note dated 27 November.

2. A set of proposed resolutions on Reservation of Title and Floating Charges put forward by Peter Millett, who has indicated that the proposals have the support of Alfred Goldman.



T H TRAYLOR
9 April 1980

THE BANKRUPTCY AND COMPANIES OFFICE
ROYAL COURTS OF JUSTICE
CHICHESTER STREET
BELFAST BT1 3JF
Telephone 35111 ext.

3 April, 1980.

Dear Trevor,

Main Committee Meeting 16 April 1980.

Item 4: Reservation of title

1. Although I would be happy to see the full implementation of the Crowther Report in relation to security interests, the more I read the voluminous literature and reports of decided cases on the subject of R.O.T. the more apprehensive I am about proposals to operate in insolvency which would have implications in other branches of the law. Thus I take the point made by the Secretary in paragraph 6 of his note of 19 February 1980.

2. If we adhere to the provisional views set out in paragraph 1 of the Secretary's note (which represented a shift from the suggestion at the 6th meeting - Edward dissenting and Alfred and John Copp reserving - that R.O.T. should not be enforceable in insolvency at all) it appears necessary to define the proposals more precisely. I think this is not easy but I have made a stab at it to try to clarify my own mind as to what the proposals would amount to and in the hope that it might help to bring out some of the problems of definition. My very tentative formulation of the proposals is as follows:-

"(1) A provision in an agreement to sell (as defined in section 2(5) of the Sale of Goods Act 1979) whereby the transfer of the property in the goods to the buyer is conditional on payment of the price shall be void against the liquidator or receiver of the buyer except in respect of goods supplied to the buyer which remain in his possession and in the form so supplied [and unmixed with other goods] or the proceeds of sale of such goods [retained by the buyer] and where notice of the provision is registered in the Companies Registry within 21 days of the making of the agreement, or such extended time as the Court may allow.

(2) Where goods are subject to an effective reservation of title which is not void against the liquidator or receiver, such liquidator or receiver may realise them within a period of 12 months from the commencement of the liquidation or receivership, accounting to the seller for the proceeds of such sale."

3. I have reservations as to the feasibility of the proposed registration requirement. I assume that it is the notice filing system of registration which is contemplated. I think that it is essential that we hear the views of the Registrar of Companies on this proposal.

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4. As we are recommending the abolition of the order and disposition clause in personal insolvency, whatever scheme in relation to R.O.T. which we propose will have to be capable of application to individual traders. There is no existing registry appropriate for such cases and as there is no equivalent to section 95 of the Companies Act 1948 in relation to individuals, perhaps no provision for registration of R.O.T. should be made.

5. Our final report will have to relate our proposals to Article 39 of the draft EEC Bankruptcy Convention, if it remains in the Convention and if the form it is to take has by then been determined. If the first variant were adopted this would appear to preclude a requirement of registration.

Item 5: Avoidance of floating charges

6. As regards section 322, Companies Act 1948, please see paragraph 8 of my note of 27 November 1979 on ILRC 88 and the New Zealand provisions therein referred to. [APPENDIX 'A']

Item 7: Fixed charges

7. In relation to charging orders, I suggest you refer members to your note of 27 February on the Charging Orders Act 1979. [APPENDIX 'B'] I think it might also be useful to circulate copies of paragraphs 16 and 17 of the Law Commission Working Paper (No. 46) on Charging Orders on Land and of paragraphs 30, 31 and 34 of their Report on Charging Orders (No. 74). I attach copy extracts for convenience. [APPENDICES 'C' and 'D']

8. If we are satisfied that the 1979 Act deals adequately with the problems which had arisen in relation to charging orders in insolvency perhaps we should say so in our final report, having regard to the Law Commission's references to full-scale review and reform of the law of bankruptcy.

Recovery of property on voidable transactions

9. Would you please consider drawing attention now to paragraph 9 of my note of 27 November 1979 on ILRC 88 above referred to [APPENDIX 'E'] as to the desirability of specifying the powers of the Court when setting aside a transaction and possibly introducing, as in New Zealand, a discretionary power to deny recovery by the trustee etc. where it would be inequitable.

Yours sincerely,

Commander T.H. Traylor M.B.E.,
Secretary, Insolvency Law Review Committee,
Department of Trade,
2-14 Bunhill Row,
LONDON,
EC1Y 8LL.

