Brooklyn Journal of International Law

Volume 23
Issue 1
Symposium:
Bankruptcy in the Global Village

Article 6

9-1-1997

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COMPARATIVE BANKRUPTCY CULTURES: RESCUE OR LIQUIDATION? COMPARISON OF TRENDS IN NATIONAL LAW—ENGLAND

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I. INTRODUCTION

Prior to the recent recession in the United Kingdom from about 1989 to 1992, the last great period of insolvency in England was the last quarter of the nineteenth century. At that time, there were no specific rescue provisions in English law; the emphasis in insolvency proceedings was very much on liquidation. As far as statutory provisions were concerned, this emphasis remained pretty much the same for about 100 years, until the end of 1986.

During those 100 years, the statutory provisions—and for the most part the judge-made caselaw—embodied a liquidation culture. When a business failed, the normal outcome was assumed to be a break-up of the business and a forced sale of the assets. Sometimes the management had moved the business and assets, either properly or improperly, prior to liquidation; although the move might have rescued the business and the jobs, the remaining insolvent entity was liquidated.

It seems to have been the peculiar position in the United Kingdom, unlike in Europe and the United States, that liquidators tended to be accountants and not lawyers. Those few accountants who specialised as liquidators were feared as "undertakers," and were not generally held in high esteem.

During this period there were no insolvency procedures specifically designed to effect a rescue. There were, however, statutory and judge-made procedures which—though they were not, strictly speaking, insolvency procedures—could operate as such and could effect the rescue of a distressed business, or could, at least, effect a better outcome for the business or assets than could a liquidation. It is worth looking at the origins

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of these remedies because they survive to this day, albeit with statutory and caselaw improvements.

II. SECTION 425 SCHEMES

The companies legislation has for a long time contained a provision which appears in the latest consolidated legislation as section 425 of the Companies Act 1985.[1] The provision applies whether or not the corporation is insolvent or is likely to become insolvent; it consists of a statutory facility to enable the shareholders or creditors to reorganise or restructure the company, or to compromise on debts and other claims so as to enable the corporation or a successor to continue trading. When used in an insolvency context, this remedy has some parallels with a Chapter 11 reorganisation under U.S. law.[2]

A "scheme" under section 425 has never, by itself, operated as a satisfactory substitute for insolvency proceedings; it has always had a number of serious defects. The main problem is that the commencement of section 425 proceedings does not create a statutory stay on creditors' remedies. Thus, unless one faced one of those rare cases where such protection was neither necessary nor desirable, a section 425 proposal was always vulnerable to attack by dissident creditors prior to the scheme's confirmation by the court.

Section 425 also has less fundamental drawbacks. From the start, the proceedings involve applications to court, which have to be carefully prepared by lawyers; therefore, considerable expense is involved. Depending on the numbers of shareholders and creditors, the summoning of the appropriate class meetings can also be expensive. The confirmation hearing itself can be contested and can, therefore, involve considerable delay and expense. Section 425 could never operate in a case where there was a need for an urgent rescue, unless the scheme had been set up and confirmed in advance as a stand-by scheme.

Since section 425 proceedings are not insolvency proceedings, there are no statutory powers of investigation or of compelling turnover, and no specific statutory provisions to attack preferences or undervalue transactions. Fraudulent conveyance provisions can, however, be applied before, during, or after the

1. Companies Act, 1985, ch. 6, § 425 (Eng.).
2. 11 U.S.C. §§ 1101-1174 (1994).

section 425 proceedings. Further, in many situations, preferences and undervalue transactions, especially with insiders or connected persons, can be attacked pursuant to corporate law provisions of statute and caselaw.

A. Receivers Appointed Out-of-Court[3]

During the second half of the nineteenth century, and in particular during the last quarter of the nineteenth century, lenders' lawyers and the courts developed a special secured creditors' remedy which has spread throughout the British Commonwealth but has not passed into U.S. practice. In the second half of the nineteenth century, it transpired that much of the value in the new limited liability corporation lay in the goodwill and trading, and not simply in the underlying assets. Thus, lenders who wanted a security interest in the corporation often wanted security in the whole enterprise, and wanted it run and realised for their benefit so as to recover as much as possible of the amount loaned. As a result, security interests were deemed to attach to a trading corporation's entire business, including all its assets and goodwill. Under a literal interpretation, the business would have been paralysed, because no item of stock or manufacture could be sold without the specific consent of the security holder. Accordingly, as a way of helping lenders and trading corporations, the judges came to interpret this type of security interest as a "floating" interest. This type of interest allowed the corporation to trade the assets subject to a security interest in the ordinary way, but on enforcement of the security interest gave priority to the security holder over unsecured creditors.[4] The security was held to float and to enable the corporation to dispose of its assets in the ordinary course without the specific consent of the security holder until a given event, for example, until the corporation was liquidated or until a receiver was appointed over its assets. In such an event, the floating charge was held to crystallise[5] into a regular "fixed" security interest over the assets still owned by the corporation.

3. *See generally* GAVIN LIGHTMAN & GABRIEL MOSS, THE LAW OF RECEIVERS OF COMPANIES (2d ed. 1994).

4. *See id.* ¶ 1-02.

5. *See id.* ¶ 3-23.

With the recognition of the "floating" charge, the role of the receiver, whether appointed by the court in proceedings begun by the floating security holder[6] or under contractual powers in the security agreement, came to involve running the whole enterprise. This was sometimes with a view to a rescue, but more often it was to better realise the security interest by selling the business (and incidental preservation of jobs) rather than by liquidating the assets. One key factor was the receiver's wide powers of trading as contrasted with a liquidator's narrow power to trade only for the purpose of winding up the corporation.

