1(5.4)

INSOLVENCY LAW REVIEW COMMITTEE

FORTYSEVENTH MEETING - BRIEF FOR ITEM 7

FINAL REPORT - PREFERENTIAL DEBTS

Comments which have been received to date from members on the first draft of a chapter on "Preferential Debts" have been collated and are attached. Discussion of the points raised has been included in the agenda for 15 October (see para 61 of the minutes of the 46th Meeting).

The majority of members are generally in favour of the views expressed in the paper, but Geoffrey Drain would prefer to support the TUC's proposal that all moneys due to employees should be preferential, ie. an extension of the present law. This may also be Duncan's view.

Duncan is particularly worried that the S of S may not bring the financial limits of the EPA into line with preferential rights. Perhaps we could strengthen para 21 of the report to make it clear that we regard it as essential that the EPA be brought into line and kept in line.

As regards Geoffrey's point: one way of dealing with this is to put the minority view in the body of the report - there are precedents for this, the most recent being the Wilson Report (pp.268, 271, 300, etc).

T H TRAYLOR
7.10.80

PREFERENTIAL DEBTS

General Comments by Members

John Copp - I like this and would not wish to alter it apart from perhaps a para giving our views on categories which are not at present preferential but perhaps ought to be; John suggests "damages for personal injury" though adds that he would probably oppose it.

John Hunter - A first-class draft - some small amendments.

Alfred Goldman - I am in agreement with the paper which entirely reflects my views.

Ritchie Penny - A very good chapter.

Peter Avis - An excellent paper.

Geoffrey Drain - Has drawn attention to four points from the written evidence of the TUC which have not been covered in the draft chapter, viz:

(a) There should be established a duty on receivers and liquidators to take account of employee interests and, wherever possible, to seek to maintain employment.

(b) The definition of "employment debts" should be widened to include all payments due under contracts of employment. In particular money collected under "check off" arrangements, in which the employer acts as intermediary only, should be given preferential treatment (on the same arguments used in para 17 to give preference to PAYE collection).

(c) Means should be sought to close any loopholes by which parent companies avoid the employment debts of their subsidiaries.

(d) The right of independent trade unions to represent their members' interests in actions or proceedings in the courts relating to receiverships and liquidations should be introduced.

Detailed comments

Para 4

Duncan MacNab has put an "X" at each end of lines 3 and 4.

John Hunter asks if reference should also be made to the pre-preferential payments provided for in s.35, Friendly Societies Act 1896, s.21 Deed of Arrangements Act 1914 and s.72 Trustee Savings Bank Act 1969 (See 'Williams' 19 Ed.p.228).

Gerry Weiss says, re: funeral expemses: "They are not creditors at the commencement of the insolvency; this thus introduces an entirely new concept with which I am not sure I agree.

Para 5 (iii)

John Hunter suggests amending to read: "PAYE deductions and deductions on account of tax, etc, from payments to certain sub-contractors in the construction industry made in....".

Para 6

John Copp says this may need amending to bring in Liquidation of Assets (and DAO?) procedures.

Para 7

John Copp assumes that the extensions made by the EPA are only minor ones and that we need not elaborate.

Para 8

Geoffrey Drain points out that in (a) and (b) the correct figure is £100 per week, not £80.

Para 9

Gerry Weiss suggests (line 9) to read, "bankruptcy, winding-up or receivership.....".

Para 14

Alfred Goldman suggests "Crown" rather than "Fisc".

Para 15 (page 10)

Peter Avis line 3. Delete "They have no real choice".
Insert "and in a practical sense have no real choice".

line 4. Delete "in no position".
Insert: "unable".

lines 11/12 Delete "are far more deserving of sympathy than the Crown".

Insert: "deserve much sympathy".

lines 15/16/17 Delete "a wholly insufficient ground".
Insert "not sufficient ground".

Delete "in favour of the Crown".

Gerry Weiss — line 7 — queries "judgment creditors".

John Hunter — line 7 — suggests deleting "judgment creditors" and inserting "for example". He adds that it is unnecessary to refer to judgment creditors. The credit giving rise to the debt the subject of the judgment may have been given voluntarily.