EXTRACT FROM ILRC 88. FRAUDULENT PREFERENCES

Voidable securities

8. At the 20th meeting we discussed section 322 of the Companies Act 1948 invalidating, in certain circumstances, a floating charge created within 12 months of winding up and it was agreed to leave over the question of the period to be prescribed and also whether the provision should be extended also to fixed charges (minutes, para.24). If there is to be an extension to cover fixed charges it occurs to me that we should also consider whether any similar provision is required in relation to fixed charges in personal insolvency. This idea is prompted by discovering that this has been done in a somewhat lengthy section in the New Zealand Insolvency Act 1967- section 57. I attach a copy, with a copy of Pratt & McKenzie's comments. Note that the section is significantly wider than section 322 of the Companies Act 1948 and apparently wider than the corresponding section of the New Zealand Companies Act 1955 in that it is not necessary for the trustee to show that the debtor was insolvent at the time the security was given. Note also subsection (3) - an answer to Re Yeovil Glove Co. Ltd. which may appeal to Muir.

Recovery of property on voidable transactions

9. When we complete our review of voidable transactions, I think we should consider whether it would be desirable that the new Insolvency Act should set out the powers of the Court when setting aside a transaction. I think practitioners would find this useful. It is done in clause 175 of the Canadian Bill and in a much more lengthy provision in section 58 of the New Zealand Insolvency Act 1967. An interesting feature of this is that it deals with a matter raised when we were discussing gifts - possible hardship to a donee. Under s.58(6) of the New Zealand Act recovery by the Assignee (trustee in bankruptcy) may be denied wholly or partly if - (a) the person from whom recovery is sought received the property in good faith and has altered his position in the reasonably held belief that the transfer or payment of the property to him was validly made and would not be set aside; and (b) in the opinion of the Court it is inequitable to order recovery or recovery in full. I attach a copy of the clause in the Canadian Bill and the New Zealand section and comment by Platt & McKenzie.

Sent on
VAL ... 28 Feb

INSOLVENCY LAW REVIEW COMMITTEE

Note to Members

CHARGING ORDERS ACT, 1979

1 Members may like to note that the Charging Orders Act 1979 received the Royal Assent on 6 December 1979. It will be brought into force on a date to be appointed by the Lord Chancellor.

2 When the law comes into force, it will amend S.40 of the Bankruptcy Act 1914 and S.325 of the Companies Act 1948 in that it provides for the making of a charging order against goods and land to constitute completion of an execution (S.4 of the Act). It will also empower the Court to make a charging order on a debtor's beneficial interest in land, certain securities, funds in Court and under any trust: further, certain instances are provided for where trust property is held by the debtor or debtors as trustee in that such property may be subject to the making of a charging order (S.2 of the Act).

3 The Act, in effect, reverses part of the decision in Overseas Aviation Engineering (GB) Ltd. (1962 3 All ER 12) in that completion of an execution on land would no longer depend upon seizure or the appointment of a receiver. It also emphasises in a statutory form the decision in Rainbow v Moorgate Properties Ltd. (1975 2 ALL ER 821) by making it mandatory upon the Court to consider the personal circumstances of the debtor and whether any other creditor of the debtor would be likely to be unduly prejudiced by the making of the order (S.1 (5)) i.e. where the making of an order would amount to gaining an unfair priority over other creditors, especially where the debtor is insolvent and bankruptcy or liquidation proceedings appear to be imminent.

4 The other part of the Overseas Aviation decision to the effect that registration under S.95 of the Companies Act 1948 is not necessary to give a charging order validity still applies as under the section a charge requiring registration must have been created by the company.

