1(5-8)

Rep. Ow.

Minutes of 61st. meeting - Comments by J.M.H.

Correction

Para. 39, last sentence. This should read "The last sentence referring to consequential amendments to the Consumer Credit Act should be omitted."

Matters arising

Reputed Ownership

Para. 36. I am not happy about the phrase "such as intangible assets" to follow "choses in action". I propose to change "chose in action" to read "thing in action", not that I prefer this but because those are in fact the words used in section 38 which is referred to. If it is still considered necessary to explain the technical phrase when we are merely quoting existing law I would prefer to give specific examples and say "such as shares in a company, insurance policies or negotiable instruments". For Duncan's information the following are two expositions of the meaning of the phrase "chose in action" -

(1) Williams & Mortimer on Executors -" By the expression chose in action is to be understood a right to be asserted, or property reducible into possession by an action, either at law or in equity".

(2) Channel J. in Turkington v. Magee 1902 2KB 427 at 430 defined chose in action as comprising "all personal rights of property which can only be claimed or enforced by action and not by taking physical possession".

Para. 40. I propose to deal with this by adding, after the recommendation for the abolition of the doctrine of reputed ownership at the end of the section, the following sentence - "Its abolition, coupled with amendments of the Bills of Sale Acts to provide for registration of floating charges, would permit individuals to create such charges which, once our recommendations for reforming these charges are adopted, we support." I think the reference to the Bills of Sale Acts is necessary because section 4 of the Bills of Sale Act (1878) Amendment Act 1882 requires that every bill of sale given by way of security must have annexed thereto or written thereon a schedule containing an inventory of the personal chattels comprised in it and any such bill of sale is void, except as against the grantor, in

/respect

respect of any personal chattels not specifically described. The definition of "personal chattels" in the 1878 Act is confined to articles capable of complete transfer by delivery.

Claims between spouses

Para. 41. I propose to take up Peter Millett's helpful comment on the historical background to section 3 of the Married Women's Property Act 1882 by adding to paragraph 1 which ends by saying that the section was introduced in consequence of the new rights then conferred upon married women and as a qualification of such rights, the following - "Before that Act all the wife's assets not held in trust for her separate use were available to her husband's creditors, although the husband's assets were not available to his wife's creditors unless she had pledged his credit." This follows Peter's note with the addition of the qualification, which I think is necessary, in respect of property held in trust for the wife's separate use.

Para. 41. The decision to extend section 36 of the 1914 Act to connected persons I find difficult to construct reasons for. Perhaps the advocates of the extension would draft the appropriate passage. It appears to me that this extension will amount to an extension of section 3 of the Partnership Act 1890 under which the rights of persons lending money to a business on terms of receiving a rate of interest varying with the profits or a share of the profits are postponed in the event of the borrower being adjudged bankrupt etc.

After-acquired property

Para. 44. There have been so many alterations to this section, some of them raising problems, that I have produced a second edition, with notes, which I will ask the Secretary to circulate.

ILRC 61ST MTG

Brief for Item 6

Chapter 15 - Insolvency Practitioners - Qualifications

Most members have commented on this chapter; in addition to the points set out below a number of minor drafting amendments have been accepted, which will be reflected in the redraft.

2 Peter Millett makes a general comment:

> "Could we mention the wretched liquidators who face Motions for committal every Monday? Our proposals for disqualification will save Court time (and therefore expense) - in future these men will simply be disqualified by the DOT. (We may have to provide for the creditors to meet to appoint a substitute)."

3 However, Ritchie feels that an Insolvency Judge should deal with disqualification as it is a serious matter and the practitioners will all be professional people of some standing. An added advantage is that it solves the problem of appeals. He has redrafted paras 771 and 772 so perhaps we should discuss this matter when we reach those paras.

4 Para 732. Duncan and Peter Avis would end the final sentence after the word 'administration'.

5 Para 734 Muir suggests adding, "We do not intend to refer to legal practitioners as such, although it is not unknown for solicitors to act as receivers, and solicitors were at one time occasionally appointed in the provinces as 'unofficial' Official Receivers. The practitioners to whom we refer are members of the accountancy profession, generally though not invariably members of a recognised professional body".
[Note: I thought the Committee's intention was not to refer to any specific profession.]

6 Para 736 line 12. Gerry suggests adding after 'creditors': "In addition to these skills, he must be capable of taking complete control of a business, sometimes of enormous size or complexity, or even both, while he carries on with a view to either selling it as a going concern or making some other proposals for its continuance as an economic unit."
[Propose to accept.]

7 Para 736 line 13 Three votes for 'surprising' and four for 'astonishing', so far.

8 Para 737 Muir suggests adding "A trustee, however, who has once been removed by the Department of Trade from his office for misconduct is thereafter permanently debarred from any further appointment as trustee."
[Propose to accept.]

9 Paras 745-748 (a) John Copp feels these paras are overlong and too detailed. (b) Gerry would add a para 745A:

745A earlier

Theoretically, the Department now has a discretionary power in being required to "certify" Trustees in Bankruptcy appointed at meetings of Creditors before they can act; in practice we understand that the Department will certify anyone who has given the necessary security provided that he has not on some previous occasion been removed from a trusteeship or liquidation.

(c) Peter Avis suggests:-

(i) transferring the last sentence of 745 to the end of 747,

(ii) deleting 746, and

(iii) adding the following (in place of 746) to the end of 745:-

"The elgibility of auditors is now governed by section 161 of the Act of 1948 and section 13 of the Act of 1976 which provide that the auditors of a company - public or private - must either:

(a) be a member of one of four specified accounting bodies (although the Secretary of State can add to or subtract from the list); or

(b) be individually authorised by the Secretary of State as having a foreign qualification equivalent to those of the recognised bodies."

10 Para 751 Muir suggests adding "Such 'syndics' are however qualified practising lawyers, and not (as in the UK) accountants. The same is true of USA trustees and liquidators."
[Propose to accept.]

11 Para 755 and 756 Peter Avis suggests merging these into one para under the sub-heading "Our recommendations", and starting 755 with the words "In our opinion".
[Propose to accept.]

12 Para 755 Muir suggests adding a fourth possibly way:

"(d) by giving the Department of Trade the power to refuse to approve any individual appointment (which is the present law)"

[Propose to accept; but (a) is it the present law for all types of insolvency practitioner and (b) will we require to say why it is unsatisfactory?]

13 Para 757 Peter Avis suggests that this para should come after 759.

14 Para 758(d) Alfred writes as follows:-

"There is only one matter to which I want to draw particular attention, and it is that it does not seem to me that paragraph 758(d) is compatible with paragraph 760.

Looking back at the Minutes of the 51st Meeting, I see that I was one of those who was then against the compulsory examination and, having now modified my view, I would like to make the following suggestion.

I should like to re-number 758(b) and (c), and perhaps they should become (c) and (d) respectively; and I set out below a new 758(b).

"The body should include in its qualifying examination either a Paper on "Insolvency", or a Paper of which a substantial head consists of questions on this subject." ~~An Insolvency practitioner should have taken and passed this Paper.~~"

If this is acceptable, then it does not seem that we need paragraph 760. "

[Propose to accept though John Copp, who was also with the minority, may wish to express a view.]

15 Para 764 Muir suggests adding "The sum thus globally insured will constitute the limit beyond which the person could not accept any further appointments, without obtaining extended cover."
[Propose to accept].

16 Para 767(d) Ritchie and Peter Avis ask if we should include 'spouse' or 'any person related' - we have had so many complaints about spouses being used.

17 Para 767 (d) and (e) John Copp asks if we mean "insolvent debtor" and adds that this needs some thought in view of paras 773-774. [See below].

18 Para 767(f) and (g) Gerry and Ritchie suggest:

Do we insert below (c) & (d)

(f) a creditor, or an employee of the creditor or if it is a company, of its associated companies
(g) a person whose right to act has previously been withdrawn pursuant to our recommendation in par. 772 post.

[Propose to accept.]

19 Para 768 Peter Millett draws attention to the chapter on Antecedent Transactions. [para 26, I think].

20 Para 770 last line. So far there are two votes to delete 'the Court' and two to leave it in as an alternative. Ritchie's proposals for 771/772 may affect the decision.

21 Paras 771 and 772A New drafts by Ritchie:

771. The Department should have no specific obligation to supervise the work of insolvency practitioners, but it would be obliged to investigate any complaint and report to the Insolvency Court any circumstances which might lead the Court to make a Disqualification Order.

772. A Judge of the Insolvency Court should have the power of his own volition or on reference by an Insolvency Registrar or on a written report by the Department to make an order (called a Disqualification Order) disqualifying any insolvency practitioner from acting in that capacity either generally or for a specific period or for a specific matter and subject to such terms as he may think fit.

772A. The Insolvency Court should have power to make Rules or Issue Practice Directions governing the conduct of insolvency practitioners and defining their duties and obligations.

[Note: I have intentionally omitted to define the grounds on which a Disqualification Order should be made as I consider it better to leave it to the Judges to work out their own code and to use the Rules and Practice Directions to define where necessary the parameters within which practitioners must operate.]

22 Para 773, line 3 Muir suggests adding after "winding up" - "ie. on the basis of 'insolvency' visualising the payment of all debts within 12 months."
[I have accepted this but mention it in view of John Copp's comments on 774.]