Para 17 (page 12)

John Copp says he is not familiar with the way these returns are made. Presumably a return rendered at, say 31 March would not include tax collected on that day but would be made up to some antecedent date. If this is so, should not the period be, say four rather than three months to allow for this?

Ritchie Penny suggests that we should mention (somewhere) that all the periods should run from the date of insolvency and there should be no choice of period as in para 5(ii) on page 3 above.

Duncan McNab says, with regard to VAT, and Betting, Gaming Licence and Bingo duties. "I was of the opinion that this time limit had been extended to six months as it was pointed out that it would be well into the fourth or fifth month at a minimum before the return was submitted. Assuming the three monthly return ended on the 31 March a company with branches could not possibly have their figures ready for submission before at least two months after the 31 March. As this would be of considerable disadvantage and might well reduce the preference to nothing, I would suggest that the three month preferences should be extended to six months".

Para 18

Ritchie Penny (re line 2 on page 13) says "We may be doing something about distress. If we do, we must be sure this still applies.

John Hunter suggests a new para 18A.

18 A. We have noted with interest that the 1883 Bankruptcy Bill, when first introduced into parliament by the President of the Board of Trade, provided for the abolition of all preferentail claims except in relation to employees' wages. /The Hansard report of/ the second reading of the bill/ quotes Mr. Chamberlain/ as saying " In some small estates the assets were swallowed up by those preferential claims, which were of four classes - First, for wages due for a certain period prior to the bankruptcy; secondly, the landlord' claim for rent; thirdly, Imperial taxes, and, fourthly, local rates. He proposed that all those preferential claims should be done away with, except the first. He would submit that all the three latter claims ought to stand on the same footing. He did not think that the State could be expected to forego the advantage it now enjoyed in favour of the landlord or the local authority. He was much gratified, although

somewhat surprised, that the Treasury made no objection to his suggestion. But he could not but feel that in the case of bankruptcies, the claim of the individual creditor, to whom the bankruptcy was a very serious matter, ought to be regarded before that of the State, or a local authority. It also appeared unfair to other creditors that claims should be sprung upon them, after the bankruptcy, preferential claims of which they could by no possibility have had notice. In the last place, he had adopted this proposal because it seemed to him that the preferences now granted tended to bad and negligent administration by all the three classes to whom he had referred. For those reasons, he had thought it right to raise this matter for discussion. It was not a question of principle, and the decision upon it would be in the hands of hon. Members when the Bill was in Committee." (Hansard, House of Commons Reports, 1883 columns 853 ~~xxxxx~~).

Page 21

Line 5 should read "employees".

Duncan McNab considers that apprentices and articled clerks should continue to enjoy pre-preferential status. He adds. " I presume it could happen that the loss of premiums paid, could cause considerable problems in certain cases to the individual concerned, I am certain the committee don't want to disadvantage young people who have signed papers to become qualified on completion of their apprenticeship".

Page 14 21 Duncan continues:

"This paragraph also deals with employees wages etc on page 21 (7) recommends that the amount to be paid to the employee be limited as fixed by the Secretary of State, and any additional claim should rank as unsecured. As payments due to an employee must rank in a similar way to money collected for PAYE etc as we decided this was held in a kind of trust then monies due over the amount fixed by the Secretary of State should also be preferential.

Holiday pay is more or less what is deducted weekly held by the company to pay wages when the employee goes on holiday. To illustrate why this is so, the Income Tax, allow as an allowable expense, the amount of wages due, unpaid reserved by a company in their accounts.

While it states that the Secretary of State can increase, adjust the financial limits of the EPA, he can also keep it at its present maximum of £80 per week even if inflation keeps at its present increasing rate of 20% per annum, so that in about five years time the £80 would be worth £40.

If past experience is anything to go by, this is exactly what would happen, as the average wage must even now be above £80 per week, the Act is even at this early date out of line with present wages, conditions.

If we accept that the Secretary of State should be responsible for the amount as fixed by the EPA I would ask the committee to agree that any amount in excess should be treated as a preferential debt as otherwise we are giving preference to the creditors at the expense of the employee.