Initially, most appointments were made by the court in proceedings started by the security holder, but gradually, and nowadays typically, the appointment came to be made outside of court by the floating security holder.

There was much complaining by commentators and judges about the way in which "floating" security allowed the security holder to "have his cake and eat it too." The company had freedom to trade, yet the lender had security over all the assets, with the ability to squeeze out ordinary trade creditors when the corporation got into financial difficulties. Another aggrieved party was the government, whose preferential but unsecured claims were also initially shut out, at least until the procedure was changed by legislation.[7] One result of creating priority for preferential payments over floating security has been the ever-increasing use of fixed security in addition to general floating security. To the extent that effective fixed security is obtained, the preferential creditors do not get priority. Nowadays, the typical "debenture" security document contains a rich "cocktail" of fixed and floating security, thus tying up all the business and assets. The receiver is usually given power to trade assets that are the subject of both fixed and floating security.

For present purposes, the main point about floating charges and out-of-court appointed receivers is that, without any

6. Floating securities holders are generally referred to as "debenture-holders" as a result of the habit of securing the issue of debentures (loan notes) with floating charges over the corporation's entire undertaking and assets.

7. *See* Preferential Payments in Bankruptcy Amendment Act, 1897, 60 & 61 Vict., ch. 19, §§ 2-3 (Eng.); *see also* Preferential Payments in Bankruptcy Act, 1888, 51 & 52 Vict., ch. 62 (Eng.).

formal insolvency proceeding, this type of secured creditor's remedy in practice operated like a rescue procedure in many cases, during the 100 years or so prior to 1987. Although it was only in a few cases that corporations were entirely saved, businesses, and many jobs, were often saved by means of a sale as a going concern rather than a break-up and liquidation.

Although regarded by specialists as a success, receivership of this type did have important limitations. Since the typical receivership was non-court-related and non-statutory, and was not really an insolvency procedure at all, the receiver's principal duty was furtherance of the secured creditor's interests. His duties towards ordinary unsecured, non-preferential, creditors were, and remain, very few indeed.[8] He has been able to concentrate on getting the secured creditor repaid, even if that has meant an early sale[9] and bad news for jobs or for the unsecured creditors. Another weakness of receivership is that it has never had the protection of a statutory stay. Prior to 1987, this omission was awkward in cases of what may be termed "utility blackmail." That is, when a receiver was appointed, the utilities which were owed pre-receivership debts could try to pressure the receiver by threatening to cut off the corporation's supplies unless pre-receivership debts were met.[10]

Another problem with receivership was that since it was not an insolvency proceeding and did not bring about a statutory stay, unsecured creditors could not, generally speaking, be prevented from getting a winding-up order from the court.[11] Although such an order did not strip the receiver of his power to carry on the business, it made it much more difficult. For example, a winding-up order meant that the receiver was no longer an agent of the corporation, as he normally was under the security agreement. Thus, he had to operate as a principal,

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8. *See* Downsview Nominees Ltd. v. First City Corp., 1993 App. Cas. 295 (P.C. 1992) (appeal taken from N.Z.). This approach is analysed critically in LIGHTMAN & MOSS, *supra* note 3, ¶ 7-13.

9. *See* Bank of Cyprus (London) Ltd. v. Gill, [1980] 2 Lloyd's Rep. 51, 53-54 (Eng. C.A. 1979).

10. *See, e.g.*, Wellworth Cash & Carry (North Shields) Ltd. v. North E. Elec. Bd., [1986] 2 British Co. L. Cas. (CCH) 99,265 (Ch.).

11. There were a few exceptions. For instance, a petition seeking a winding-up order could be adjourned to allow receivers to finish trading. *See Re* Northern Developments (June 16, 1976) (Templeman, J.) (unreported decision, on file with author).

thereby losing certain immunities given to agents by English law.

The biggest problem, however, was that in many cases there was no floating charge covering the whole, or substantially the whole, of the corporation's assets, and therefore no receiver could be appointed to run the business with a view to a rescue or a better realisation than in a liquidation. For example, major corporations quoted on the London Stock Exchange did not typically give floating security, since such security would have had an adverse effect on their credit ratings or credit standing with suppliers and lenders.

B. *The Cork Committee Report*[12]

In 1977, back in the days of the last Labour Party government in the United Kingdom, a specialist review committee (Cork Committee) was set up to review insolvency law and practice. It was chaired by one of the leading "undertakers" of the day, Sir Kenneth Cork. The Cork Committee included leading insolvency lawyers; it made a thorough survey of insolvency law and took evidence from a wide range of corporations and other business organisations. However, by the time the Cork Committee Report was published in 1982, Margaret Thatcher was in power as Prime Minister under a Conservative government, and many of the suggested reforms no longer fit in with the new political outlook. Nevertheless, the new government accepted the need for reform in several major areas, and some of those bore on the question of rescue. The Cork Committee Report is thus regarded as the commencement of the current "rescue culture."

One of the most important points made by the Cork Committee was that the appointment of out-of-court receivers pursuant to floating security, over the previous 100 years or so, had been an important way of preserving businesses and jobs, and had been superior to liquidation in creating realisations.[13] As a result, the Cork Committee recommended a new form of insolvency proceeding which could be used whenever such receivers were not or could not be used, so that every corpora-

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12. REPORT OF THE REVIEW COMMITTEE, INSOLVENCY LAW AND PRACTICE, 1982, Cmnd. 8558 [hereinafter CORK COMMITTEE REPORT].
13. *Id.* para. 495, at 117.

tion would have a similar opportunity of rescue or better realisations.[14]

III. Introduction to the Reforms

In order to understand the reforms initiated as a result of those Cork Committee recommendations accepted by the government, it will be necessary to emphasise one or two important differences between the approach to insolvency in England and that in the United States. The focus in the Cork Committee Report, and in English law generally, has been to rescue the business and the jobs, but not necessarily the corporation itself. In a Chapter 11 proceeding, the same corporate entity emerges at the end of a successful reorganisation plan, whereas it is only in a small number of English cases that the corporation itself survives. In England, most rescues of businesses have involved the sale of the business to other entities, while the insolvent rump of the corporation has, generally speaking, gone into liquidation.