Trevor Traylor

T H TRAYLOR
Secretary
27.2.80

Law Commission Working Paper
Charging Orders on Land
APPENDIX 'C'

14. Russell L.J., in a dissenting judgment, examined the pre-1956 charging system and showed that a charge arising under that system would not have been treated as "execution"; and he saw no justification for holding that the 1956 Act had altered the position. Lord Denning M.R., on the other hand, regarded the history as irrelevant, on the ground that section 35 had introduced an entirely new scheme in relation to charges on land. He cited cases relating to charging orders on shares, in which the orders were described as being in the nature of execution[13]; and he pointed out that in section 35 the imposition of the charge is expressly stated to be "for the purpose of enforcing a judgment....." (The earlier legislation had not used this expression in relation to the general charge.) Harman L.J. agreed with Lord Denning; he considered that the writ of elegit (which was an undoubted form of execution) had been replaced in the 1956 Act not only by the extension of the scope of receivership (section 36(1)) but also by the charge procedure under section 35: "the new remedy given by section 35 is merely an alternative method of execution against the debtor's land".[14] We would observe that a charge would often be more effective than the appointment of a receiver under section 36 because it would enable the creditor to apply for an order for sale.

16. The point which arises directly out of _Overseas Aviation_ may seem to be a small one, but it is impossible not to recognise that a major question of bankruptcy policy underlies it. There is a school of thought which holds the view that it is already too easy for a judgment creditor to acquire

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13. _Finney_ v. _Hinde_ (1879) 4 Q.B.D. 102, 104 (Pollock B.); _In re O'Shea's Settlement_ [1895] 1 Ch. 325, 329 (Lord Halsbury). Lord Denning also cited _In re Love_ [1952] Ch. 138 in which Lord Evershed M.R. (at p. 152) described a statutory chargee of a partnership interest as (or equivalent to) an execution creditor.

14. [1963] Ch. at p. 46.

a charge over his debtor's land in priority to the other creditors; and, accordingly, that any change in the law ought to be in the opposite direction, removing from the Bankruptcy and Companies Acts those provisions which single out execution against land by treating it as "complete" at a stage before any of the fruits of execution have been gathered. The removal of the present distinction between land and goods in this context seems, indeed, to have recommended itself to the Bankruptcy Law Amendment Committee[15] (the Blagden Committee) in 1957: under their proposals[16] a judgment creditor would be entitled to retain the benefit of his execution (whether against land or goods) to the extent only of what he had actually received before the debtor's bankruptcy supervened. If that were the law, a charging order (assuming it to be a form of execution) would not operate to give a judgment creditor any priority, and the additional appointment of a receiver would not, by itself, be of any significance in this context.

17. It is clear, however, that the arguments are not all one way. A creditor may be satisfied with security alone; indeed, where there is a continuing business relationship between him and the debtor, he may actually prefer security to immediate payment if there is a risk that a demand for immediate payment might precipitate the closing down of the debtor's business. As the law now stands, a creditor may obtain a judgment without intending to execute it, solely with a view to obtaining a charging order (coupled with an order appointing a receiver) which will protect his interest in the event of the debtor's subsequent bankruptcy or liquidation. The continuation of the debtor's trade made possible by the principal creditor's acceptance of security may in the end prove advantageous to the other creditors as well. Any change in the law along the

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15. (1957) Cmnd. 221.
16. *Ibid*. para. 101.

Law Commission Report - Charging Orders

APPENDIX 'D'

He said:[26]

"... I should have thought it plain that when a judgment creditor gets a charge on the debtor's property, it is a form of 'execution': for it is a means of enforcing the judgment. I do not think the case of *In re Hutchinson*[27] [which dealt with a charging order on shares] should be taken to decide the contrary. The reasoning is obscure. And in any event it must be read in the light of later cases. A charging order on shares has since been said to be 'in the nature of an execution', see *per* Pollock B. in *Finney* v. *Hinde*[28], *per* Lord Halsbury in *In re O'Shea's Settlement*[29]. And Lord Evershed M. R. has gone further and described a charging order on shares as an 'execution', see *In re Love*[30]. And that is what I think it is".

Lord Denning went on to point out that in section 35 the imposition of the charge is expressly stated to be "for the purpose of enforcing a judgment ...". (The earlier legislation had not used this expression.) Harman L. J. agreed with Lord Denning; he considered that the writ of elegit (which was an undoubted form of execution) had been replaced in the 1956 Act not only by the extension of the scope of receivership (section 36(1)) but also by the charge procedure under section 35: "The new remedy given by section 35 is merely an alternative method of execution against the debtor's land"[31]. We would observe that a charge would often be more effective than the appointment of a receiver under section 36 because it would enable the creditor to apply for an order for sale.

