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INSOLVENCY LAW REVIEW COMMITTEE

SECOND MEETING


Meeting to be held in the Conference Room, 2-14 Bunhill Row on Thursday 24 March 1977 at 10.00 am.

AGENDA

- 1 Minutes of the meeting on 1 March 1977. ✓
- 2 Matters arising.
- 3 Principles and philosophy of insolvency law (Working papers ILRC 3, 5 and 6).
- 4 Agree programme for the next six months.
- 5 Receiverships - continued (Working paper ILRC 7).
- 6 Agree main items for discussion at the next meeting.
- 7 Confirm date of next meeting (Thursday April 28).



T H Traylor  
Secretary  
14 March 1977



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NOTE BY MR P G H AVIS

MEMORANDUM ON PARAGRAPH 37 IN THE DRAFT MINUTES OF THE SECOND MEETING OF THE REVIEW COMMITTEE ON 24TH MARCH 1977.

1. It is hoped the following notes will be of general interest when considering the role of the Bank as a holder of a floating charge. While the views of other Banks have not been sought, there is no reason to believe their views would differ to any extent.

*See Scottish report by Jim.*

2 (a). The importance of the floating charge as a security for the provision of short to medium term finance for corporate businesses should not be underestimated. The characteristic of this type of charge is that it constitutes a general equitable charge upon the undertaking and all the assets, from time to time, of the Company, yet still permits the Company to deal with its assets as it wishes in the ordinary conduct of its business. Only upon the happening of certain specific events, of which the most significant are the appointment of a Receiver by the proprietor of the charge or the entry of the Company into liquidation, does the charge become converted into a specific equitable charge upon the Company's undertaking and assets. The special qualities of the floating charge are therefore its flexibility and the freedom it permits to the charging Company to continue to deal with its assets without reference to the proprietor of the charge. This type of security is especially attractive to the Bank when providing a working capital facility which is greater than that which could prudently be provided unsecured against an assessment of a Company's worth made upon the basis of its balance sheet value, written down to show the likely position should the Company fail. The security is, of course, especially appropriate in any case where it would not be possible for the Company to provide adequate security by specific mortgages over immovable property.

(b) The bank balance of the trading customer moves in and out of credit according to the pattern of trade, stock purchases are financed by the bank facilities, pending their sale in some form or another and the bank facility enables this objective to be achieved in a most simple way, easily administered and understood

Bank, i.e. overnight debit balances only are charged the agreed debit rate of interest. In the main, stock and debtors are the only assets <sup>which</sup> of a Company functioning in this way has to offer by way of security and it is this security which the bank lending is actually financing. It will be appreciated that the floating charge does not cover merely one debtor or one item of stock supplied by another trader, but all the debtors and all the stocks and sometimes these comprise many hundreds of trading transactions. The advantage of such a charge is that it has the ability to encompass within its security the total amounts of the debtors and stocks which, together, can provide the cover which the trading Company needs to finance the debts it has incurred in its normal day to day trading activities.

(c) At the other end of the time scale, the floating charge is often considered to be the best type of security for the medium to long term finance raised by a Company by the issue of debenture stock. An important factor in favour of the floating charge as security in such a situation is, again, the freedom which it leaves in the hands of the Company to deal with its assets.

(d) Although the floating charge as a form of security is unknown in many countries, it is suggested that this fact is a detriment to them and it is noted that Scotland has seen fit to introduce the floating charge into its legal system. It is also noted that the "Cork No. 1. Committee" (Paragraphs 59 and 60 of the Committee's Report) accepted and endorsed the concept of the floating charge as security and that this present Committee has accepted that the floating charge should be retained.