Another important difference between English and U.S. law is that in the United States, a Chapter 11 reorganisation usually leaves the management in control as a debtor-in-possession,[15] while in England, the former management of an insolvent company is not usually allowed to remain in control. The general view is that even where there is a likely rescue of the corporation or the business, a licensed "insolvency practitioner" should take over.

From an English point of view, the judiciary in the United States tends to be pro-debtor. This pro-debtor stance may be based on the idea that the United States is a pioneering society where the entrepreneurs take the risks and are too often oppressed by the banks and financiers. In England, judges tend to favour the financiers; bankers appear to have acquired respectability over the centuries whereas those who take risks in business have not. English judges also tend to be sympathetic towards insolvency practitioners as opposed to debtors;

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14. *Id.* paras. 495-521, at 117-122.

15. *See* Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1044 (1992); Lynn M. LoPucki & George G. Triantis, *A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies*, 35 HARV. INT'L L.J. 267, 305 (1994).

the licensed insolvency practitioners tend to be professionals known to the court, whereas the debtor's descent into insolvency tends to be treated as a ground for suspicion. Further, insolvency practitioners act either in the interests of a secured financier or at the direction of the court.

One example of judges' favourable view of financiers has already been given above: the recognition of the floating security interest can be seen as a special favour for financiers.[16] A great number of loans to corporations other than those listed on the London Stock Exchange are still in the form of loans secured by a floating charge over all or substantially all of the corporation's assets.

The fact that judges recognise the effectiveness of "agency" with respect to receivers appointed out-of-court can be seen as another favour to financiers. Security agreements have been recognised as creating a very peculiar and yet very real agency.[17] The security agreement invariably provides that any receiver appointed by the security holder is to be the agent of the debtor corporation, which will alone be responsible for the receiver's actions. However, the corporation cannot fire this agent; the appointment is irrevocable because it is part of the security mechanism. On the other hand, courts have treated the agency as being real, that is, they have applied agency immunity to receivers.[18] Thus, if a receiver as agent causes the corporation to breach a contract, the courts have given the receiver the usual agency immunity from a suit for wrongful interference with contract,[19] except where proprietary interests are involved. This practice has proved to be an extremely useful weapon in rescuing businesses.

The agency mechanism has also been held by the courts to have other useful functions. The receiver is not personally liable for rent because he is not a party to any lease.[20] He is not personally liable for property taxes because the corporation is the occupant.[21] Additionally, although a receiver (in con-

16. *See supra* notes 6-7 and accompanying text.

17. *See* Rhodes v. Allied Dunbar Pension Servs. Ltd., [1989] 1 W.L.R. 800, 807H (Eng. C.A. 1988).

18. *See* Welsh Dev. Agency v Export Fin. Co., 1992 British Co. Cas. (CCH) 270, 290F (C.A. 1991).

19. *See id.*

20. *See* cases cited in LIGHTMAN & MOSS, *supra* note 3, para. 15-14.

21. *See* Ratford v. Northavon Dist. Council, 1987 Q.B. 357, 371E-72B (Eng.

trast to a liquidator) has no power to disclaim unprofitable contracts, the courts have held that a receiver, as agent of the corporation, can effectively cause the corporation to repudiate an unprofitable contract, leaving the other party a useless or much less valuable right to claim damages as an unsecured creditor. Hence, notwithstanding his agency for the corporation, the receiver may exercise the superior rights of his appointor, based on the appointor's security interest.[22]

As pointed out above, the potential weakness in an otherwise rosy picture is that an aggrieved unsecured creditor can present a petition to wind-up the corporation; if a winding-up order is made, that order will automatically revoke the agency of the receiver, and with it, may also revoke some of the important protections that he has while he is trading.

Another difficulty arising from the lack of a statutory stay is that in the last twenty years or so, it has become increasingly common in England for vendors of chattel to adopt the European habit of placing retention of title clauses into contracts of sale. The receiver of a manufacturing business may well find that much, and possibly all, of his stock at the corporation's factory is claimed by vendors as their property. He has no defence to this claim, unless he can find a legal argument in relation to the wording of the clause or its incorporation into the contract.

IV. THE RESCUE CULTURE REFORMS

A. *Administration Orders*

The legislation engendered by the Cork Committee's reform proposals came into force, with some exceptions, at the beginning of 1987.[23] The single most important reform was designed to fill the gap left by those cases where receivership pursuant to a floating charge over all or substantially the whole of the company's property was not possible, or where the security holder was not willing to appoint such a receiver.[24]

C.A. 1986).

22. *See* Airlines Airspares Ltd. v. Handley Page Ltd., 1970 Ch. 193 (1969), *explained in* Astor Chem. Ltd. v. Synthetic Tech. Ltd., 1990 British Co. Cas. (CCH) 97, 104C-H (Ch. 1989).

23. *See* Insolvency Act, 1986, ch. 45 (Eng.).

24. For example, the lender who is adequately secured by real property does

On the basis of the Cork Committee's recommendations, the legislation created a statutory and court-controlled version of such a receivership called an "administration order."[25] Rather confusingly, the type of receiver discussed above is called an "administrative receiver."