23 Para 774 John Copp says:

"I think that insufficient consideration has been given to this. At the least I believe that we should exclude from the recommendation the voluntary winding up of companies the shareholders of which are themselves corporations. In such circumstances insolvency expertise may well be unnecessary while other skills may be involved in the return of assets in kind - eg. confidential technology - to the shareholders. To protect the possibility of an error in the solvency declaration, the exclusion might only apply if the corporate shareholders undertook liability for debts."

T H TRAYLOR
Secretary
2 July 1981

ILRC 61ST MTG

Addendum to Brief for Item 6

Chapter 15 - Insolvency Practitioners - Qualifications

1 Para 758. Edward says:

"I think that the four requirements are:-

(1) An ethical code of professional conduct which, if not specifically referring to insolvency, extends to conduct as an insolvency practitioner and breach of which involves professional sanctions.

(2) Strict accounting obligations as regards monies belonging to third parties passing through members' hands.

(3) A system of practising certificates renewable annually.

(4) Competitive examination, including, if only as an optional item, a paper on "Insolvency".

I do not think professional bodies necessarily have written Constitutions which include codes of ethics; and I consider that the control of third parties monies coming into the hands of members is particularly significant as regards insolvency practitioners."

2 Para 768 Edward comments:

"I think 'any company relationship which might be present, such as.....' is too vague. Perhaps we might indicate that we have in mind a company relationship beyond that of membership of the same group of companies - in the Companies Acts sense - and suggest use of the definitions of "associated company" in the Income Tax Acts."

3 Para 770. Edward thinks that the reference to the Court should remain and adds:

> "Given that there is an element of illegality here in the sense that conduct by an unqualified insolvency practitioner will bear the taint of illegality, would it be wise to make it clear whether or not everything that the unqualified practitioner did before being removed was effective or ineffective? My own view is that to make it a criminal offence to act and to allow summary removal is sufficient. To make all previous acts invalid would be to occasion chaos."

4 Para 772. Edward comments:

> "I do not think the Department should have the right to withdraw approval save as regards the transitional period when individuals are allowed to continue to practice notwithstanding that they cannot fulfil the necessary criteria. Once the transitional period is over control should be vested in the professional bodies. It is they who should decide to oust an individual or a firm, thereby automatically removing the individual or the firm from the category of qualified insolvency practitioners."

T H TRAYLOR
Secretary
7 July 1981

INSOLVENCY LAW REVIEW COMMITTEE

Note to Members

CHAPTER 15 - INSOLVENCY PRACTITIONERS

Attached are two copies of the first part of this chapter; the second part (not yet prepared) will deal with "Powers and duties of insolvency practitioners".

2 The disciplinary control proposed in para 770 is for debate, the idea being to reduce the workload falling on the Department, by making "acting when not qualified" a punishable offence. If it is accepted, will para 772 still be required? (It was taken from ILRC 169).

3 The following papers and minutes are relevant:

(a) ILRC 7, paras 2(iii) and (iv) and Annex, paras 1-3;
(b) ILRC 73;
(c) ILRC 117;
(d) ILRC 115, Part A;
(e) ILRC 169;
(f) ILRC 170;
(g) DT7
(h) Minutes:
  (i) 2nd Mtg, paras 27, 28,
  (ii) 35th Mtg, para 3,
  (iii) 43rd Mtg, paras 36, 37,
  (iv) 51st Mtg, paras 31-35,
(i) Oral evidence:
  (i) CLSC pp.12-14,
  (ii) CLCB p. 40,
  (iii) CCAB pp.51-54,
  (iv) DOT pp.6-9.

4 This draft will be included in the agenda for the next meeting; I should be grateful if you would return one copy with suggested amendments as soon as possible.

Trevor Traylor

T H TRAYLOR
Secretary
17 June 1981

ILRC - 61ST MTG

Brief for Item 9 - "The Gay Brigade"

1 Alfred has no comments and approves the draft.

2 John Copp approves and adds "In particular I agree with the second solution and I believe it should be limited to husbands and wives and NOT extended to co-habitees."

3 Ritchie takes a similar view, viz:-
"John Hunter's very helpful paper poses the question of whether "spouses" should be developed to cover co-habitees and mistresses. I recommended this in ILRC 146 but since then I have had grave doubts about the wisdom of the current liberal trends in this area of law. It seems likely that owing to the difficulty of definition the development may create more problems than it will solve and this will particularly apply in insolvency when the date of commencement of co-habitation may be so important. Such commencement is often preceded by a "twilight" period of association, with or without adultery.

There is also the fact of the impermanence of co-habitation and the additional problems of deciding on the timing and effect of termination. Substantial injustice could be caused where the co-habitee is abandoned but nevertheless has to pay the price of his or her temporary status.

For all these reasons I now wish to withdraw my suggestion that any persons other than true spouses should be treated as such. I suggest that in many cases the business (social liaisons) might have created a partnership by implication. In the absence of such a partnership, unmarried co-habiting parties should be treated as at arm's length."

4 Peter Avis approves the draft and supports the suggestion in para 3 of the Note to Members (23/6/81) that we leave the Courts to decide whether or not persons living as husband and wife should be of opposite sexes. Duncan on the other hand thinks we should resolve the matter.

5 Muir suggests that the last 4 lines of para 9 should be deleted and the following rider inserted:-

Rider to page 4, para 9
"Line 6. After "insolvency" delete all and read,
'In the context of the equality for practically all purposes of the spouses to a marriage, we regard it not only as satisfactory, but as necessary, that the spouses should for business purposes and in relation to insolvency, be treated as in approximately the same position as partners.'
New para 10. This was the solution adopted in the two reported cases of Re Beale (1876) 4 Ch.D.246 and in the more recent case of Re Meade (1951) 1 Ch.774, where the man and woman concerned were not married; in the former case they thought that they were married but in law were not, and in the latter, the mistress of the bankrupt

had provided the capital for the business run by her lover, from which they both lived. In each case the Court, being unable to apply the statutory postponement provision because of the absence of lawful wedlock, achieved the same result by applying the principle that he who provides part of the capital of a business cannot call for payment until the creditors of that business have been paid; Harman J in the latter case expressed satisfaction with the result, "since otherwise a mistress would be in a better position than a wife". A similar judgment has been given in an unreported case, where a father had lent money to his son to set him up in business.

11. Not only are spouses today treated as for practically all purposes equal, but persons (of different and even of the same sex) living together are beginning to be treated by the legislature and by the courts as "quasi-spouses" - a subject to which we have referred in our discussion of, and our recommendations relating to, the Family Dwelling (see Chapter). In the light of these social developments, it seems to us to be in this field also not only satisfactory but also necessary that in the case of such persons, so living together (at least if constituting what is now sometimes referred to as a "suitable union") they should be treated without ambiguity as falling within the principle stated above as the basis for those cases, and that the statute should be so drawn as to postpone their mutual claims, and so as to catch their reciprocally-provided assets, in the insolvency of either, in relation to the debts of a business carried on by either, as if they were busband and wife.

Renumber 10 as
Para 12. Our proposals in this field should apply to bankruptcy, to liquidation of assets, and to voluntary arrangements."

6 Referring to John Hunter's 'Notes', Muir says:

(a) On Note 1 - "I agree with the para".

(b) On Note 2 - "No, I agree to JH's second alternative".

(c) On Note 3 - "I have sought to cover this in my Rider.

(d) On Note 4 - "I agree".

7 Para 7, Line 4 Duncan feels that money or other estate lent for the purpose of her husband's business should be treated as assets of his estate. [I think this has been accepted.]

T H TRAYLOR
Secretary
2 July 1981

ILRC - 61ST MTG

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New para 10. This was the solution adopted in the two reported cases of Re Beale (1876) 4 Ch.D.246 and in the more recent case of Re Meade (1951) 1 Ch.774, where the man and woman concerned were not married; in the former case they thought that they were married but in law were not, and in the latter, the mistress of the bankrupt

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11. Not only are spouses today treated as for practically all purposes equal, but persons (of different and even of the same sex) living together are beginning to be treated by the legislature and by the courts as "quasi-spouses" - a subject to which we have referred in our discussion of, and our recommendations relating to, the Family Dwelling (see Chapter). In the light of these social developments, it seems to us to be in this field also not only satisfactory but also necessary that in the case of such persons, so living together (at least if constituting what is now sometimes referred to as a "suitable union") they should be treated without ambiguity as falling within the principle stated above as the basis for those cases, and that the statute should be so drawn as to postpone their mutual claims, and so as to catch their reciprocally-provided assets, in the insolvency of either, in relation to the debts of a business carried on by either, as if they were busband and wife.

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7 Para 7, Line 4 Duncan feels that money or other estate lent for the purpose of her husband's business should be treated as assets of his estate. [I think this has been accepted.]

Trevor Traylor

T H TRAYLOR
Secretary
2 July 1981

JLRC 61ST MTG

Brief for Item 5 - 'Antecedent Transactions'

The redraft of the Chapter, "Recovery of Assets disposed of by the Debtor" is down for approval; it was sent out on 25 June together with a copy of Peter Millett's covering letter. Subsequently, Peter accepted the suggestion that a receiver should apply to the Court for an Order appointing him Administrator before attacking voidable prefs, etc, and he prepared appropriate amendments. These were sent out on 30 June.