3. However, to perform its present essential functions, it is in the Bank's view imperative that the floating charge should remain an effective and immediate security. Accordingly, it is considered that certain of the suggestions put to the Committee would so seriously undermine the security aspect of the floating charge that it could no longer be regarded by a bank as in any way fulfilling its present functions. The Bank takes the view that the stability of the clearing

deposits and these should never be seen to be at risk, hence the need for secured lending in so many instances. Bearing this in mind, the Bank considers that some of the suggestions which have been made would, if implemented, have the inevitable result of severely restricting the provision of finance to, for example, trading companies, removing thereby virtually the only means of securing a trading advance (mainly by way of overdraft) which many medium sized trading Companies have.

4. Turning to the matters raised in paragraph 37 of the Minutes of the last meeting of the Committee, the Bank understands the proposal to which reference is there made to be that, rather than look at individual items of money as available for particular classes of creditors, the Receiver should consider the position as a whole with a view to obtaining the best amount of money in his realisations. This seems to be a logical consequence of the proposal that a Receiver should have the duty to look at the position of the Company as a complete entity at that time and act, as far as he can, in the best interests of all parties, according to their respective priority rights. If these interpretations are correct, the Bank does not see any substantial difference between them and the present practical and legal position. The Bank therefore would not disagree with such proposals.

5. The Bank regards a Receiver's present principal duty as being to effect as speedy and profitable a realisation of the Company's undertaking and assets as is reasonably possible. The new proposals do not seem inconsistent with that present duty. Further, the Bank recognises that, in practice and perhaps in law, a debenture-holder who appoints a Receiver has not, and should not seek to exert, power to control the activities of a Receiver (except, perhaps, as regards grave misfeasance) in the conduct of the Receivership. These activities are in the discretion of the Receiver and the debenture-holder's only usual right is to remove the Receiver or replace him. Were the debenture-holder to seek to dictate to the Receiver, it is conceived that the debenture-holder would risk finding himself a mortgagee in

*This emphasises the  
need for high  
quality receivers*

the Bank to select its Receivers with such care. Of course, under the present law, the Receiver must have due regard to the priorities of creditors, but, as we understand them, the new proposals would not seek to change that situation. They would, we believe, merely intend to emphasise the present legal duty of the Receiver to obtain the best realisation reasonably possible.

6.

*preferential debts*

The Bank readily accepts that a Receiver should be under no duty to distribute prematurely to any creditor the proceeds of assets which the Receiver has realised. Indeed, the Bank would regard it as right that a Receiver should have statutory protection from pressure for premature distribution. It is not thought that this would result in any unnecessary delays in the completion of a Receivership, as such delays would be in breach of the Receiver's general duties - either old or new. It will be appreciated that the present legal position of the Receiver does not, of course, preclude - in proper cases - a Receiver (with the consent of the debenture-holder who appointed him and who will inevitably have to finance him) prolonging a Receivership where this is thought to be likely to increase the value of the Company.

7.

*Schedule 15 Act*

To summarise the Bank's position, the Bank would wish to see the floating charge retained fundamentally in its present form, as a security vehicle. It would not wish to see a Receiver either given rights to act wilfully to the detriment of the debenture-holder, even though such rights might be in the interest of the unsecured creditors, or burdened with duties in excess of those at present imposed upon him by law. It would however, of course, not object - and indeed would welcome - some statutory codification of a Receiver's rights and duties.

8.

It is suggested that, rather than to change substantially the present position at law of a Receiver appointed under a floating charge, consideration might be given to establishing new procedures which might better protect the interests of unsecured creditors in cases where a Company which had created a floating charge fell into difficulties. One possibility might be to enable



vesting the management of the Company in a trustee approved by the creditors. The assets of the Company would, of course, remain subject to the floating charge, but until the debenture-holder appointed a Receiver, the trustee and not the Board of Directors of the Company would have conduct of the Company's affairs. A second possibility would be to empower the Court, on application by any substantial creditor who could show good cause, to make an order which would create a floating charge, subject to the debenture-holder's floating charge, over the undertaking and assets of the Company, such second floating charge being for the benefit of the then existing unsecured creditors of the Company, and to empower the Court also to appoint a Receiver under that second floating charge.

P.G.H. AVIS.

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