The administrator under an administration order is appointed by the court. The filing of a petition seeking an administration order and the order itself create a mandatory statutory stay, subject to exceptions agreed upon by the administrator or the court.[26] The administrator is an agent of the corporation, and has all the powers that would be given to a receiver appointed under a floating security.[27] In order to have an administrator appointed, the corporation or its creditor must show that the corporation is insolvent or likely to become insolvent and that the administration order is likely to achieve one of the four types of statutory goals set out in section 8 of the Insolvency Act 1986. One possible statutory goal is the survival of the corporation and its business;[28] other possible goals are protection of a section 425 scheme, or new, simpler forms of reorganisation known as Corporate Voluntary Arrangements[29] (CVAs). Neither a section 425 scheme nor a CVA would have the protection of a statutory stay themselves. The final and most often-used statutory goal is a better realisation of the assets of the corporation than would be achieved in a liquidation; in fact, administration orders will almost always result in a better realisation than in a liquidation.[30] In the case of pure holding corporations with no employees, and no ongoing business, there can be special problems in falling within the statutory criteria.

The major limitation on administration orders arises from the very reason for their introduction. Administration orders were meant to plug a gap when administrative receivers could

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not need to enforce his security over the business as a whole, and may not wish to do so in an effort to avoid poor public relations, in particular with future borrowers.

25. Insolvency Act, 1986, ch. 45, § 8 (Eng.).

26. *See id.* §§ 10-11.

27. *See id.* § 14.

28. *See id.* § 8(3)(a).

29. *See infra* Part IV.B.

30. For example, a compulsory winding-up by the court automatically fires all employees whereas an administration order does not.

not or would not be appointed; thus, the ability and willingness of a floating security holder to appoint will effectively veto any application for an administration order,[31] unless the secured creditor's security would be avoided in administration pursuant to the statutory avoidance provisions.[32] This would be the case, for example, if the security would amount to a voidable preference or an undervalue transaction.[33]

The introduction of administration orders came just in time for the last great recession. The stock of some corporations listed on the London Stock Exchange fell during the recession, and the administration order procedure was available in situations where it might not previously have been. Well-known examples include British & Commonwealth Holdings plc,[34] a substantial conglomerate; Maxwell Communications Corporation plc,[35] the public corporation flagship of the late Robert Maxwell; and the Olympia & York corporation.[36] In fact, none of these may have collapsed because of the recession itself, or at least not solely because of the recession. Nevertheless, these corporations are good examples of cases where an appointment of an administrative receiver was not possible or not desirable, yet liquidation would probably have been disastrous for creditors. Administration orders were made in each case, leading to CVAs or section 425 schemes and a much better outcome for creditors and jobs.

Although administrators are, in many ways, analogous to administrative receivers, the legislation gives them one or two additional special powers which are used in rescues and better realisations. For example, in that rare type of rescue where both the corporation and the business were preserved, a receiver had no power to change the directors of the corporation in order to satisfy a purchaser or investor of the stock of the corporation. Administrators, on the other hand, have a special

31. *See* Insolvency Act, 1986, ch. 45, § 9(1).

32. *See id.* § 9(3).

33. *See id.* § 9(3)(b)(i).

34. *Re* British & Commonwealth Holdings plc (Nos. 1 & 2), 1992 Ch. 342 (C.A. 1991); *Re* British & Commonwealth Holdings plc (No. 3), [1992] 1 W.L.R. 672 (Ch. 1991).

35. *Re* Maxwell Communications Corp. (No. 2), [1994] 1 All E.R. 737 (Ch. 1993).

36. Olympia & York Canary Wharf Ltd. v. Adamson (*Re* Olympia & York Canary Wharf Ltd.), 1993 British Co. Cas. (CCH) 154 (Ch. 1992).

statutory power to remove directors.[37] Further, in retention-of-title cases, administrators have the benefit of a mandatory statutory stay that extends to retention-of-title claimants.[38] In fact, the statutory stay protecting administration orders has been interpreted widely enough to prevent an airport seizing aircraft as security for landing charges[39] and to prevent landlords exercising self-help remedies to re-enter premises and terminate a lease.[40] An administrative receiver would not have had such protections.

B. Corporate Voluntary Arrangements

The other main innovation in the context of rescue was the introduction of CVAs. A CVA, as opposed to a section 425 scheme, is a much simplified form of restructuring or reorganisation. First, no application to court is necessary if the creditors pass the CVA by the requisite majority.[41] A court challenge is possible within a relatively short period,[42] but otherwise the CVA takes effect. The statutory provisions protect the interests of secured creditors from being affected without consent,[43] but secured creditors could not be affected by a section 425 scheme without their consent.[44] There are no class meetings in the case of CVAs, so that the whole procedure is much cheaper and simpler. However, since a challenge can be made on the grounds of unfair prejudice,[45] CVAs are suitable only for simpler cases, and are usually not suitable where creditors are of very different types with very different interests. Nevertheless, CVAs have worked, particularly in conjunction with administration orders where the making of an administration order has been needed to provide the statutory stay. A notable example of the combination of the two was the case of the English corporations in the Olympia & York col-

37. *See* Insolvency Act, 1986, ch. 45, § 14(2)(a) (Eng.).
38. *See id.* §§ 10-11.
39. *See* Bristol Airport plc v. Powdrill, 1990 Ch. 744 (Eng. C.A. 1989).
40. *See* Exchange Travel Agency Ltd. v. Triton Property Trust plc, 1991 British Co. Cas. (CCH) 341 (Ch. 1990), *explained in Olympia & York Canary Wharf Ltd.*, 1993 British Co. Cas. (CCH) at 156.
41. *See* Insolvency Act, 1986, ch. 45, §§ 3-5 (Eng.).
42. *See id.* § 6(3).
43. *See id.* § 4(3).
44. *See* Companies Act, 1985, ch. 6, § 425(2) (Eng.).
45. *See id.* § 6(1)(a).

lapse.[46] Although the numbers were very large, there were not too many distinct classes of creditors.