Holidays are now statutory, and normally assessed from April to April, as such they are always in arrears, the employee has no chance of being up to date with his holiday entitlement. Employees asking for holidays in advance (even if earned by time due), ie. after April, would not be well received in most firms. I hope I am making this clear but the following example will, I trust, do so:-

John Smith, is due 3 weeks holidays, earned up to April. He gets 2 weeks in the summer, 1 week in the winter but even by August he is due a further 8 days in November, when taking his late holiday 14 days.

We must guard against being over zealous in our approach and causing hardships in order to dispense with Government Departments Preferential Claims.

I cannot accept that wages due to employees are relatively unimportant Page 16 (24). It may be that the Banks and others stand to lose more in total, but everything is relative and money lost by a plumber can be more important to him than large losses by a bank."

Para 21 (contd)

Geoffrey Drain says:

My starting point is that whatever we may feel about the principle of preferential debts - and I share the general approach of the Committee - we should do nothing to worsen the position of employees. In commenting on the Chapter's proposals, I therefore support from the statement in the third paragraph that the objectives should be a pari passu distribution of assets and that therefore no debt should be accorded priority unless this can be justified by reference to principles of fairness and equity which would be likely to command general public acceptance. I think that there is a strong argument that the employee is disproportionately harmed by the insolvency of the employer and that therefore principles of equity require making all employment debts preferential.

The report however argues that the improvements made to the financial position of employees in the event of insolvency are sufficient to justify repealing the former provisions relating to employees' preferences. At present these co-exist with the EPA and can, under limited circumstances, give preference to debts owed to employees but not covered by the EPA.

This argument can be criticised on the following grounds:

(a) It might cause actual loss to some groups owed more than the statutory limits at a time of increasing insolvency and job loss. Although the number of groups thus affected may be small the sums of money involved for them can be considerable. The balance of cost and equity therefore argues against this proposal.

(b) It is certainly not sufficient to assume (para 21) that the Employment Secretary will increase the financial limits "to meet identified social needs". Experience with the present Government gives no ground for such an assumption, and I find this the weakest supposition of the draft.

(c) In any case the whole argument (paras 19-21) that preferential treatment for employees derives as "a social measure" is misleading on two counts. First, we are talking about money actually owed to employees. Second, to use this phrase gives the impression that this series of debts is treated on entirely separate principles whereas, (the point of para 1), such preference is entirely consistent with the principle of pari passu unless there is justification by wider principles of fairness and equity. The EPA has not removed such justification.

(d) The EPA still leaves uncovered certain groups, such as seafarers and freelance writers.,

Para 22 Line 5

Peter Avis suggests inserting "however" after "where".

Para 23

Duncan McNab has written "No" alongside the last three lines.

Para 24

Duncan McNab queries line 4.

Para 25 lines 5/6

Gerry Weiss suggests amending to read "If these objections are valid they are equally so in the case of....".

Para 26

Gerry Weiss asks (lines 9-12) "Is it worth saying that this argument will lose some force if the principle of the Administrator was adopted?

Duncan McNab suggests adding "and as a result" at the end of line 12.

Peter Avis line 16 - for "often" read "sometimes".
line 20 - for "so" read "correct, and it is disputed by the banks".

Para 30

Ritchie Penny says "other deductions from wages in the nature of trust payments, eg, under Attachment of Earnings Orders must be mentioned somewhere. See Minutes of 39th Mtg, para 35".

Duncan McNab has put "6 months" alongside sub-paras (4) and (5).

ILRC - 47TH MEETING

Brief for Item 4

Disqualification of directors of insolvent companies (ILRC 135-136)

The only comments received have been from John Hunter. He says:-

"The evidence we have received indicates clearly that section 9 of the Insolvency Act 1976 does not go far enough. I would favour the Chairman's suggestion that disqualification should be automatic, subject to the director's right of appeal to the Court to be relieved, but, far from increasing the qualifying number of insolvent liquidations, I would like to see the disqualification applied from the first liquidation. If this is not acceptable, then, in addition to automatic disqualification after 2 or 3 insolvent liquidations, I would like to see section 9 retained but with the repeal of sub-section 1(a) (ii) so as to enable the Court, on application, to disqualify a director after one insolvent liquidation where satisfied that his conduct as director made him unfit to be concerned in the management of a company."

