

petition for the winding-up of authorised firms, recognised investment exchanges,<sup>70</sup> and unauthorised firms that have been carrying on regulated activities in breach of the general prohibition,<sup>71</sup> or to apply to the court for an administration order for such firms or exchanges,<sup>72</sup> and confers various rights of participation in relation to administration, compulsory winding-up or receivership proceedings for such entities.<sup>73</sup> The FCA is also empowered to participate in proceedings relating to voluntary arrangements for authorised persons and recognised investment exchanges,<sup>74</sup> and for the voluntary winding-up of such entities. The Prudential Regulation Authority (“PRA”)<sup>75</sup> has equivalent powers<sup>76</sup> in respect of PRA-regulated persons,<sup>77</sup> which include banks, building societies, credit unions, insurers and certain other investment firms.

### The Insolvency Act 2000 and the Enterprise Act 2002

#### *The move from administrative receivership to administration*

1-14 The Insolvency Act 1986 was further amended by the Insolvency Act 2000, which introduced into the 1986 Act new provisions on voluntary arrangements and moratoria and amended the provisions of the Company Directors Disqualification Act 1986 on the disqualification of directors. Of much greater import, however, were the insolvency provisions of the Enterprise Act 2002, of which the most significant were those that, with certain exceptions, abolished the long-established institution of administrative receivership. This is not a collective insolvency procedure, rather a debt enforcement remedy available to a creditor holding a floating charge which, together with any fixed charges, covers the whole or substantially the whole of the debtor company’s property.<sup>78</sup> The remedy is a powerful one, enabling the creditor to appoint an administrative receiver to take control of the company and its assets, largely displacing the directors, and to continue trading as deemed agent of the company, sell off the business or

<sup>70</sup> As defined in Financial Services and Markets Act 2000 s.285. Such exchanges are not required to be authorised.

<sup>71</sup> Section 367(1); see further below, para.5–17. See *Blackstone’s Guide to the Financial Services and Markets Act 2000*, edited by Michael Blair, 2nd edn (Oxford: Oxford University Press, 2009) at [26.21].

<sup>72</sup> Section 359(1), and see also s.362(6) allowing the regulator to apply to the court for the sanction of a compromise or arrangement under Pt 26 of the Companies Act 2006 where proposed during the administration.

<sup>73</sup> Sections 371 (compulsory winding-up), 363 (receivership), 362 (administration). The regulator’s consent is required before an administrator can be appointed by the company or its directors: s.362A.

<sup>74</sup> Sections 356, 365.

<sup>75</sup> Which is now the Bank of England, exercising these functions through the Prudential Regulation Committee: s.2A, as inserted by the Bank of England and Financial Services Act 2016.

<sup>76</sup> As inserted by the Financial Services Act 2012 Sch.14.

<sup>77</sup> As defined in Financial Services and Markets Act 2000 s.355(1).

<sup>78</sup> See para.1–39 and Ch.10.

individual assets or hive them down to a new, debt-free company which can then be sold off. There had long been disquiet over the power held by such a creditor, the making of what were sometimes seen to be precipitate appointments at almost no notice<sup>79</sup> and, where the creditor was over-secured (as was not uncommon) the lack of incentive to ensure that the costs of the receivership were kept down and the assets realised at the best price. Moreover, the receiver’s primary duty (apart from discharging preferential debts from floating charge assets) was to its appointing creditor, not to the general body of creditors. A further cause for concern was the ability of the creditor to block an administration—a collective procedure designed for the benefit of the creditors generally—by appointing an administrative receiver before the making of an administration order; and although in many cases the creditor was content to allow an administration, this was not always the case and its ability to block it was perceived as inimical to the rescue culture which had begun to be promoted during the 1990s.<sup>80</sup> The Insolvency Act 1986 had introduced a system of company voluntary arrangements, but it proved to be a rather ineffective mechanism for corporate rescue, largely because it did not in itself trigger a moratorium, which could only be brought about through administration.

Following a series of studies<sup>81</sup> and a flurry of government papers,<sup>82</sup> the decision was taken that in principle all insolvency proceedings should be collective in character. To that end, the Enterprise Act 2002 introduced into the Insolvency Act 1986 a provision prohibiting, with certain exceptions,<sup>83</sup> the appointment of an administrative receiver by the holder of a floating charge created on or after 15 September 2003. Instead, the chargee may appoint an administrator, but the making of distributions to the chargee is not a legitimate objective if it is reasonably practicable to achieve either of the two prior-ranking objectives (rescue of the company as a going concern and achieving a better result for creditors as a whole than on an immediate winding-up). The Act also provided that in an insolvency proceeding a prescribed part of the assets subject to a floating charge should be made available for the satisfaction of unsecured

<sup>79</sup> But see the empirical evidence reported in J. Franks and O. Sussman, *The Cycle of Corporate Distress, Rescue and Dissolution: A Study of Small and Medium Size UK Companies* (2000), discussed below, para.10–05.

<sup>80</sup> See Vanessa Finch and David Milman, *Corporate Insolvency Law*, 2017, Chs 6, 7 and 9; and Louise Gullifer, “The Reforms of the Enterprise Act 2000 and the Floating Charge as a Security Device” in Wolf-Georg Ringe, Louise Gullifer and Philippe Théry (eds), *Current Issues in European Financial and Insolvency Law: Perspectives from France and the UK* (Oxford: Hart Publishing, 2009), Ch.2. For further discussion of the rescue culture, see paras 1–33 and 2–23.

<sup>81</sup> See, e.g. P. Aghion, O. Hart and J. Moore, “A Proposal for Bankruptcy Reform in the UK” (1993) 9 I.L. & P. 103; and “Insolvency Reform in the UK: A Revised Proposal” (1995) 11 I.L. & P. 67.

<sup>82</sup> DTI, *Productivity and Enterprise—Insolvency: A Second Chance* (Cmnd.5234, 2001); DTI/Treasury, “A Review of Company Rescue and Business Reconstruction Mechanisms: Report by the Review Group” (2000); DTI Insolvency Service, *Company Voluntary Arrangements and Administration Orders: A Consultative Document* (1993); and *Revised Proposals for a New Company Voluntary Arrangement Procedure* (1995).

<sup>83</sup> See below, para.10–05.

debts. The effect is to reduce the advantages of a floating charge. The Act also abolished Crown preference.

### The fragmentation of debt

1-15 The overall effect of the changes introduced by the Enterprise Act was to strengthen the position of ordinary unsecured creditors and to transfer management control of the insolvent company's business and assets from the secured creditor and its administrative receiver to the insolvency administrator, a trend observable in other jurisdictions that have moved away from the practice of piecemeal realisation of assets to reorganisation of the company and its business.<sup>84</sup> However, a study conducted some years after the enactment of the Enterprise Act indicated that while there was an increase in recoveries, this was offset by increased costs.<sup>85</sup> At the same time, fragmentation in corporate debt capital structures was making it more challenging to achieve co-ordinated solutions to financial distress outside of the auspices of a formal insolvency procedure.<sup>86</sup>

This debt fragmentation was in part due to a marked shift by banks away from relationship lending, based on the debtor's credit and business prospects and secured against the debtor's assets generally without specific identification and valuation, to finance by specialist companies against specific assets (receivables, inventory, plant and machinery, property) on the basis of careful valuation. This shift was partly influenced by the decisions of the House of Lords in *Brumark*<sup>87</sup> and *Spectrum*,<sup>88</sup> which largely put paid to the ability of banks to obtain a fixed charge over receivables. But the main reason for the move from relationship lending to asset-based finance was the decision of the banks to shore up their share capital and restrict lending, driving companies seeking finance to approach specialist, asset-based financiers and the banks themselves to set up subsidiaries

<sup>84</sup> For a perceptive analysis of this trend, with references to the shift in the UK approach, see Jay Lawrence Westbrook, "The Control of Wealth in Bankruptcy" (2004) 82 Texas L. Rev. 795, 805. The trend has intensified in recent years, with a large number of jurisdictions introducing reorganisation-oriented reforms. See e.g. the summary of reforms in World Bank, "Resolving Insolvency Reforms by Economy, 2008-2017".

<sup>85</sup> John Armour, Audrey Hsu and Adrian Walters, "The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings" (2006), a report prepared for the Insolvency Service.

<sup>86</sup> John Armour, "The Rise of the 'Pre-Pack': Corporate Restructuring in the UK and Proposals for Reform" in R.P. Austin and Fady J.G. Aoun, *Restructuring Companies in Troubled Times: Director and Creditor Perspectives* (Ross Parsons Centre of Commercial, Corporate and Taxation Law, 2012); see also Sandra Frisby, "Report on Insolvency Outcomes", a report to the Insolvency Service in 2006, pp.33 et seq., later amplified by her "Interim Report to the Insolvency Service on Returns to Creditors from Pre- and Post-Enterprise Act Insolvency Procedures" (2007).

<sup>87</sup> *Re Brumark Investments Ltd, sub. nom. Agnew v IRC* [2001] 2 A.C. 710.

<sup>88</sup> *Re Spectrum Plus Ltd* [2005] 2 A.C. 680. For the ramifications of this case, see Joshua Getzler and Jennifer Payne (eds), *Company Charges: Spectrum and Beyond* (Oxford: Oxford University Press, 2006).

for asset-based lending, which being secured carries a lower risk and reduces capital adequacy requirements. Asset-based finance takes various forms: asset-based lending, factoring and invoice discounting,<sup>89</sup> conditional sale, hire-purchase and leasing.<sup>90</sup> It is also not uncommon for factors and invoice discounters to take and register a charge over assets other than the receivables they are purchasing. The move to asset-based financing created a distinct problem for rescue operations in that whilst banks engaged in relationship lending tend to value the preservation of the business and will make efforts to bring this about, the general approach of asset-based financiers is to exercise their default remedies against the assets and then pull out, without too much regard to the impact on the company.<sup>91</sup>

Although the move to asset-based financing is an element in the diffusion of debt, the more dominant causes of fragmentation at the larger end of the market are capital market debt issuances, the multi-tiering of debt, syndicated financing, sales and resales of credit default swaps<sup>92</sup> and the slicing of distressed debt through sales of participations. A consequence of this is to complicate restructurings because the composition of the creditors is constantly changing, with major creditors being unwilling to reveal themselves, participate in creditors' meetings and receive information on account of the constraints which rules on insider trading impose on their ability to trade their debt holdings. Bondholders in particular can be a source of difficulty in that unless a representative is appointed, there is usually no way of knowing who the current bondholders are. There are also the more general difficulties associated with co-ordinating a large body of creditors who are heterogeneous as to rights and interests<sup>93</sup> to achieve a restructuring solution, although these difficulties can in some contexts be somewhat mitigated by the negotiation of inter-creditor agreements *ex ante* that allocate certain control rights to senior lenders and may provide for a standstill.<sup>94</sup>

In the last decade there have been a number of proposals to reform UK corporate insolvency law with a view to better facilitating the achievement of

<sup>89</sup> Usually this consists of the sale of receivables, the credit coming from arrangements to prepay the price in advance of maturity of the receivables.

<sup>90</sup> See John Armour, "Should We Redistribute in Insolvency?" in J. Getzler and J. Payne (eds), *Company Charges: Spectrum and Beyond* (Oxford: Oxford University Press, 2006), pp.189-226; and Vanessa Finch, "Corporate Rescue in a World of Debt" (2008) J.B.L. 756.

<sup>91</sup> This was already noted some years ago by Frisby, "Report on Insolvency Outcomes", pp.35 and 39, and appears to be the same today.

<sup>92</sup> Some of which are held as "naked" CDSs, that is, without ownership of the underlying security, so that the purchaser is either buying to resell or speculating on the likelihood of default and consequent right to collect payment from the protection seller. In theory, this latter variety of CDSs provides a perverse incentive to holders of the CDSs to force a bankruptcy. Whether this happens in practice is another matter. For one reason why it may not, see Alan Kornberg and Sarah Paterson in Rodrigo Olivares-Caminal et al., *Debt Restructuring*, 2nd edn (Oxford: Oxford University Press, 2016) at [3.28] (noting the risk that CDS holders may not be able to rely on the swap protection where they precipitate the event from which they seek protection).

<sup>93</sup> See the analysis of Sarah Paterson on the impact of the emergence of distressed debt trading in London markets, in "Bargaining in Financial Restructuring: Market Norms, Legal Rights and Regulatory Standards" (2014) 14(2) *Journal of Corporate Law Studies* 333.

<sup>94</sup> See below, para.12-03.

debt restructuring and corporate rescue outcomes.<sup>95</sup> The first wave of these proposals was prompted by the financial crisis of 2007–2008 and the recession that followed<sup>96</sup>; more recently, developments in the European Union (particularly the issuance of a European Commission Recommendation on the design of Member States' domestic restructuring laws, which was subsequently followed by a proposal for a directive on this subject),<sup>97</sup> combined with a fall in the UK's ranking in the World Bank's annual "Doing Business" insolvency report,<sup>98</sup> have led to a further proposal from the Insolvency Service for significant reform.<sup>99</sup> These proposals have for the most part not yet been implemented,<sup>100</sup> but in the meantime practitioners have innovated, making creative use of existing procedures (particularly, administration in pre-packaged form, sometimes combined with a scheme of arrangement) to achieve restructurings for financially distressed companies.

### The Banking Act 2009

- 1–16 This Act, which replaced the emergency Banking (Special Provisions) Act 2008, was designed to provide a more efficient and effective system of regulation for bank failures, consequent upon the collapses of Northern Rock and Lehman Brothers.<sup>101</sup> The Act has now been amended in a number of important ways to ensure UK implementation of the EU Bank Recovery and Resolution Directive.<sup>102</sup> That implementation process has also led to changes to other aspects of English corporate insolvency law, including the rules on preferential debts.<sup>103</sup>

<sup>95</sup> These tend to go hand-in-hand, for a corporate rescue of a financially distressed debtor cannot usually be achieved without, at minimum, a restructuring of its liabilities.

<sup>96</sup> "Proposals for a Restructuring Moratorium: A Consultation" (July 2010). This followed an earlier consultation paper, "Encouraging Company Rescue" (June 2009). See further para. 11–32.

<sup>97</sup> Commission Recommendation of 12 March 2014 on a new approach to business failure and insolvency, C(2014) 1500 final, followed by European Commission, Proposal for a Directive of the European Parliament and of the Council on preventative restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30 (COM/2016/0723). See further below, para. 1–18.

<sup>98</sup> World Bank, *Doing Business: Measuring Business Regulations*, "Resolving Insolvency". The change in the UK ranking followed a change in 2015 in the Resolving Insolvency methodology.

<sup>99</sup> Insolvency Service, *Review of the Corporate Insolvency Framework: A consultation on options for reform* (May 2016).

<sup>100</sup> However, the provision in s.233 of the Insolvency Act 1986 for the protection of essential supplies in insolvency proceedings was expanded and a new provision for further protection for companies in administration or under voluntary arrangements (s.233A) added by the Insolvency (Protection of Essential Supplies) Order 2015 in exercise of the power conferred by the Enterprise and Regulatory Reform Act 2013 ss.92–95. See below, para. 7–29.

<sup>101</sup> See below, paras 1–58 et seq.

<sup>102</sup> Below, para. 1–59.

<sup>103</sup> Below, para. 8–20.

### Small Business, Enterprise and Employment Act 2015

The Small Business, Enterprise and Employment Act 2015 (the "SBEEA") grew out of two government initiatives. The first was the "red tape challenge", a deregulatory initiative designed to reduce burdens on business.<sup>104</sup> The second was the "transparency and trust" initiative, aimed at enhancing transparency of UK company ownership and increasing trust in UK business, including in insolvency.<sup>105</sup> The result was a wide-ranging set of reforms. Most of the changes were set out in the SBEEA, though some (including some corporate insolvency law changes) were achieved through the complementary Deregulation Act 2015,<sup>106</sup> and a few insolvency-related aspects of the "transparency and trust" agenda (particularly those relating to the regulation of pre-packaged administration, and the regulation of insolvency practitioner remuneration)<sup>107</sup> were pursued separately.<sup>108</sup>

The reforms implemented by the SBEEA are noted where relevant throughout the book, but given the scale of the changes, it is appropriate to signal some of the most important here. Insolvency procedure has been changed significantly with the abolition of requirements for physical meetings of creditors (or shareholders, as the case may be) to be held.<sup>109</sup> Decisions must now be sought from creditors (or shareholders) using a range of alternative procedures, the "qualifying decision procedures" prescribed in the Insolvency Rules 2016,<sup>110</sup> except where 10% in value or number of creditors (or shareholders) of any class, or 10 creditors (or shareholders) of any class, request a physical meeting in writing,<sup>111</sup>

<sup>104</sup> On the insolvency aspects of this initiative, see Insolvency Service Consultation, "Red Tape Challenge—changes to insolvency law to reduce unnecessary regulation and simplify procedures: Consultation" (July 2013). Not all of the changes consulted on were deregulatory in nature: see, for example, the proposal to empower the administrator to bring wrongful and fraudulent trading actions (pp.37–38), which was implemented in the Small Business, Enterprise and Employment Act 2015.

<sup>105</sup> Department for Business, Innovation and Skills, *Transparency & Trust: Enhancing the Transparency of UK Company Ownership and Increasing Trust in UK Business* (July 2013).

<sup>106</sup> See s.17 (partial authorisation of insolvency practitioners, noted below, para.10–25) and Sch.6 to the Deregulation Act 2015. Some parts of Sch.6 repealed provisions of the Insolvency Act 1986 that had fallen into disuse (e.g. s.151, repealed by para.9 of Sch.6) or become redundant, but other parts were designed to cure difficulties experienced with the application of existing rules in practice (see for example, paras 5 and 6 on entry into administration, noted below, para. 11–45).

<sup>107</sup> Prompted by the report by Elaine Kempson, "Review of Insolvency Practitioner Fees: Report to the Insolvency Service" (July 2013).

<sup>108</sup> Provision was however made in the Small Business, Enterprise and Employment Act 2015 for the Secretary of State to regulate (including by prohibiting) sales to connected parties in administration, a provision designed as a "fall back" if other initiatives for the regulation of pre-packaged sales in administration came to be regarded as unsuccessful: s.129, and below, para.1–37. On insolvency practitioner remuneration reform, see Insolvency (Amendment) Rules 2015 (SI 2015/443), and below, para.5–09.

<sup>109</sup> Small Business, Enterprise and Employment Act 2015 s.122, inserting s.246ZE into the Insolvency Act 1986.

<sup>110</sup> Insolvency Rules 2016, Pt 15. The procedures include electronic voting (r.15.4) and virtual meetings (r.15.5).

<sup>111</sup> Insolvency Act 1986 s.246ZE(7), (8), (3).

or statute or a court order otherwise provides.<sup>112</sup> More radically, there is an option for the “deemed consent procedure” to be used as an alternative to a qualifying decision procedure,<sup>113</sup> pursuant to which assent is deemed given except where more than 10% in value of relevant creditors (or shareholders) give notice of their objection.<sup>114</sup> The requirement that creditors submit a formal proof of their claim to be entitled to participate in a distribution in liquidation or administration has been relaxed for creditors with small claims.<sup>115</sup> Those who have been a director of a company that enters insolvency proceedings have been made subject to a new source of personal liability (the “compensation order”, available in connection with disqualification),<sup>116</sup> additional to their liability for breach of directors’ duties and wrongful and/or fraudulent trading. Actions for wrongful and fraudulent trading, previously confined to liquidators, have been made available to administrators,<sup>117</sup> and both liquidators and administrators have been given power to assign these and other office-holder actions (including the avoidance actions available to liquidators and administrators under s.238 of the Insolvency Act 1986, for the avoidance of transactions at undervalue, and s.239 of the Act, for the avoidance of preferences) to third parties,<sup>118</sup> with a view to increasing the likelihood of such actions being brought.<sup>119</sup> Requirements for liquidators (particularly in court-ordered winding-up) to obtain sanction before exercising various powers, including the power to bring office-holder actions,<sup>120</sup> have been removed,<sup>121</sup> bringing the position for liquidators in line with that for administrators.

### The European dimension

1-18 Though the EU has not yet assumed general competence in the field of substantive insolvency law, there are several instruments of EU law which affect English insolvency law, jurisdiction and procedure and which, so far as not directly applicable, have been implemented in the UK by subordinate legislation under the European Communities Act 1972. Some of these are specific to

<sup>112</sup> Insolvency Act 1986 s.246ZE(5).

<sup>113</sup> Except in relation to a decision on remuneration, or where statute or an order of the court otherwise provides: Insolvency Act 1986 s.236ZF(1), (2).

<sup>114</sup> Insolvency Act 1986 s.246ZF and Insolvency Rules 2016 r.15.7. “Relevant creditors” are those who would be entitled to vote in a qualifying decision procedure on the matter: s.246ZF(7).

<sup>115</sup> Small Business, Enterprise and Employment Act 2015 s.131 and Insolvency Rules 2016 r.14.31. The amount presently prescribed is £1,000 or less. See below, para.8–50.

<sup>116</sup> Small Business, Enterprise and Employment Act 2015 s.110 and below, paras 1–25 and 14–52.

<sup>117</sup> Small Business, Enterprise and Employment Act 2015 s.117.

<sup>118</sup> Small Business, Enterprise and Employment Act 2015 s.118; see below, paras 5–06 and 6–36.

<sup>119</sup> *Transparency and Trust*, cited above fn.105, [57].

<sup>120</sup> Insolvency Act 1986 Sch.4, para.3A, for which sanction was previously required in both voluntary and compulsory winding-up.