C. *Administrative Receivers*

The statutory reforms have also improved the situation of administrative receivers; they have been given statutory powers of investigation similar to those possessed by liquidators and administrators.[47] They have also been given statutory protection from utility blackmail, a protection also shared with liquidators and administrators.[48] Further, administrative receivers have some limited statutory duties to give information to unsecured creditors,[49] but neither the legislation nor the courts have imposed a general duty of care upon administrative receivers towards unsecured creditors.

V. SHORTCOMINGS IN THE REFORMING LEGISLATION

Unfortunately, the legislation appears to have largely forgotten about the foreign element.[50] Although there are some new specific statutory provisions dealing with cross-frontier cooperation of insolvency courts—which currently extends only to some Commonwealth countries and colonies[51]—there appears to be a general failure to think through the existence of a foreign element in a typical insolvency situation. Thus, for example, the legislation is unclear as to whether the reforms dealing with administrative receivership, administration orders, and CVAs apply to foreign-registered corporations which have a sufficient link with the English jurisdiction. Fortunately, the Courts have helped in this regard: one decision now says that there can be an administrative receiver for a foreign-registered company with a sufficient connection to the jurisdiction.[52] The position of administration orders and CVAs re-

46. *Re* Olympia & York Canary Wharf Ltd. (No. 3), 1993 British Co. Cas. (CCH) 154 (Ch. 1992).

47. *See* Insolvency Act, 1986, ch. 45, § 236(2) (Eng.).

48. *See id.* § 233.

49. *See id.* §§ 48(2), 49(2).

50. Recall the newspaper headline "FOG IN [ENGLISH] CHANNEL: CONTINENT CUT OFF"—the classic example of English insularity and the country's tendency to see things from only an English perspective. *See* William Grimes, *Chunnelvision*, N.Y. TIMES, Sept. 16, 1990, § 6 (Magazine), at 34.

51. *See* Insolvency Act, 1986, ch. 45, § 426 (Eng.).

52. See *Re* International Bulk Commodities Ltd., 1993 Ch. 77 (1992), a case

mains unclear.[53] It is hoped that the English courts will interpret the legislation in a way similar to the way they have interpreted matters concerning administrative receivers.

VI. POWERS AND IMMUNITIES AS AN AID TO RESCUE

The new legislation, effective from the beginning of 1987, corrected some of the deficiencies in administrative receivership, which stemmed from the fact that administrative receivership was not a proper insolvency procedure. Not only are administrative receivers, like liquidators and administrators, now protected from utility blackmail, but they have new powers of discovery and turnover. They can apply to the court, in the same way as liquidators and administrators do, to seek discovery of documents and examination on oath of former directors and others who might have information relating to the affairs of the corporation.[54] Further, like liquidators and administrators, administrative receivers can apply to the court for an order for delivery of property, books or records of the corporation.[55] Recent caselaw has established that the court hearing such a turnover application has jurisdiction to try and determine questions of title, and that the provision is not restricted to plain cases.[56]

The most important limitation on administrative receivership, and one which highlights the difference between it and insolvency procedures, is the lack of a statutory stay. Thus, receivers are still often vulnerable, in principle, to the attacks of retention-of-title claimants. However, the courts have helpfully accepted the notion that if the receiver has any arguable defence, his personal undertaking to pay for goods that he uses or disposes of will be accepted by the courts pending trial. This policy is to prevent any immediate order for delivery of the

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concerning discovery orders available to administrative receivers but not ordinary receivers. Had it been held that the receivers appointed under floating security over a foreign corporation were not administrative receivers, they would have had to petition for a winding-up order and then persuade a liquidator to seek a discovery order.

53. *See* Gabriel Moss, *Administration Orders For Foreign Companies*, 6 INSOLVENCY INTELLIGENCE 19 (1993); Gabriel Moss, *Administration Orders For Foreign Companies Revisited*, 7 INSOLVENCY INTELLIGENCE 33 (1994).

54. *See* Insolvency Act, 1986, ch. 45, § 236 (Eng.).

55. *See id.* § 234(2).

56. *See Re* London Iron & Steel Co., 1990 British Co. Cas. (CCH) 159 (Ch.).

goods or any restriction on their use until there is a final ruling on the claim.[57]

There is one important advantage which flows from the lack of a statutory stay. Since, in theory, creditors' remedies are not barred, the courts have not imposed upon receivers any "expenses doctrine." To elucidate this point, a short explanation of the "expenses principle" in liquidations is necessary. Where there is a liquidation of a corporation, if property is retained by a liquidator for the benefit of creditors generally, then the courts usually order liquidators to pay debts and taxes which arise from the retention of the property by the liquidator.[58] This doctrine has been given a limited and highly discretionary role in relation to administration orders where there is a statutory stay.[59] However, the courts have held that no such principle applies to receivership, where there is no statutory stay.[60] Thus, not only is a receiver acting as agent for the corporation not liable for expenses such as rent and property taxes, but these cannot be claimed by creditors as an "expense" of the receivership. This is very helpful for the successful trading of the corporation in receivership, and is a definite boost to attempts to rescue the business. For example, during the recession it proved extremely difficult to sell hotels for sensible prices; a sale in any event might take a long time and require a prolonged period of trading. The ability to avoid the payment of property taxes on a hotel during the period of receivership trading is a very important factor in trying to keep the hotel business going. Achieving a similar result in liquidation would have been impossible, and even in administration might have been difficult.