Trevor Traylor

T H TRAYLOR
Secretary
2 July 1981

INSOLVENCY LAW REVIEW COMMITTEE

Note to Members

RECOVERY OF ASSETS DISPOSED OF BY THE DEBTOR

Enclosed is a redraft of the Chapter on Antecedent Transactions, together with a copy covering letter from Peter Millett. The previous draft was taken by the Committee at the May meeting and in Matters Arising at the June meeting. I am putting it on the agenda for the next meeting, therefore, while the matter is fresh in our minds.

2 Peter's proposal that the receiver or administrator must first obtain a Protection Order will need careful thought. I think it is clear from Part 1 of our report that a PO can only follow an Insolvency Application. We have also laid down the courses open to the Court following the making of a PO, and they do not include making a receivership.

3 Peter's difficulty appears to be primarily concerned with the necessity to stop other creditors taking proceedings for the recovery of their debts (which they can do in a receivership). I can see no problem in an administration because the Administration Order acts as a stay (see para 516 on page 184 of Part 1). Moreover, the AO is presumably the effective date for calculating antecedent periods.

4 Could we not solve the problem in a receivership by requiring the receiver to apply to the Court to be appointed administrator?

T H TRAYLOR
Secretary
25 June 1981

A copy of a letter from Peter Millett dated 23 June 1981

I enclose two copies of redraft of chapter on Recovery of Assets.

The principal new material is to be found in the following paragraphs:-

Para 13	(Fraudulent conveyances in consideration of marriage)
Paras 24-26	(Connected persons)
Para 27(i)-(ii)	(Addition of a third period)
Para 31	(Duncan McNab's £100 limit)
Paras 52-56	(Recovery of voidable preferences by a receiver or administrator)
Paras 57-63 (particularly 60-63)	(Sureties and guarantors)
Para 65 (end)	(Minority view)
Para 68	(Termination of period - see below)

With consequential changes in the summary.

I have had great difficulty with the concept of the receiver or administrator recovering voidable preferences - and am inclined to think that it is misconceived. The Accountants' Panel were concerned that a winding up order might prejudice the carrying on of the business; so they wanted to allow recovery of preferences without a winding up order (and therefore without a liquidator). But we have solved this problem by the concept of a Protection Order - which is not tantamount to a Winding Up Order. I think the problem has gone away - only shouldn't the OR (or provisional liquidator) under the Protection Order bring proceedings?

However, I have been loyal to the Committee's decision, I have, however, provided that, before proceeding, the receiver or administrator must obtain a Protection Order. This was not considered by the Committee, but is absolutely essential. We cannot have one creditor, who has been paid off, sued by the receiver for repayment, while another, who hasn't, threatening to sue for his debt!

Without a Protection Order, I think it is totally unworkable. On the basis that the receiver needs the leave of the Court anyway, and must effectively prove that the company is insolvent, the Court would be disposed to make a Protection Order anyway. So I hope that the Committee accepts this.

One effect is that one no longer needs the "appointment of the receiver" etc. in para 68. There will be a Protection Order to fix the period. (That is correct for voidable preferences - but I have left uncovered the gift or other voluntary disposition - sorry!).

One other matter. The Committee insisted on a third period, and I have tried to be loyal to that too. But aren't we overcomplicating this? We now have four points:-

/over

Unlimited .....if fraudulent

10 years .....if insolvent and to a connected person

5 years .....if insolvent and not to a connected person

1 year .....regardless of insolvency

(We could, of course, have kept the 2 years for connected persons, but at least the Committee jibbed at 5 periods!)

3 preamble

4 beg.

5 chapter

6 ss, the latter

8 language

9 thought

11 ? upon

13 unless

14 English

15 proved N.P
proposal
insolvency

p.14 ? NP after "absolute" person

p.15 add to 15

16 "settlement" absolute

p.16 exception

20(1) had.

(1A) * Guild settlor nominal

28 alone or

27(1) statutory

(iii) duty of nominal

29 crim. beg.

30 malice.
income

EEC.

33 Bankrupt

36 Bankruptcy

37 dishonesty

38 belief

39 hypothec
of guarantees.
Acts of —

40 nevertheless

43 Canada
para 15,

45 not real

46(2) refund.

47 cross → 61

47 Committee

50 fraud by,

52 caught

54 secured

56 debt

57 1913
1947

61 cross

62 against

67 retroaction

70 administrator

9 OLD SQUARE
LINCOLN'S INN
LONDON WC2A 3SR
01-405 9471

29th June, 1981

Dear Trevor,

I.L.R.C.

Recovery of Assets

Thank you for your suggestion * re: the recent bringing proceedings to recover a worldwide profarma. Quite brilliant. It meets my problem.

I have prepared the appropriate amendments to implement it — and enclose them herewith.

Yours,
Peter.

(1313)

* See Note to Members 25/6/81

T.H.T.

RECOVERY OF ASSETS

DRAFT AMENDMENTS

Para. 54 Delete whole paragraph and substitute:

54. We agree with this suggestion, which we regard as equally applicable to an Administrator (Chapter 9). It would defeat our intention to make the appointment of an Administrator an effective and satisfactory alternative to liquidation if such a power were not conferred upon an Adminstrator; and it would be undesirable for the powers of a receiver to be significantly less extensive than those of an Administrator. We regard the suggested extension of the receiver's powers as according with our wish to make the receiver more responsible to the general body of creditors (Chapter 8), and as following logically upon our proposals that unsecured creditors should participate

? §§ 444/454

in the proceeds realised by the receiver (Chapter :).

54A. At the same time, however, it will be necessary to provide safeguards to prevent proceedings being brought unnecessarily when, for example, there is a reasonable prospect that, once the debenture has been repaid, the company may prove to be solvent. It is also essential that, whenever proceedings are brought by a receiver or Administrator to set aside a voidable preference, a general stay of actions, proceedings and executions against the company should be in force. Otherwise, one creditor who had been paid his debt might find himself facing proceedings to recover the payment while another, who had not been paid, was threatening to sue for his debt. We have provided that, on the appointment of an Administrator, all actions and proceedings, and the rights of creditors to enforce security or payment or to levy executions, will be stayed to the same extent as if a Protection Order had been made (para.516); but the appointment

of a receiver does not have a similar effect. We propose, therefore, that unless a Protection Order is already in force, a receiver who wishes to bring proceedings to challenge a voidable preference must first be appointed to be an Administrator.

Para. 55. Delete first sentence and substitute:

55. Accordingly, we recommend that in future proceedings to set aside a voidable preference should be capable of being brought by an Administrator or, if a Protection Order is in force, by a receiver; but in either case only with the sanction of the Committee and after the leave of the Court has been obtained.

Para.56 Delete first sentence and substitute:

56. Where leave is granted, the Court should give directions for any money recovered in the proceedings to be paid into a designated interest-bearing account.

Para.63. Lines 1-2: Delete "trustee or liquidator"

and substitute: "claimant".

Para 69. Delete.

Para.71(10) Delete first sentence and substitute:

(10) Proceedings to set aside a voidable preference should be capable of being brought by an Administrator, or if a Protection Order in force, by a receiver; but in either case only with the sanction of the Committee and after the leave of the Court has been obtained:

Delete last sentence.

Para. 71(13) Line 1.

Delete "The trustee or liquidator" and substitute: "The Claimant"

Para. 71(18). Insert, between first and second sentence:-

Where proceedings are brought by a receiver or Administrator, then unless a Protection Order is already in force, the relevant period should be the period next before the date of his appointment.

?

Para 71(19). Delete.

DRAFT CHAPTER FOR FINAL REPORT (23-6-81)

RECOVERY OF ASSETS DISPOSED OF BY THE DEBTOR

1. General

1. Most civilised systems of law recognise the need to enable certain transactions between a debtor and other parties to be set aside in appropriate circumstances, so that assets disposed of by the debtor may be recovered and made available to meet the claims of his creditors. The Roman lawyers developed the Paulian Action for this purpose, and in modern though essentially unaltered form the remedy it provided remains available to this day in those countries whose legal systems are derived from the Civil Law. The Paulian Action has never been introduced into England, and no comparable form of action has ever been developed by the Common Law; but analogous remedies have been provided by Statute and have formed part of the law of England since the

Sixteenth Century.

2. As in other countries, the remedies provided by Statute fall into two categories. Those in the first category form part of the general law, and may be invoked whether or not the debtor has become insolvent. Those in the second form part of the law of insolvency, and may be invoked only after the debtor has first been declared to be insolvent.