<sup>121</sup> Small Business, Enterprise and Employment Act 2015 s.120. See further below, para.5–04.

particular types of organisation. For example, the Capital Requirements Directive and Regulation<sup>122</sup> contains provisions resulting from the Basel III Accord requiring the authorisation of banks and other credit institutions and capital adequacy requirements for such institutions and for investment firms in order to ensure their solvency,<sup>123</sup> while the Bank Recovery and Resolution Directive<sup>124</sup> (“BRRD”) prescribes tools for early intervention and resolution in the event of their anticipated failure,<sup>125</sup> and the Credit Institutions Winding-up and Reorganisation Directive (as amended by the BRRD) deals with cross-border aspects of the exercise of such resolution powers across the EU, and of other forms of reorganisation measures or winding-up procedures to which such institutions and firms may become subject after or as an alternative to a resolution process.<sup>126</sup> Similarly, there has been a series of directives on insurance.<sup>127</sup> Special protection against rules of insolvency law has been given to the financial markets by the Settlement Finality Directive and the Financial Collateral Directive.<sup>128</sup> But what affects insolvent companies generally in an EU insolvency is the European Insolvency Regulation (as recast),<sup>129</sup> containing detailed provisions on jurisdiction to open insolvency proceedings (as defined) in a Member State and the extraterritorial scope of such proceedings, the applicable law, recognition of the proceedings in other Member States, publicity, and co-operation and co-ordination where proceedings falling within the scope of the Regulation are opened in

<sup>122</sup> Regulation (EU) No.575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No.648/2012 (OJ L176/1, 27 June 2013) and Directive 2013/36 of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87 and repealing Directives 2006/48 and 2006/49 (OJ L176/338, 27 June 2013), together “CRD IV”.

<sup>123</sup> See Directive 2013/36, Recital 34.

<sup>124</sup> Directive 2014/59 of the European Parliament and of the Council establishing a framework for the recovery and resolution of credit institutions and investment firms and amending Council Directive 82/891, and Directives 2001/24, 2002/47, 2004/25, 2005/56, 2007/36, 2011/35, 2012/30 and 2013/36, and Regulations (EU) No.1093/2010 and (EU) No.648/2012, of the European Parliament and of the Council.

<sup>125</sup> And, in the case of the resolution tools, various prescribed related entities: see above, arts 1(1), 2(1) sub-para.23, and art.37(1).

<sup>126</sup> European Parliament and Council Directive 2001/24 of 4 April 2001 on the reorganisation and winding-up of credit institutions, [2001] OJ L125/15, as amended by the Bank Recovery and Resolution Directive cited above, fn.124. As to the choice between resolution and normal insolvency procedures, see below, para.1–59.

<sup>127</sup> See most recently Directive 2009/138 of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast), [2009] OJ L 335/1, Title IV of which replaces Council Directive 2001/17 of 19 March 2001 on the reorganisation and winding-up of insurance undertakings, [2001] OJ L110/28. See Gabriel Moss, Bob Wessels (eds), *EU Banking and Insurance Insolvency*, 2nd edn (Oxford: Oxford University Press, 2017).

<sup>128</sup> See below, paras 1–61 et seq. As to the interaction between these Directives and the Bank Recovery and Resolution Directive (above, fn.124), see below, para.1–73.

<sup>129</sup> Regulation (EU) 2015/858 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings, [2015] OJ L141/19, repealing Council Regulation 1346/2000 of 29 May 2000 on insolvency proceedings, [2000] OJ L160/1.

more than one Member State in relation to the same debtor, or in relation to multiple members of a corporate group.<sup>130</sup> The Regulation is designed to improve the efficacy of domestic insolvency procedures in cross-border cases, rather than to regulate the design of those procedures: this is left for the most part to Member States to determine.<sup>131</sup> But, as indicated above,<sup>132</sup> the European Commission has recently proposed a directive on aspects of the design of Member States' restructuring and insolvency laws.<sup>133</sup> This would require Member States to offer business debtors a restructuring procedure that complies with the minimum standards prescribed by the Directive. This will be the first significant move by the EU into substantive insolvency law (outside of the banking sphere), and may not be the last: there have been a number of proposals for harmonisation in various areas of insolvency law in recent years.<sup>134</sup>

The UK is presently in the midst of negotiations to leave the European Union. The outcome of these "Brexit" negotiations is unclear, but it appears likely that at least some of the above arrangements will eventually be replicated in another form (likely through a bilateral arrangement) as part of securing the UK's trading position. Membership of the European Economic Area would render the UK subject to some of the above instruments (including the Credit Institutions Winding-up and Reorganisation Directive),<sup>135</sup> but such membership does not appear to be currently contemplated.

### International insolvency

1-19 There has also been much activity in relation to cross-border insolvency at the international level. The United Nations Commission on International Trade Law (UNCITRAL) has been particularly prominent in this field. A growing number of countries, including the United Kingdom,<sup>136</sup> have adopted the 1997 UNCITRAL Model Law on cross-border insolvency,<sup>137</sup> which is discussed in Chapter 16. More recently, UNCITRAL's Working Group V (Insolvency) has produced a draft Model Law on the recognition and enforcement of insolvency-related

<sup>130</sup> See Ch.15. The Insolvency Regulation does not apply to credit institutions, investment firms and other firms, institutions and undertakings to the extent covered by Directive 2001/24 (cited above, fn.126), insurance undertakings, and collective investment undertakings: see further van Zwieten in R. Bork and K. van Zwieten, *Commentary on the European Insolvency Regulation* (Oxford: Oxford University Press, 2016) paras 1-57 et seq.

<sup>131</sup> Although the Regulation does regulate some aspects of domestic law, particularly aspects of insolvency procedure: see for example the rules in Ch.IV of the Regulation on the provision of information for creditors and lodgment of their claims, and the rules in arts 24-29 on insolvency registers.

<sup>132</sup> See para.1-15.

<sup>133</sup> See "Proposal for a Directive" cited above, fn.97.

<sup>134</sup> See the summary in European Commission, "Inception Impact Assessment: Initiative on insolvency" DG JUST (A1), 2016/JUST/025—Insolvency II, Section A.

<sup>135</sup> As a result of its inclusion in Annex IX of the EEA Agreement.

<sup>136</sup> Cross-Border Insolvency Regulations 2006 (SI 2006/1030).

<sup>137</sup> Republished in 2013 with a Guide to Enactment and Interpretation.

judgments, prompted<sup>138</sup> by the decision of the Supreme Court in *Rubin v Eurofinance SA*<sup>139</sup> that recognition and enforcement of foreign judgments against third parties (on the facts, a transaction avoidance judgment) fell outside the scope of the Model Law as implemented in the UK, and was not a matter that the Model Law had been designed to govern.

UNCITRAL has also done important work at the domestic insolvency law level, particularly through the publication in 2004 of its *UNCITRAL Legislative Guide on Insolvency Law*, a major work, later supplemented by the addition of further parts on the treatment of enterprise groups in insolvency both at the domestic and at the international levels (Pt III of the Guide, added in 2010), and on directors' obligations in the period approaching insolvency (Pt IV of the Guide, added in 2013).<sup>140</sup>

### The sources of corporate insolvency law

#### (1) The common law

Although the greater part of corporate insolvency law is statutory,<sup>141</sup> there are certain régimes governed wholly or partly by common law principles and by the inherent jurisdiction of the court. Until the passing of what is now the Insolvency Act 1986, the law relating to the receivership of companies was almost entirely based on contract and on rules developed by the courts, and although the powers and principal obligations of administrative receivers<sup>142</sup> are now codified in the Insolvency Act 1986, much of receivership law continues to be based on common law principles. Arrangements and compromises concluded between a company and its creditors by contract without any insolvency proceeding remain wholly outside the purview of legislation except so far as they involve dispositions and other dealings which would be void or voidable under the Insolvency Act if the company were subsequently to go into winding-up or administration. By contrast, winding-up is almost exclusively governed by the Act and subordinate legislation. Yet even winding-up is influenced by the creative power of the courts. The principle of *pari passu* distribution of assets among ordinary, unsecured creditors, which under the Bankruptcy Act 1914 was encapsulated in precisely 11 words<sup>143</sup> and in the case of compulsory winding-up is now relegated

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<sup>138</sup> See UNCITRAL Working Group V (Insolvency), "Insolvency Law: Recognition and enforcement of foreign insolvency-derived judgements—Note by the Secretariat" A/CN.9/WG.V/WP.126, [2].

<sup>139</sup> *Rubin v Eurofinance SA* [2013] 1 A.C. 236.

<sup>140</sup> See below, para.16-10, on new work being done by Working Group V on cross-border insolvency in enterprise groups.

<sup>141</sup> There are several good compilations of the insolvency legislation, of which the most comprehensive is that by Len Sealy and David Milman, *Sealy & Milman: Annotated Guide to the Insolvency Legislation 2018*, 21st edn (London: Sweet & Maxwell, 2018).

<sup>142</sup> See below, paras 10-41 et seq.

<sup>143</sup> Bankruptcy Act 1914 s.33(7), incorporated into companies winding-up by the Companies Act 1985 s.612 (later repealed).

to subordinate legislation,<sup>144</sup> has been developed by the courts into a fundamental concept of insolvency law having the most profound repercussions on the validity of pre-liquidation contracts and dispositions entered into between the company and its creditors and between creditors *inter se*.<sup>145</sup> The related anti-deprivation rule, by which arrangements for the divestment of a company's property by reason of its entry into insolvency proceedings may be invalidated,<sup>146</sup> is similarly judge-made. Moreover, the statutory provisions delimiting the assets available for distribution predicate that unless otherwise provided, the attachment, perfection and priority of security interests and other real rights are to be determined by the general law applicable to transactions outside winding-up,<sup>147</sup> the bulk of which is non-statutory. Finally, although the statutory regime makes detailed provision as to how creditors are to evidence their claim for the purposes of establishing an entitlement to a distribution from the assets available for this purpose (the statutory process of "proof"), some forms of liability fall outside these rules, and the treatment of such non-provable liabilities is also a matter of judge-made law.<sup>148</sup>

The court's inherent jurisdiction over its own officers enables it to deny to a liquidator appointed by the court<sup>149</sup> rights and remedies to which he or she is on the face of it entitled by law where the exercise of those rights or remedies would in the opinion of the court be unfair or inequitable.<sup>150</sup> But the rule is rarely invoked successfully and is generally considered the last resort for a party who has no other reasonable grounds for challenging a liquidator's decision. For this reason it is confined to the exceptional case involving dishonourable behaviour or the threat of dishonourable behaviour or to enable the court to allow the liquidator to fulfil a promise even if not legally binding.<sup>151</sup>

Of greater significance in practice are common law powers of judicial assistance, by which English courts have power to assist a foreign court dealing with the bankruptcy of a company over which that court has jurisdiction. The common

<sup>144</sup> Insolvency Rules 2016 r.14.12, previously Insolvency Rules 1986 r.4.181.

<sup>145</sup> In this connection it should be appreciated that what the courts are at bottom concerned with is to invalidate contractual provisions designed to bypass the collective distribution machinery laid down by the Insolvency Act, to the detriment of the general body of creditors. That would be the concern whatever the insolvency distribution rules might be. But since the rule for ordinary creditors is that of *pari passu* distribution, such provisions are commonly attacked as undermining the principle of such distribution, by which is meant the collective machinery leading to *pari passu* distribution. See below, paras 3–07 and 8–02.

<sup>146</sup> Except where commercially sensible and entered into in good faith: see below, Ch.7.

<sup>147</sup> See below, para.6–01.

<sup>148</sup> Below, para.8–54.

<sup>149</sup> A liquidator in a creditors' voluntary winding-up is not an officer of the court and is not bound by the rule in *ex p. James*, nor can he be treated by analogy in the same way as an officer of the court (*Re T. & H. Knitwear Ltd* [1988] Ch. 275).

<sup>150</sup> This is commonly known as the rule in *Ex p. James*, having been formulated (although not for the first time) in the Court of Appeal decision in *Re Condon Ex p. James* (1874) L.R. 9 Ch. 609.

<sup>151</sup> *Re T.&N. Ltd* [2004] O.P.L.R. 343, per David Richards J, citing the judgment of Salter J in *Re Wigzell Ex p. Hart* [1921] 2 K.B. 835; and *Re Collins & Aikman Europe SA* [2006] B.C.C. 861.

law posits that ideally, bankruptcy proceedings should have universal application, such that "the worldwide assets of the company and the worldwide claimants to those assets are treated on a common basis",<sup>152</sup> and to this end the court may provide a range of forms of assistance to the foreign court. Whilst the scope of available assistance has been narrowed by recent case law,<sup>153</sup> the common law power remains an important tool in cross-border cases.

In *Re Lehman Bros International (Europe) (in administration) (No.4)*,<sup>154</sup> Lord Neuberger<sup>155</sup> noted that whilst the introduction of the Insolvency Act and Rules of 1986 had effected a "comprehensive overhaul of the insolvency legislation", the 1986 legislation was not a complete code, and that long-established judge-made rules survived its introduction provided that they were "well-established, consistent with the terms and underlying principles of current legislative provisions, and reasonably necessary to achieve justice".<sup>156</sup> His Lordship sounded a strong note of caution, however, regarding the development of new-judge made rules: "in the light of the full and detailed nature of the current insolvency legislation and the need for certainty, any judge should think long and hard before extending or adopting an existing rule, and, even more, before formulating a new rule".<sup>157</sup> This caution must be understood within the context of the case with which the Supreme Court was concerned, in which the Court of Appeal below had cured an "inexplicable" lacuna in the drafting of the provisions of the Insolvency Act and Rules on the payment of interest accruing after the commencement of insolvency proceedings<sup>158</sup> by what Lord Neuberger characterised as an "entirely new judge-made rule" that in effect rewrote the statutory provisions.<sup>159</sup> Subsequent case law suggests that the lower courts are taking Lord Neuberger's caution seriously.<sup>160</sup> At the same time, however, other developments—most obviously, the UK exit from the European Union, and the likely eventual disappearance of some rules presently imposed, directly or

<sup>152</sup> *Stichting Shell Pensioenfonds v Kryss* [2015] A.C. 616 at [38], per Lord Sumption and Lord Toulson.

<sup>153</sup> See *Singularis Holdings Ltd v Pricewaterhouse Coopers* [2015] A.C. 1675, discussed below, paras 16–55 and 16–57.

<sup>154</sup> *Re Lehman Bros International (Europe) (in administration) (No.4)* [2017] 2 W.L.R. 1497.

<sup>155</sup> With whom Lord Kerr and Lord Reed agreed. Lord Sumption and Lord Clarke gave separate judgments on one of the issues of statutory construction, but otherwise agreed with Lord Neuberger.

<sup>156</sup> *Re Lehman Bros International (Europe) (in administration) (No.4)* [2017] 2 W.L.R. 1497 at [13], giving as examples the anti-deprivation rule (see below, Ch.7), the rule against double-proof (see below, para.8–49), the rule in *Cherry v Boulbee* (but see below, para.8–49) and "certain rules of fairness (alluded to in *In re Nortel GmbH* [2014] A.C. 209, [22])", a reference to the rule in *Ex p. James* noted above, fn.150 and accompanying text.

<sup>157</sup> *Re Lehman Bros International (Europe) (in administration) (No.4)* [2017] 2 W.L.R. 1497.

<sup>158</sup> In cases where the company moved from administration to liquidation without interest accruing in the administration having been paid.

<sup>159</sup> *Re Lehman Bros International (Europe) (in administration) (No.4)* [2017] 2 W.L.R. 1497 at [119]–[123].

<sup>160</sup> See, e.g. *Re Nortel Networks UK Ltd* [2017] EWHC 1429 (Ch), and *In the matter of Lehman Brothers Europe Ltd (in administration)* [2017] EWHC 2013 (Ch), and *Re Zinc Hotels (Holdings) Ltd* [2018] EWHC 1936 (Ch).

indirectly, by EU instruments—will place new pressure on judges to innovate. Even under the present law there are a great many matters on which the insolvency legislation is silent,<sup>161</sup> suggesting that some degree of judicial innovation is both inevitable and, provided consistent with the legislative framework, desirable.

## (2) Primary and subordinate legislation

- 1-21 There are six principal sets of primary and subordinate legislation dealing with the insolvency of companies at large and a seventh specifically directed to the insolvency of banks.

### INSOLVENCY ACT 1986

The Insolvency Act 1986, as amended by the Insolvency Act 1994, the Insolvency (No.2) Act 1994, the Insolvency Act 2000, the Enterprise Act 2002 and the Small Business, Enterprise and Employment Act 2015, is the main enactment dealing with corporate insolvency. It also covers personal bankruptcy. There are also a few free-standing provisions in the amending legislation, for example, s.14 of the Insolvency Act 2000 empowering the Secretary of State to make regulations implementing the UNCITRAL Model Law on Cross-Border Insolvency,<sup>162</sup> or s.144 of the Small Business, Enterprise and Employment Act 2015 empowering the Secretary of State to establish a single regulator of insolvency practitioners if the other changes to the regulatory regime made by that Act<sup>163</sup> are not considered to be successful.

### INSOLVENCY RULES 2016

- 1-22 The Insolvency Rules 2016<sup>164</sup> provide the procedural underpinning of the Insolvency Act, although as will be seen the division between Act and Rules is not clear-cut, the Act itself containing various procedural requirements, while the Rules embody a few substantive provisions.<sup>165</sup> The same was true of the predecessor to the 2016 Rules, the Insolvency Rules 1986. In other respects, however, the 2016 Rules represent a significant improvement on the 1986 Rules. The ordering of subjects within the 1986 Rules was mildly eccentric. For example,

<sup>161</sup> For example, on the making and determination of expense claims (see *Re Nortel Networks*, above), or on the treatment of non-provable liabilities (below, para.8–54).

<sup>162</sup> See the Cross-Border Insolvency Regulations 2006 (SI 2006/1030).

<sup>163</sup> See below, para.1–31.

<sup>164</sup> SI 2016/1024, replacing Insolvency Rules 1986 SI 1986/1925 as amended.

<sup>165</sup> See below, para.1–30.

Ch.9 in Pt 4 dealt with proof of debts in liquidation, but the reader had to trawl through to Pt 12, “Miscellaneous and General”, to discover the answer to the vital question of what debts are provable.<sup>166</sup> In the 2016 Rules these matters are now dealt with sensibly in a single part that addresses claims by and distributions to creditors in administration, winding-up and bankruptcy.<sup>167</sup> This is just one of the areas in which the Rules have been restructured and consolidated, and the result (a product of several years of work by the Insolvency Rules Committee) is a much more accessible statutory instrument.

The Insolvency Rules 2016 also gave effect to the changes introduced by the Small Business, Enterprise and Employment Act 2015 to decision-making procedure in insolvency proceedings. Thus, the new forms of “qualifying decision procedure” which are to be used where physical meetings of creditors (or shareholders) were previously required<sup>168</sup> are prescribed by the 2016 Rules.<sup>169</sup> Similarly, the provision in the 2015 Act for creditors owed small debts to be deemed to have proved their debt for the purpose of establishing an entitlement to a dividend was given effect in the 2016 Rules.<sup>170</sup> More generally, rules on electronic communication with creditors, including the provision of documents in electronic form, have been relaxed, and new provision has been made for creditors who wish to “opt out” of receiving notices and reports to do so.<sup>171</sup>

### FINANCIAL MARKETS LEGISLATION AFFECTING CORPORATE INSOLVENCY

Reference has already been made to the powers of intervention in insolvency conferred on the Financial Conduct Authority and the Prudential Regulation Authority by Pt XXIV of the Financial Services and Markets Act 2000.<sup>172</sup> Major dispensations from the rules of insolvency law, mostly implementing EU legislation, have been given by and under the Companies Act 1989<sup>173</sup> in respect of market charges and market contracts<sup>174</sup> and systems-charges taken by settlement

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<sup>166</sup> Insolvency Rules 1986 r.12.3.

<sup>167</sup> Insolvency Rules 2016 Pt.14.

<sup>168</sup> See above, para.1–17.

<sup>169</sup> See Insolvency Rules 2016 Pt 15.

<sup>170</sup> See above, para.1–17 and Insolvency Rules 2016 r.14.31.

<sup>171</sup> Insolvency Rules 2016 Pts 1, 9. On opt-out see rr.1.37–1.39, and s.246C of the Insolvency Act 1986.

<sup>172</sup> See above, para.1–13.

<sup>173</sup> As amended by the Financial Markets and Insolvency Regulations 2009 (SI 2009/853), which provide further protection for the actions of recognised investment exchanges and recognised clearing houses in the event of default by any of their members. This protection is now expressed to apply to various transactions cleared through recognised central counterparties: Financial Services and Markets Act 2000 (Over the Counter Derivatives, Central Counterparties and Trade Repositories) Regulations 2013 (SI 2013/504), amending Companies Act 1989 Pt VII. See below, para.1–62.

<sup>174</sup> Companies Act 1989 Pt VII, as amended; Financial Markets and Insolvency Regulations 1991 (SI 1991/880), as amended by the Financial Markets and Insolvency Regulations 2009.

banks to secure obligations arising from dealings in uncertificated securities<sup>175</sup> and financial collateral arrangements.<sup>176</sup>

#### EMPLOYMENT AND PENSIONS LEGISLATION

- 1-24 There are also provisions under both employment legislation and pensions legislation for the protection of employees on the insolvency of their employer or on transfer of the employer's undertaking.<sup>177</sup> Pension liabilities have become an increasingly important feature of corporate insolvency in recent years.

#### DISQUALIFICATION OF DIRECTORS

- 1-25 The Company Directors Disqualification Act 1986,<sup>178</sup> to which reference has been made earlier, gathered together the statutory provisions on disqualification of directors previously dispersed over the Companies Act 1985 and the Insolvency Act 1985. However, although s.6 of the Company Directors Disqualification Act imposes on the court a duty to disqualify directors of an insolvent company who it is satisfied are unfit to be concerned in the management of a company, the Act is directed primarily at improper conduct on the part of directors rather than on insolvency as such. It is therefore considered only briefly in Ch.14. Some attention is however paid to a new feature of the Act, introduced by the Small Business, Enterprise and Employment Act 2015,<sup>179</sup> by which a person disqualified under the CDDA can be required to pay compensation where the conduct for which they were disqualified caused loss to one or more creditors of a company that is in insolvent liquidation, administration or administrative receivership, of which they were at any time a director.<sup>180</sup> There are a number of important differences between this rule and the rules by which company directors may be subject to personal civil liability under the Insolvency Act 1986 (most commonly, for wrongful trading under ss.214 and 246ZB) and the Companies Act 2006 (most commonly, for breach of directors' duties, as those duties are affected by the rule in *West Mercia Safetywear Ltd v Dodd*<sup>181</sup>). These differences are considered in Ch.14.