Before the reforming legislation, receivers only had such powers as were spelled out in the security agreement or were implied by an antiquated property statute.[61] Arguably, the statutory powers were inadequate for the running of a modern business. If a receiver found himself running a business with

57. *See* Lipe Ltd. v. Leyland DAF Ltd., 1993 British Co. Cas. (CCH) 385 (C.A.).

58. For a detailed discussion of this principle, see *Re Atlantic Computer Systems plc*, 1992 Ch. 505 (C.A. 1990).

59. *See id.* at 527-28.

60. *See id.* at 526-527.

61. Law of Property Act, 1925, 15 & 16 Geo. 5, ch. 20, § 110(1) (Eng.), *repealed in part by* Insolvency Act, 1986, ch. 45, sched. 10 (Eng.).

inadequate powers in the security agreement and inadequate statutory powers, he could find himself in real difficulty. In some cases, there were also awkward technical problems relating to the transfer of property by the receiver. All these problems were effectively solved by the Insolvency Act 1986, which allows every conceivable power that a receiver could want to be implied in the security agreement, unless it is expressly excluded.[62] The statute gives administrators exactly the same powers as administrative receivers and some additional ones. Thus, no rescue should fail for lack of powers held by the administrative receiver or administrator.

One feature common to both administrative receivership and administration orders is the need to keep liquidation at bay. The existence of an administration order automatically prevents a winding-up order or a resolution by the stockholders from causing a voluntary liquidation.[63] By contrast, the existence of a receivership does not, in and of itself, bar liquidation. However, administrative receivers do, at least, now have an express power to defend a winding-up petition.[64]

Although the caselaw is not completely clear or consistent, it now appears that administrative receivers are not liable in negligence to the corporation for damaging the interests of the unsecured creditors.[65] However, receivers do have an established equitable duty to the corporation, although it is much more limited than a general duty of care.[66] Thus, the caselaw establishes that when the receiver sells the business, he must get the best price reasonably obtainable in the circumstances, and that the unsecured creditors are protected to that extent.[67] However, the caselaw also establishes that the receiver is not bound to wait for a better price—for example if there is a rising market—but may go ahead and sell.[68] This may cause severe prejudice to unsecured creditors.

62. *See* Insolvency Act, 1986, ch. 45, § 42(1); *see also id.* sched. 1.

63. *See id.* § 11(1)(a).

64. *See id.* sched. 1, para. 21.

65. *See* Downsview Nominees Ltd. v. First City Corp., 1993 App. Cas. 295, 298G (P.C. 1992) (appeal taken from N.Z.). This approach is analysed critically in LIGHTMAN & MOSS, *supra* note 3, paras. 7-13.

66. *See Downsview Nominees Ltd.*, 1993 App. Cas. at 299B.

67. *See id.*

68. *See* Bank of Cyprus (London) Ltd. v. Gill, [1980] 2 Lloyd's Rep. 51, 54 (Eng. C.A. 1979).

One possible solution is to bring administrative receivership and administration orders closer together. A further reform could give administrative receivership a statutory stay; in exchange, administrative receivers would have a general duty of care toward the corporation. Like administrators, administrative receivers could also be released from liability by the court, as administrators are.[69] Such measures would improve rescue procedures generally, although they might bring administrative receivers within some form of modified "expenses principle." In some cases this might make rescues more difficult. Realistically, under the current political agenda, the chances of sensible reforming legislation in this area are low, since there are not too many votes for this type of technical reform.

VII. SPECIAL SITUATIONS

A. Banks

The subject of the rescue culture and insolvency in relation to banks was highlighted recently in relation to the collapse of Barings, England's oldest merchant bank.[70] Banks were originally excluded from the scope of administration orders. It is fair to say that generally throughout the world, banks and insurance companies are given special treatment in insolvency because of the profound regulatory concerns that affect these two industries. In the case of domestic banks, administration orders were introduced subsequently, with special statutory modifications to take into account the position of the regulator, the Bank of England.[71] Foreign-registered banks, however, were not included in this move, probably as a result of the assumption (which may well prove to be incorrect) that foreign-registered corporations were generally excluded from administration orders. Banks do not normally give floating security, and therefore are unlikely to be the subject of administrative receivership.

Administration orders have worked extremely well for

69. *See* Insolvency Act, 1986, ch. 45, § 20(1)-(2) (Eng.).

70. *See generally* INSOLVENCY OF BANKS: MANAGING THE RISKS (Fidelis Oditah ed., 1996); Laura Proctor, Note, *The Barings Collapse: A Regulatory Failure, or a Failure of Supervision?*, 22 BROOK. J. INT'L L. 735 (1997).

71. *See* Banks (Administration Proceedings) Order, S.I. 1989, No. 1276.

banks, with the rescue of the Barings business being the most prominent example. By contrast, since both the relevant corporate entities in relation to the Bank of Credit and Commerce International (BCCI) were foreign registered, administration orders could not be used. The same is true of the Iraqi foreign trade bank, Rafidain Bank, which became insolvent as a result of the United Nations sanctions imposed on Iraq. I shall deal with the solution arrived at by practitioners and the courts in relation to foreign banks when I discuss the other specially-excluded category, insurance companies. There is, nevertheless, a much-needed reform to the effect that foreign banks which have a sufficient connection with the jurisdiction should be capable of having administration orders made for them in England.

B. Insurance Companies

Insurance companies, whether domestic or foreign, were initially, and still are excluded from the application of administration orders, subject to one possible cross-frontier exception:[72] it is theoretically possible, though rather unlikely in practice, for a foreign insolvency court which has a special statutory tie-up with England to make a request to the English court pursuant to section 426 of the Insolvency Act 1986 for an administration order to be made in respect of the corporation.[73]

More generally, around 1991, practitioners and the courts were faced with a rising tide of insurance insolvency and the inability to use the administration order procedure. The pathfinder case involved the KELM companies[74] (later the KWELM companies),[75] a group whose affairs involved billions of dollars. The directors of the corporations—three English-registered, one Bermudian—presented a winding-up petition against the corporation, with a view to holding the fort while

72. *See infra* Part VII.C.