3. The principal remedy in the first category is that provided by Section 172 of the Law of Property Act, 1925, which replaced Section 5 of the Statute of Fraudulent Conveyances of 1584, usually referred to simply as "the Statute of Elizabeth". This enables the Court to set aside a disposal by the debtor of his property made with intent to defraud his creditors. There is no time limit within which proceedings must be brought to set aside the disposition. Since the remedy is provided by the general law, and does not form part of the insolvency code, it is not necessary that the debtor should first be declared to be insolvent. It might, therefore, be thought

to lie outside our terms of reference; but we are satisfied that this is not the case, for two main reasons. In the first place, the Section may not be invoked by the debtor himself, who cannot be heard to allege his own fraudulent intent or challenge the validity of his own acts, nor by any assignee of the debtor, who remains bound by the transaction as fully and effectually as the debtor; but only by a creditor or, after insolvency proceedings have been taken, by the general body of creditors acting through a trustee or liquidator. In the second place, resort to the Section is normally unnecessary unless the debtor is unable to pay his debts without recourse to the property disposed of, so that the remedy is seldom if ever invoked unless the debtor has in fact became insolvent, even if (perhaps because he died before insolvency proceedings could be brought) he has never been legally declared to be so. For these reasons, we conclude that the remedy provided by the Section must be regarded as one of the remedies which are available to the creditors of an insolvent debtor, and ought

properly to be taken into consideration in any comprehensive review of the law of insolvency. We shall deal with this subject in Section 2 of this Chapter and make proposals for reform.

4. Several different statutory provisions fall within the second category. From the earliest introduction of a bankruptcy code in England in 1602 and in Scotland in 1623 - it has been found necessary to provide for the setting aside of certain transactions between the debtor, later made bankrupt, and other parties in the period preceding his bankruptcy. There are two types of case. In one the transaction is one in which the initiative is taken by the creditor who, foreseeing the probable insolvency of his debtor, takes active steps to recover the debt or otherwise improve his own position in that event. In the other, the initiative is taken by the debtor himself who, in contemplation of his own imminent insolvency, seeks to preserve his assets for the benefit of his family and friends or favoured creditors.

5. Cases where the initiative is taken by the creditor are dealt with by various statutory provisions which enable (i) mortgages and charges created over the insolvent's property to be set aside in certain circumstances; (ii) the assignment by a trader of his existing and future book debts to be set aside in the absence of registration; and (iii) incomplete executions over the insolvent's property to be ineffective in an insolvency. The issue raised in such cases is whether, and to what extent, the diligent creditor who takes steps to protect his own position should be permitted to retain the fruits of his diligence, or whether his attempts to gain priority in the event of an insolvency should be frustrated. We deal with these cases elsewhere (Chapter). In the present Chapter, we shall be concerned with transactions voluntarily initiated by the debtor himself. Such cases fall into two classes:-

(i) The disposal of assets by the debtor by way of gift or other voluntary disposition,

including any disposition for less than full consideration, even when there is no intent on the part of the debtor to defraud freditors. We shall deal with this type of case in Section 3 of this Chapter;

and

(ii) the preferring of one creditor (or more than one) by paying to him the whole or part of his debt, or otherwise treating him more favourably than other creditors of like degree, for example by providing security or further security for an existing debt, or by returning goods which have been delivered but not paid for, to the detriment of the general body of creditors. We shall deal with this type of case in Section 4 of this Chapter.

6. The statutory provisions dealing with such transactions are directed at an altogether different objective from that at which Section

172 of the Law of Property Act, 1925, and the Statute of Elizabeth I which preceded it, were directed. The latter They were designed to protect creditors from fraud; the bankruptcy code, on the other hand, is directed towards achieving a pari passu distribution of the bankrupt's estate among his creditors. The justification for setting aside a disposition of the bankrupt's assets made shortly before his bankruptcy is that, by depleting his estate, it unfairly prejudices his creditors; and even where the disposition is in satisfaction of a debt lawfully owing by the bankrupt, by altering the distribution of his estate it makes a pari passu distribution among all the creditors impossible.

2. Fraudulent conveyances

7. Section 172(1) of the Law of Property Act, 1925 provides:-

"Save as provided in this Section, every conveyance of property...with intent

to defraud creditors, shall be voidable, at the instance of any person thereby prejudiced".

The Section applies to gifts and other voluntary dispositions as well as to other transactions made with the requisite intent to defraud creditors.

8. Despite the use of the word "conveyance", it has been held that the Section applies to any disposition of property, whether effected by an instrument in writing or not. Doubts have, however, been expressed whether this is correct, and whether, even if it is correct, the language of the Section is apt to include the mere payment of money.

9. The Section does not render a transaction voidable unless there is an intent to defraud creditors. Unfortunately, it is not entirely clear what is the meaning of "to defraud" in this context; though it seems that, in practice, the requisite inference of fraud

will be drawn whenever the necessary consequences of the transaction is to defeat, hinder, delay or defraud the creditors or to put assets belonging to the debtor beyond their reach. Where the requisite intention is proved or inferred, any person prejudiced may have the transaction set aside, whether or not there was any intention of defrauding that person.

10. As has already been pointed out, there is no time limit in which proceedings must be brought to have the transaction set aside, and it is not necessary that the debtor shall have first been made bankrupt. The remedy is therefore available where the debtor, though insolvent, has died without having been adjudicated bankrupt, and whether or not his estate is being administered in bankruptcy.

11. Section 172(3) of the Law of Property Act, 1925 provides:

"This section shall not extend to any estate or interest in property conveyed for valuable consideration and in good faith or upon good consideration and in good faith to any person not having, at the time of the conveyance, notice of the intent to defraud creditors".

12. The sub-section is not happily drawn, and the relationship between the requirements of the two sub-sections is obscure. In particular it is difficult in the context to give any logical meaning to "good", as distinguished from "valuable", consideration. We recommend that the Section be repealed and re-enacted in an amended form so that it is made clear:-

(i) that the Section applies to the mere payment of money, as well as to any disposition of property whether effected by an instrument in writing or not;

(ii) that the necessary intent is an intent

on the part of the debtor to defeat, hinder, delay or defraud creditors, or to put assets belonging to the debtor beyond their reach, and that such intent may be inferred whenever this is the natural and probable consequence of the debtor's actions, in the light of the financial circumstances of the debtor at the time, as known, or taken to have been known, to him;

(iii) that the Section applies to any disposition made with the necessary intent, even if supported by valuable consideration, where that does not consist of full consideration in money or money's worth received by the debtor; but

(iv) that no disposition may be set aside if made in favour of a bona fide purchaser for money or money's worth without notice, at the time of the disposition, of the debtor's fraudulent intent.

in law

13. Marriage constitutes "valuable consideration" but not "money or money's worth". One result of our proposals, therefore, is that in future fraudulent dispositions made in consideration of marriage will be liable to be set aside without proof of notice on the part of the other party to the marriage of the debtor's fraudulent intent. Such transactions are extremely rare. In modern social conditions we consider it appropriate to treat dispositions in consideration of marriage as gifts rather than as commercial bargains and, where fraud is present, just and equitable to prefer the debtor's unpaid creditors to his innocent spouse.

14. It has long been an established principle of English law that a man is entitled to discharge his liabilities in any order he pleases. He is entitled to pay a debt which is lawfully due even if he is, and knows himself to be, insolvent, so that the result of paying one creditor must be that others will go unpaid. While steps can be taken by the creditors to recover such payments under the bankruptcy code, by having

the debtor declared bankrupt, they cannot be challenged under the general law. The payment of a debt lawfully due cannot, in the absence of exceptional circumstances, be brought within Section 172, even though made with the deliberate intent to prefer one creditor over another, or to defeat particular creditors.

15. We have carefully considered whether this rule, which was established in the Nineteenth Century, should now be changed. We have come to the conclusion that it should not. It is not fraudulent, though it may be unfair, to prefer one creditor to another; in certain circumstances it may not even be deserving of moral censure. We are firmly of the view that a remedy designed to protect creditors from dishonesty should not be capable of being invoked where dishonesty is not provided to be present. Moreover, any change would have far-reaching consequences of a kind which we would find unacceptable. It would mean that a debtor who had good reasons to suppose that his liabilities exceeded

his assets must suspend payment to all his creditors, or risk a charge of dishonesty. It would introduce into our law of insolvency a notional "cessation of payments", that is to ~~say~~ say, a date after which all transactions by the debtor became impeachable, or re-introduce in an unacceptably vague form the concept of the act of bankruptcy which we propose to abolish. In our view, the vice of the payment which prefers one creditor to another is not that it defeats or defrauds the creditors who remain unpaid, but that it militates against a pari passu distribution in bankruptcy. The right to recover payments so made is, therefore, in our view properly regarded as an integral part of the insolvency code and ought not to be capable of being invoked outside it. Those cases where considerations of fairness require that repayment be made, but where for one reason or another recovery cannot be obtained under the present insolvency code, should be dealt with by amending the relevant provisions of the insolvency code, and not by extending the

ambit of the present law as enacted in Section 172 of the Law of Property Act, 1925, and as proposed by the Bill in substance retained.

3. Gifts and other voluntary dispositions

(1) The present law.

16. Section 42 of the Bankruptcy Act, 1914, provides that, with three exceptions, any "settlement" of property shall be void against the settlor's trustee in bankruptcy:-

(i) If the settlor commits an available act of bankruptcy within two years after the date of the settlement; or

(ii) if the settlor commits an available act of bankruptcy within ten years after the date of the settlement, unless the parties claiming under the settlement can prove that the settlor was, at the time of making the settlement, able to pay all his debts without the aid of the property comprised in the settlement, and that the interest of the settlor in such

property passed to the trustee of the settlement upon its execution.