<sup>175</sup> Financial Markets and Insolvency Regulations 1996 (SI 1996/1469).

<sup>176</sup> Financial Collateral Arrangements (No.2) Regulations 2003 (SI 2003/3226). See further paras 1-61 et seq.

<sup>177</sup> See below, paras 2-24 and 8-25.

<sup>178</sup> As amended by the Companies Act 1989, the Insolvency Act 2000, the Financial Services and Markets Act 2000 (Consequential Amendments and Repeals) Order 2001 (SI 2001/3649), the Enterprise Act 2002, the Small Business, Enterprise and Employment Act 2015, and sundry other legislation peripheral to insolvency.

<sup>179</sup> s.110, adding s.15A to the Company Directors Disqualification Act 1986.

<sup>180</sup> Company Directors Disqualification Act 1986 s.15A(3), (4).

<sup>181</sup> *West Mercia Safetywear Ltd v Dodd* (1988) 4 B.C.C. 30.

#### HUMAN RIGHTS LEGISLATION

Certain provisions of the insolvency legislation may possibly attract the application of the Human Rights Act 1998. It is beyond the scope of this work to address human rights issues.<sup>182</sup> 1-26

#### BANK AND BUILDING SOCIETY INSOLVENCY

The Banking Act 2009 creates a special insolvency regime for failing banks and building societies.<sup>183</sup> 1-27

#### (3) European Union legislation

The various EU Directives mentioned earlier have been implemented by statutory instrument. By contrast, the European Insolvency Regulation<sup>184</sup> has direct effect, and implementing legislation is neither required nor permissible. 1-28

#### Business, entity or group enterprise?

The subject of insolvency proceedings has always been, and continues to be, the particular corporate entity that has become insolvent, and this focus is accentuated by the reluctance of English law to pierce the corporate veil.<sup>185</sup> What insolvency law here and overseas has so far singularly failed to accommodate is the management of enterprise groups<sup>186</sup> where one or more, or possibly all, members of the group have become insolvent. Whereas the preparation and filing of group accounts has long been required,<sup>187</sup> when it comes to insolvency the distinct legal personality of each individual company within the group is 1-29

<sup>182</sup> See E. Bailey and H. Groves, *Corporate Insolvency: Law and Practice*, 3rd edn (LexisNexis Butterworths, 2007), Ch.20.

<sup>183</sup> See below, para.1-59.

<sup>184</sup> Examined in detail in Ch.15.

<sup>185</sup> See below, para.3-12.

<sup>186</sup> Defined by UNCITRAL Working Group V (Insolvency Law) as "two or more legal entities (group members) that are linked together by some form of control (whether direct or indirect) or ownership" (A/CN.9WG.V/WP.92, 2010, para.2). The European Insolvency Regulation, which in recast form (cited above, fn.129) makes provision for "cooperation, communication and coordination" where proceedings within the scope of the Regulation are opened in relation to multiple members of a "group of companies", defines the group concept by reference to the EU Accounting Directive (Directive 2013/34 of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertaking, amending Directive 2006/43 of the European Parliament and of the Council and repealing Council Directives 78/660 and 83/349 (OJ L182/19)): see art.2(13) of the Regulation.

<sup>187</sup> See now Companies Act 2006 ss.403-408.



**Modern receivership: the receiver and manager**

**10-02** With the expansion of business and the increased provision of credit to finance the establishment and operation of the undertaking, creditors became increasingly concerned to secure stronger protection for their investment, in particular, by reserving the right to appoint not merely a receiver, but a manager of the business, the two offices almost invariably being combined in the same person. In order for the receiver and manager to have effective powers of management it was, of course, necessary to provide the creditor with global security covering the whole or substantially the whole of the company's assets and undertaking. Thus evolved the modern debenture, which typically created a fixed charge over fixed assets and a floating charge over the rest of the company's undertaking, with power to appoint a receiver and manager,<sup>5</sup> having extensive authority to get in the assets, run the company's business and dispose of the assets either piecemeal or as part and parcel of a sale of the business as a going concern. A debenture-holder could still apply to the court for the appointment of a receiver but there was little advantage in doing so, for an application to the court would involve time and expense and the receiver's powers would be circumscribed by the terms of the order and his need to work within a judicial framework, whereas a receiver and manager appointed pursuant to the debenture had all of the powers conferred by the debenture and could still be declared to act as agent of the mortgagor.

**Extended receivership without management**

**10-03** The two categories of receivership mentioned above in paras 10-01 and 10-02 are not exhaustive. There are other types of receivership which go beyond the collection of income but fall short of management of the debtor's business.<sup>6</sup> Thus, for example, the Law of Property Act 1925 provides that the role of the receiver of income under the Act can be expanded by the mortgagee delegating their powers to the receiver, such powers including (in the case of a mortgage of land) the power to grant leases over the land.<sup>7</sup>

**The introduction of the administration regime**

**10-04** Administration was introduced at the recommendation of the Cork Committee. The Committee regarded receivership and management as a valuable tool for the

<sup>5</sup> Thus crystallising the floating charge (see para.10-36).

<sup>6</sup> For a taxonomy of receivership after the Insolvency Act 1986, see below, para.10-21.

<sup>7</sup> Law of Property Act 1925 ss.109(3) and 99; Sandra Frisby and Malcolm Davis-White, *Kerr & Hunter on Receivers and Administrators*, 19th edn (London: Sweet & Maxwell, 2010) Ch.19.

preservation of viable businesses.<sup>8</sup> The Committee noted, however, that it was not always possible to appoint a receiver and manager: this would depend on whether there was a creditor of the kind described in para.10-02, i.e. one with global security. It reported that there had been a "significant" number of cases in which "companies have been forced into liquidation, and potentially viable businesses capable of being rescued . . . closed down, for want of a floating charge under which a receiver and manager could have been appointed".<sup>9</sup> In response, the Committee recommended the introduction of a new procedure, "administration", in which an external manager (an "administrator") could be appointed by the court with a view to rehabilitating an insolvent company or preserving all or part of its business.<sup>10</sup> The administrator would enjoy all of the powers that a receiver and manager typically enjoyed, including the power to carry on the company's business.<sup>11</sup> Receivership and management would remain as an alternative to administration: indeed, the Committee recommended that a creditor with global security be given notice of any application for an administration order, so that they could appoint a receiver and manager instead.<sup>12</sup> The Committee did, however, recommend that such a receiver and manager be required to be a qualified insolvency practitioner, that some aspects of receivership and management be clarified in statute, and that rules be introduced to strengthen the ability of unsecured creditors to obtain information about the receivership.<sup>13</sup>

These recommendations were given effect in the Insolvency Act 1985, re-enacted in the Insolvency Act 1986. The Act set out a number of rules relating to receivership, including what was termed "administrative receivership"—the label for a receiver and manager of the whole or substantially the whole of the company's property.<sup>14</sup> Part II of the Act introduced the administration procedure, in which application could be made to the court to appoint an administrator to take control of the assets and manage the company for the benefit of all of the creditors. The administrator was given the same extensive powers as an administrative receiver.<sup>15</sup> An application to the court had the effect of imposing a freeze on the exercise of most remedies, including the enforcement of security, but did not prevent the appointment of an administrative receiver, and if such an appointment were made before the making of an administration order, the court was in general precluded from making such an order except with the debenture-holder's

<sup>8</sup> *Insolvency Law and Practice: Report of the Review Committee* (June 1982, Cm. 8558, London) para.495.

<sup>9</sup> *Insolvency Law and Practice: Report of the Review Committee* (above), para.496.

<sup>10</sup> Or where this was not possible, to achieve a better result for creditors than would be expected if the company were immediately wound-up: *Insolvency Law and Practice: Report of the Review Committee* (above, fn.8), para.507.

<sup>11</sup> *Insolvency Law and Practice: Report of the Review Committee* (above, fn.8), para.497.

<sup>12</sup> *Insolvency Law and Practice: Report of the Review Committee* (above, fn.8), para.504.

<sup>13</sup> *Insolvency Law and Practice: Report of the Review Committee* (above, fn.8), Chs 8 and 15.

<sup>14</sup> Insolvency Act 1986 s.29(2), analysed below, paras 10-07 et seq.

<sup>15</sup> Insolvency Act 1986 s.14 and Sch.1.

consent.<sup>16</sup> Thus, except where the security was vulnerable, the debenture-holder could always block administration by appointing an administrative receiver, as the Cork Committee had recommended.

## 2. THE PARTIAL ABOLITION OF ADMINISTRATIVE RECEIVERSHIP

10-05 A review group set up by the Department of Trade and Industry and the Treasury published a report in 2000<sup>17</sup> showing that views on the merits of administrative receivership were divided. Most respondents felt that administrative receivership was an integral part of the rescue culture that had been developing and contributed to the rescue and survival of companies, in that the receiver could take rapid and effective action to prevent further deterioration on the business of the company, a sizeable number of businesses were sold off by the receiver on a going concern basis and the costs of initiating the procedure were relatively low.<sup>18</sup> Banks were keen to support the rescue of viable companies but feared that changes to the existing system would reduce their security and their ability to enforce it. On the other hand, others felt that receivership placed too much power in the hands of one creditor and that this could lead to unnecessary business failures, particularly since there was a lack of incentive to consider the interests of other creditors and to maximise the value of the debtor company's estate.<sup>19</sup> Banks that were over-secured had little incentive to ensure that receivers they appointed kept costs and fees down and avoided precipitate realisation of assets. Research conducted by Professor Julian Franks and Dr Oren Sussman,<sup>20</sup> based on material provided by three clearing banks, has shown that about 75% of companies emerged from bank supervision and avoided formal insolvency procedures but that during the period in which the company was in intensive care, the amount owed to the bank shrank, while the amount owed to trade and expense creditors increased. Where a formal insolvency proceeding ensued, the average recovery rates were 77% for the bank, 27% for preferential creditors and virtually nil for unsecured creditors.<sup>21</sup> A subsequent small survey by R3, subsidiary to its main survey for the period January 2002 to June 2003, gave a similar, dismal return for ordinary unsecured creditors, at just 5 pence in the pound.<sup>22</sup>

<sup>16</sup> Insolvency Act 1986 s.9(3).

<sup>17</sup> *Review of Company and Business Reconstruction Mechanisms* (May 2000), para.73.

<sup>18</sup> *Review of Company and Business Reconstruction Mechanisms* (above), para.48.

<sup>19</sup> *Review of Company and Business Reconstruction Mechanisms* (above, fn.17), para.49.

<sup>20</sup> *The Cycle of Corporate Distress, Rescue and Dissolution: A Study of Small and Medium Size UK Companies* (2000), sponsored by the DTI/Treasury Working Group on Company Rescue and Business Reconstruction Mechanisms.

<sup>21</sup> *The Cycle of Corporate Distress, Rescue and Dissolution*, pp.3-4.

<sup>22</sup> R3, "Corporate Insolvency in the UK", 12th Survey (July 2004), p.27.

The principal recommendation of the review group was that the power of veto given to the holder of a floating charge to block an administration by appointing an administrative receiver should be abolished.<sup>23</sup> But under the influence of the Treasury, which considered that the whole institution of administrative receivership was inimical to corporate rescue through a collective insolvency proceeding, government thinking hardened. A White Paper published by the Department of Trade and Industry in 2001<sup>24</sup> set out the new approach.

The outcome was a set of provisions in the Enterprise Act 2002 amending the Insolvency Act 1986 in two major respects. First, the new provisions make it easier for a company to go into administration by dispensing with the need for a court order. This was an essential step because as research had shown, a key factor powering many appointments of administrative receivers was speed in the assumption of management control and the collection of assets, and the delay involved in court-appointed administration was considered to place assets at risk.<sup>25</sup> Secondly, the provisions prohibit the appointment of an administrative receiver altogether under a "qualifying floating charge",<sup>26</sup> except where it is a charge created before 15 September 2003 or, if it is a charge created on or after that date, it falls within one of the specified exceptions.<sup>27</sup> Save in these cases, the debenture-holder's remedy is to appoint an administrator, which is less efficacious from the viewpoint of the debenture-holder in that whilst an administrative receiver's primary task was to safeguard the interests of his debenture-holder, an administrator is required to give priority to other objectives, where reasonably practicable.<sup>28</sup> There are eight exceptions, which are designed to safeguard large capital market arrangements involving the issue of a capital market investment, public-private partnership projects incorporating step-in rights, utility projects incorporating step-in rights, urban regeneration projects, large-scale project finance incorporating step-in rights,<sup>29</sup> financial market charges, system-charges and collateral security charges, private registered providers of social housing and registered social landlords, and protected railway companies.<sup>30</sup> As regards a floating charge falling within one of these categories or created before 15

<sup>23</sup> *Review of Company and Business Reconstruction Mechanisms* (above, fn.17), para.73.

<sup>24</sup> "Insolvency—A Second Chance" (Cm. 5234).

<sup>25</sup> Alan Katz and Michael Mumford, *Comparative Study of Administration and Administrative Receivership as Business Rescue Vehicles* (London: ICAEW, August 2003), p.14. See further below, para.11-04.

<sup>26</sup> As defined by the Insolvency Act 1986 Sch.B1 para.14. See below, para.11-07.

<sup>27</sup> Enterprise Act 2002 s.250, inserting s.72A into the Insolvency Act 1986. Section 72A applies in spite of an agreement or instrument which purports to empower a person to appoint an administrative receiver, by whatever name (s.72A(4)(b)). For the efficacy of the Enterprise Act provisions, see below, para.11-126.

<sup>28</sup> See below, para.11-06.

<sup>29</sup> See *Feetum v Levy* [2006] Ch. 585.

<sup>30</sup> Insolvency Act 1986 ss.72A-72GA and Sch.2A. The exceptions relating to urban regeneration and protected railway companies were inserted by the Insolvency Act 1986 (Amendment)(Administrative Receivership and Urban Regeneration etc) Order 2003 (SI 2003/1832). For the definitions of the various categories, see Insolvency Act 1986 Sch.2A, as amended.

September 2003, the holder of the charge remains free to appoint an administrative receiver, and while such a receiver is in office, no administrator can be appointed.<sup>31</sup>

The general prohibition applies only to the appointment of administrative receivers “of a company”. “Company” is now defined for this purpose as a company registered under the Companies Act 2006.<sup>32</sup> Societies registered under the Co-operative and Community Benefit Societies Act 2014 will fall outside this definition, so as to escape the prohibition.<sup>33</sup>

### 3. THE LEGAL NATURE OF ADMINISTRATIVE RECEIVERSHIP<sup>34</sup>

**10-06** The term “administrative receiver”, first introduced by the Insolvency Act 1985, and carried forward into the Insolvency Act 1986,<sup>35</sup> is simply the statutory label for the individual who was previously termed receiver and manager. Administrative receivership has long been the de facto monopoly of the accountancy profession and requires professional skill and judgment of a high order, since it is the task of the administrative receiver, with his team of assistants, to take over the management of the company from the directors, with a view to trading it out of its difficulties,<sup>36</sup> and for that purpose to keep the company afloat, negotiate with banks and other creditors, dispose of unprofitable sectors of the business, eliminate unnecessary expenditure and generate income, so that in due course the business can be sold as a going concern or hived down into a specially formed subsidiary which can be disposed of as a clean company with assets but no

<sup>31</sup> Insolvency Act 1986 Sch.B1 paras 17(b) and 25(c). See further below, para.10-13.

<sup>32</sup> No definition of “company” is provided for in Ch.IV of Pt III of the Insolvency Act 1986, which contains the general prohibition on the appointment of administrative receivers (s.72A) and the exceptions to that prohibition (ss.72A-GA). However “administrative receiver” is defined for the purpose of s.72A by reference to a definition in Ch.I of Pt III (see ss.72A(3), 251). That definition (in s.29) refers to receivers and managers of “a company’s property”, and “company” is defined for the purpose of Ch.I as a “company registered under the Companies Act 2006 in England and Wales or Scotland”. This definition, supplied by the Companies Act 2006 (Consequential Amendments, Transitional Provisions and Savings) Order 2009/1941, Sch. 1 para.74(2), is narrower than its predecessor (contained in s.251 of the Insolvency Act 1986): see below fn.126.

<sup>33</sup> As under the previous law: see *Re Dairy Farmers of Great Britain Ltd* [2010] Ch. 63, on whether industrial and provident societies (now co-operative and community benefit societies) were “companies” for the purpose of Pt III of the Insolvency Act 1986, the relevant definition at that time being contained in s.251 of the Insolvency Act 1986.

<sup>34</sup> See generally Sandra Frisby and Malcolm Davis-White, *Kerr & Hunter on Receivers and Administrators*, 19th edn (London: Sweet & Maxwell, 2010); Gavin Lightman et al, *Lightman and Moss: The Law of Administrators and Receivers of Companies*, 6th edn (London: Sweet & Maxwell, 2017); and Ian Fletcher, *Law of Insolvency*, 5th edn (London: Sweet & Maxwell, 2017), Ch.14.

<sup>35</sup> See below.

<sup>36</sup> Of course, this is not always possible. Sometimes the administrative receiver has no choice but to close the business down and dispose of the assets at the best price he can get.

liabilities.<sup>37</sup> Only a qualified insolvency practitioner can act as administrative receiver.<sup>38</sup>

As mentioned earlier,<sup>39</sup> administrative receivership is not a true collective insolvency proceeding but remains in principle a method by which a particular debenture-holder can enforce his security. But by statute several insolvency features have become attached to administrative receivership, so that it is considered an insolvency proceeding even though the administrative receiver’s duty is in principle owed only to his debenture-holder,<sup>40</sup> not to the general body of creditors.

#### The administrative receiver defined

An administrative receiver is defined by s.29(2) of the Insolvency Act 1986 in the following terms: **10-07**

- “(a) a receiver or manager of the whole (or substantially the whole) of a company’s property appointed by or on behalf of the holders of any debentures of the company secured by a charge which, as created, was a floating charge, or by such a charge and one or more other securities; or  
(b) a person who would be such a receiver but for the appointment of some other person as the receiver of part of the company’s property.”

Several aspects of this definition require comment.

#### “The whole or substantially the whole of a company’s property”

Four questions arise in relation to this phrase: (1) What does “whole or substantially the whole” mean? (2) As at what date is the position to be tested? (3) What is the effect of the prior appointment of a receiver of part of the property? and (4) Can an administrative receiver be appointed if another administrative receiver is in post under a different debenture? **10-08**

<sup>37</sup> Alternatively, the business might be sold on rather more rapidly, and indeed such sale might even be conducted on a “pre-packaged” basis (where the sale is negotiated prior to the formal appointment of the administrative receiver and then executed on or shortly after their appointment): see e.g. *Edenwest Ltd v CMS Cameron McKenna* [2013] B.C.C. 152.

<sup>38</sup> See below, para.10-25.

<sup>39</sup> See above, para.1-39.

<sup>40</sup> And, by statute, to preferential creditors as regards assets within the scope of a floating charge. See below, paras 10-61 et seq.

## (1) "Whole or substantially the whole"

**10-09** What matters here is not the scope of the debenture under which the receiver is appointed but the scope of the appointment. Debentures frequently empower the debenture-holder to crystallise a floating charge, and to appoint a receiver, in respect of a specific asset or part only of the assets, since this provides the necessary security over a threatened asset or class of assets without inhibiting the continuance of the rest of the company's business. A receiver so appointed is not an administrative receiver even if the debenture under which he is appointed covers substantially the whole of the assets. It is necessary that his receivership should encompass substantially the whole of the assets. It is thought that this is to be determined by reference to the total value of the company's property, not by reference to the number of items within the scope of the appointment. This approach has been taken by the Victorian Supreme Court in a case on the interpretation of the same statutory language in Australian law, the Court holding that a creditor with a charge over 68% of the debtor's assets by value did not have security over "the whole or substantially the whole of a company's assets".<sup>41</sup>

(2) *As at what date?*

**10-10** It is clear from the wording of s.29(2) that the time when the above requirement has to be satisfied is the time of the receiver's appointment. The fact that the company acquires substantial additional assets later which happen to fall outside the scope of the charge, and thus of the appointment, is irrelevant.

(3) *Prior receiver of part of property*

**10-11** Limb (b) of s.29(2) provides that the term "administrative receiver" includes a person who would be a receiver of the whole or substantially the whole of the company's property but for the appointment of some other person as receiver of part of the company's property. For example, another debenture-holder may have appointed a Law of Property Act receiver under a fixed charge of a specific property or a receiver under a floating charge limited to a particular class of asset. In fact, it is not unusual for floating charges to be taken over a limited class of asset, for example, those taken to secure the financing of stock in trade for brewers or for motor dealers, which are commonly confined to the stock in question. Section 29(2)(b) appears to have been inserted *ex abundante cautela*,

<sup>41</sup> *Exp. p. Horne re Australian Property Custodian Holdings Ltd (administrators appointed) (receivers and managers appointed)* [2010] VSC 492, affirmed on appeal [2011] VSCA 280, [25] (see also case note by Victoria Ferguson and Liz Saxton in (2012) 3 JIBFL 190). The 32% of remaining property comprised a term deposit that had been excluded from the scope of the charge for regulatory reasons.

for on the view taken here the requirement that the floating charge and any other charges together cover the whole or substantially the whole of the company's property relates only to the relationship between the company and the debenture-holder,<sup>42</sup> and is thus not affected by the fact that another receiver holds part of the property.