E L Reeves

E L REEVES
Assistant Secretary
9 October 1980

ILRC - 47TH MEETING

Brief for Item 5 - Winding up Generally

Comments on ILRC 137 and 138 have been received from Mr John Hunter, Mr Taylor and Mr Walker-Arnott and are attached.

E L REEVES
Assistant Secretary
10 October 1980

ILRC 137-138 COMMENTS BY MR J M HUNTER

Mr Hunter explains that he has had little time to examine these papers but asks for these hurried comments to be circulated before the meeting:-

ILRC 137

Para 15

No proposal is made as to how the liquidator's remuneration should be fixed where there is no creditors' meeting.

Section 242 of the 1948 Companies Act provides that in a compulsory winding-up the liquidator is to receive such remuneration by percentage or otherwise as the court may direct. However, by rule 159 of the Companies Winding-up Rules the remuneration is to be fixed by the committee of inspection unless the court otherwise directs and is to be a percentage on realisations and distributions. (I find this rule difficult to reconcile with section 242). Where there is no committee of inspection the remuneration is to be fixed by the OR's scale of fees on realisations and distributions, unless the court otherwise orders.

Under section 296 of the 1948 Act the remuneration of a liquidator in a creditors' voluntary winding-up is fixed by the committee of inspection or, where there is no committee, by the creditors.

In C65 (ILRC 138 Annex N p.1) Raymond Wright suggests that where there is no committee and the liquidator charges the OR's scale a formal meeting of creditors should not be necessary unless asked for by creditors.

I think we should endeavour to achieve uniformity in this matter between compulsory and voluntary winding-up and I put forward the following suggestions for consideration:-

(1) Where there is a creditors' committee it should fix the remuneration, by percentage or otherwise and having regard to the factors listed by CCAB in C139 (ILRC 138, Annex N p.2) rather than the Solicitors Remuneration Order, which is not readily adaptable to the work of a liquidator.* Where the liquidator and the committee cannot agree, I would prefer that the remuneration should be fixed by a general meeting of creditors than by the Court as proposed by the Panel.

(2) Where there is no committee -

(a) If the liquidator's charges are based on the OR's scale they should be notified to creditors and if objection is received from, say one tenth in value of the creditors, a meeting of creditors should be called to fix the remuneration.

(b) If the liquidator's charges are not based on the OR's scale, they should be fixed by the creditors at a meeting.

These proposals would take the Court and the Department out of fixing the liquidator's remuneration and leave it in the hands of the creditors in both compulsory and voluntary winding-up.

* Alternatively adopt clause 38 of Canada Bill:-

> Basis for remuneration
>
> **38.** (1) Where the registrar taxes an account pursuant to section 37, he shall, in addition to any other requirement of this Act, have regard to
>
> (*a*) any applicable tariff;
>
> (*b*) the duration of the services rendered and the time properly and reasonably spent in their performance;
>
> (*c*) the nature of the services authorized to be performed;
>
> (*d*) the size of the estate; and
>
> (*e*) the results achieved.
>
> Advance on remuneration
>
> (2) The registrar may, as prescribed, authorize the payment to an interim receiver, a trustee, a solicitor or an accountant of an advance on his remuneration for services to the estate.

Para 21

I see no reason why Registrars should not be empowered to hear petitions in open court. This is done in Northern Ireland under a rule of court introduced in April 1979. Perhaps I might also draw attention to section 106(1) of the Judicature (Northern Ireland) Act 1978 under which solicitors are given a statutory right of audience in the High Court and the Court of Appeal in bankruptcy matters and matters relating to the winding-up of a company, as well as a general right of audience in chambers. Solicitors have always had this right in bankruptcy matters in Ireland, but the extension by the 1978 Act to company winding-up matters is new. Unopposed winding-up petitions are now normally dealt with by solicitors without counsel.

Para 24

The Panel adopt C116 re Centrebind. I am not clear about the last sentence of the submission in C116. What order is the Court to be empowered to make and against whom?