The three exceptions are:-

(i) a settlement made before and in consideration of marriage:

(ii) a settlement made in favour of a purchaser or incumbrancer in good faith and for valuable consideration;

(iii) a settlement made on or for the wife or children of the settlor of property which has accrued to the settlor in right of his wife. (This category must now be considered as obsolete)

17. Settlements caught by the Section are declared to be void, but this has been construed as meaning voidable. Third parties who acquire title for valuable consideration and in good faith, without notice of any intention on the part of the settlor to defeat creditors, are thus protected.

18. The Section defines "settlement" as including any conveyance or transfer of property, and defines "property" as including money. If, however, a payment of money is to be a settlement within the Section, it must have been settled as property. An out-and-out gift of money, not hedged about with conditions that it should be invested and kept in a certain way, is not a settlement within the Section. A substantial gift of money, intended to be retained by the donee as capital, will, however, normally be regarded as a settlement. Thus, where the debtor gives his daughter a substantial sum as the down payment on a house, or his son a substantial sum to set him him up in business, this will be regarded as within the Section.

19. The general principle which underlies the Section is that "persons must be just before they are generous: debts must be paid before gifts can be made". The Section was intended to prevent assets from being put in the hands

19A criminal bankruptcy. 4. para 29.

of the debtor's family or associates in order to preserve them from the claims of creditors.

(2) Defects in the present law

20. The defects of the present law may be summarised as follows:-

(i) Out-and-out gifts of money are outside the Section altogether. In order to set aside such a gift, resort may have to be made to the fiction that it constituted a settlement, there being an implied intention that the subject-matter of the gift be preserved as capital.

(ii) Dispositions for a merely nominal consideration are caught by the Section, but otherwise all dispositions for valuable consideration are outside the Section, even where the consideration represents a gross undervalue.

(iii) No transaction may be impeached under the Section where the debtor died before

a bankruptcy petition had been presented
~~being adjudicated bankrupt.~~ against him

(iv) The language of the Section is archaic, and, apart from referring to "settlements", and "settlor", presupposes in most purposes that the debtor is a man. Thus, the Section refers to a "settlement made on or for the wife or children of the settlor".

21. To some extent these deficiencies of the present law are mitigated by the fact that, in many cases where a transaction cannot be challenged under Section 42, it can be successfully challenged as a fraudulent conveyance under Section 172 of the Law of Property Act, 1925.

(3) One suggestion for reform: "pooling" spouses' assets

22. We have received numerous complaints that property is often unavailable to creditors in a bankruptcy because it is held in the name of the bankrupt's wife, or because the

business which is in reality the business of the bankrupt is carried on in his wife's name. One solution which has been proposed to us is that when a person is made bankrupt all the assets of his spouse should be pooled with his own and made available to meet the creditors' claims.

23. We reject this proposal as an unjustified interference with individual property rights, which would produce an unfair result in many cases, and which in many respects would be a reversion to outmoded concepts of matrimonial property which have long since been abandoned. If the proposal were adopted, elementary notions of fairness would require that the wife's own property, not derived directly or indirectly from the debtor, should be exempt. This would not only lead in many case to an uncertain and unsatisfactory inquiry, but would in effect reintroduce the Victorian concept of "the wife's separate property" which was abandoned almost a century ago. We regard the proposal as entirely out of

line with modern attitudes to the proprietary rights of husband and wife.

(4) Our preferred solution: "connected persons".

24. This is not, however, to say that husband and wife, or persons living together as man and wife, or other closely connected persons, should be treated in all respects as if they were unrelated parties dealing with each other at arms' length. Special relationships call for special provision to be made. In this Chapter we shall include a number of proposals designed to make it easier for assets to be recovered from persons and companies which are closely connected with the debtor; and elsewhere (see Chapters -) we shall recommend that, in certain circumstances, loans and advances made to the debtor by such persons should be subordinated to the claims of the debtor's other creditors. We believe that these proposals will meet most of the criticisms of the present law in this regard which we have received.

25. If these proposals are adopted, it will be necessary for a comprehensive definition to be included in the Insolvency Act of the cases in which persons should be regarded as closely connected with each other. This has been done in the Canadian Insolvency Bill, which we regard as setting a suitable precedent.

26. We consider that, as in the Canadian Bill, individuals should be treated as connected:-

(a) where one is married to the other;

(b) where, being of opposite sexes, they live together as man and wife;

(c) where one is connected with the other by blood relationship, illegitimate relationship, affinity or adoption (including de facto adoption),

(i) in direct line or

(ii) in collateral line to the degree existing between brothers and sisters,

whether they have the same parents or or only one common parent.

We also consider that companies which are members of the same group, or which have substantially common directors or shareholders, should be treated as connected with each other; and that directors and substantial shareholders of a company should be treated as connected with the company. For this purpose, a person should be regarded of a substantial shareholder of a company if he, alone or together with persons connected with him, controls the composition of its board of directors or holds more than half in nominal value of its equity share capital.

(5) Our proposals for reform

27. We propose that Section 42 be repealed and replaced by an entirely new Section, drafted in modern language, applicable equally whether the debtor is a man or a woman, and referring, not to "settlements of property", but to "gifts or other voluntary dispositions of money or property".

We also recommend:-

(i) that, except where the gift or other disposition was made in favour of a person connected with the debtor, the existing period of ten years should be reduced to five years;

(ii) that the existing period of two years should (in every case) be reduced to one year;

(iii) that where the debtor has died before the making of a Protection Order and his estate is being administered as an insolvent estate, the Section should apply as if a Protection Order had been made in respect of the deceased immediately before his death; and

(iv) that the Section should apply (a) to dispositions at a nominal consideration and (b) to dispositions not at arms' length at a conspicuous undervalue.

28. We consider that it should be a question of fact in every case whether persons not connected with each other were, at a particular time, dealing

with each other at arms' length, but that connected persons should be conclusively presumed not to be dealing with each other at arms' length. This is the approach adopted in Canada, which we consider fully justified.

29. We do not consider it appropriate that transactions even betweeen connected persons should be liable to be set aside merely becuase they were at an undervalue, unless the undervalue was significant. To this extent we do not favour the approach adopted in criminal bankruptcy. We have deliberately chosen the phrase "conspicuous undervalue", which we prefer to "gross undervalue". Where persons not connected with the debtor deal with him at arms' length, transactions should be upheld, even if at a conspicuous undervalue. Otherwise, bargain-hunters and buyers at "closing down" sales would be unjustifiably put at risk.

see Chapter ... in Appendix ... & para 65, post

30. The abandonment of the concept of settlement, and the extension of the Section to out and out gifts, makes it necessary to exempt small transactions

Why only gain of income?

and gifts made out of ordinary income. We accordingly recommend that there be excluded small gifts and other dispositions made in the ordinary course of the debtor's affairs and not abnormal in the circumstances of the debtor at the time. The original draft of ~~Article 4(A)(1) of~~ the proposed Uniform Law, Annex I to the EEC draft Bankruptcy Convention, used this language in Article 4(A)(1) to exempt small gifts, and we consider it to provide a useful model. ~~be appropriate.~~

31. It is the opinion of one member of the Committee that an upper limit to this exemption of £100 for any one gift should be prescribed, in order to avoid disputes as to the meaning of "small" and reduce the risk of inconsistency in the treatment of different debtors. The rest of the Committee consider it unnecessary and undesirable for any upper limit to be prescribed, taking the view that a fair appraisal of the circumstances of the particular debtor as at the date of each gift which is in question, is to be preferred to the laying down of an arbitrary norm, which in any event would need to be "indexated", as under the ~~Act of~~ Insolvency Act, 1976.

32. It has been represented to us that any new statutory provision should apply to corporate debtors as well as individuals. We are not

convinced of the need for this, since in almost every case a transaction liable to be challenged under these provisions would, in the case of a body corporate, be ultra vires and void as against the liquidator, as well as constituting a probable misfeasance on the part of the directors responsible. However, such an extension of the Section might in occasional circumstances prove useful to a liquidator seeking to challenge transactions between companies in the same group, and accordingly we recommend the adoption of this proposal.

33. It has been represented to us that, in one situation, the prescribed periods are too short. This is where a director of an insolvent company misappropriates assets of the company or is guilty of other fraudulent conduct towards the company. If he is subsequently charged with a criminal offence, civil proceedings by the liquidator are likely to be delayed for many years. If judgment is ultimately recovered and the director made bankrupt, any disposition by the director in favour of his wife ~~and~~ or family

is likely to have been made many years before his own bankruptcy, and well outside any relevant statutory period. Accordingly it has been suggested to us that, in such cases, the relevant periods should be those before the liquidation of the company, together with the whole of the period between that date and the bankruptcy of the individual director.

34. We have some sympathy for this view, but consider that there are formidable objections to the proposal. The extended period would presumably be available only where the liquidator of the company was among the creditors proving in the bankruptcy of the director, and then only when fraud was alleged. This would have serious disadantages. If the assets recovered in the bankruptcy in reliance on the extended period were held for the benefit of the general body of creditors, they would gain a fortuitous advantage from the presence among them of the liquidator; while if the assets recovered were held solely for the benefit of the liquidator, this would lead to unfortunate disputes among the creditors as to

whether or not the assets could have been recovered (for example, by relying on Section 172), without reliance on the extended period.