(4) *Another administrative receiver in post*

The view has been expressed that a person cannot be appointed as administrative receiver if another administrative receiver has already been appointed.<sup>43</sup> However, it is necessary to distinguish the appointment of an administrative receiver from his exercise of management functions. It is clear that only one person, or two or more people acting jointly under the same instrument,<sup>44</sup> can perform the functions of an administrative receiver at any one time but that is not a reason for denying the validity of the second appointment. All that happens is that the second administrative receiver has to wait on the sidelines until the prior administrative receivership has been completed. There is nothing unusual in this kind of situation. It is a common occurrence for a company to go into liquidation while still in administrative receivership. In such a case, the liquidator's statutory powers in relation to the control and disposal of the assets and the management of the company's business for the purpose of its beneficial winding-up<sup>45</sup> are not exercisable while an administrative receiver is in post, for so long as the debenture-holder's security interest in the whole of the assets subsists, it has priority over the claims of the general body of creditors whom the liquidator represents. This demonstrates that there is no inherent objection to having two office-holders in post at the same time, although only one of them can exercise *in rem* management powers. As between two administrative receivers, priority should in principle be determined by the priority of the respective debentures under which they were appointed<sup>46</sup>; but once the first administrative receiver has

<sup>42</sup> See below para.10-12.

<sup>43</sup> See Fidelis Oditah, "Lightweight Floating Charges" [1991] J.B.L. 49 at 51 et seq.; and David Marks and Dominic Emmet, "Administrative Receivers: Questions of Identity and Double Identity" [1994] J.B.L. 1.

<sup>44</sup> Insolvency Act 1986 s.33(2).

<sup>45</sup> Insolvency Act 1986 Sch.4.

<sup>46</sup> Where there are two floating charges each of which covers all of the assets, priority will in principle go to the earlier, even if the later was the first to crystallise, for there is a presumption that the freedom which a floating charge allows to a company to dispose of its assets in the ordinary course of business does not extend to the grant of another floating charge over all of the assets. See *Re Benjamin Cope & Sons Ltd* [1914] Ch. 800. The position is otherwise where the subsequent floating charge covers only part of the assets and power to create such charge in priority to the first floating charge was reserved to the company by the first floating charge (*Re Automatic Bottle Makers Ltd* [1926] Ch. 412). However, the distinction drawn in the latter case between a subsequent floating charge covering all of the assets and one covering only part of the assets seems unnecessary; the sole question in each case should be whether the terms of the first floating charge permit a subsequent charge to be given ranking in priority to the earlier floating charge.

effectively entered upon the receivership, he can only be displaced by a court order removing the first receiver.<sup>47</sup> While the court may be expected to give due weight to the priority of the competing debentures, the fact that a debenture-holder no longer has power to replace its receiver without leave of the court shows that this is not now considered to be a matter exclusively within the private domain, and that the court will have regard to the interests of creditors.<sup>48</sup> Can it be said that the effect of the first security is to prevent the second security from covering the whole or substantially the whole of the company's property? This calls for an emphatically negative response. Notwithstanding the infelicitous wording of s.29(2)(b), it is clear that s.29(2)(a) is concerned solely with relations between the debenture-holder and the company and is not addressed to competing security interests. All that is necessary is that, as between the debenture-holder and the company, security which includes a floating charge is given over substantially the whole of the company's property. How that security ranks with a similar security given to another creditor is irrelevant. The later interest still covers substantially the whole of the company's property, subject to the prior charge. Put another way, the company's property after giving the first charge over all of its property is its equity of redemption, and in charging this to the second debenture-holder the company is charging the whole of its remaining property.

This is not a mere technical question. It is important that the law should allow concurrent appointments—even if only one can take effect in possession—for the second chargee needs to be able to ensure that there is no interval between the completion of the first administrative receivership and the appointment of the second administrative receiver during which the latter appointment could be blocked by the making of an administration order. Recognition of the validity of the second appointment *ab initio* ensures a seamless progression from one receivership to the other.

#### (5) An administrator in post

**10-13** By contrast, it is not possible to have a concurrence of administration and administrative receivership. It is a question of who is appointed first. Once a company is in administration, an administrative receiver may not be appointed.<sup>49</sup> If, on the other hand, an administrative receiver is in office, an administrator may not be appointed by the company or its directors,<sup>50</sup> and an application for an

<sup>47</sup> Insolvency Act 1986 s.45(1).

<sup>48</sup> That some judicial control may be necessary is demonstrated by the facts in *Downsview Nominees Ltd v First City Corp* [1993] A.C. 295, where a debenture-holder who appointed a receiver for the sole purpose of preventing enforcement of a subsequent debenture by a receiver previously appointed by the holder of the second debenture was held liable in damages for loss caused. See further below, para.10-34.

<sup>49</sup> Insolvency Act 1986 Sch.B1 para.43(6A).

<sup>50</sup> Insolvency Act 1986 Sch.B1 para.25(c).

administration order must normally be dismissed unless his appointor consents to it, whether the receiver was appointed before or after the making of the application.<sup>51</sup> Where, however, the court has and exercises power to appoint an administrator, any administrative receiver must vacate office.<sup>52</sup>

#### “Appointed by or on behalf of the holders of any debentures of the company”

This precludes a receiver appointed by the court from being an administrative receiver, a logical provision, for the powers of a court-appointed receiver are limited by the terms of the order appointing him, which could be incompatible with the powers conferred on administrative receivers by Sch.1 of the Act. This view has been challenged by some authorities, in particular by Professor Ian Fletcher, an eminent authority who argues that there is evidence within the Act to indicate that court-appointed receivers were intended to fall within the ambit of s.29 of the Act. Several reasons are advanced for this view, as set out in the following passage<sup>53</sup>:

10-14

“Provisions intended to apply only to receivers appointed out of court refer, not to receivers ‘appointed by or on behalf of debenture-holders’ but to receivers ‘appointed under powers contained in an instrument’ [citing ss. 33-38]. Section 29 appears within a group of sections under the heading ‘Preliminary and General Provisions’ and another section in this group, s. 31, expressly provides that it has no application to a court-appointed receiver. Furthermore if the wording of s. 29 is to be taken as excluding court appointed receivers, then the similar wording in s. 40 of the Act could have the effect of excluding court appointed receivers from the duty to pay preferential debts out of the proceeds of a floating charge despite s. 40 appearing in a group of sections under the heading ‘Provisions applicable to every receivership’.”

There are several answers to the points made above.

(1) Section 29(2)(a) defines an administrative receiver as:

“ . . . a receiver or manager of the whole (or substantially the whole) of a company's property appointed by or on behalf of the holders of any debentures of the company secured by a charge which, as created,

<sup>51</sup> Insolvency Act 1986 Sch.B1 para.39. The court is also free not to dismiss the application where it thinks that the security is vulnerable under the avoidance provisions: para.39(b)-(d).

<sup>52</sup> Insolvency Act 1986 Sch.B1 para.41(1).

<sup>53</sup> Fletcher, *Law of Insolvency*, 2017, para.14-026. See to similar effect Frisby and Davis-White (eds), *Kerr & Hunter on Receivers and Administrators*, 2010, para.7-56. Cf. Lightman et al, *Lightman and Moss: The Law of Administrators and Receivers of Companies*, 2014, para.29-000, taking the same view as advanced here.

was a floating charge, or by such a charge and one or more other securities.”

The phrase “appointed by or on behalf of the holders of any debentures” in s.29(2)(a) is thus used specifically with reference to a charge which, as created, was a floating charge. The same applies to s.40. By contrast, ss.31 and 33–38 cover any kind of receiver appointed under an instrument, whether the instrument is a charge or another kind of instrument and whether or not it includes a floating charge. It is therefore perfectly understandable that the draftsman wished to avoid carrying over the phrase used in ss.29(2)(a) and 40 into the quite different context of ss.31 and 33–38 and decided instead to use the phrase “appointed under powers contained in an instrument”.

- (2) Section 33(1), which uses the same phrase, provides that the appointment of a person as receiver “is of no effect unless it is accepted by that person before the end of the business day next following that on which the *instrument of appointment* is received by him or on his behalf” [emphasis added]. The reference to an instrument of appointment clearly excludes an appointment by the court.
- (3) An administrative receiver is deemed to be the agent of the mortgagor.<sup>54</sup> This rule existed long before the Insolvency Act but it never applied to a court-appointed receiver,<sup>55</sup> and a receiver originally appointed by the mortgagee but subsequently appointed by the court ceased to be the agent of the mortgagor.<sup>56</sup>
- (4) Under s.46(1) an administrator receiver is required, on his appointment, to send to the company and to publish “in the prescribed manner” a notice of his appointment. Under r.3.2(2)(e) of the Insolvency Rules 1986, the notice is required to state “the name of the person by whom the appointment was made”. Clearly, this is inapplicable to a court appointment.
- (5) Finally, the whole point of s.72A of the Insolvency Act was to eliminate the regime of administrative receivership except in the cases mentioned in ss.72B–72GA. It is inconceivable that Parliament intended to allow the regime to continue by means of an appointment by the court. That would be the effect if a receiver appointed by the court was held to fall within the definition of s.29 (so as to be an “administrative receiver” for the purposes of the provisions of Ch.1 of Pt III of the Act on the

<sup>54</sup> Insolvency Act 1986 s.44(1)(a).

<sup>55</sup> H.G. Hanbury and C.H.M. Waldock, *Law of Mortgages* (London: Stevens and Sons, 1938), pp.159–160.

<sup>56</sup> *Hand v Blow* [1901] 2 Ch. 721, per Romer LJ at 732; and Falcon Chambers, *Fisher and Lightwood's Law of Mortgage*, 12th edn (London: LexisNexis Butterworths, 2008), p.28.8.

privileges and responsibilities of administrative receivers), for s.72A prohibits only appointments by the debenture-holder.<sup>57</sup>

It is therefore not surprising that in *Re A.&C. Supplies Ltd*,<sup>58</sup> Blackburne J considered (albeit obiter) that while he had power to remove an administrative receiver, he had no power to appoint one.

**“Secured by a charge which, as created, was a floating charge, or by such charge and one or more other charges”**

Several points arise in connection with this element of the statutory definition. 10–15

(1) *Distinction between fixed and floating charge*

Professor Goode has discussed elsewhere the nature of the floating charge and the characteristics which distinguish it from a fixed charge.<sup>59</sup> The courts have been much occupied with the distinction in relation to a charge over book debts given in favour of a bank where the chargor is required to pay the proceeds into a bank account but is free to draw on the account as and when needed unless the bank intervenes. This was upheld by the Court of Appeal in its controversial decision in *Re New Bullas Trading Ltd*,<sup>60</sup> a decision which the Privy Council declined to follow in *Agnew v Commissioners of Inland Revenue*<sup>61</sup> on the basis that the company’s power to utilise the proceeds was inconsistent with the nature of a fixed charge. This is plainly correct. It has been established for well over a century that the mere fact that the chargee has power to intervene is not sufficient to establish the charge as a fixed charge; it is necessary both to introduce and to operate a control mechanism which ensures that the company is not free to deal with the proceeds as its own pending the bank’s intervention. The Privy Council decision was followed by the House of Lords in *Re Spectrum Plus Ltd*.<sup>62</sup> 10–16

<sup>57</sup> Or more precisely the holder of a qualifying floating charge, as to which see further paras 11–07 et seq.

<sup>58</sup> *Re A.&C. Supplies Ltd* [1998] B.C.C. 708.

<sup>59</sup> *Goode and Gullifer on Commercial Law*, ed. Ewan McKendrick, 5th edn (London: Penguin Books and LexisNexis, 2016), Ch.25; and *Goode and Gullifer on Legal Problems of Credit and Security*, ed. Louise Gullifer, 6th edn (London: Sweet & Maxwell, 2017), Ch.4.

<sup>60</sup> *Re New Bullas Trading Ltd* [1994] B.C.L.C. 485.

<sup>61</sup> *Agnew v Commissioners of Inland Revenue* [2001] 2 A.C. 710.

<sup>62</sup> *Re Spectrum Plus Ltd, National Westminster Bank Plc v Spectrum Plus Ltd* [2005] 2 A.C. 680, in which the House of Lords reversed the decision of the Court of Appeal, overruled *Siebe Gorman & Co Ltd v Barclays Bank Ltd* [1979] 2 Lloyd’s Rep. 142 and disapproved *Re New Bullas Trading Ltd* [1994] B.C.C. 36, by which the Court of Appeal had rightly regarded itself as bound. For detailed analyses of the *Spectrum* case, see Joshua Getzler and Jennifer Payne (eds), *Company Charges: Spectrum and Beyond* (Oxford: Oxford University Press, 2006).

## (2) Crystallisation is irrelevant

- 10-17 The fact that the charge under which the receiver is appointed crystallised before his appointment, and was therefore no longer floating, is irrelevant. What matters is its character at the time of creation. This is in line with the definition of “floating charge” in s.251 of the Insolvency Act as a charge which as created was a floating charge.<sup>63</sup>

## (3) Residual floating charge suffices

- 10-18 It is not necessary that the floating charge should itself cover the whole or substantially the whole of the company’s property; it suffices that a floating charge and one or more fixed charges together encompass such property. Because of the advantages of a fixed charge over a floating charge in terms of priority over subsequent security interests and the claims of preferential creditors, lenders tend to take fixed security over as many classes of asset as possible, leaving the floating charge to gather up the rest. This is fully compatible with s.29(2). A vestigial (“lightweight”) floating charge is all that is needed. But if there is no floating charge at all, the receiver will not be an administrative receiver. Accordingly, there may be circumstances in which the debenture-holder would find it convenient to argue that a charge which is described as a fixed charge is in fact a floating charge—an argument which for other purposes he could be expected strenuously to resist!

Where there are fixed charges as well as a floating charge, it is not necessary that all of the charges should be comprised in the same debenture. What matters is their aggregate effect.

## (4) Susceptibility of future assets to floating charge suffices

- 10-19 The fact that at the time of the receiver’s appointment there are no assets currently within the scope of the floating charge does not prevent the receiver from being an administrative receiver. It suffices that the floating charge has the potential to catch after-acquired property of the company. In *Re Croftbell Ltd*,<sup>64</sup> it was conceded that a receiver was not precluded from being an administrative receiver merely because at the time of the debenture the company had no assets (for otherwise the company could not grant a floating charge at the commencement of its business when it had no assets) or all of the assets were subject to a

<sup>63</sup> The definition is also relevant (inter alia) to the treatment of priorities between preferential debts and those secured by a crystallised floating charge. See below, para.10-61.

<sup>64</sup> *Re Croftbell Ltd* [1990] B.C.L.C. 844. Vinelott J’s analysis has since been endorsed by the Court of Appeal in *SAW (SW) 2010 Ltd v Wilson* [2018] 2 W.L.R. 636.

fixed charge. But it was contended that if the evidence showed that the company had no intention of entering into trading transactions, so that the floating charge served no purpose but to frustrate the appointment of an administrator by the court,<sup>65</sup> it had to be disregarded. This contention was rejected by Vinelott J, who held that the question of whether a debenture-holder had power to appoint an administrative receiver could not turn on the company’s intentions at the time it executed the debenture, for those intentions might change and future assets might fall within the floating charge.

## Appointment under fixed charge

If a debenture-holder has a floating charge and a fixed charge which together encompass substantially the whole of the company’s property, is a receiver appointed under the fixed charge an administrative receiver? In an unreported decision by Vinelott J in *Meadrealm Ltd v Transcontinental Gulf Construction Ltd*,<sup>66</sup> this question was answered in the negative; only a receiver appointed under a floating charge could qualify as an administrative receiver. However, the decision is not easy to reconcile with the wording of s.29(2), and would seem to focus on the wrong issue. The crucial question is not the nature of the charge or charge-element under which the receiver is appointed but the property over which he is appointed. A receiver appointed in respect of only part of the assets simply cannot function as an administrative receiver, for he has no *in rem* powers over those assets outside the scope of his appointment and is therefore inhibited from effectively managing the company’s business. Hence the requirement that the receiver be appointed in respect of the whole or substantially the whole of the company’s property. That is all that s.29(2) requires. If this requirement is satisfied, it should not matter under which element of a security package the appointment is made. Indeed, to speak of an appointment “under a fixed charge” is rather misleading, for it confuses the security interest with the instrument by which the security is created and the source of the appointment with the property to which the appointment relates. If a fixed charge covers substantially the whole of the company’s property and there is a residual floating charge over the rest, that should suffice. Admittedly, the continuance of the company’s business could, in theory at least, lead to the acquisition of further substantial assets outside the scope of the floating charge, so that the fixed charge would cease to cover substantially the whole of the company’s property but again that would seem to be irrelevant, for as stated earlier the material time is the time of the receiver’s appointment.

10-20

<sup>65</sup> See Insolvency Act 1986 s.9(3) (now Sch.B1 para.39). See below, para.10-26.

<sup>66</sup> *Meadrealm Ltd v Transcontinental Gulf Construction Ltd*, unreported, 29 November 1991.

### The three categories of receiver

10-21 With the enactment of the Insolvency Act 1986, there are three categories of receiver:

- (i) the administrative receiver, defined above;
- (ii) the receiver of income only;
- (iii) other types of receiver, for example:
  - (a) a receiver under a debenture creating only a fixed charge but conferring on the receiver more extensive powers than the collection of income, for example, the power to secure repayment by getting in and realising assets and the wide range of powers typically contained in a security trust deed<sup>67</sup>;
  - (b) a receiver under a debenture which includes a floating charge, but does not cover all or substantially all of the company's property,<sup>68</sup> whether the receiver is appointed out of court or by the court<sup>69</sup>;
  - (c) an all-assets receiver, or receiver and manager,<sup>70</sup> appointed by the court at the instance of a debenture-holder.

Receivers appointed out-of-court who are not properly characterised as administrative receivers (for example, receivers of type iii(a) or (b) above) are often described as "LPA receivers". The Law of Property Act 1925 makes provision for the appointment of receivers to enforce mortgages (broadly defined)<sup>71</sup> created by deed, where the mortgage money has become due and the mortgagee is entitled to exercise their power of sale under the Act.<sup>72</sup> The kind of receiver contemplated is a receiver of income, but the Act also provides for the role of such a receiver to be extended—either by delegation of the mortgagee's powers, or in the terms of the mortgage deed.<sup>73</sup> It is therefore possible for someone with powers beyond those enjoyed by a receiver of income to be properly characterised as an LPA receiver. Whether such a person is properly described in this

<sup>67</sup> This form of receivership was apparently widely used in the post-Global Financial Crisis period in relation to non-trading companies: David Milman, "The Continuing Institution of Receivership and Its Relationship to Other Security Enforcement Tools and Recovery Devices in English Law" (2009) 247 Co. L.N. 1.

<sup>68</sup> Other than a receiver who would be a receiver of the whole but for the appointment of another person as receiver of part and who is thus himself an administrative receiver.

<sup>69</sup> For a case where a receiver of a particular property was appointed by the court on the application of the mortgagee even though there was an administrator in post, see *Sinai Securites Ltd v Hooper* [2004] B.C.C. 973.

<sup>70</sup> As in *Parsons v Sovereign Bank of Canada* [1913] A.C. 160; and *Reid v Explosives Co Ltd* (1887) 19 Q.B.D. 264.

<sup>71</sup> Law of Property Act 1925 s.205(1)(xvi).

<sup>72</sup> Law of Property Act 1925 ss.101(1)(iii), 109(1). The requirement that the power of sale must have become exercisable can be relaxed by the terms of the deed: s.101(3); Frisby and Davis-White, *Kerr & Hunter on Receivers and Administrators*, 2010, paras 19-2 and 19-5.

<sup>73</sup> Law of Property Act 1925 ss.109(3), 101(3).

way, rather than as some other form of non-administrative receiver, will depend on whether the appointment is made in reliance on the provisions of the Act. Not much may turn on this distinction, however: certainly the provisions of the Insolvency Act 1986 that govern the appointment of non-administrative receivers do not distinguish between LPA and non-LPA receivers.<sup>74</sup>

The more important distinction is between administrative receivers and other forms of receivers. The Insolvency Act 1986 gave administrative receivers privileges not enjoyed by other forms of receiver, but also subjected them to additional burdens (for example, in relation to eligibility to act as an administrative receiver)<sup>75</sup> and duties. The Enterprise Act 2002 reforms targeted only administrative receivership, leaving other forms of receivership unaffected. The rest of this chapter is confined to the administrative receiver.

### Mode of appointment

A receiver is only an administrative receiver if he is appointed out of court by the debenture-holder. 10-22

### Administrative receiver compared with other types of receiver

An administrative receiver has a number of characteristics which mark him out from other types of receiver. 10-23

- (i) An administrative receiver is deemed to be the company's agent unless and until it goes into liquidation,<sup>76</sup> and the same is true of a Law of Property Act receiver.<sup>77</sup> One consequence of this is that such a receiver will not normally be subject to a third-party costs order in respect of costs incurred in unsuccessful litigation instituted in the name of the company, because the receiver is not a third party; his position is in this respect analogous to that of directors.<sup>78</sup> A receiver appointed by a debenture-holder in relation to part only of a company's property is the

<sup>74</sup> i.e. ss.28-41. Sections 33-38 apply to appointments made "under powers contained in an instrument", but s.29(2) provides that any reference in the Act to such appointments includes an appointment made under powers which, by virtue of any enactment, are implied in and have effect as if contained in an instrument. This would include LPA receivership: see above, text to fn.4.

<sup>75</sup> Below para.10-25.

<sup>76</sup> Insolvency Act 1986 s.44(1).

<sup>77</sup> Law of Property Act 1925 s.109(2).

<sup>78</sup> *Dolphin Quays Developments Ltd v Mills* [2008] 1 W.L.R. 1829. The analogy with the board of directors is a very limited one, for the reason that the administrative receiver's agency has many "peculiar incidents": *Edenwest Ltd v CMS Cameron McKenna* [2013] B.C.C. 152, at [62]-[63] and [75], see further below para.10-24.