The written evidence contains a very considerable number of detailed suggestions, many of which appeal to me and some I would like to hear discussion on. I have picked out the following, in particular, which I think we might look at briefly; no doubt other members will want to refer to other submissions.

Annex A

C139 CCAB Last para of (i). The suggestion is that where an outside liquidator is appointed in a compulsory winding-up the liquidation should proceed as if it were a creditors' voluntary winding-up. See also C164 (Annex I) (also from CCAB) and C92, Society of Conservative Lawyers, para (iv) where the suggestion is not confined to non-official liquidators. The Insolvency Practitioners Association put forward a similar proposal in C56 (attachment to letter dated 19 May 1976) and in C106.

Annex B

Re appointment of liquidator in compulsory winding-up, see C46, C56, C106(iii) and C164(i): propose certification by Department, as in bankruptcy, instead of appointment by Court. Affidavit of fitness should not be required, or should not be required repeatedly for the same proposed liquidator: C46(iii), C56 and C106(v).

Annex F

Re statement of affairs. We should look at these proposals and recommend a realistic timetable.

Annex G

Proposal in C106, Insolvency Practitioners Association, re duty of directors in a liquidation.

Proposal in C188, Law Society of Scotland, re express provision relating to cessation of powers of directors on liquidation.

Annex J

Both proposals re public examinations.

Annex L

The proposal in C47 that section 264 of the 1948 Act (power to exclude creditors not proving in time) should be extended to include voluntary winding-up.

Annex R

C13 J Denza. Proposal to restrict expensive circulations of creditors.

C86 Norman H Davis. Templeman J's dicta in Herbert Berry Associates Ltd: suggestion that winding-up should become the sole remedy for enforcement of judgments against a company.

I wish to raise a matter not dealt with in ILRC 137 or 138:-

Private Examinations under section 268 of Companies Act 1948

I think the courts have been too restrictive in the operation of this section. The liquidator should be able to obtain a summons under this section if he can demonstrate that he has grounds for believing that the potential witness comes within this section and that he has refused or failed to attend on the liquidator voluntarily, unless it appears that the potential witness would be prejudiced in relation to an action by the company which is pending or which the liquidator has decided to institute.

ILRC 137 - Winding up Generally

Comments by Mr C A Taylor

Para 2	There is a difficulty here as the failure to pay may be the fault of over-optimistic valuations by the Board. I do agree however that creditors should have power to change the liquidator.
Para 4	If creditors cannot be paid then the company is not clearly solvent.
Para 5	The lien should be for work done.
Para 7	Presumably after para 2 of the paper.
Para 8	The members may well not want the creditors' nominee and should not have him foisted on them.
Para 9	No; the expenses of realisation must come first.
Para 10	No. It is essential that a sworn statement of affairs be submitted. Without this no receiver ought to deal with property which may belong to third parties.
Para 12	"Rights to remuneration out of the estate ahead of the holder of the charge"; this is a non-sequitor.
Para 13	See comments on para 10.
Para 15	I cannot agree that the Order is necessarily a suitable guide.
Para 16	No. The intentions of the Court in making a compulsory order are that the company's business be brought to an end; it is notice to the world.
Para 17	No.
Para 19	But no doubt that was part of the bargain for the lease; it is up to the parties to exclude such a provision.
Para 21(b)	No; by Registrars but only in open court.
Para 25	No. The obligation should be on the banker as only he has the information and knowledge.

INSOLVENCY LAW REVIEW COMMITTEE

ILRC 137 & 138

WINDING-UP GENERALLY

COMMENTS BY E.I. WALKER-ARNOTT ON THE REPORT OF THE ACCOUNTANTS' PANEL

Paragraph 5

I do not think there is any need to introduce a specific lien in support of the Liquidator's claim for his fees and expenses. The basic question is the order of priority of claims against the assets, and provided the Liquidator's fees and expenses rank high enough - as, I believe, they do under the present law - the Liquidator's position is adequately protected. A lien over assets could, as regards the practicalities, give the Liquidator an over-strong position vis. a vis. the creditors in the agreement of his fees.

Paragraph 8

I agree that there is no need to make special provision for the change from creditors' voluntary liquidation to members' voluntary liquidation.