The effect of *Overseas Aviation*: charging orders on land

25. The effect of *Overseas Aviation* is that a judgment creditor who wishes to ensure that his debt enjoys priority over those of unsecured creditors in the event of the debtor's bankruptcy cannot do so merely by obtaining a charging order on land. He must go on to obtain the appointment of a receiver as well. This presents no real difficulty to the initiated: soon after *Overseas Aviation*, the Rules of the Supreme Court were amended so as to permit the application for a charging order to be accompanied by a simultaneous application for the appointment of a receiver[32] and in practice the court accedes almost automatically to the latter application[33].

26. But although the desirability of coupling an application for a charging order with one for a receiver is clear to those who have mastered the law and procedure it may be said to constitute a trap for the unwary, and the fact that this trap can be avoided by the initiated is perhaps more an aggravation than a comfort to those less skilful creditors who fall victim to it. In any case, it is unsatisfactory that creditors should be obliged, for purely technical reasons, to

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[26] [1963] Ch. at p. 40. With reference to the penultimate sentence of this extract, it would seem from the report that Lord Evershed M.R. was in fact referring to a charging order on the share of a partner in a business.
[27] (1885) 16 Q.B.D. 515.
[28] (1879) 4 Q.B.D. 102, 104.
[29] [1895] 1 Ch. 325, 329 (C.A.).
[30] [1952] Ch. 138, 152.
[31] [1963] Ch. at p. 46.
[32] See now O. 50, r. 9, and n. 15, above.
[33] In other words it is usually a mere formality, as was the issue of a writ of elegit under the old system: see the judgment of Russell L. J. in *Overseas Aviation* [1963] Ch. 24, 48.

apply for the appointment of a receiver in cases in which they would not otherwise do so. The appointment of a receiver may be a wholly inappropriate remedy—where, for example, the land in question is the debtor's own home or place of business and so produces no rent for a receiver to receive. Yet costs must still be incurred in securing his appointment, and these costs fall upon the debtor or (if bankruptcy ensues) upon the general body of unsecured creditors.

27. It is therefore argued that the effect of *Overseas Aviation* should be reversed, so that a charging order alone is sufficient to make the chargee a secured creditor with priority for his debt. This argument is supported not only by the factors mentioned in the preceding paragraph but by two other contentions.

28. First, it is said that a charging order ought of itself to give priority because bankruptcy law does give priority to a creditor whose debt is secured by a charge expressly created by the debtor and a statutory charge is strictly analogous. This point is strengthened by the fact that the priority which the existing law accords to express charges continues to apply (subject only to the rules about fraudulent preference) even if the express charge is given shortly before the bankruptcy and even if it is obtained under threat of bankruptcy proceedings. We said in the working paper that we could see no grounds for distinguishing between express charges acquired in these circumstances and statutory charges acquired through the court, and this remains our view.

29. Secondly, it is said that since, under the existing law, a creditor with a charging order can in fact secure priority by taking one further and largely formal step (albeit an inconvenient and usually inappropriate one)—namely, obtaining a receiver—the law might just as well give him priority from the outset.

30. Although these arguments are in our view very persuasive, both are based upon the provisions of existing bankruptcy law; and if existing bankruptcy law is wrong they must inevitably lose their force. Some of those who commented on our working paper consider that in the relevant respects the existing law of bankruptcy is indeed wrong, and it is for this reason that they rejected the proposal to reverse *Overseas Aviation*. The number of those who did reject it was very much smaller than the number of those who gave it their approval and support, but although those who rejected the proposal were in a minority we were impressed by their arguments.

31. The arguments of the minority did not come altogether as a surprise to us: we had indeed sketched out their nature beforehand in the working paper[34]. But consultation has convinced us that they should be given more weight. Briefly, they do suggest that even though a provision to reverse the effect of *Overseas Aviation* might fit happily into the framework of existing bankruptcy law it should still be resisted because that framework is itself unsatisfactory. It is urged that it is already too easy for one creditor to steal a march on the others by acquiring some special cachet (be it an express charge or the appointment of a receiver) which will give his debt priority in a bankruptcy. It would follow that

[34] Para. 16.

the Court in *Overseas Aviation*, by reducing (or by refusing to extend) the category of available cachets, has taken a step in the right direction, and that simply to reverse the effect of that decision would therefore be a retrograde step.