35. We are, therefore unable to support what is, at first sight, an attractive proposal. We are persuaded that in most cases any disposition by a fraudulent director, made in contemplation of proceedings against him by the liquidator, would be liable to be set aside, without limit of time, as a fraudulent conveyance.

4. Fraudulent preferences

(1) General

36. As has already been pointed out, the payment of a debt lawfully due, even if made by a debtor in contemplation of his impending bankruptcy, and with the deliberate intention of preferring the creditor to whom the payment is made over his other creditors, is neither illegal nor fraudulent. Where, however, the expected bankruptcy supervenes shortly afterwards

such a payment has the effect of preventing the proper distribution of the bankrupt's estate pari passu among the creditors. It was, therefore, natural that, even in the absence of any provision to this effect made by statute, the judges of the Bankruptcy Courts should have evolved a doctrine by which such payments could be recovered by the trustee for the benefit of the general body of creditors. The doctrine which they developed, and which was later given statutory form, was concerned with what has become generally known as "fraudulent preference".

37. Since the Act of 1883, it has been irrelevant whether or not the creditor alleged to have been "fraudulently preferred" knew or suspected that this was the case; so that the element of fraud, if present at all, refers exclusively to the state of mind of the debtor himself or, in the case of an insolvent company, to the state of mind of those of its directors who made the relevant decision to "prefer" the creditor in question. Even in relation to their state of mind, however,

the word "fraudulent" is inappropriate. In some cases there can undoubtedly be seen to have been an element of conscious and unfair discrimination between creditors "having about it a taint, and in extreme cases, much more than a taint, of dishonesty", (per Lord Greene M.R., in Re: Kushler Ltd., (1943) Ch. 248.) In many cases, however, transactions designed to prefer particular creditors have been inspired by motives which, according to ordinary notions, would not be thought to be deserving of moral censure.

38. In our view the word "fraudulent" in this context is inaccurate and misleading, and we are satisfied that its use has unfortunate consequences. We believe that many creditors who have been unfairly preferred, and who would otherwise readily agree to repay moneys paid to them shortly before the bankruptcy, may be reluctant to do so when what they mistakenly suppose to be a charge of fraud against themselves is involved. We recommend that in future the word "fraudulent" should no longer be used in this context, and that it should be replaced by the word "voidable".

39. The doctrine appears to have been first formulated by Lord Mansfield C.J. in the year 1768. Although the doctrine was judge made and had no basis in statute law, by the year 1862 it had come to be regarded as sufficiently well established and defined to permit its importation wholesale into the code for the winding up of insolvent companies which was established by the Companies Act of that year. Section 164 of that Act applied to the winding up of such companies the law "as to undue or fraudulent preferences" then applicable in bankruptcy. In the 1869 Act, however, the first statutory definition of such preferences was attempted, and this definition (except as to (i) the period in respect of which such preferences might be attacked, (ii) the protection accorded to a creditor acting in good faith, and (iii) the preferring of ~~guarantees,~~ sureties or guarantors) has remained the law, both in bankruptcy and winding up, down to the present day. In its present form, the law is enacted in Section 44 of the ~~Bankruptcy~~ Act of 1914, as amended by Section 115(3) of the Companies Act, 1947, (unrepealed), and for

the purposes of insolvent winding up is imported verbatim into section 320 of the ~~1948~~ Act of 1948.

(2) The intention to prefer

40. Prior to the 1869 Act, it was sufficient, to justify the recovery of money paid or property transferred as a fraudulent preference, for the trustee to establish that the payment or transfer was made to the creditor by the debtor (i) voluntarily, i.e. not in the ordinary course of business and without any pressure or demand on the part of the creditor, and (ii) in contemplation of bankruptcy, i.e. knowing his circumstances to be such that bankruptcy would be the probable result, though it might not be the inevitable result. The 1869 Act, however, introduced for the first time, as a prerequisite for establishing a voidable preference, proof that the payment or transfer was made "with a view of giving the creditor a preference over the other creditors". This was probably not intended to represent a departure from the law as previously established by the Bankruptcy Courts. Nevertheless, Since 1869 the critical question in determining whether a payment by a debtor to a creditor constitutes

a voidable preference has been whether the debtor made the payment with the dominant intention of preferring the creditor. The burden of establishing the presence of the necessary intention is on the trustee or liquidator.

41. There is no doubt that this gives rise to a difficult and unsatisfactory inquiry. It has been represented to us that the present law makes it too difficult for recovery to be obtained in any but the clearest cases, largely because of the difficulty in discharging the burden of proving that the debtor, or in the case of a corporate debtor, its directors, had the necessary intention, and that such intention was paramount. Various proposals have been put forward to remedy this, including (i) reversing the burden of proof, and (ii) introducing a short period of "absolute recovery".

42. In Australia, a more radical solution has been adopted, by dispensing altogether with the need to establish an intention to prefer.

Under Section 122 of the Bankruptcy Act 1963, enacted in consequence of the Clyne Report, the test is no longer whether the debtor made the payment with a view to giving a preference to the creditor, but whether the payment had the effect of giving a preference to the creditor. Of course, such a test could not be adopted without qualification, for every payment by an insolvent debtor to one creditor must, in the absence of pari passu payment to all, have the effect of preferring the creditor who has the good fortune to receive it. Accordingly, Section 122(2) of the Australian Act excludes any payment to a creditor who can prove that the payment was made in good faith and in the ordinary course of business; and Section 122(4) of the Act provides that the payment should not be regarded as being made in good faith if the creditor who received the payment knew or had reason to suspect (i) that the debtor was unable to pay his debts as they became due from his own money and (ii) that the effect of the payment would be to give him a preference, priority or advantage over other creditors.

343. We have given long and anxious consideration

to the question whether to recommend dispensing altogether with the need to establish an intention to prefer, and adopting a test similar to that adopted in Australia. We have found this a difficult question. We have observed that, whereas the requirement of proving an intention to prefer has never formed part of the law in the United States of America, in Canada the Senate, which has been examining proposals to reform and modernise the law of insolvency, proposes to retain it in the Canadian Insolvency Bill. Our own Committee has been divided. A minority would dispense with the requirement, and indeed see no reason why pressure for payment on the part of the creditor, which even before 1869 prevented the payment from being recoverable, should continue to afford the creditor a defence.

see § 25

44. The advantage of the Australian solution is that it dispenses with a difficult and unsatisfactory inquiry; its disadvantage is that it obscures what in the view of the majority of the Committee is the true principle on which such payments ought to be recoverable. It is one thing for the law to permit the recovery of payments made by the debtor to his own family or associates in order to save them

at least from his own impending ruin. It is quite another to permit recovery of all payments made after the debtor has become insolvent, excepting only the creditor who had no reason to suspect that the debtor was insolvent. The only justification for the latter course must be on the footing that, once the debtor has in fact become insolvent, whether or not he knows it, he ought to be treated as if he had suspended payments at once. It introduces, for the purpose of identifying the insolvent's estate, a notional cessation of payments earlier than the commencement of the insolvency, a ~~fiction~~ which we have already expressed our opposition at paragraph 15.

45. It should be observed that, whichever test is adopted, payments made in the ordinary course of business and without pressure on the part of the creditor would continue to be irrecoverable. The principal difference between the two tests lies in their approach to the creditor who, suspecting that the debtor is or may be insolvent, brings pressure to obtain payment. Such payments have never been recoverable in England; before 1869, because they were not "voluntary", and after 1869, because, unless the pressure was not real but collusive, it negatived

any intention on the part of the debtor to prefer.

46. The majority of the Committee have therefore reached the conclusion that the requirement of an intention to prefer should be retained, and that genuine pressure by the creditor should continue to afford a defence. Their reasons for reaching this conclusion are as follows:

(1) The law should not lightly permit the recovery of payments made in discharge of lawful debts properly due when the payment was made, particularly since the creditor may well have used the money to pay his own creditors. Such payments should be recoverable only if really improper.

(2) The creditor who is active to obtain payment of his own debt ought in principle to be allowed to retain the fruits of his diligence. He ought not to be made to ~~return~~ refund them for the benefit of others who were less diligent.

(3) Creditors who delay taking steps to obtain

payment of their own debts, whether by commencing insolvency proceedings or otherwise, take the obvious risk that the debtor will pay other creditors in the ordinary course of business or in response to commercial pressure. But there is no reason why they should expose themselves to the risk that he will put his own family and associates first, or discriminate between his creditors on any but normal commercial principles.

(4) The proposed change would introduce into the law of insolvency a notional "cessation of payments", and would be inconsistent with our approach to the commencement of insolvency proceedings, and in particular with our proposals to abolish the concept of the act of bankruptcy.