- agent of the debenture-holder who appoints him unless the debenture provides otherwise,<sup>79</sup> as it almost invariably will.
- (ii) The appointment of an administrative receiver usually prevents the making of an administration order.<sup>80</sup> This is not true of other receivers.
  - (iii) An administrative receiver is an office-holder for the purpose of certain provisions of the Insolvency Act,<sup>81</sup> and the Company Directors Disqualification Act,<sup>82</sup> with attendant powers, duties and privileges which are not necessarily possessed by other receivers.
  - (iv) The powers conferred on the administrative receiver by the debenture-holder are deemed to include those set out in Sch.1 to the Insolvency Act; in the case of other receivers, such powers must be conferred by the terms of the debenture itself.
  - (v) Only a receiver who is an administrative receiver can apply for an order under s.43 of the Insolvency Act to dispose of property charged to another creditor.
  - (vi) An administrative receiver is required to obtain a statement of affairs from the officers of the company, and to send a report to the registrar of companies<sup>83</sup>; other types of receiver are merely required to file accounts.
  - (vii) An administrative receiver may be removed only by the court<sup>84</sup>; a receiver who is not an administrative receiver may be removed by the debenture-holder who appointed him, if the debenture so provides.
  - (viii) An administrative receiver cannot be appointed during the period in which the company is in administration<sup>85</sup>; no such restriction applies to the appointment of other types of receiver, although they would be powerless to act until the administration order had been discharged.<sup>86</sup>

<sup>79</sup> *Re Vimbos Ltd* [1900] 1 Ch. 470; and *Deyes v Wood* [1911] 1 K.B. 806.

<sup>80</sup> See below, para.10–26.

<sup>81</sup> Insolvency Act 1986 ss.233(1) (cf. s.233A), 234(1) and 236. The administrative receiver is also subject to a duty to co-operate with a liquidator appointed to the company: Insolvency Act 1986 s.235(3)(e).

<sup>82</sup> Company Directors Disqualification Act 1986 s.7(3).

<sup>83</sup> Insolvency Act 1986 ss.47 and 48, as to which see below, para.10–67.

<sup>84</sup> Insolvency Act 1986 s.45(1). Prior to the Insolvency Act 1985, it was for the debenture-holder to remove a receiver and appoint another in his place, if so empowered by the debenture.

<sup>85</sup> Insolvency Act 1986 Sch.B1 para.43(6A).

<sup>86</sup> Because of the restrictions imposed on the enforcement of security, the repossession of goods and the commencement or continuance of proceedings (Insolvency Act 1986 Sch.B1 para.43) and the fact that the management of the business is placed under the control of the administrator (Insolvency Act 1986 Sch.B1 paras 59, 60, 64(1) and Sch.1).

- (ix) An administrative receiver must vacate office on the making of an administration order<sup>87</sup>; other types of receiver need vacate office only on being required to do so by the administrator.<sup>88</sup>
- (x) The acts of an administrative receiver are valid notwithstanding any defect in his appointment<sup>89</sup>; there is no similar rule for ordinary receivers.

These differences reflect the fact that the administrative receiver takes over substantially the whole of the company's assets and manages the business, so that he is treated in much the same way as an office-holder in a collective insolvency proceeding such as administration or liquidation.

### The multi-faceted character of administrative receivership

To define an administrative receiver is simple, because the Insolvency Act itself provides us with a definition. It is much more difficult to identify the legal essence of administrative receivership. This is because the administrative receiver has two sets of powers and owes duties to two different parties, in consequence of which he does not fit readily into any identified mould.<sup>90</sup> The first set of powers relates to the possession, management and realisation of the security. These powers are exercised in right of the debenture-holder and, being given for the enforcement of the debenture-holder's rights *in rem*, are unaffected by the company's liquidation. The second set of powers, conferred by the company through the execution of the debenture and exercised by the receiver as agent of the company, enables him to conclude contracts in the name of the company, thus committing it to further liabilities, and to engage and dismiss staff and generally run the business. The agency powers come to an end on the winding-up of the company except to the extent to which their exercise is ancillary to the enforcement of the security.<sup>91</sup>

In his legal relationships the administrative receiver, like the Roman God Janus, faces two ways. He owes a limited duty of care to the company as its deemed agent<sup>92</sup> and a separate duty of care to the debenture-holder who appointed him,<sup>93</sup> yet at the same time he possesses a high degree of autonomy. His agency for the company is of a peculiar kind, since it exists primarily for the protection and enhancement of the debenture-holder's security. Accordingly the

<sup>87</sup> Insolvency Act 1986 Sch.B1 para.41(1).

<sup>88</sup> Insolvency Act 1986 Sch.B1 para.41(2); *Re Fivestar Properties Ltd* [2015] EWHC 2782 (Ch), [2016] 1 W.L.R. 1104, at [3]–[4]. Presumably a court-appointed receiver of all of the company's assets remains in office unless and until the court orders otherwise.

<sup>89</sup> Insolvency Act 1986 s.232.

<sup>90</sup> See below.

<sup>91</sup> See below, para.10–68.

<sup>92</sup> As to the source and extent of this duty, see below, para.10–48.

<sup>93</sup> See below, para.10–48.

company has no power either to terminate the agency or to control its deemed agent as to the manner in which he performs his duties. Further, his obligations to the company are subordinated to his duties to his debenture-holder, so that even if his acts cause damage to the company's interests, he incurs no liability so long as what he did was for the proper protection of the debenture-holder and he did not needlessly damage the company's business.<sup>94</sup> In addition, his deemed agency for the company largely protects his debenture-holder from responsibility for his acts or omissions.<sup>95</sup>

On the other hand, the administrative receiver is not at the beck and call of the debenture-holder. To the contrary, the debenture-holder has no right to give directions to the receiver in the conduct of his receivership; indeed, if the debenture-holder does so, he risks being held liable for any improper acts or omissions of the receiver, who will then be treated as his agent.<sup>96</sup> The independence of the administrative receiver is reinforced by the fact that he can now only be removed by order of the court.<sup>97</sup> He is also required by statute to ensure that where the free assets of the company are insufficient to pay preferential creditors, any shortfall is made good from property subject to a floating charge in priority to the claims of the chargee.<sup>98</sup>

So the administrative receiver is a protean character, changing his colour, shape and function according to circumstances. He can best be described as an independent contractor whose primary responsibility is to protect the interests of his appointor but who also owes a duty to his deemed principal, the company, to refrain from conduct which needlessly damages its business or goodwill, and a separate duty, by statute, to observe the priority given to preferential creditors over claims secured by a floating charge. Since this is the only kind of receiver discussed below, we shall for brevity refer to him hereafter simply as "the receiver". The precise nature of the agency power and its relationship with the exercise of security rights on behalf of the debenture-holder are examined below.<sup>99</sup>

#### 4. APPOINTING THE RECEIVER OUT OF COURT

##### Who can be appointed

**10-25** A person can be appointed a receiver of a company only if qualified to act as an insolvency practitioner in relation to the company.<sup>100</sup> This means that he must be

<sup>94</sup> See below, para.10-49.

<sup>95</sup> Insolvency Act 1986 s.44(1)(a).

<sup>96</sup> See below, para.10-77.

<sup>97</sup> Insolvency Act 1986 s.45(1).

<sup>98</sup> See para.10-61.

<sup>99</sup> See para.10-48.

<sup>100</sup> Insolvency Act 1986 s.230(2). But the fact that a receiver is appointed who is not qualified does not affect the validity of his acts (Insolvency Act 1986 s.232).

qualified both generally and in relation to the company itself. A qualified insolvency practitioner is a person authorised by a recognised professional body<sup>101</sup> to act as an insolvency practitioner for companies.<sup>102</sup>

Only an individual can be a qualified insolvency practitioner.<sup>103</sup> Moreover, a person cannot be appointed who is an undischarged bankrupt, a person to whom a moratorium period under a debt relief order applies, a person who is subject to an in-force bankruptcy or debt restrictions order, a person subject to a disqualification order or undertaking under the Company Directors Disqualification Act 1986 or a person that lacks capacity within the meaning of the Mental Capacity Act 2005.<sup>104</sup> Even if otherwise qualified, an insolvency practitioner cannot act as receiver of a company until he has furnished appropriate security for the proper performance of his functions,<sup>105</sup> as where he is covered by a bond, whether in relation to his practice generally or in relation to a particular receivership.

##### Grounds for appointment

The Insolvency Act is silent as to the grounds on which a receiver may be appointed out of court. Although a chargee under a charge by deed has certain implied powers under s.101 of the Law of Property Act 1925 to appoint a receiver of income, this power will be exercisable only when the chargee has become entitled to exercise its power of sale, unless the deed provides otherwise.<sup>106</sup> The well-drawn debenture should therefore provide for every event on which the appointment of a receiver may be desired. There is no implied power to appoint a receiver merely because the security is in jeopardy.<sup>107</sup> A purported appointment will not, of course, be effective if the debenture under which the appointment is made is invalid. In addition, it is necessary that any conditions for making the appointment which are specified in the debenture are either satisfied at the time of the receiver's acceptance of the appointment<sup>108</sup> or are waived by

10-26

<sup>101</sup> Insolvency Act ss.390(2) (as substituted by Deregulation Act 2015) and 390A. As to who is a recognised professional body, see Insolvency Act 1986 s.391 (as substituted by the Deregulation Act 2015), the Insolvency Practitioners (Recognised Professional Bodies) Order 1986 (SI 1986/1764), and above, para.1-31.

<sup>102</sup> Under the rules introduced by the Deregulation Act 2015, it is now possible for insolvency practitioners to be qualified to act only in relation to companies, or only in relation to individuals, or in relation to both: Insolvency Act 1986 s.390A.

<sup>103</sup> Insolvency Act 1986 s.390(1).

<sup>104</sup> Insolvency Act 1986 s.390(4)-(5).

<sup>105</sup> Insolvency Act 1986 s.390(3).

<sup>106</sup> Law of Property Act 1925 ss.109(1) and 101(3), discussed above fn.72.

<sup>107</sup> *Cryne v Barclays Bank Plc* [1987] B.C.L.C. 548. The court has power to appoint a receiver "in all cases in which it appears to the court to be just and convenient to do so" (Supreme Court Act 1981 s.37(1)), and it is a well-established ground for appointment that the security is in jeopardy (Supreme Court Act 1981 s.37(1)).

<sup>108</sup> It is this, rather than the time of making the appointment, that is the relevant time (*R.A. Cripps & Son v Wickenden* [1973] 1 W.L.R. 944, per Goff J at 953-954).

the directors under the terms of the debenture, failing which the appointment will be a nullity. So an appointment made on the basis of a premature or otherwise invalid demand is of no effect.<sup>109</sup> However, an appointment made on an invalid ground is effective if at the time of the receiver's acceptance of the appointment<sup>110</sup> a valid ground of appointment existed.<sup>111</sup> The appointment:

- (i) may be made despite the filing of an application for an administration order<sup>112</sup>;
- (ii) may not be made during the currency of an administration order<sup>113</sup>;
- (iii) if made before such an order, is displaced by the order, upon the making of which the administrative receiver must vacate office<sup>114</sup>;
- (iv) prevents the making of an administration order except:
  - (a) by the consent of the person by whom or on whose behalf the receiver was appointed; or
  - (b) where, if an administration order were made, any security by virtue of which the receiver was appointed would be liable to be released or discharged as a transaction at an undervalue or a preference or liable to be avoided under s.245 of the Insolvency Act as a floating charge given for past value by an insolvent company.<sup>115</sup>

The phrase "would be liable to be released or discharged" presumably means that the court must be satisfied on the evidence before it, which may well be incomplete, that on a balance of probabilities the conditions in which a court could exercise its powers of release or discharge or in which the floating charge would be rendered void would be fulfilled if an administration order were then made, whether or not the court would be likely to exercise its powers in the particular circumstances. Such a ruling is, of course, operative solely for the purpose of making an administration order and does not constitute a *res judicata* preventing the debenture-holder from contending in subsequent proceedings under ss.238–240 or 245 that the debenture is not liable to be avoided under those sections.

<sup>109</sup> See below, para.10–30.

<sup>110</sup> See fn.108 above.

<sup>111</sup> See, e.g. *Byblos Bank SAL v Al-Khudhairi* [1987] B.C.L.C. 232, applied in *Re Brampton Manor (Leisure) Ltd v McLean* [2007] B.C.C. 640.

<sup>112</sup> Insolvency Act 1986 Sch.B1 para.39.

<sup>113</sup> Insolvency Act 1986 Sch.B1 para.43(6A).

<sup>114</sup> Insolvency Act 1986 Sch.B1 para.41(1).

<sup>115</sup> Insolvency Act 1986 Sch.B1 para.39. See generally Ch.13 as to these grounds of avoidance. Potential invalidity of the security for non-registration is not designated as an event enabling an administration order to be made, since this can be cured by registration out of time with leave of the court prior to the initiation of steps for the winding-up of the company. See Companies Act 2006 s.873.

### Blocking an administration order

The effect of the Insolvency Act is that an administrative receiver and an administrator cannot be in post at the same time.<sup>116</sup> The reason for such a rule is obvious: since both are given the widest powers of management but represent different interests, it is not possible for their functions to be exercised concurrently. Subject to the provisions of para.39(1) of Sch.B1, it is the first to be appointed who prevails. A debenture-holder whose security is not vulnerable to avoidance thus has power to block an administration by appointing an administrative receiver, and he may do this at any time prior to the company's entry into administration, whether or not an application for an administration order has already been made.<sup>117</sup> It therefore behoves the debenture-holder to keep a watchful eye to ensure that he does not overlook such an application. He is helped in this regard by an entitlement to be warned that an application has been made: para.12(2) of Sch.B1 requires notice of the application to be given to him as soon as reasonably practicable,<sup>118</sup> thus enabling him to appoint an administrative receiver where entitled to do so, or to intervene and apply to have his own nominee appointed as administrator.<sup>119</sup> Non-compliance with this requirement should not render the order a nullity,<sup>120</sup> though it might form the basis for an application to set the order aside. The position is apparently otherwise in relation to out-of-court appointments: an appointment of an administrator out-of-court by a junior debenture-holder without giving prior notice<sup>121</sup> to a senior debenture-holder entitled to appoint their own administrator or an administrative receiver renders the appointment a nullity.<sup>122</sup>

10-27

### Conditions of a valid appointment by the debenture-holder

In order for the debenture-holder's appointment of a receiver to be valid, seven conditions must be fulfilled:

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- (i) The company is not in administration.<sup>123</sup>

<sup>116</sup> Insolvency Act 1986 Sch.B1 paras 17(b), 25(c), 39, 41(1) and 43(6A).

<sup>117</sup> Insolvency Act 1986 Sch.B1 paras 39(2) and, as to the position after the company is in administration, 43(6A).

<sup>118</sup> Insolvency Act 1986 Sch.B1 para.12(2), and see Insolvency Rules 2016 r.3.8 and Sch.4(3).

<sup>119</sup> Insolvency Act 1986 Sch.B1 para.36.

<sup>120</sup> This is a question of statutory construction, to be answered by asking whether Parliament can fairly be taken to have intended "total invalidity" to be the consequence: *Re Soneji* [2006] 1 AC 340 at [15]; *Re Bezier Acquisitions* [2012] All E.R. (Comm) 322 at [19]–[20].

<sup>121</sup> As required by Sch.B1 para.15.

<sup>122</sup> *Re Eco Link Resources Ltd* [2012] BCC 731. See also *Adjei v Law for All* [2011] BCC 963, in which a failure to give notice of intention to appoint an administrator to a charge holder entitled to notice under Sch.B1 para.26(1) was assumed to invalidate the appointment, Norris J overcoming this result by making an administration order with retrospective effect.

<sup>123</sup> See above para.10–13.

(ii) The security under which the receiver is appointed is valid. The appointment will be void *ab initio* if:

- (a) the company is already in winding-up, or goes into winding-up, and the security was registrable but not registered<sup>124</sup> or is set aside by the court under s.241 or rendered void by s.245 of the Insolvency Act or as a post-petition disposition not sanctioned by the court<sup>125</sup>; or
- (b) the company is a foreign company, as opposed to one registered under the Companies Act 2006.<sup>126</sup>

If the company is not in winding-up when the receiver is appointed, the fact that the security is potentially void or voidable does not at that time affect the validity of the appointment but subsequent avoidance of the security nullifies the appointment retrospectively unless, in the case of an order for release or discharge of the security, the court exercises what appears to be a power to set aside the security as from the date of its order, without retrospective effect.<sup>127</sup>

- (iii) The obligations secured by the debenture arise from a valid contract. Hence, a receiver appointed under a valid debenture because of default in payment of sums payable under an invalid guarantee secured by the debenture is not validly appointed.<sup>128</sup>
- (iv) The power to appoint a receiver has become exercisable under the terms of the debenture.<sup>129</sup>
- (v) The appointment has been made by the person<sup>130</sup> and in the manner<sup>131</sup> authorised by the debenture.
- (vi) The person appointed is qualified to act.<sup>132</sup>

<sup>124</sup> Companies Act 2006 s.874.

<sup>125</sup> Insolvency Act 1986 s.127 (see para.13–121); and *Re Goldberg (No.2)* [1912] 1 K.B. 606, which concerned comparable provisions under the then Bankruptcy Act by which the trustee's title to the bankrupt's estate related back to the act of bankruptcy on which the adjudication order was made.

<sup>126</sup> This results from the new definition of company introduced by the Companies Act 2006 (Consequential Amendments, Transitional Provisions and Savings) Order 2009, SI 2009/1941. See Gabriel Moss, Nick Segal and Ian Fletcher, "A Very 'Consequential' Amendment: No More Administrative Receivers for Foreign Companies" (2010) 23(4) *Ins. Int.* 1. There is a somewhat different position in administration, where a foreign company may be put into administration if it is incorporated in an EEA state or if, although not so incorporated, it has its centre of main interests in an EEA state other than Denmark.

<sup>127</sup> See below, para.10–32.

<sup>128</sup> *Ford & Carter Ltd v Midland Bank Ltd* (1979) 129 N.L.J. 543.

<sup>129</sup> See above and, in the case of an appointment made after failure to comply with a demand for payment, below, paras 10–29 et seq.

<sup>130</sup> *Harris & Lewine Pty Ltd (in liquidation) v Harris & Lewin (Agents)* (1975) A.C.L.C. 28 at 279.

<sup>131</sup> *R. Jaffe Ltd (in liquidation) v Jaffe (No.2)* [1932] N.Z.L.R. 195.

<sup>132</sup> Under s.390 of the Insolvency Act 1986; see above, para.10–25.

(vii) The debenture-holder is not estopped from making the appointment. A promissory estoppel will only arise where there has been a clear and unequivocal statement by the debenture-holder that is relied upon by the debtor to its detriment.<sup>133</sup>

Where these conditions are satisfied, the appointment of the receiver will be a valid appointment. Good faith in the making of an appointment does not appear to be a prerequisite of its validity but if an appointment is made in bad faith the debenture-holder will be liable for any loss thereby caused to the company.<sup>134</sup> The fact that the company is in liquidation is not a bar to the appointment of a receiver,<sup>135</sup> and it is not necessary to obtain either the consent of the liquidator or the leave of the court to such an appointment. However, as the liquidator is an officer of the court the receiver cannot take possession of any assets within the liquidator's control except with his consent or by leave of the court, to which the receiver is entitled as a matter of right.<sup>136</sup>

The acts of an individual as administrative receiver are valid notwithstanding any defect in his appointment, nomination or qualifications,<sup>137</sup> but the section is confined to defects in form or procedure and cannot be invoked where the receiver has never been validly appointed at all.<sup>138</sup>

#### The demand for payment

One of the most common grounds on which a receiver is appointed pursuant to powers conferred by the debenture is non-compliance with a demand for payment. An appointment made on the basis of a premature or otherwise invalid demand is of no effect. Two questions then arise: what constitutes a valid demand for payment? And what time must the debenture-holder allow the company to satisfy the demand?

10–29

#### The validity of the demand

On this question, the authorities establish the following propositions:

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- (i) *Unless otherwise provided by the debenture itself, the demand is valid if calling merely for payment of "all moneys due" without specifying the amount.*<sup>139</sup> The commercial necessity of allowing the creditor to

<sup>133</sup> *Closegate Hotel Development (Durham) Ltd v Mclean* [2014] Bus. L.R. 405, rejecting a claim that a floating charge holder was estopped from appointing an administrator.

<sup>134</sup> See below, para.10–34, as to examples of bad faith.

<sup>135</sup> *Re Pound & Hutchins* (1889) 2 Ch.D. 402.

<sup>136</sup> *Re Potters Oils Ltd (No.2)* [1986] 1 W.L.R. 201 at 206; and *Pound & Hutchins*, above.

<sup>137</sup> Insolvency Act 1986 s.232.

<sup>138</sup> See below, para.10–32.

<sup>139</sup> *Bank of Baroda v Panessar* [1987] Ch. 335; and *Bunbury Foods Pty Ltd v National Bank of Australasia Ltd* (1984) 51 A.L.R. 609.

make a general demand in this way without stating the amount due was well put by the High Court of Australia in *Bunbury Foods Pty Ltd v National Bank of Australasia Ltd*.<sup>140</sup>

“... to require the creditor in all cases to specify the amount of the debt may operate to impose an onerous burden upon him. Some accounts may be so complex and so constantly changing that it is difficult at any given time to ascertain or to assert the precise amount that is due and payable. Indeed, the ascertainment of the amount may in some instances require the resolution over time of complex issues of fact and law. Yet, in order to preserve the value to the creditor of his security, he may need to call up the debt as a matter of urgency. It is of some materiality to note that it is not essential to the validity of a notice calling up the debt that it correctly states the amount of the debt... There is little point in requiring that the notice should state the amount if the correctness of the amount is not essential to the validity of the notice. In this situation insistence on the requirement may result in creditors taking insufficient care in stating the amount of the debt, thereby contributing to confusion on the part of debtors.”<sup>141</sup>

- (ii) *A demand is not normally rendered invalid because it is for more than the amount due.*<sup>142</sup> An understatement of the amount due clearly does not prejudice the debtor company, and this is usually true of an overstatement, since in most cases the debtor is manifestly unable to pay even the lower, correct, amount. The principle established in relation to the enforcement of mortgages is that the making of an excessive demand by the mortgagee does not dispense with the duty of the mortgagor to tender that which is actually due.<sup>143</sup> However, there may be exceptional cases where this is not so. One possible case is where the debtor company has been led by the creditor to believe that a tender below the excessive amount demanded will be rejected, although even here it might be said that the company should still tender what is actually due. Another is where the company is dependent on the creditor for information as to the amount due—as where it is a surety for future advances from time to time made to the principal debtor—and the company would have been able to pay the sum actually due if it had known what it was but is unable to pay an amount demanded by the creditor which is grossly in excess of the indebtedness.