32. We are in considerable sympathy with this view. On the other hand, if what we need is a sensible barrier against "priority gaining" (a term which we use in no pejorative sense), no one could really argue that *Overseas Aviation* provides it. The barrier erected by that decision is, on the contrary, ineffective (since it can be circumvented), inefficient (since the circumvention wastes time and money), unfair (since the possibility of circumvention is open only to the more knowledgeable) and illogical (since circumvention forces the creditor to ask for something he does not want).

33. We therefore find ourselves with this problem: on the one hand, we have no doubt that *Overseas Aviation* has left the law in an anomalous state and that the decision, even judged solely as a barrier against priority gaining, is not satisfactory; on the other hand, we no longer think it would be right to deal with this situation simply by reversing the effect of the decision.

34. One solution might lie in a full-scale review and reform of the law of bankruptcy, in the course of which the whole problem of priority gaining would be considered and dealt with in its context. Thus, as we mentioned in the working paper[35], the Bankruptcy Law Amendment Committee (the Blagden Committee) in their report in 1957 recommended[36] a change providing (in the case of land, as indeed the existing law does provide in the case of goods) that a judgment creditor is entitled to retain the benefit of his execution to the extent only of what he has received before the debtor's bankruptcy supervenes[37]. We also referred in the working paper[38] to the possibility that some general change in our law might result from our membership of the European Economic Community.

35. It seems unlikely, however, that any wide-ranging changes in our law of bankruptcy will be enacted in the immediate future. We feel bound, therefore, to put forward recommendations designed to resolve the particular problem which results from *Overseas Aviation*. Our doing so does not, of course, in any way lessen the desirability of a full-scale review of the general law of bankruptcy being undertaken.

36. But before we turn to our positive recommendations we must retrace our steps for a moment and consider the possible effect of the *Overseas Aviation* decision in relation to charging orders on securities.

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[35] Para. 16.

[36] (1957) Cmnd. 221, para. 101.

[37] In the working paper (para. 17) we pointed out one possible drawback to this proposal—namely that it might drive a creditor who would be content merely with security to resort to actual and speedy execution as his only means of protection, and thus perhaps to precipitate bankruptcies unnecessarily.

[38] Para. 18.

RESERVATION OF TITLE
AND FLOATING CHARGES

In an attempt to focus discussion, we propose to move the following resolutions on the 16th April :-

1. Reservation of Title Clauses should be void if not registered.

2. Legislation should confirm the receiver's right to dispose of assets subject to such a Clause notwithstanding anything to the contrary in the Clause, without prejudice to the right of the vendor to claim a share of the proceeds of sale.

3. Enforcement of fixed charges should be restricted for 12 months after the appointment of a receiver.

4. Section 322 should be strengthened by preventing the debenture-holder "washing" the overdraft: (see ILRC 79).

5. The unsecured creditors should receive a special 10% stake in the net realisation made by the receiver, subject to an upper limit so that the percentage taken by the unsecured creditors should not in any event exceed that taken by the receiver: (see ILRC 111).

These five proposals are designed by us as a package. The first three benefit the holder of a floating charge.

We would not support them unless the other two proposals or their equivalent were also adopted.

P Millett
A Goldman

2.4.80

INSOLVENCY LAW REVIEW COMMITTEE

Note to Members

Attached is the agenda for the meeting on 16 April, together with the following papers:

(a) Minutes of the last meeting.

(b) ILRC 108 - written evidence on the avoidance of floating charges.

(c) ILRC 109 - written evidence on the propriety of floating charges.

(d) ILRC 110 - written evidence on fixed charges.

(e) ILRC 111 - Floating charges - proposals for change.

(f) ILRC 112 - Reply to ILRC 111 by Peter Avis.

2 ILRC 111 was prepared towards the end of 1978 and Peter Avis submitted his comments to it (ILRC 112) shortly afterwards. However, it was felt that the matter should not come before the Committee until written evidence had been received from the Clearing Banks. This was subsequently received and distributed as C165.

3 Members may also like to refer back to the minutes of the 17th meeting, paras 8-17, when we were considering the part of the Chairman's draft report which dealt with floating charges. Also to the minutes of the 20th meeting, paras 20-24 when Peter Millett's paper (ILRC 79) was discussed.

T H TRAYLOR
26 March 1980