47. The whole Committee, however, is satisfied that, in the present state of the law, the task which faces the trustee or liquidator is too difficult, and that in consequence many payments

which ought in fairness to be recovered are not challenged. We believe that the best solution to this problem is to reverse the burden of proof, at least in those cases where the debtor and creditor were not at arms' length. Accordingly, we recommend that, in the case of any payment or transfer to ~~for~~ for the benefit of~~:~~ a creditor who is not at arms' length, the payment or transfer shall be presumed to have been made with a view to giving the creditor a preference, unless the creditor proves that the payment or transfer was made in the normal course of affairs of the debtor in relation to the creditor. It should be a question of fact in every case whether persons not closely connected with each other were, at the particular time, dealing with each other at arms' length; but once again we propose that connected persons (see paragraph 26 :) should be conclusively presumed not to be dealing with each other at arms' length.

What amount counts, see para 61

(3) The relevant period for the avoidance of preferences

48. Under the existing law, transactions may be set aside only if effected within the period of

six months preceding the relevant date, that is to say, the presentation either of the bankruptcy petition or the compulsory winding up petition, or the passage of the resolution for creditors' voluntary winding up. This period had originally been fixed by the 1869 Act at three months; before that Act, the retrospective period was unlimited. The increase to six months was introduced by Section 115(3) of the Companies Act, 1947 (still unrepealed) and applicable to both bankruptcy and winding up).

49. We have considered whether the current period of six months should be lengthened, shortened, or maintained at its present duration. We have come to the conclusion that it would not be realistic to shorten it. On the whole, and with the exception referred to below, we do not think that it would be just or convenient to lengthen the period. Insofar as the validity of the transaction will depend upon contemporaneous evidence of the parties' acts and the states of their respective affairs at the relevant time, too long a period could in our opinion work injustice.

50. We are, however, concerned at one particular situation which occurs from time to time and which in our view calls for a remedy. A trading subsidiary of a parent company becomes hopelessly insolvent. The directors of the parent company take no steps to put the subsidiary into liquidation. Instead, they take steps to secure the repayment of all inter-company balances owed by the subsidiary to the parent company and other companies in the group. They then do everything necessary to keep the creditors at bay, in the hope that the six months period will elapse before any of them presents a petition. Of course, in such a case the directors both of the parent company and of the subsidiary might expose themselves to charges of "fraudulent trading" and even more so,

To charges of "wrongful trading", a proposed new category of misconduct which we discuss in chapter (B).

51. In our view, the most appropriate solution would be to lengthen the statutory period in such cases. We would not favour a general lengthening of the period in all cases where the parties were not at arms' length, as has been proposed in Canada, but would confine the longer period to cases where the parties were members of the same group of companies and similar cases. We have considered dispensing with any time limit in cases where it could be proved that the directors had refrained from putting

the subsidiary into liquidation, or from taking steps to inform the creditors of the position, as part of a deliberate scheme to postpone the commencement of the winding up until the lapse of time had made recovery proceedings impossible. On the whole, we would prefer a simpler solution. We recommend that, where the creditor and debtor were members of the same group of companies, or shared substantially common directors or shareholders, or consisted of a company and one or more of its directors, the relevant period should be two years.

(4) Recovery by a Receiver or Administrator.

52. Under the present law, proceedings to set aside a voidable preference may be brought only by a liquidator or trustee in bankruptcy, and not by a receiver appointed under a floating charge. Money ~~recovered~~ or property which is recovered by the liquidator in respect of a voidable preference is ~~used~~ held for the benefit of the general body of creditors, and is not ~~covered~~ caught by the floating charge.

53. The second of these two rules follows inevitably from the essential characteristic of a floating charge. Until it crystallises, the company is free to carry on its business and apply its money in payment of debts due to unsecured creditors. The charge does not extend to money so applied. It has, however, been represented to us that the first of these rules is unfortunate, and occasionally operates to the detriment of the unsecured creditors. It has been suggested to us that a receiver should, in appropriate circumstances, have power to bring proceedings to set aside a voidable preference, at the expense and for the benefit of the unsecured creditors.

new 54
54A

54. We agree with this suggestion, which is consistent with our wish to make the receiver responsible, not only to the secured creditor who appointed him, but also to the general body of creditors (Chapter 8); and with our recommendation that unsecured creditors should participate in the proceeds realised by the receiver (Chapter :) At the same time, however, it will be necessary to provide safeguards to prevent proceedings

being brought unnecessarily when, for example, there is a reasonable prospect that, once the debenture has been repaid, the company may prove to be solvent.

55. Accordingly, we recommend that in future proceedings to set aside a voidable preference should be capable of being brought by a receiver or Administrator, but only with the sanction of the Committee and after having obtained the leave of the Court. The Court should not grant leave unless satisfied that the company is insolvent, and that it is expedient that the proceedings be brought by the applicant. The party against whom it is proposed to bring the proceedings should be given notice of the application, and should have the right to appear and oppose the granting of leave.

New first sentence

56. Where leave is granted, the Court should at the same time automatically make a Protection Order, unless one is already in force, and give directions for any money recovered in the proceedings to be paid into a designated interest-bearing account. The distribution of the money

New first sentence

should remain under the control of the Court. If the company should unexpectedly turn out to be solvent, the money should be repaid to the party from whom it was recovered, together with all interest earned on the account. The costs of unsuccessful proceedings should, unless the Court otherwise ordered, be a charge against the proportion of the receiver's realisations held for unsecured creditors (Chapter .).

(5) Sureties and guarantors

57. Prior to 1913, it was established that a payment to a creditor with a view, not to preferring the creditor, but to releasing a surety or guarantor for him, could not be set aside. This was altered by the 1913 ~~Act~~. It remains the law, however, that even in this situation repayment can be obtained only from the creditor to whom the payment has been made. It cannot be obtained directly from the surety or guarantor. Before 1947, the surety or guarantor could not even be

made a party to the proceedings. ~~The~~ Act ~~of~~ 1947, however, ~~provided for~~ permitted the surety or guarantor to be joined by a third party, so that all questions between the trustee or liquidator, the creditor, and the surety or guarantor could be determined in the same proceedings.

58. This procedural reform, however, has done little to remedy the defects in the present law. In many cases, following receipt of the payment later sought to be set aside, the creditor (as he will often be obliged to do) will have released the guarantee and returned to the guarantor any securities therefor. Even if the guarantee remains in force, and is adequately secured, so that it is plain to see that, if the preference is set aside, the liability to make repayment will ultimately fall upon the guarantor, the creditor is a necessary party to the proceedings, even though he has no financial interest in their outcome.

59. It has been urged upon us that any criticism of the present law is misplaced, since it is open to a creditor who takes a guarantee to

stipulate that the guarantor should remain liable if payment by the principal debtor is set aside as a preference. This practice has been followed by some of the clearing banks for many years. We do not think that this is an answer to the criticism of the present law. In the first place, not all guaranteed debts are owed to clearing banks; in the second, if the provision is founded on fairness and equity, it ought to be provided by the general law, and not left only to those cases in which the parties are expertly advised.

60. In our view, justice and logic alike require that, wherever possible, the burden of repayment should ultimately be borne by the party intended to be preferred. If so, then it should be possible to proceed directly against him, without being obliged to join the creditor at all. If, on the other hand, it is decided to proceed against the creditor, then it must be recognised that the surety or guarantor is a necessary party.

61. Accordingly, we recommend three changes. First, we propose that where the payment or transfer was made with a view to obtaining the release of a guarantor or surety in whole or part, the transaction should be treated as a preference given to the guarantor or surety as well as to the creditor, and the guarantor or surety should be treated as a creditor who has received a benefit to the extent to which he has been or is liable to be released. Where the guarantor or surety and the debtor were "connected persons" (see paragraph 26 :), the burden will lie upon the guarantor or surety to negative the existence of an intention to prefer.

62. Secondly, we propose that where a payment or transfer to a creditor has been set aside as a voidable preference, the creditor should, on repayment to the trustee or liquidator, have the same remedies against the surety or guarantor, and against any property securing the guarantee, as he would have had if the debtor had not made

the payment to the creditor. No proceedings should, however, be capable of being brought to enforce any security against property, where this would prejudice a bona fide purchaser of the property or of some interest therein without notice of the facts alleged to constitute a preference. In these circumstances, only the personal remedy will lie.

63. Thirdly, we propose that the [trustee or liquidator] (the claimant) should be able to proceed at his option either (i) directly against the guarantor or surety, without joining the creditor; or (ii) against the creditor, joining the guarantor or surety unless the creditor waives this requirement. In many cases it will be fairly easy to decide which course to pursue. If the wrong course is taken and costs are incurred without good reason, the Court will have a wide discretion to order the costs to be paid by the offending party.

(6) Administration of the estates of deceased insolvents

64. Under the existing law, no claim to set aside

a voidable preference may be brought if the debtor has died without first having been adjudicated bankrupt. We consider that this rule should be changed. We recommend that, where the debtor has died before the making of a Protection Order and his estate is being administered as an insolvent estate, proceedings to set aside any voidable preference given by him during his lifetime should be capable of being brought in like manner as if a Protection Order in respect of the deceased had been made on the same day as but immediately before his death.

5. Proposals common to more than one remedy.

(1) Powers of the Court

65. We consider that, when a claim is made to set aside a gift or other voluntary disposition, or a voidable preference, the Court should have a discretion in appropriate circumstances to refuse recovery in whole or part. We recommend the adoption of a provision on the lines of Section 58(6) of the Insolvency Act 1967 of New Zealand. Under such a provision, the

Court should refuse recovery in whole or part if:

(a) the person from whom recovery is sought received the money or property in good faith and has altered his position in the reasonably held belief that the payment or transfer to him was validly made and was not liable to be set aside; and

(b) in the opinion of the Court it would be unjust to order recovery or recovery in full, as the case may be.