<sup>140</sup> *Bunbury Foods*, above fn.139.

<sup>141</sup> *Bunbury Foods*, above, fn.139, at 619.

<sup>142</sup> *Bunbury Foods*, above fn.139, and cases there cited.

<sup>143</sup> *Campbell v Commercial Banking Co of Sydney* (1879) 40 L.T. 137; and *Clyde Properties Ltd v Tasker* [1970] N.Z.L.R. 754.

(iii) *A demand is invalid if what is claimed is not due at all.*<sup>144</sup> But if the receiver was appointed by the debenture-holder at the invitation of the board of the company and that invitation was extended in the mistaken belief that grounds had occurred entitling the debenture-holder to make the appointment, the company cannot treat the receiver as a trespasser for the period during which he is in possession of the assets prior to being required by the company to withdraw after their discovery of the mistake.<sup>145</sup>

(iv) *If, following an excessive demand, the company tenders the amount actually due, the subsequent appointment of a receiver will be invalid, since ex hypothesi there is no default.*

(v) *The company is entitled only to such time as is reasonable to implement the mechanics of payment,<sup>146</sup> but is not entitled to an opportunity to raise the finance required.<sup>147</sup>* In this respect, the English rule is stricter than that applied in Canada.<sup>148</sup> In Canada there is at least one decision in which it has been held that the duty to give reasonable notice is not merely a presumptive rule of construction of the security instrument but is founded on the twin concepts of public policy and unconscionability and cannot be waived.<sup>149</sup> It is fair to say that the doctrine of unconscionability has been developed in Canada into a major instrument for controlling contract terms in a way that goes well beyond English law, which continues to attach great importance to predictability in the legal outcome of commercial disputes.<sup>150</sup>

<sup>144</sup> *Jaffe v Premier Motors Ltd* [1970] N.Z.L.R. 146.

<sup>145</sup> *Ford and Carter*, cited above fn.128.

<sup>146</sup> Previously, the length of time needed may have depended on whether the demand is made during or outside banking hours (*Sheppard & Cooper Ltd v TSB Bank Plc (No.2)* [1996] B.C.C. 965, per Blackburne J at 969), but in modern banking practice payments can usually be effected speedily by electronic means in and outside of banking hours.

<sup>147</sup> *Cripps (Pharmaceuticals) Ltd v Wickenden* [1973] 2 All E.R. 606; and *Bank of Baroda*, cited above fn.139, where in both cases the time elapsing between service of the demand and the appointment of the receiver was approximately one hour and Goff J in the former case was prepared to accept that even minutes would be sufficient if the company was unable to pay.

<sup>148</sup> *Ronald Elwyn Lister Ltd v Dunlop Canada Ltd* (1982) 135 D.L.R. (3d) 1. Australian law is sometimes said to be similarly generous, given the High Court's statement in *Bunbury Foods* (fn.139) that “a debtor required to pay a debt payable on demand must be allowed a reasonable time to meet the demand”, but subsequent cases have interpreted this decision as no more generous than the mechanics of payment test: see e.g. *Parras Holdings Pty Ltd v Commonwealth Bank of Australia* [1998] FCA 682; *Lightman and Moss: The Law of Administrators and Receivers of Companies*, 2017, para.7-035.

<sup>149</sup> *Waldron v Royal Bank of Canada* [1991] 4 W.W.R. 289 (British Columbia Court of Appeal). Section 244 of the Canadian Bankruptcy and Insolvency Act 1992 now requires the creditor to give the debtor 10 days' notice before enforcing the security.

<sup>150</sup> In *Sheppard & Cooper Ltd v TSB Bank Plc* [1996] B.C.C. 653, the Court of Appeal hinted that the demand point might need review, recognising its importance in a number of Commonwealth jurisdictions as well as English decisions on it. See the judgment of Sir John Balcombe at 658.

- (vi) If the debtor company clearly could not have met the demand in any event, the shortness of time between demand and payment is irrelevant.<sup>151</sup>
- (vii) Where the company is a surety, it is a question of construction whether the debenture-holder has to make demand on the principal debtor as well as on the company.<sup>152</sup>

### Conditional appointment

**10-31** The debenture-holder may execute an instrument of appointment of the intended receiver in advance, and the receiver may accept the intended appointment in advance, under an instrument of appointment to take effect after default and demand for payment,<sup>153</sup> subject to s.33 of the Insolvency Act.<sup>154</sup> Accordingly, it is not an objection to the validity of the appointment that the receiver has the instrument in his hands before demand has been made. The common practice of making appointments in this way reflects the perceived need to have the receiver in possession as soon as possible after demand in order to preserve the assets and reduce the risk of their removal.

### Effect of defective or invalid appointment

**10-32** Under s.232 of the Insolvency Act, the acts of an individual as receiver are valid notwithstanding any defect in his appointment, nomination or qualifications. But in relation to the appointment or nomination, the section is confined to defects in form or procedure and does not validate acts done by one who was appointed under an invalid security or when the power of appointment had not become exercisable or who has acted without being appointed at all or when disqualified.<sup>155</sup> In cases outside s.232, a receiver who acts when not validly appointed is liable to the company in damages for trespass or conversion, where

<sup>151</sup> *Cripps (Pharmaceuticals)*, cited above fn.147; *Bank of Baroda*, cited above fn.139; and *Sheppard & Cooper (No.2)*, cited above fn.146, where the interval between the demand and the appointment was no more than an hour but the company had made it clear that it was unable to pay.

<sup>152</sup> See, e.g. *DFC Financial Services Ltd v Coffey* [1991] B.C.C. 218, where the Privy Council, taking a different view on the construction point from the Court of Appeal of New Zealand, held that the debenture-holder was entitled to proceed directly against the surety as if it was a primary obligor without first making demand on the principal debtor as well.

<sup>153</sup> *Cripps (Pharmaceuticals)*, cited above fn.147; and *Windsor Refrigerator Co v Branch Nominees Ltd* [1961] Ch. 375.

<sup>154</sup> See below, para.10-35.

<sup>155</sup> *Morris v Kanssen* [1946] A.C. 549, a decision on a comparable provision in the Companies Act 1929 s.143 and Table A, applied by analogy by Lord Hoffmann in *OBG v Allen* [2008] A.C. 1 at [90]-[91]. The decision in *Re Blights Builders Ltd* [2007] BCC 712 to use the equivalent statutory provision for administrators (Sch. B1 para.104) to validate the acts of an administrator invalidly appointed appears incorrect.

the elements of these torts are satisfied,<sup>156</sup> or alternatively as constructive trustee of assets coming into his hands.<sup>157</sup>

The company can ratify a defective or invalid appointment and may be estopped from disputing the validity of the appointment if with knowledge of its invalidity the company proceeds to deal with the receiver on the footing that he was validly appointed.<sup>158</sup> In the absence of such ratification or estoppel, an appointment made before the right to appoint was exercisable is not cured by subsequent accrual of the right to appoint, nor can a second appointment be validly made until the appointor has remedied his wrongdoing by restoring the company to possession of its assets and renewing his demand.<sup>159</sup>

At common law, the invalidity of a receiver's appointment does not convert him into the agent of the debenture-holder who appointed him,<sup>160</sup> so that the debenture-holder is not in principle responsible for the receiver's acts or omissions.<sup>161</sup> However, by s.34 of the Insolvency Act, the appointee may now ask the court for an order requiring the debenture-holder to indemnify him against any legal liability he has incurred solely by reason of the invalidity of the appointment. In practice, such indemnities are commonly exacted by receivers as a condition of accepting appointment.

### Points to check before accepting an appointment

It follows from what has been said above that before accepting appointment as receiver the intended appointee should satisfy himself as far as possible that the security was duly registered and appears otherwise unimpeachable, that the instrument of appointment was signed by those empowered to sign it and that the appointment appears to be valid in other respects, and should wherever possible obtain an indemnity against the consequences of an invalid appointment.<sup>162</sup>

10-33

<sup>156</sup> There cannot be conversion of a chose in action, such as contractual rights (*OBG Ltd v Allan*, cited above, Lord Nicholls and Baroness Hale dissenting on this point). The claimant may have a claim in tort for inducing a breach or for causing harm by unlawful means (*OBG Ltd v Allan*).

<sup>157</sup> *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1986] Ch. 246.

<sup>158</sup> *Bank of Baroda*, cited above fn.139. See also above, para.10-30, as to the effect of inviting the debenture-holder to make the appointment in the mistaken belief that the debenture-holder had become entitled to do so. A similar estoppel applies where there is acquiescence in the appointment of an administrator. See below, para.11-46.

<sup>159</sup> *Cripps (Pharmaceuticals)*, cited above fn.147, per Goff LJ at 618.

<sup>160</sup> *Bank of Baroda*, cited above fn.139.

<sup>161</sup> *Bank of Baroda*.

<sup>162</sup> These are not, of course, the only matters he will need to consider. Others include the sufficiency of the assets to meet his remuneration and expenses, the fact that the company is or is likely to go into liquidation (thus bringing an end to the receiver's agency powers) and the adequacy of his own professional expertise. See generally *Lightman and Moss: The Law of Administrators and Receivers of Companies*, 2017, para 7-050.

### Must the debenture-holder consider the company's interests when appointing a receiver?

- 10-34** The debenture-holder is entitled to prefer his own interests to those of the company in making the appointment, for his position is inherently adverse to that of the company, and it is a general principle of mortgage law that a mortgagee is entitled to subordinate the debtor's interest to his own, so long as he is acting in good faith.<sup>163</sup> Accordingly, the debenture-holder owes no general duty to the company to refrain from appointing a receiver merely because this would cause damage to the company,<sup>164</sup> unless he acts in bad faith,<sup>165</sup> for example, by appointing a receiver solely<sup>166</sup> for the purpose of disrupting an existing receivership under a subsequent debenture and preventing its enforcement<sup>167</sup> or maliciously with a view to damaging the company or another creditor. He does, however, have a duty not to appoint a person whom he has reasonable grounds for believing is incompetent<sup>168</sup> or not qualified to act as an insolvency practitioner. There must, it is thought, be a strong presumption that a person who is legally qualified to act possesses the necessary competence and accordingly that a belief in his competence is reasonable.

### When the appointment takes effect

- 10-35** The appointment is of no effect until it is accepted by the appointee before the end of the business day next following that on which the instrument of appointment is received by him or on his behalf but subject to this it is deemed to be made when the instrument of appointment is so received.<sup>169</sup> It is not entirely clear from the statutory provisions whether failure to accept the appointment renders it retrospectively void or merely terminates it on expiry of the time allowed for acceptance. The words "is of no effect" rather than "ceases to have effect" suggest that the former is the proper interpretation. At first sight, the point appears to be relevant to the validity of the appointee's acts in the period between

<sup>163</sup> *Shamji v Johnson Matthey Bankers Ltd* [1991] B.C.L.C. 36; and *Cuckmere Brick Co Ltd v Mutual Finance Ltd* [1971] Ch. 949, per Salmon LJ at 965.

<sup>164</sup> *Shamji*, cited above; and *Re Potters Oils Ltd (No.2)* [1986] 1 W.L.R. 201.

<sup>165</sup> *Shamji*, cited above fn.163; and *Re Potters Oils Ltd (No.2)* [1986] 1 W.L.R. 201; and see also *Horn v Commercial Acceptances Ltd* [2011] EWHC 1757 (Ch) at [72]–[77] (noted in *Lightman and Moss*, 2017, para.13–009) clarifying that proof of dishonesty is not a prerequisite to a finding of bad faith.

<sup>166</sup> See *Cukurova Finance International Ltd v Alfa Telecom Turkey (Nos 3 to 5)* [2016] AC 923 at [78]: "the Board considers that if a chargee enforces his security for the proper purpose of satisfying the debt, the mere fact that he may have additional purposes, however significant, which are collateral to that object, cannot vitiate the enforcement of his security".

<sup>167</sup> *Downsview Nominees Ltd v First City Corp* [1993] A.C. 295.

<sup>168</sup> See *Shamji*, cited above fn.163.

<sup>169</sup> Insolvency Act 1986 s.33. To save time, the instrument of appointment may be executed in advance of default and given to the intended receiver to become effective by his acceptance of it after demand and default.

receipt of the instrument of appointment and expiry of the time allowed for his acceptance of it. But this possibility is more apparent than real, because no formality is prescribed for acceptance, which may be in writing, by word of mouth or even by conduct,<sup>170</sup> so that it is difficult to envisage a situation in which the appointee could act as receiver without thereby accepting the appointment and perfecting his status. What is clear is that acceptance of the appointment within the time laid down operates retrospectively to the date of receipt of the instrument of appointment.

## 5. EFFECT OF THE APPOINTMENT

### General effects

The appointment of a receiver:

- (i) crystallises a floating charge, if this has not already crystallised;
- (ii) usually prevents the making of an administration order<sup>171</sup>;
- (iii) suspends the directors' powers of management as regards assets comprised in the security and the general conduct of the business<sup>172</sup>;
- (iv) terminates those contracts of employment which are incompatible with the administrative receiver's management powers—a question which depends not so much on the designation of the office held by the employee as on the particular circumstances<sup>173</sup>—but does not affect other contracts of employment<sup>174</sup>; and
- (v) does not affect the subsistence of other contracts.<sup>175</sup>

### Impact of the appointment on the powers and duties of directors

#### (1) In general

The broad effect of the appointment of a receiver is to divest the directors of the company of their management powers during the currency of the receivership.<sup>176</sup>

<sup>170</sup> Acceptance must be confirmed in writing within five business days and the appointment publicised (Insolvency Act 1986 s.46(1); and Insolvency Rules 2016 r.4.1). But non-compliance with these formalities does not affect the validity of the appointment.

<sup>171</sup> See above, para.10–26.

<sup>172</sup> See below, paras 10–37 et seq.

<sup>173</sup> Contrast *Re Mack Trucks (Britain) Ltd* [1967] 1 All E.R. 977 with *Griffiths v Secretary of State for Social Services* [1974] Q.B. 468.

<sup>174</sup> *Re Foster Clark's Indenture Trusts* [1966] 1 All E.R. 43.

<sup>175</sup> See further paras 10–53 et seq.

<sup>176</sup> *Moss Steamship Co Ltd v Whinney* [1912] A.C. 254, per Lord Atkinson at 263; and *Re Emmadart Ltd* [1979] Ch. 540, per Brightman J at 547.

winding up or administration of the company in that the liquidator or administrator may bring proceedings in the name of the company for any breach of a director's duties to the company so far as the conduct constituting the breach has not been effectively ratified by its members. For that purpose, a summary remedy is available to the liquidator<sup>66</sup> by way of misfeasance proceedings under s.212 of the Insolvency Act. As we shall see, the ability of members to waive a breach or ratify improper conduct becomes severely circumscribed where the improper acts occur at a time when the company is insolvent.<sup>67</sup> Prior to the Companies Act 2006, the duties of directors were largely governed by the common law and principles of equity. Now they have been codified in and replaced by Ch.2 of Pt 10 of the Companies Act, although many of the provisions are based on the rules of common law and equity and, indeed, provide for their interpretation by reference to those rules.

### Executive and non-executive directors

- 14-09 An executive director, that is, one who is not merely a member of the board but a full-time employee engaged in day-to-day management of the company, owes two distinct sets of duties, those deriving from his status as director and those imposed on him as an employee participating in day-to-day management, usually under the terms of a service contract. A non-executive director, an outsider brought on to the board by virtue of his general standing or business acumen and devoting only part of his time to the company's affairs (primarily by attending board meetings and reading the relevant papers), owes only the first set of duties. In setting the standard of duty, the courts do not in general distinguish between executive and non-executive directors.<sup>68</sup> A director is not personally liable for negligent advice given by the company unless he assumed personal responsibility for it and that assumption was relied on by the claimant.<sup>69</sup>

### The director's duties as director

- 14-10 A director owes the following general duties to the company in his capacity as director:

- (1) to act in accordance with the company's constitution and only exercise powers for the purposes for which they are conferred<sup>70</sup>;

<sup>66</sup> As to the position of the administrator, see below, para.14-15.

<sup>67</sup> See below, para.14-20.

<sup>68</sup> See *Dorchester Finance Co Ltd v Stebbing* [1988] B.C.L.C. 488; but see paras 14-10 and 14-12, below. For the role of the non-executive director generally, see B.R. Cheffins, *Company Law: Theory, Structure and Operation* (Oxford: Clarendon Press, 1997), Ch.13.

<sup>69</sup> *Williams v Natural Life Health Foods Ltd* [1998] 1 W.L.R. 830.

<sup>70</sup> Companies Act 2006 s.171.

- (2) to promote the success of the company<sup>71</sup>;
- (3) to exercise independent judgment<sup>72</sup>;
- (4) to exercise reasonable care, skill and diligence<sup>73</sup>;
- (5) to avoid conflicts of interest<sup>74</sup>;
- (6) not to accept benefits from third parties conferred by virtue of his directorship<sup>75</sup>; and
- (7) to declare an interest in a proposed transaction or arrangement.<sup>76</sup>

There are also various transactions or arrangements which a director may not enter into without the approval of the members. These are not discussed here.

As a result of an amendment made by the Small Business, Enterprise and Employment Act 2015, s.170(5) of the Companies Act 2006 now provides that the general duties listed above apply to shadow directors "where and to the extent that they are capable of so applying". Under the previous version of this subsection, the general duties were expressed to apply to shadow directors "where, and to the extent that, the corresponding common law rules or equitable principles apply"<sup>77</sup> and it had previously been held that, applying such equitable principles, shadow directors did not necessarily come under the same fiduciary duties as *de jure* or *de facto* directors.<sup>78</sup> This view was subsequently doubted,<sup>79</sup> but in any case the amended provision is intended to alter the position so that the general duties are applicable to shadow directors.<sup>80</sup>

The director's general duties fall into broadly three groups: the duty to act within his powers; the duty to promote the company's success,<sup>81</sup> and the associated duties of care and skill; and fiduciary duties of a kind similar to those owed by an agent to his principal and embodying in different forms the duty of loyalty. The standards are the same for executive and non-executive directors.<sup>82</sup> The duty will vary according to the size and business of the particular company and the experience or skills that the particular director holds himself out as possessing.<sup>83</sup>

<sup>71</sup> Companies Act 2006 s.172.

<sup>72</sup> Companies Act 2006 s.173.

<sup>73</sup> Companies Act 2006 s.174.

<sup>74</sup> Companies Act 2006 s.175.

<sup>75</sup> Companies Act 2006 s.176.

<sup>76</sup> Companies Act 2006 s.177.

<sup>77</sup> Companies Act 2006 s.170(5).

<sup>78</sup> See *Ultraframe*, cited above fn.41, per Lewison J at [1288], a decision criticised as "unfortunate" in *Gower & Davies*, 10th edn, cited above fn.65, para.16-9.

<sup>79</sup> *Vivendi SA v Richards* [2013] B.C.C. 771.

<sup>80</sup> Explanatory Notes to the Small Business, Enterprise and Employment Act 2015, paras 593-595.

<sup>81</sup> Which has been characterised as a fiduciary duty, with associated remedial implications: *Sinclair Investments (UK) Ltd v Versailles Trade Finance Ltd* [2012] Ch. 453.

<sup>82</sup> *Dorchester Finance*, cited above fn.68.

<sup>83</sup> *Daniels v Anderson* (1995) 16 A.C.S.R. 607.



A non-executive director cannot be expected to have the detailed knowledge of the company's affairs required of an executive director, but even non-executive directors are required to take reasonable steps to guide and monitor the management of the company.<sup>84</sup>

The consequences of a breach of any of the above duties are not spelled out in the Act but are expressed as being the same as would apply if the corresponding common law rule or equitable principle applied.<sup>85</sup> Under these rules and principles, the available remedy or remedies will turn on, *inter alia*, the proper characterisation of the duty, and in particular whether it is a fiduciary duty or a non-fiduciary one (a wider range of remedies being available for breach of fiduciary duty).

(1) *Duty to act within his powers*

- 14-11 The director of a company owes a duty to act within the company's constitution and to exercise powers only for the purposes for which they are conferred. Where either of these duties is broken, then unless the resulting transaction is validly ratified by the members, it is liable to be set aside if the other party did not act in good faith, and the directors will be liable for any loss sustained by the company even if they acted in good faith and without negligence.

(2) *Duty to promote the success of the company and to exercise reasonable care, skill and diligence*

- 14-12 Section 172(1) sets out the core duty of a company's directors, and this is buttressed by the duty of care, skill and diligence in s.174. The core duty is to act in a way that he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so to have regard, amongst other things, to the various factors listed in s.172(1). The interests to which the directors have to have regard are those of the company's employees and its members. However, the duty is subject to any enactment or rule of law requiring directors, in certain circumstances, to have regard to the interests of creditors of the company,<sup>86</sup> an important qualification which we shall come to shortly. The duty in s.172 is subjective ("the question is whether the director honestly believed that his act or omission was in the interests of the company"<sup>87</sup>), but if there is no evidence that the director actually considered the question, then the test is whether "an intelligent and honest man in

<sup>84</sup> *Equitable Life Assurance Society v Bowley* [2004] 1 B.C.L.C. 180; and *AWA Ltd v Daniels* (1992) 7 A.C.S.R. 759, affirmed on appeal sub. nom. *Daniels v Anderson*, cited above fn.83.

<sup>85</sup> Companies Act 2006 s.178(1).

<sup>86</sup> Companies Act 2006 s.172(3).