73. Insolvency Act, 1986, ch. 45, § 426 (Eng.).

74. "KELM" is a collective reference to Kingscroft Insurance Company, Ltd., El Paso Insurance Company, Ltd., Lime Street Insurance Company, Ltd., and Mutual Reinsurance Company, Ltd. *See In re* Kingscroft, 138 B.R. 121, 122 (Bankr. S.D. Fla. 1992).

75. Denoting the addition of Walbrook Insurance Company, Ltd. *See* Allstate Ins. Co. v. Hughes, 174 B.R. 884, 886 n.1 (S.D.N.Y. 1994).

the directors put forward a section 425 scheme. The filing of a petition gave rise to a discretionary stay, to be decided on a case-by-case basis by the courts. Moreover, the directors succeeded in persuading the federal court in Florida that they were the equivalent of debtors-in-possession, and should therefore be protected by a section 304 order under the U.S. Bankruptcy Code with respect to pending proceedings in Florida.[76]

Certain creditors were dissatisfied with the way in which the companies were being run; they wanted more control over the proceedings and the shaping of the scheme. This led to a successful application for the appointment of provisional liquidators, thereby bringing about a statutory stay.[77] Furthermore, the provisional liquidators were given exceptionally wide powers, similar to those possessed by an administrator, to manage the run-off and to take over the preparation of a section 425 scheme. In the United States, the appointment of provisional liquidators was followed by a sweeping general stay throughout the United States pursuant to section 304.[78] The provisional liquidation later led to a successful section 425 scheme and continued protection under section 304.[79]

The precedent set by the KELM cases has been followed throughout the recent wave of insurance insolvencies. There has been one major exception, where the insurance company went into liquidation in order to pursue statutory avoidance remedies, with adverse results to creditors. In other cases, the control and management by provisional liquidators with wide powers, combined with the putting together of a section 425 scheme, has proved an extremely successful alternative to liquidation. It is fair to say that businesses have not been rescued in these cases, since the insurance companies were in run-off; however, the run-offs have been conducted in a way far more beneficial to creditors than a liquidation could possibly have been.

The result of the use of provisional liquidation, as developed by practitioners and judges, is that we have something similar to administration orders, but not tailor-made for that purpose. The simple and obvious reform would be to extend

76. *See In re Kingscroft*, 138 B.R. at 124.

77. *See* Insolvency Act, 1986, ch. 45, § 130(2) (Eng.).

78. *See Hughes*, 174 B.R. at 886.

79. *See id.* at 887.

administration orders to insurance companies, with special modifications to take account of the special position of the regulator, the Department of Trade and Industry.[80] As I have pointed out above, this has already happened in relation to English-registered banks.

The technique used in relation to insurance companies has also been adapted for use in the case of foreign-registered banks. In *Re Bank of Credit & Commerce International S.A.*,[81] the provisional liquidators took upon themselves the role of arguing for adjournment of the winding-up petition and seeking to negotiate a deal with the stockholders so as to try to rescue the bank.[82] That rescue attempt did not succeed, but provisional liquidation of this imaginative sort at least created a chance of a rescue.

While BCCI went into liquidation and never reopened its doors, the ultimate fate of Rafidain Bank has not yet been decided. There, provisional liquidators are in place and have held the fort for some years. A liquidation would produce a minimal dividend which would hardly be worth having. An eventual end to the trade embargo on Iraq is likely to produce payment in full of the billions of dollars worth of credit around the world. The provisional liquidation has therefore functioned, and continues to function, rather like administration, that is, as a way of keeping the English branch of the bank afloat pending the ultimate resolution of the sanctions issue. This function is plainly in the interests of creditors and has generally been welcomed by them.

C. Cross-frontier Rescues

In matters of personal insolvency, the old legislation required cooperation between insolvency courts throughout the British Empire.[83] This legislation was useful when the Empire covered a large part of the globe. Even then, however, there was a major problem in that there was no equivalent provision in relation to corporate insolvency. As a result of the

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80. *See* Gabriel Moss, *DTI Proposals for Non-life Insurance Companies: A Step in the Wrong Direction?*, 8 INSOLVENCY INTELLIGENCE 43 (1995).
81. 1992 British Co. Cas. (CCH) 83 (Ch. 1991).
82. *See id.* at 90F.
83. *See* Insolvency Act, 1986, ch. 45, § 426 (Eng.).

Cork Committee's recommendations,[84] it was decided to introduce provisions which could lead to cross-frontier cooperation between insolvency courts, not only throughout the United Kingdom (which has three different legal systems, in England, Scotland and Northern Ireland) but throughout parts of the British Commonwealth and other former colonies which have a similar system of law.[85] To some extent this has been achieved under section 426 of the Insolvency Act 1986. Of course, the Commonwealth and former colonies do not include major trading partners such as the United States, Japan, and the rest of the European Union.

With regard to the European Union as a whole, 1996 saw, at long last, agreement on a European Insolvency Convention.[86] However, the United Kingdom has so far succeeded in holding up the Convention as part of the "Beef War" (i.e., the "mad cow" disease controversy) hostilities with the rest of Europe. The draft Convention certainly has its shortcomings[87] for European cross-frontier rescues, but as people have pointed out, it is probably better than having nothing.