Paragraph 10

In practice, the problem raised by the Barleycorn case (that is, the costs and expenses of the winding-up ranking ahead of the sum secured by the floating charge) arises rarely. However, the Mesco Properties case shows that corporation tax in respect of chargeable gains arising on disposals of assets during the liquidation, are necessary disbursements of the liquidation and rank, very highly, for payment out of the available assets: and that such corporation tax amounts to "costs, charges and expenses" incurred in the winding-up. Thus, it is arguable that where there is a liquidation corporation tax in respect of chargeable gains on disposals could rank ahead of the amount secured by the floating charge.

I agree that this uncertainty calls for a clear restatement of the priorities and in my view the costs and expenses of the winding-up (whether or not including corporation tax) should not rank ahead of the sum secured by the floating charge.

Paragraph 12

If the Liquidator's remuneration is to rank pari passu with the Receiver's entitlement to remuneration (and therefore ahead of the amount secured by the charge), this should only be possible by determination (whether by agreement or application to the Court) before the Liquidator starts incurring fees and expenses. It should be necessary for the Liquidator or the creditors wishing him to act, to establish that there is a need for him to do something during the receivership.

Paragraph 15

I agree that fees should be determined by relation to some specified criteria. I am not satisfied that the criteria in the Solicitors' Remuneration Order are necessarily appropriate, and I do not believe that we need fix on the particular criteria. We can simply refer to the Solicitors' Order as a useful analogy.

Paragraph 19

Where a lease provides that the landlord may forfeit upon the tenant going into liquidation, there is, under the present law, a right for the tenant to apply to the Court for relief from forfeiture within one year of the liquidation. In practice, provided the tenant continues to pay the rent and comply with the covenants, there is a stay on forfeiture for one year, enabling the Liquidator to assign the lease, if it has value. After the expiry of the one year the tenant is no longer able to apply for relief.

I see no reason for altering the law in the way proposed.

Paragraph 25

I believe the view has been taken in the Committee that the introduction of the "administrator", linked with the new initiation procedures, means that Section 227 is no longer needed. I think we will have to look at this carefully when we settle the wording of our Report on the administrator and on the initiation procedures.

On the assumption that something like Section 227 may still be needed, I do not agree with the British Bankers Association recommendation in Appendix B that a company be permitted to

operate its bank account until final hearing of the Petition unless the Court orders otherwise. It is not practicable to distinguish in legislation between one form of conduct of a bank account and another: in particular, between ordinary course operation of a bank account and exceptional transactions conducted through a bank account. The practical protection is for the company to apply under Section 227 and explain, in the context of the particular character of its business, what it seeks to be able to do through its bank account.

ILRC - 47TH MEETING

Additional Brief for Item 7

PREFERENTIAL CREDITORS - DRAFT REPORT

Comments by Mr C A Taylor

Para 21

But under subrogation, ought the bankruptcy to be saddled with the whole of the amount considered by the Secretary of State as meeting a social need? See page 21 and page 15.

Para 26

Not only do the banks receive the benefit of the employees' preferential status, but the "rolling over" of the wages account may also have the effect of turning an unsecured debt into a secured one. The banks are looking, not only to what they can receive under subrogation, but also under their charge. Should we not refer to our decisions on "washing"?

Para 29

The danger here is that the creditor may in fact become a partner or supplier of equity capital, who is participating in the profits (if any) of the venture. The general principle enunciated by Bacon C J in Re Beale (4 Ch.D 246) and endorsed by Romer J in Re Meade (1951 1 Ch.774) was that he who provides part of the capital of a business cannot call for payment until the creditors of the business are paid.

Para 30(8)

Subject to (4) above.

Para 30(9)

If this is to work we will have to, notwithstanding (7) above, fix amounts for employees' preferences. The amount awarded by the Secretary of State on social grounds will not in logic be right.

Para 30(11)

But see my comments on para 29. I fear banks may use this power to lean on the unsecured creditors to give up part of their "rights". Some sort of provision of this nature might be useful in considering moratoria, but that is a subject which really needs tackling and which we haven't done so far.

9.10.80