<sup>87</sup> *Regentcrest Plc (in liq.) v Cohen* [2001] B.C.C. 494, per Jonathan Parker J at 513.

the position of the director of the company concerned could have reasonably believed that the transactions were for the benefit of the company".<sup>88</sup>

A director is required to exercise reasonable care, skill and diligence in the performance of his duties. This duty, previously imposed both at common law and in equity, is not a fiduciary duty.<sup>89</sup> The common law originally tended to pitch the standard of care at a relatively low level, but more recently it had been held that s.214(4) of the Insolvency Act 1986 relating to wrongful trading accurately reflected the standard of a director's duty of care, skill and diligence at common law, so as to require him to take the steps that would be taken by a reasonably diligent person having the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions, as well as the general knowledge, skill and experience which the director in fact possesses.<sup>90</sup> This equation of the common law standard with that imposed by s.214(4) has now been given statutory effect by s.174(2) of the Companies Act. A director thus has to meet at least the objective standard as well as any higher standard to be expected from his own knowledge, skill and experience. Accordingly, the case law on the duty of care prior to the Act remains relevant. Thus, a director:

- (1) need not be an expert in the type of business in which his company is engaged, so that it suffices if he used the care and skill of the non-professional reasonable man<sup>91</sup>;
- (2) is not required to give his whole time and attention to the company's affairs<sup>92</sup>;
- (3) if a non-executive director is entitled to rely on the executive directors and officers of the company, for example, for the accuracy of financial statements presented<sup>93</sup>;
- (4) is entitled to rely on outside advice by a person whom he reasonably believes to be competent to give it, so long as he exercises his own judgment as to such advice<sup>94</sup>; and
- (5) may delegate specific tasks and functions to others, which indeed is almost always essential if the company's business is to be carried on

<sup>88</sup> *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] Ch. 62 per Pennycuik J at [74], and for instructive analysis of the application of this in the context of s.172, see Gower and Davies, cited above fn.65 at [16-41] et seq.

<sup>89</sup> *Bristol and West Building Society v Mothew* [1996] 4 All E.R. 698, per Millett LJ, citing with approval the judgment of Ipp J in *Permanent Building Society v Wheeler* (1994) 14 A.C.S.R. 109 at 157-158.

<sup>90</sup> *Re D'Jan of London Ltd* [1993] B.C.C. 646.

<sup>91</sup> *Re City Equitable Fire Insurance Co* [1925] Ch. 407.

<sup>92</sup> *Re City Equitable Fire Insurance Co*, cited above. This reflects the fact that a director is not as such an employee of the company.

<sup>93</sup> *Re City Equitable Fire Insurance Co*, cited above fn.91; and *Dovey v Cory* [1901] A.C. 477.

<sup>94</sup> *Re Faure Electric Accumulator Co* (1888) 40 Ch.D. 141.

efficiently,<sup>95</sup> but must pass on information in his possession that is relevant both to the need for carrying out the task delegated and the rigour with which it needs to be done.<sup>96</sup>

However, a director must not abdicate involvement or responsibility. He therefore risks liability if: he neglects to attend board meetings; he leaves all decisions to others<sup>97</sup>; he fails to apply his judgment to the advice of outsiders; or signs cheques without inquiry<sup>98</sup> or insurance proposal forms without reading them.<sup>99</sup> Again, where some directors know that one of their number had been convicted of offences involving fraud, they have a duty to be on their guard, and it is no defence that the other directors, who knew nothing of the conviction, would likewise have been bamboozled by the fraudulent director.<sup>100</sup>

### (3) Duty to observe fiduciary obligations

- 14-13** Directors must not only act within their powers and those of the company, they must exercise their powers in good faith in the interests of the company and the shareholders as a whole. In particular, they must not misappropriate the company's assets, nor must they usurp for their own advantage corporate opportunities which, if they pursue them at all, should be pursued for the benefit of their company, or otherwise subordinate the company's interests to their own or those of third parties or abuse their powers or position.<sup>101</sup> These fiduciary duties are now encompassed in ss.175 to 177 of the Companies Act 2006 and embody two distinct equitable rules, the "no-profit" rule and the "no-conflict" rule.<sup>102</sup>

### The director's duties as an employee-manager

- 14-14** An executive director must, in addition to discharging his duties *qua* director, fulfil in his capacity as an employee participating in day-to-day management the

<sup>95</sup> *Re Westmid Packing Services Ltd (No.3)* [1998] B.C.C. 836, per Lord Woolf at 842; and *Re Barings Plc (No.5)* [1999] 1 B.C.L.C. 433, per Jonathan Parker J at [B2]. But overall responsibility is not delegable and there is a duty to supervise the discharge of the delegated function (*Re Barings Plc (No.5)* [1999] 1 B.C.L.C. 433, per Jonathan Parker J, at paras [B3] and [B7]).

<sup>96</sup> *Lexi Holdings Ltd v Luqman* [2009] B.C.C. 716, per Briggs J at [54]. An appeal on a different point was allowed by the Court of Appeal [2009] 2 B.C.L.C. 1. See below.

<sup>97</sup> *Re Westmid Packing Services Ltd* [1998] 2 B.C.C. 836, per Lord Woolf at 842.

<sup>98</sup> *Re City Equitable Fire Insurance Co*, cited above fn.91; *Re Faure Electric Accumulator Co*, cited above fn.94; and see *Re Majestic Recording Studios Ltd* (1988) 4 B.C.C. 519.

<sup>99</sup> *Re D'Jan of London*, cited above fn.90.

<sup>100</sup> *Lexi Holdings Plc v Luqman* [2009] 2 B.C.L.C. 1, reversing on this point the decision of Briggs J [2008] 2 B.C.L.C. 725.

<sup>101</sup> For further details, see the sources cited at fn.65 above.

<sup>102</sup> For recent explanations of these, see: *Re Allied Business & Financial Consultants Ltd* [2009] 2 B.C.L.C. 666; and *Ultraframe*, cited above fn.41.

express and implied terms of his service contract<sup>103</sup> and apply to the performance of his duties that degree of knowledge, care and skill which is reasonably to be expected of a person holding his position as well as that he actually has. A person holding the post of chief executive or managing director will be expected to exercise the care, skill and knowledge appropriate to that office (although obviously the degree of skill and knowledge required will vary with the size and complexity of the company) and any higher skill, etc., he actually possesses.

### Proceedings by liquidator or administrator for breach of duty owed to the company

#### The nature of the proceedings

The liquidator or administrator of a company can institute proceedings in the name of the company for any breach of duty by a director in respect of which the company itself could have made a claim prior to the liquidation or administration. Alternatively, where a company is in the course of being wound up, s.212 of the Insolvency Act provides a summary remedy against any one of a range of parties (including an existing or former director) who are or have been involved with the promotion, formation or management of the company, where that party has been guilty of misfeasance or of breach of any fiduciary or other duty to the company. In such a case, the liquidator (or the official receiver, a creditor or a contributory) may institute misfeasance proceedings against the director or other party concerned for an order in the winding up for examination of the director and for the repayment or restoration of money, return of property, or payment of compensation to the company for the misfeasance.<sup>104</sup> Misfeasance is not a distinct species of wrongdoing, simply a well-worn label for breaches of duty owed by directors to the company.<sup>105</sup> The reference in s.212 to fiduciary "or other" duties means that claims for breach of non-fiduciary duties are also within the scope of the section, including claims for negligence.<sup>106</sup> The effect of the section is essentially procedural: s.212 allows summary proceedings to be instituted in respect of the breach in the Companies Court within the liquidation.<sup>107</sup>

14-15

<sup>103</sup> Which will usually involve his devoting his whole time and attention to the company's affairs.

<sup>104</sup> Insolvency Act 1986 s.212(3). As to the court's power to grant relief, see below, para.14-19.

<sup>105</sup> *Re Continental Assurance Co of London Plc* [2001] B.P.I.R. 733, per Park J at [393].

<sup>106</sup> As in *Re D'Jan of London*, cited above fn.90. As Hoffmann LJ noted in his judgment (at [1]), what is now s.212(1) was not always so widely drawn, being limited to misfeasance and breach of trust and therefore applicable only to misfeasance in the nature of a breach of trust resulting in loss to the company (*Re Etic Ltd* [1928] Ch. 861; and *Cavendish Bentinck v Fenn* (1887) 12 App. Cas. 652).

<sup>107</sup> See *Re Continental Assurance Co of London Plc* [2001] B.P.I.R. 733, per Park J at [393], who also pointed out that although s.212 does not create any additional liabilities and obligations, it does confer on the court a measure of discretion as to remedies going beyond what is available at common law, a point also made by Lord Scott in *Stone & Rolls Ltd v Moore Stephens* [2009] 1 A.C. 1391 at [110].

“[Section 212] does not create duties which did not otherwise exist. It provides a convenient procedure for relief to be claimed and awarded for breaches of the common law and equitable duties which a director owes under the general law.”<sup>108</sup>

However, it is limited to breaches of duty by a person in his capacity as an officer of the company, etc. and cannot be used to pursue ordinary claims for debt or breach of contract.<sup>109</sup> The summary procedure under s.212 is not available to an administrator,<sup>110</sup> who, however, has the same power as the liquidator to institute proceedings in the name of the company for breach of a duty owed to the company.<sup>111</sup>

#### *Against whom proceedings may be brought*

- 14-16** Misfeasance proceedings may be brought against a person who: (i) is or has been an officer of the company; (ii) has acted as liquidator<sup>112</sup> or administrative receiver of the company; or (iii) not being a person within (i) or (ii), is or has been concerned, or has taken part, in the promotion, formation or management of

<sup>108</sup> *Re MDA Investment Management Ltd (No.1)* [2005] B.C.C. 783 at [71]. It is sometimes said that the relief available under s.212 is limited to compensation for loss, or at least that “a misfeasance claim will not succeed unless loss has been caused to the company by the breach of duty (whether such loss consists of a depletion of the company’s previously held assets or a diversion of profits or property which would otherwise have been available to the company”: *Gore-Browne on Companies*, cited above fn.65, Ch.61 at [12], citing inter alia *Re Simmons Box (Diamonds) Ltd* [2001] 1 B.C.L.C. 176 (but in that case the only complaint was of negligence, of which damage is an essential element) and *Re Derek Randall Enterprises Ltd* [1990] B.C.C. 749. In the latter case, a director who had received for himself commission for which he should have accounted to the company subsequently gave the company’s bank a guarantee in support of which he paid into a special blocked account with the bank a sum exceeding that which he had misappropriated. A majority of the Court of Appeal upheld the decision of Millett J that the effect of the payment was to restore to the company the sum misappropriated, so that it no longer had any loss. Dillon LJ dissented on the ground that the moneys paid in were represented as those of the director concerned and that they did not in reality benefit the company, for, although they reduced the debt to the bank, the director as surety was entitled to be subrogated *pro tanto* to the bank’s claims. The difference of opinion in the Court of Appeal seems to have turned on whether the sum paid in was that which had been misappropriated or was the surety’s own money. Millett J and the majority in the Court of Appeal adopted the former view, and on this basis concluded that the director would not have been subrogated, since it was not his money that was used to support the guarantee and thereby reduce the overdraft. Accordingly, the payment did in fact benefit the company, such that there was no longer any obligation to restore the funds to the company. In another context, however, s.212 has been applied to require directors to restore funds they authorised be paid out of the company in breach of duty even where the payment caused the company no loss: this is the effect of *West Mercia Safetywear Ltd v Dodd* (1988) 4 B.C.C. 30, which concerned a preference authorised in breach of duty (below, para.14-21).

<sup>109</sup> *Re Etic Ltd* cited above fn.106.

<sup>110</sup> *Irwin v Lynch* [2011] 1 W.L.R. 1364 at [4]. However, a similar remedy may be invoked against an administrator (Insolvency Act 1986 Sch.B1 para.75).

<sup>111</sup> Insolvency Act 1986 Sch.1, para.5.

<sup>112</sup> See above, para.5-03.

the company.<sup>113</sup> Those covered by (i) include both *de jure* directors and *de facto* directors, but in *Revenue & Customs Commissioners v Holland*,<sup>114</sup> Lord Hope expressed the view that such proceedings may not be brought against shadow directors, because s.212, in contrast to s.214(7), makes no reference to shadow directors. Since in that case it was not contended that the individual in question was a shadow director, Lord Hope’s remarks are clearly obiter, and it is respectfully submitted that they are not correct. Section 214(1) refers to a person who is or has been a director of the company, so it was felt necessary to insert s.214(7) for the avoidance of doubt. By contrast, s.212(1) is drawn very widely to include any person who is or has been concerned, or has taken part, in the promotion, formation or management of the company. That is surely wide enough to cover a shadow director without the need for specific mention. Moreover, s.212 is purely procedural, so that it would be surprising if a breach of duty by a shadow director were not susceptible to the summary remedy that section provides.

#### *Liquidator’s claim is purely derivative*

However, a claim by the liquidator for misfeasance or other breach of duty owed to the company is purely derivative<sup>115</sup>; he can sue only in respect of claims vested in the company and has no rights of action in respect of claims vested in particular creditors or other third parties, for example, for loss suffered by them through the company’s fraud or misrepresentation induced by the director concerned.<sup>116</sup> Again, the liquidator does not sue in right of the general body of creditors, as he is considered to do in proceedings for contribution under s.214 of the Insolvency Act<sup>117</sup>; he sues in right of the company,<sup>118</sup> and while this may benefit the general body of creditors by increasing the amount available for distribution, this is not necessarily the case, since any recoveries will in the first instance enure for the benefit of a prior assignee or chargee under a charge covering the money or property recovered.<sup>119</sup> Since the liquidator sues in right of the company, the respondent may join as third parties those against whom he has claims for contribution or indemnity.<sup>120</sup> But the respondent does not have a right to set off against his liability for misfeasance a cross-claim he has against the

14-17

<sup>113</sup> Insolvency Act 1986 s.212(1). Under para.75 of Sch.B1 to the Act such proceedings may also be taken against an administrator.

<sup>114</sup> [2010] 1 W.L.R. 2793 at [22].

<sup>115</sup> Albeit misfeasance proceedings have distinctive characteristics. See F. Oditah, “Misfeasance Proceedings against Company Directors” [1992] L.M.C.L.Q. 207, 210.

<sup>116</sup> *Re Ambrose Tin & Copper Mining Co* (1880) 14 Ch.D. 390.

<sup>117</sup> See above, para.6-36 and below, paras 14-48 and 14-57.

<sup>118</sup> See further para.14-21 as to the position of creditors.

<sup>119</sup> *Re Anglo-Austrian Printing and Publishing Union* [1895] 2 Ch. 891; and see above, para.6-34, and below, para.14-21, text and fn.141.

<sup>120</sup> *Cohen v Davis* [2007] 2 B.C.L.C.

company, for example, for a debt owed by the company, for a breach of trust or other misfeasance does not constitute a dealing so as to satisfy the requirement of mutual dealings between the respondent and the company.<sup>121</sup>

#### Orders that can be made

14-18 The court may compel a person against whom proceedings have been brought under s.212:

- (1) to repay, restore or account for the money or property misapplied or any part of it, with interest at such rate as the court thinks just; or
- (2) to contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary or other duty as the court thinks just.<sup>122</sup>

Thus, an order under s.212 is in the nature of a class remedy and can be made only in favour of the company, not in favour of an individual creditor.<sup>123</sup>

#### Relief from liability

14-19 Where a director or other officer of the company has been found liable for negligence, default, breach of duty or breach of trust, if the court finds that he has acted honestly and reasonably, and that having regard to all the circumstances of the case (including those connected with his appointment) he ought fairly to be excused, the court may relieve him, either wholly or partly, from his liability on such terms as it thinks fit.<sup>124</sup> But if the conditions for the grant of relief are not satisfied, because the director has not acted honestly and reasonably, the court may still temper the wind to the shorn lamb by limiting the amount to be paid under s.212 to a sum below that which is necessary to remedy the misfeasance.<sup>125</sup>

<sup>121</sup> *Manson v Smith* [1997] 2 B.C.L.C. 161; and *Re Anglo-French Co-operative Society Ex p. Pelly* (1882) 21 Ch.D. 492. In *Manson v Smith*, Millett LJ gave as a second reason the fact that the liability to the company against which the respondent seeks to assert a right of set-off does not arise until a judgment on the misfeasance claim, which post-dates the date of liquidation, which is the date as at which the mutual dealings are established. However, this point may now be taken care of by the hindsight principle discussed above, para.9-21.

<sup>122</sup> Insolvency Act 1986 s.212(3).

<sup>123</sup> *Kyrris v Oldham* [2004] 1 B.C.L.C. 305.

<sup>124</sup> Companies Act 2006 s.1157.

<sup>125</sup> For a case where this was done, see *Re Loquitur Ltd, Inland Revenue Commissioners v Richmond* [2003] 2 B.C.L.C. 442.

The postulate of a negligent director acting reasonably is a curious one; nevertheless, the section makes it clear that conduct which is negligent at common law may be reasonable for the purpose of s.1157 of the Companies Act 2006.<sup>126</sup>

#### Ratification by the members

Where the company is solvent and likely to remain so, it is open to its members<sup>127</sup> to authorise or ratify what would otherwise have been a breach of duty by the directors, in which case the liquidator has no cause of action to pursue in the company's name.<sup>128</sup> The approval need not be given at a general meeting; it suffices that all of the shareholders with a right to attend and vote at a general meeting had assented.<sup>129</sup> The situation is quite different where the transaction is likely to cause loss to creditors because the company is insolvent at the time of or inconsequence of the breach or (probably) likely to become so, for it is then the creditors, not the members, who have the primary interest in the proper application of the company's assets, so that a purported approval or ratification by the members of a breach of duty by the directors causing loss to the company will be ineffective.<sup>130</sup>

14-20

#### 4 DUTIES TO CREDITORS AT COMMON LAW AND THE RULE IN WEST MERCIA SAFETYWEAR V DODD

In *Winkworth v Edward Baron Development Co Ltd*,<sup>131</sup> Lord Templeman stated that a company owes a duty to future, as well as present, creditors to preserve its assets, but this dictum must, it is thought, be intended to be confined to cases where the company, although solvent at the time of the breach of duty complained of, is unlikely to remain so, and there is accordingly a risk to creditors.<sup>132</sup>

14-21

<sup>126</sup> *Re D'Jan of London*, cited above fn.90; and *Equitable Life Assurance Society v Bowley* [2004] 1 B.C.L.C. 180. Both cases were decisions on s.727 of the Companies Act 1985, the predecessor of s.1157 of the 2006 Act.

<sup>127</sup> As to the position where directors are also members, see Companies Act 2006 s.239.

<sup>128</sup> *Rolled Steel Products (Holdings) Ltd v British Steel Corp* [1986] Ch. 246; and *Multinational Gas and Petrochemical Co v Multinational Gas and Petrochemical Services Ltd* [1983] Ch. 258. But the shareholders cannot effectively ratify acts which are a fraud on the company creditors or are otherwise unlawful. See *Avelin Barford Ltd v Perion Ltd* (1989) 5 B.C.C. 677; *Ridge Securities Ltd v I.R.C.* [1964] 1 W.L.R. 479; *Att-Gen's Reference (No.2 of 1982)* [1984] 1 Q.B. 624; and *Re Halt Garages (1964) Ltd* [1982] 3 All E.R. 1016.

<sup>129</sup> This is the so-called "Duomatic principle" from the decision of Buckley J in *Re Duomatic Ltd* [1969] 2 Ch. 365, which, however, was a principle of long standing.

<sup>130</sup> *Walker v Wimborne* (1976) 50 A.L.J.R. 446; *Re Horlsey & Weight Ltd* [1982] Ch. 442; *Nicholson v Permakraft (NZ) Ltd* [1985] 1 N.Z.L.R. 242; *Kinsela & Am. v Russell Kinsela Pty Ltd* (1986) 10 A.C.L.R. 395; *Lexi Holdings Plc v Luqman* [2007] EWHC 2652 (Ch), per Briggs J at [191]; *Bilta (UK) Ltd (in liquidation) v Nazir (No.2)* [2016] A.C. 1 at [38]. This rule complements the *West Mercia* duty-shifting rule discussed immediately below: *Singularis Holdings Ltd v Daiwa Capital Markets* [2017] Bus. L.R. 1386 at [129]-[130].

<sup>131</sup> *Winkworth v Edward Baron Development Co Ltd* [1986] 1 W.L.R. 1512 at 1516.

<sup>132</sup> See *Brady v Brady* [1988] 2 All E.R. 617.

Indeed, even in relation to existing creditors, it is important to bear in mind that the duties are owed to them through the company, not directly, and their interests are protected by proceedings in the name of the company to which ratification of the breach of duty by the shareholders is no defence.<sup>133</sup> The true principle is not that the directors owe duties to creditors as well as to the company but that when the company is insolvent or “bordering on” insolvency<sup>134</sup> the directors, in discharging the general duties that they already owe to the company, must have regard predominantly to the interests of creditors,<sup>135</sup> who now have the primary interest in the proper application of the company’s assets and whose interest is mediated through the company. This rule is conventionally attributed to the 1987 decision of the Court of Appeal in *West Mercia Safetywear v Dodd*.<sup>136</sup> The rule is expressly enshrined in s.172 of the Companies Act 2006 (relating to the director’s duty to act in the best interests of the company by promoting its success),<sup>137</sup> but it is clear from the case law that the shift in focus to creditor interests also affects other duties, both of loyalty and care.<sup>138</sup>

A breach of *West Mercia* affected duty is a breach of a duty owed to the company, actionable by or in right of the company. The remedy for breach will

<sup>133</sup> *Miller v Bain* [2002] 1 B.C.L.C. 266; *Sycotex Pty Ltd v Baseler* (1993) 13 A.C.S.R. 766, per Gummow J at 785; and D.D. Prentice, “Creditors’ Interests and Directors’ Duties” (1990) 10 O.J.L.S. 275.