A minority of the Committee would extend this provision to proceedings to set aside a fraudulent conveyance.

66. We also recommend that there should be spelt out in the legislation the consequential powers of the Court whenever any transaction is set aside, whether in whole or in part, and whether as a fraudulent conveyance, gift or other voluntary disposition, or voidable preference. This has

been done in New Zealand and is proposed in Canada. We consider that such provision would be particularly useful in cases where guarantors or sureties were involved, or where a transaction at an undervalue was sought to be set aside.

(2) The prescribed periods.

67. The prescribed periods for setting aside voidable preferences terminate at present on the presentation of a petition, or in the case of a voluntary winding up the passage of the resolution for winding up, and therefore leave uncovered the period which must ensue before the receiving order or winding up order is made or the resolution passed. This gap is filled in bankruptcy by the relation back of the trustee's title to the act of bankruptcy on which the petition was founded or the earliest of any other acts of bankruptcy within the preceding 3 months, and in a winding up by the Court, by the provisions of Sections 227 and 229 of the Act of 1948. The retroactive periods for avoiding settlements by a bankrupt (terminate only commence) at the relation back date. The abolition of

the concepts of acts of bankruptcy and relation-back which we propose makes it necessary to reconsider the date on which the prescribed retroactive periods should terminate? commence

68. We propose that, in future, the relevant period should be the period next before the making of the Protection Order or, where a Liquidation of Assets has not been preceded by a Protection Order (Chapter 13), the period next before the appointment of the liquidator. Where proceedings are taken by the trustee of a Voluntary Arrangement (Chapter 7), the relevant period should be the period next before the date on which the Arrangement was executed by the debtor.

69. Where an Administrator is appointed and the Order includes a direction that no insolvency application should be presented during the period of administration without the leave of the Court, then if a Protection Order is subsequently made we propose that the period of Administration should not be included in the computation of the period next before the Protection Order for the purpose of

challenging antecedent transactions.

(3) The time within which proceedings must be brought.

70. We are concerned at the length of time which sometimes elapses between the date of the transaction sought to be impeached and the commencement of the proceedings to have it set aside. Under the law as it stands at present, once the bankruptcy or winding up has commenced, there is no time limit within which proceedings must be brought. While this is appropriate where the transaction is challenged as a fraudulent conveyance, we regard it as unjust in other cases. Accordingly, we recommend that in future no proceedings to set aside a gift or other voluntary disposition, or a voidable preference, otherwise than as a fraudulent conveyance, shall be brought more than three years after the making of the Protection Order, appointment of the liquidator or execution of the Arrangement (as the case may be), with power for the Court to extend the time in any particular case for just cause shown.

5. Summary of recommendations

71. Our recommendations are as follows:-

(a) Fraudulent conveyances

(1) Section 172 of the Law of Property Act, 1925, should be repealed and re-enacted in an amended form so that it is made clear:-

(i) that the Section applies to the mere payment of money, as well as to any disposition of property whether effected by an instrument in writing or not;

(ii) that the necessary intent on the part of the debtor is an intent to defeat, hinder, delay or defraud creditors, or to put assets belonging to the debtor beyond their reach, and that such intent may be inferred whenever this is the natural and probable consequence of the debtor's actions;

(iii) that the Section applies to any disposition made with the necessary intent, even if supported by valuable consideration, where that does not consist of full

consideration in money or money's worth received by the debtor; but

(iv) that no disposition may be set aside if made in favour of a bona fide purchaser for money or money's worth without notice, at the time of the disposition, of the debtor's fraudulent intent.

(2) The payment of a debt lawfully due should not, save in exceptional circumstances, be within the amended Section 172.

(b) Gifts and other voluntary dispositions

(3) Section 42 of the 1914 Act should be repealed and replaced by an entirely new Section, drafted in modern language, and applicable equally whether the debtor is a man or woman.

(4) The new Section should:-

(i) refer, not to "settlements of property", but to "gifts or other voluntary dispositions of money or property";

(ii) apply (a) to dispositions at a nominal consideration and (b) to dispositions not at arms' length at a conspicuous undervalue;

(iii) apply to corporate as well as individual insolvents;

(iv) exclude small gifts and other dispositions made in the ordinary course of the debtor's affairs and not abnormal in the circumstances of the debtor at the time.

(5) The period of ten years for setting aside gifts or other voluntary dispositions should be reduced to five years except in the case of connected persons. The period of two years should be reduced to one year in all cases.

(c) Fraudulent preferences

(6) So-called "fraudulent preferences" should be renamed "voidable preferences".

(7) The requirements (i) of a dominant intention to prefer and (ii) of the absence of pressure on the part of the creditor should be retained.

(8) The burden of proof should be reversed in the case of any payment or transfer to a creditor who is not at arms' length. In such a case, the payment or transfer should be presumed to have been made with a view to giving the creditor a preference, unless the creditor proves that the payment or transfer was made in the normal course of affairs of the debtor in relation to the creditor.

(9) The relevant period for setting aside voidable preferences should continue to be six months, except where the creditor and debtor were members of the same group of companies, or shared substantially common directors or shareholders, or consisted of a company and one or more of its directors. In such cases the period should be increaed to two years.

(10) Proceedings to set aside a voidable preference should be capable of being brought

An Administration or if a Protection Order is in force, by
by a receiver [or Administator], but [only] in either case only
with the sanction of the Committee and after
having obtained the leave of the Court. has been obtained.
The Court should not grant leave unless
satisfied that the company is insolvent,
and that it is expedient that the proceedings
be brought by the applicant. [Where leave
is granted, the Court should at the same time
automatically make a Protection Order, unless
one is already in force.]

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(11) Where the payment or transfer was made with a view to obtaining the release of a guarantor or surety in whole or part, the transaction should be treated as a preference given to the guarantor as well as to the creditor, and the guarantor should be treated as a creditor who has received a benefit to the exrent to which he has been or is liable to be released from the guarantee.

(12) Where a payment or transfer to a creditor has been set aside as a voidable preference the creditor should, on repayment, have the

remedies against the surety or guarantor, and against any property securing the guarantee, as he would have had if the debtor had not made the payment to the creditor. No proceedings should, however, be capable of being brought to enforce any security against property where this would prejudice a bona fide purchaser of the property or some interest therein without notice of the facts alleged to constitute a preference. In such circumstances, only the personal remedy will lie.

(13) [The trustee or liquidator] the claimant should be able to proceed at his option either (i) directly against the guarantor or surety, without joining the creditor; or (ii) against the creditor, joining the guarantor or surety unless the creditor waives the requirement.

(d) Recommendations common to more than one remedy

(14) It should be a question of fact in every case whether persons not closely connected with each other were, at the particular time,

dealing with each other at arms' length; but connected persons should be conclusively presumed not to be dealing with each other at arms' length.

(15) It will be necessary for a comprehensive definition of "connected persons" to be contained in the new Insolvency Act. We have suggested a definition, which includes:-

(i) persons married to each other, or living together as man and wife;

(ii) persons who are closely related to each other;

(iii) Companies which are members of the same group,or share substantially common directors or shareholders; and

(iv) a company and any of its directors or substantial shareholders.

(16) Where a claim is made to set aside a gift or other voluntary disposition, or a voidable preference, the Court should have a discretion

to refuse recovery in whole or part if:

(i) the person from whom recovery is sought received the money or property in good faith and has altered his position in the reasonably held belief that the payment or transfer to him was validly made and was not liable to be set aside; and

(ii) in the opinion of the Court it would be unjust to order recovery or recovery in full, as the case may be.

(17) The consequential powers of the Court whenever any transaction is set aside, whether or in part, and whether as a fraudulent conveyance, gift or other voluntary disposition, or voidable preference, should be set out in the new Act.

(18) The relevant period within which gifts or other voluntary dispositions and voidable preferences may be open to challenge should be the period next before the making of a Protection Order or, where a Liquidation of Assets has not been preceded by a Protection Order, the period

next before the appointment of the liquidator. Where proceedings are taken by the trustee of a Voluntary Arrangement, the relevant period should be the period next before the date in which the Arrangement was executed by the debtor.

(19) Where an Administrator is appointed in respect of a company, and the Order includes a direction that no insolvency petition should be presented during the period of administration without the leave of the Court, then if a Protection Order is subsequently made in respect of the company, the period of Administration should not be included in the computation of the period next before the Protection Order.

(20) Where the debtor has died before the making of a Protection Order and his estate is being administered as an insolvent estate, proceedings to set aside any gift or other voluntary disposition, or voidable preference, made or given by him during his lifetime should be capable of being brought in like manner

as if a Protection Order in respect of the deceased had been made immediately before his death.

(21) In future, no proceedings to set aside a gift or other voluntary disposition or voidable preference, otherwise than as a fraudulent conveyance, should be capable of being brought more than three years after the making of the Protection Order, appointment of the liquidator or execution of the Arrangement (as the case may be), with power for the Court to extend the time in any particular case for just cause.