With regard to cross-frontier rescue affecting countries outside the scope of section 426, matters are largely left to the good sense of the judges in the light of the prevailing caselaw. The basic principles on which the English courts act are that one court, usually the court of the place of incorporation, should act as the court of the principal insolvency proceedings, and that other courts should act in a way ancillary to the principal proceedings. The ancillary nature of the other proceedings, as far as England is concerned, involves giving directions on the transmission of assets to the principal insolvency proceeding. While this is well-established in the caselaw relating to liquidation, the caselaw dealing with rescue procedures is not well developed. In one case, an English Commercial Court judge refused to allow assets to be remitted to the United States to join assets that were subject to a Chapter 11

84. *See* CORK COMMITTEE REPORT, *supra* note 12, paras. 1911-12.

85. *See* PARL. DEB., H.C. (5th ser. Hansard) cols. 550-51 (July 18, 1985) (on file with author); Hughes v. Hannover Ruckversicherungs-Atkiengesellschaft (unreported decision, C.A. Jan. 28, 1997) (LEXIS, UK Library, Engcas File).

86. European Union Convention on Insolvency Proceedings, Nov. 23, 1995, 35 I.L.M. 1223.

87. Since we do not know whether the draft Convention will *ever* come into effect in its present form, I have not gone into detail here.

reorganisation.[88] It must be noted, however, that in that case there were no ancillary insolvency proceedings commenced in England and—perhaps more importantly—the terms of the proposed reorganisation were thought to be discriminatory against European creditors.[89] More helpful are recent dicta saying that the English courts will do their best to assist U.S. Chapter 11 proceedings.[90]

The transmission of assets from an English ancillary insolvency proceeding is subject to the deduction of debts made preferential under English legislation. It seems to be the case generally that domestic conflict-of-laws principles in different jurisdictions provide first for the payment of local preferential creditors. Furthermore, transmission of assets to the principal insolvency proceeding may also be complicated by the application of local English mandatory set-off provisions. In a recent first instance decision affecting BCCI, English liquidators were directed to retain monies payable to world-wide creditors who had claimed in the English liquidation and would have, as a result of the application of English mandatory set-off rules, received monies but who would not, under the law of the principal insolvency proceedings in Luxembourg, have received such payments.[91] This decision is very much open to question, although it may not have much effect on cross-frontier rescues.[92] Certain dicta in the same case try to cast doubt on the validity of the whole concept of ancillary insolvency proceedings,[93] but the court recognised that it was bound by caselaw precedent to accept the existence of ancillary insolvency pro-

88. *See* Felixstowe Dock & Ry. Co. v. United States Lines Inc., [1989] 1 Q.B. 360, 389 (1987).

89. *See id.* This view of *Felixstowe* has recently acquired the support of one of England's top judges. *See* Lord Hoffmann, Cross-Border Insolvency: The 1996 Denning Lecture 14-17 (Apr. 18, 1996) (on file with the *Brooklyn Journal of International Law*) (transcript available from the Bar Association for Commerce, Finance and Industry, 60 Temple Chambers, Temple Avenue, London EC4Y 0HP, Eng.).

90. *See* Banque Indosuez S.A. v. Ferromet Resources Inc., 1993 Butterworths Co. L. Cas. 112, 117I (Ch. 1992). This was Lord Hoffmann again—when he was still a first instance judge.

91. *In re* Bank of Credit & Commerce Int'l S.A. (No. 10), [1997] 2 W.L.R. 172 (Ch. 1996).

92. *See* Gabriel Moss & Nick Segal, *Cross-Border Issues, in* INSOLVENCY OF BANKS: MANAGING THE RISKS, *supra* note 70, ch. 6, para. 6.13.

93. *In re* Bank of Credit & Commerce Int'l S.A. (No.10), [1997] 2 W.L.R. at 193.

ceedings.[94]

In my view, the road ahead should expand the cross-frontier cooperation of insolvency courts, not only in relation to liquidation procedures, but also in relation to cross-frontier rescues. We already have the individual example of the Protocol in the Maxwell Communication Corporation case,[95] where the judges in charge of the Chapter 11 proceeding in the United States and administration order proceedings in England approved a system for cooperation between the examiner and the debtor-in-possession in the United States and the court-appointed administrators in England.[96] It should be possible to expand the principles behind this single case to a general body of principles for cooperation between insolvency courts in different countries generally. The prospect for the harmonisation of substantive insolvency provisions, including those relating to rescues, appears to be so remote that cooperation between insolvency courts appears to be the way forward.[97] It is, probably, the experience of most people in the field that whilst there are many technical differences between different systems of insolvency law, and even some fundamental differences in the approach to liquidation versus rescue as between the United States, the United Kingdom, and the rest of Europe, insolvency courts are adept at cooperating despite such problems. The example of the Maxwell Communication Corporation case has shown that it is possible to bridge the philosophical divide between the United Kingdom and the United States, and this shows that cooperation between the insolvency courts of each system is entirely possible. Whether larger philosophical gaps can be bridged remains to be seen, but the task of making a start is as urgent as when Mark Phillips and I first urged this route in 1992.[98]

94. *See id.* at 197.

95. *Re* Maxwell Communications Corp., [1993] 1 W.L.R. 1402 (Ch. 1993).

96. *See id.*; *see also* Hoffmann, *supra* note 89, at 18-20 (discussing this judicial co-operation).

97. *See* Gabriel Moss & Mark Phillips, *International Insolvency: Jurisdiction and Co-operation*, PRACTICAL L. FOR COMPANIES, Apr. 1992, at 6.

98. *Id.*

VIII. CONCLUSION

The rescue culture is now here to stay. It has not only permeated the legislation, but also the approach of practitioners and judges. Sadly, the Insolvency Act 1986 is regarded as one of worst-drafted statutes in U.K. legislative history. The faults are many, but they do not cost money to put right, and reform will help to save businesses and jobs. Thus, there is some hope for change in the near future.