<sup>134</sup> *Bilta v Nazir*, cited above fn.130 at [123] per Lord Toulson and Lord Hodge (cf. Lord Sumption at [103], describing the rule as one applicable to “actually or potentially insolvent” companies). As Rose J explained persuasively in *BAT Industries plc v Sequana SA* [2017] Bus. L.R. 82, this ought to require more than a “real risk” of insolvency: “there is no case where, on the facts, the company could not also be accurately described in much more pessimistic terms, as actually insolvent, or ‘on the verge of insolvency’, ‘precarious’, ‘in a parlous financial state’, etc” (at [477]).

<sup>135</sup> See the authorities cited in fn.130 above and *Facia Footwear Ltd v Hinchcliffe* [1998] 2 C.L.C. 218 at 228. As indicated in the last edition of this book, this ought to require directors to consider the impact of their actions on the interests of creditors ahead of, but not to the exclusion of, shareholders. This is particularly so given that the rule may apply at a pre-insolvency stage, when the company is merely “bordering” on insolvency. Consistently with this, in *Bilta v Nazir*, cited above fn.130, Lord Toulson and Lord Hodge described the effect of the rule as to require directors to conceive of the company’s interests as embracing those of creditors rather than as being synonymous with the interests of shareholders: [126] (cf. Lord Sumption at [104], describing the common law rule as treating the interests of the company as “synonymous” with those of its creditors).

<sup>136</sup> *West Mercia Safetywear v Dodd* (1988) 4 B.C.C. 30. See further Kristin van Zwieten, “Director liability in insolvency and its vicinity” (2018) 38(2) *Oxford Journal of Legal Studies* 382; Andrew Keay, “Office-Holders and the Duty of Directors to Promote the Success of the Company” (2010) 23 *Ins. Int.* 1, “Formulating a Framework for Directors’ Duties to Creditors: An Entity Maximisation Approach” (2005) 64 C.L.J. 614, and “Directors’ Duties to Creditors: Contractarian Concerns Relating to Efficiency and Over-Protection of Creditors” (2003) 66 M.L.R. 665; and E.M. Iacobucci, “Director’s Duties in Insolvency: What Is at Stake?” (2003) 39(3) *Can. Bus. L.J.* 398 at 400–401.

<sup>137</sup> Section 172(3) of the Companies Act 2006 provides that s.172(1) has effect subject to any enactment or rule of law requiring directors to consider the interests of the company’s creditors.

<sup>138</sup> See for example *Roberts v Frohlich* [2012] B.C.C. 407 at [83]–[85] and [98]; *Re MDA Investment Management (No 1)* [2005] B.C.C. 783 at [70]–[71] and [75]; *Re HLC Environmental Projects Ltd* [2014] B.C.C. 337 at [99].

depend on the characteristics of the particular duty that has been breached, including whether it is a fiduciary or non-fiduciary duty. Where compensation for loss is sought, the loss recoverable is that of the company; loss suffered by individual creditors is not recoverable directly under this head.<sup>139</sup> More generally, whatever the nature of the relief sought, creditors have no standing to bring the action, except as provided for in s.212.<sup>140</sup> But a creditor who brings such an action under s.212 does so in a representative capacity. Recoveries are obtained in right of the company, forming part of its general assets (and thus are susceptible to capture under a prior assignment or charge over future property).<sup>141</sup> Given this, it is most likely that such an action would be brought by a liquidator:

“[T]he protection which the law gives to the creditors of an insolvent company while it remains under the directors’ management is through the medium of the directors’ fiduciary duty to the company, whose interests are not to be treated as synonymous with those of the shareholders but rather as embracing those of the creditors

Such protection would be empty if it could not be enforced. To give effect to it, this action is brought by the liquidators in the name of the company to recover, for the benefit of the creditors, the loss caused to the company by the directors’ breach of their fiduciary duty.”<sup>142</sup>

The *West Mercia* rule is commonly explained as a device to discourage directors from deploying company assets in “high risk, high reward” investments in circumstances of insolvency, where shareholders might (given the protection of limited liability) be predicted to particularly favour such investments.<sup>143</sup> In the reported English case law, however, *West Mercia* has been more commonly used

<sup>139</sup> There is some parallel here with the principle of reflected loss which debars individual shareholders from asserting claims against a party causing loss to the company solely in their capacity as shareholders and on the basis of a diminution in the value of their shares. The breach is of a duty owed to the company, the loss is that of the company and only the company can sue for it. See *Johnson v Gore Wood & Co* [2002] 2 A.C. 1; *Perry v Day* [2005] B.C.C. 375; *Gardner v Parker* [2005] B.C.C. 46; and *Shaker v Al-Bedrawi* [2003] Ch. 350.

<sup>140</sup> See above, para.14–15.

<sup>141</sup> A view reluctantly reached by Vaughan Williams J in *Re Anglo-Austrian Printing and Publishing Union* [1895] 2 Ch. 891. This is in contrast to recoveries under the statutory provisions designed for the benefit of the general body of creditors, i.e. all the statutory provisions other than those which declare a transaction void. See above, para.13–136 and below, para.14–57.

<sup>142</sup> *Bilta v Nazir*, cited above fn.130 at [126]–[127] per Lord Toulson and Lord Hodge. For some arguments as to why the duty should be mediated through the company, see Prentice, “Creditors’ Interests and Directors’ Duties”, 1990, cited in *Liquidators of Progen Engineering Pte Ltd v Progen Holdings Ltd* [2010] S.G.C.A. 31 at [52].

<sup>143</sup> See the literature reviewed in van Zwieten, “Director liability in insolvency and its vicinity”, fn.136. See also *Peoples Department Stores Inc v Wise* (2004) 244 D.L.R. (4th) 564 at [45]. This decision, which also concerns the statutory duties of directors, attracted widespread interest in Canada, and an entire issue of the *Canadian Business Law Journal* was devoted to a symposium on it. See [2005] *Can. Bus. L.J.* 167. For a detailed comment on the case after the decision of the Court of Appeal, see Jacob S. Ziegel, “Corporate Governance and Directors’ Duties to Creditors: Two Contrasting Philosophies”, *Annual Review of Insolvency Law* 2003, p.133.

dishonesty, not merely blameworthiness.<sup>153</sup> In *Twinsectra Ltd v Yardley*,<sup>154</sup> which concerned a claim against a person for liability as an accessory to a breach of trust, the House of Lords held (Lord Millett dissenting) that it was not sufficient for the defendant's conduct to be dishonest by the ordinary standards of reasonable and honest people, it was also necessary that he should himself have been aware that by those standards he was acting dishonestly. If he had been so aware he was guilty of dishonesty and could not be allowed to shelter behind some private standard of honesty not shared by the community.<sup>155</sup> So for the purposes of s.213, robbing Peter to pay Paul would be all right if you genuinely believed that it would not be regarded as dishonest by the standards of reasonable and honest people, although it would not suffice that such conduct met your own private standards of morality if you were aware that the community would regard such conduct as dishonest. However, in *Barlow Clowes Ltd v Eurotrust Ltd*,<sup>156</sup> there was a return to orthodoxy by the Privy Council, which held that the defendant's views about generally acceptable standards of dishonesty were irrelevant and that nothing in the speeches of Lords Hutton and Hoffmann was intended to convey the contrary. It has to be said that the interpretation given by the Privy Council to the speeches of Lords Hutton and Hoffmann in *Twinsectra* is a masterpiece of verbal manipulation which distorts the plain meaning of what they had said, as correctly summarised in the headnote to the Law Reports, and in effect adopts the dissenting speech of Lord Millett. It is not without irony that the Opinion of the Privy Council was given by Lord Hoffmann himself by way of reinterpretation of his own speech in *Twinsectra*! Be that as it may, the Court of Appeal adopted the reasoning in *Barlow Clowes*,<sup>157</sup> and this has been recently endorsed as a sensible development by the Supreme Court.<sup>158</sup> As such, conduct regarded as dishonest by the standards of reasonable and honest people will be treated as dishonest even if the defendant genuinely believed that such conduct would not be so regarded.

The mere provision by a company of financial support for its subsidiary to enable it to trade as a going concern and in so doing incur debts does not constitute fraudulent trading.<sup>159</sup> In *Re White & Osmond (Parkstone) Ltd*,<sup>160</sup> Buckley J stated that there was nothing wrong in directors incurring credit at a

<sup>153</sup> *Re Patrick & Lyon Ltd* [1933] Ch. 786; *Re Augustus Barnett & Son Ltd*, above, fn.151; and see D.D. Prentice (1987) 103 L.Q.R. 11. On dishonesty and the second limb of s.213 (i.e. the carrying on of business for "any fraudulent purpose"), see *R. v Hollier* [2013] EWCA Crim 2041 at [28]–[29].

<sup>154</sup> *Twinsectra Ltd v Yardley* [2002] 2 A.C. 164.

<sup>155</sup> *Aktieselskabet Dansk Skibsfinansiering v Bros* [2001] 2 B.C.L.C. 324 at 334; and *Royal Brunei Airlines Sdn Bhd v Tan* [1995] 2 A.C. 378.

<sup>156</sup> *Barlow Clowes Ltd v Eurotrust Ltd* [2006] 1 W.L.R. 1476.

<sup>157</sup> *Abou-Ramah v Abacha* [2007] 1 Lloyd's Rep. 115.

<sup>158</sup> *Ivey v Genting Casinos (UK) Ltd (trading as Crockfords Club)* [2017] 3 W.L.R. 1212.

<sup>159</sup> *Re Augustus Barnett*, cited above fn.151.

<sup>160</sup> *Re White & Osmond (Parkstone) Ltd*, unreported 1960, but referred to in *R. v Grantham* [1984] 2 All E.R. 166.

time when, to their knowledge, the company was not able to meet its liabilities as they fell due. What was wrong was allowing a company to continue incurring debts when it was clear that it would never be able to satisfy its creditors:

"... there is nothing to say that directors who genuinely believe that the clouds will roll away and the sunshine of prosperity will shine upon them again and disperse the fog of their depression are not entitled to incur credit to help them get over the bad time."

However, in *R. v Grantham*,<sup>161</sup> this "clouds and sunshine" (or "silver lining") test was disapproved. The question, said the Court of Appeal, was not whether the directors thought that the company would be able to pay its way at some indeterminate time in the future but whether they thought that the company, in incurring further credit, could pay its debts as they fell due or shortly thereafter. If they realised there was no prospect of the company being able to do this, they were guilty of fraudulent trading even if they had some expectation that ultimately all debts would be paid. In general, it is fraudulent trading for a company to obtain new credit, knowing it will be unable to repay it when due, in order to pay off existing creditors.<sup>162</sup>

Section 213 is capable of applying even if there is only one defrauded creditor and even if he is defrauded by only one transaction, provided that the fraud was perpetrated in the course of carrying on a business.<sup>163</sup> But not every deception of a creditor constitutes the carrying on of a business with intent to defraud creditors. So it has been said that:

"... the director of a company dealing in second-hand motor cars who wilfully misrepresents the age and capability of a vehicle in stock is, no doubt, a fraudulent rascal but I do not think he can be said to be carrying on the company's business for a fraudulent purpose, although no doubt he carries out a particular business transaction in a fraudulent manner."<sup>164</sup>

It has also been held that the mere fact of preferring one particular creditor does not of itself constitute fraudulent trading.<sup>165</sup>

<sup>161</sup> Above.

<sup>162</sup> To this extent the mere fact that the net deficiency is reduced by the continued trading, which would be a defence to an allegation of wrongful trading under s.214, provides no answer to a claim under s.213 for fraudulent trading. See further below, para.14–44.

<sup>163</sup> *Morphitis v Bernasconi* [2003] B.C.C. 540, applying *Re Gerald Cooper (Chemicals) Ltd* [1978] Ch. 262.

<sup>164</sup> *Re Murray-Watson Ltd* (unreported, April 6, 1977), per Oliver J, cited by Templeman J in *Re Gerald Cooper (Chemicals)*, cited above fn.163, at 267.

<sup>165</sup> *Re Sarflax Ltd* [1979] Ch. 592. However, a director who procures the preference may be guilty of a misfeasance. See above, para.14–21.

creditors suffices. Dishonesty is an essential ingredient of fraudulent trading.<sup>181</sup>

- (2) Only a director<sup>182</sup> can be proceeded against for wrongful trading, since this is essentially a negligent failure of management, whereas any person knowingly a party to fraudulent trading by the company may be the subject of proceedings.
- (3) The wrongful trading provisions are confined to culpable conduct after the time when the director concerned knew or ought to have known that there was no reasonable prospect of the company avoiding insolvent liquidation (or insolvent administration).<sup>183</sup> In the case of fraudulent trading, the whole period of trading is potentially relevant.
- (4) Proceedings for wrongful trading are purely civil, the only sanctions being an order under ss.214/246ZB requiring the director concerned to contribute to the company's assets, and/or disqualification from being concerned in the management of a company and a related compensation order under the Company Directors Disqualification Act 1986.<sup>184</sup>
- (5) The provisions relating to fraudulent trading are directed primarily against the improper incurring of new debt where there is no reasonable prospect of this being paid. The wrongful trading provisions are designed for the protection of past as well as future creditors. There is thus a tension between the two sets of provisions, for it is not permissible to protect existing creditors at the expense of new creditors.<sup>185</sup> So directors who continue trading without increasing the net deficiency of assets are free from liability under ss.214/246ZB<sup>186</sup> if they achieve this result by using new credit to pay off existing creditors knowing that the new creditors will not be able to be paid when payment is due or shortly thereafter but will be guilty of fraudulent trading. In short, ss.213/246ZA have paramountcy, and in determining whether the directors have taken every step they ought to have taken to minimise the potential loss to the company's creditors, the court must take into account in their favour that they could not lawfully rob Peter (the new creditors) to pay Paul (the existing creditors) even if the result of so doing would have been to reduce the net deficiency as at the time of commencement of the winding up to a figure lower than that existing when they first ought to have concluded that there was no reasonable

<sup>181</sup> See above, para.14-25.

<sup>182</sup> As to the meaning of "director" in this context, see below, para.14-34.

<sup>183</sup> So it is not wrongful trading to bring a company to the point of insolvency by negligent management.

<sup>184</sup> As to compensation orders under the CDDA, see above, para.14-03 and below, para.14-52.

<sup>185</sup> See above, para.14-25, as to incurring new debt.

<sup>186</sup> See further below, para.14-54.

prospect of the company avoiding insolvent liquidation/administration.

### The ingredients of wrongful trading

Before a person can be held guilty of wrongful trading, four conditions must be satisfied: 14-32

- (1) The company has gone into insolvent liquidation, or entered insolvent administration.<sup>187</sup> A company goes into insolvent liquidation or enters insolvent administration if it goes into liquidation or enters administration at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of the winding up or administration.<sup>188</sup> This is the balance sheet test described in an earlier chapter.<sup>189</sup> "Debts and liabilities" includes prospective and contingent debts. It is thought that whether the company is in fact insolvent according to this test is to be determined in the light of all facts known when the matter comes before the court, whether or not they were known at the time the company went into liquidation or administration. The use of hindsight creates no problem in this situation, for what the court has to consider in an application under ss.214/246ZB is whether there is a net deficiency of assets and, if so, whether and how the delinquent director should be required to contribute to the assets.
- (2) At some time, before the commencement of the winding up<sup>190</sup> or the company's entry into administration, a person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or entering insolvent administration.<sup>191</sup>
- (3) That person was a director at that time.
- (4) The director fails to establish the statutory defence of taking every step he ought to have taken to minimise the potential loss to creditors.

The onus is on the liquidator to establish the first three elements and on the respondent to establish the defence.

<sup>187</sup> Insolvency Act 1986 ss.214(2)(a), 246ZB(2)(a).

<sup>188</sup> Insolvency Act 1986 ss.214(6)-(6A), 246ZB(6).

<sup>189</sup> Above, paras 4-22 et seq. The reason why the sections adopt the balance sheet test is, of course, that if it were to be satisfied, there would be no ultimate loss to creditors and no need for a contribution to the assets of the company.

<sup>190</sup> And on or after 28 April 1986 (Insolvency Act 1986 s.214(2)).

<sup>191</sup> See also above, paras 4-29 and 4-33.

### Trading not an essential requirement

14-33 Although the marginal heading to s.214 refers to “wrongful trading”, the text of s.214 makes no reference to trading at all. All that is required is a culpable failure to act properly with a view to minimising the potential loss to the company’s creditors from the relevant point in time.<sup>192</sup> It is worth underlining the point made earlier that what attracts s.214 is not mismanagement which brings a company to the brink of insolvency,<sup>193</sup> but a failure thereafter, when the writing is on the wall, to take proper steps for the protection of creditors. Accordingly, a director can be involved in wrongful trading if he is guilty of an act or omission which is not a reasonable step in minimising potential loss to creditors, even if he procures the company to cease trading as soon as he realises that insolvent liquidation or insolvent administration is inevitable. Indeed, the premature cessation of trading might constitute wrongful trading.<sup>194</sup> Non-trading activity capable of attracting liability includes the failure to collect in debts due to the company, the failure to preserve assets, the payment of excessive remuneration to directors and entry into transactions at an undervalue after cessation of trading.

### Who is a “director”

14-34 For the purpose of ss.214/246ZB, “director” not only covers a *de jure* director, whether executive or non-executive but also includes a shadow director<sup>195</sup> and *de facto* director.<sup>196</sup> This exposes to potential liability various types of person who might not ordinarily be thought of as directors.

#### (1) Controlling shareholders

14-35 In appropriate cases, a controlling shareholder (including a parent company<sup>197</sup> and even, it is thought, a government department responsible for a company in state ownership) could be susceptible to a claim for wrongful trading if inter-

<sup>192</sup> See below, paras 14-41 et seq.

<sup>193</sup> Although such mismanagement might be a breach of the director’s duty of care to the company for which the liquidator could take proceedings in the company’s name.

<sup>194</sup> See below, para.14-45 and fn.224.

<sup>195</sup> Insolvency Act 1986 ss.214(7), 246ZB(7). See above, para.14-06.

<sup>196</sup> *Re Hydromdam (Corby) Ltd* [1994] B.C.C. 161, per Millett J at 162; and *Re Richborough Furniture Ltd* [1996] B.C.C. 155. See above, para.14-05. For ss.214/246ZB to apply it is not necessary that the respondent should still be a director at the time of the acts or omissions which are alleged to constitute wrongful trading. It suffices that he was a director at some time when he had what is referred to below as “deemed knowledge” of the company’s impending (insolvent) liquidation/administration. Hence, resignation after the acquisition of such knowledge does not by itself relieve him of liability.

<sup>197</sup> See above, fnn.38 and 51, noting an important difference between the position of parent companies under the Companies Act 2006 and Insolvency Act 1986 in relation to shadow directorship.

fering too regularly in the day-to-day management of the company, as could the controller of a company that is itself a director.<sup>198</sup>

#### (2) Company doctors

There is no exemption for the company doctor who is brought in to extricate the company from its difficulties and who acts as a director or shadow director<sup>199</sup>; indeed, the company doctor’s very expertise, or professed expertise, may impose on him a high standard of care if he is to avoid liability for wrongful trading.

14-36

#### (3) Lending banks

A bank exercising management control for the protection of its loan and security—as opposed to merely giving professional advice<sup>200</sup>—is capable of being a shadow director.<sup>201</sup> So, banks should be careful to restrict themselves to advice and not seek to dictate what cheques should be paid, what parts of the business should be sold or what policies should be adopted by the board. However, a bank or other funder does not become a shadow director merely because it attends regular meetings with the directors in order to lay down conditions for future lending, becomes sole signatory of the company’s bank account and gives directions designed solely to protect its own interests as a secured creditor.<sup>202</sup>

14-37

### Who is not a “director”

#### (1) Professional advisers

A person is not a shadow director solely because the directors act on advice given by him in a professional capacity,<sup>203</sup> for example, as solicitor, banker or accountant. But the professional adviser acting as such is excluded only from the

14-38

<sup>198</sup> But see above, fn.49, as to directors who are not natural persons.

<sup>199</sup> See *Re Tasbian Ltd (No.3)* [1992] B.C.C. 358, where it was not disputed that a company doctor was capable of being a *de facto* or shadow director for the purpose of disqualification proceedings and it was held that there was an arguable case on the facts.

<sup>200</sup> See below, para.14-38.

<sup>201</sup> See *Re A Company (No.005009 of 1987)* (1988) 4 B.C.C. 424, where Knox J refused to strike out a claim against the bank, ruling that the liquidator had raised a triable issue. Exceptionally, a bank might also be liable as an assistant to a breach of duty by directors, applying ordinary principles of accessory liability, but this will require proof of dishonesty. For a case in which such a claim succeeded, see *Westpac Banking Corp v Bell Group Ltd (in liq.) (No.3)* [2012] WASCA 157; (2012) 89 ACSR 1 on appeal from *The Bell Group Ltd (in liq.) v Westpac Banking Corp (No. 9)* [2008] WASC 239; (2008) 70 ACSR 1, discussed in van Zwielen, “Director Liability in Insolvency and its Vicinity”, above fn.136.

<sup>202</sup> *Ultraframe (UK) Ltd v Fielding* [2006] F.S.R. 17; and *Re PFTZM Ltd* [1995] 2 B.C.L.C. 354.

<sup>203</sup> Insolvency Act 1986 s.251.



proper steps were taken to minimise loss to creditors.<sup>210</sup> Determination of the time at which deemed knowledge is first acquired may be crucial in that there can be no liability for wrongful trading in respect of acts or omissions before that time. So a director who, although aware that the company is unable to pay its debts as they fall due and will be forced into winding up, reasonably believes that on liquidation its assets will be sufficient to cover its liabilities and the expenses of winding up incurs no liability under s.214. It is not sufficient for the application of s.214 (although it is a necessary precondition of its application) that the company in fact ends up failing the balance sheet test of solvency on winding up; what has also to be shown is that the director concerned knew, or ought to have concluded, that the company would fail that test. (The same is true of s.246ZB in relation to companies in insolvent administration.) Inevitably, there will be a temptation to use hindsight, a temptation which should be resisted.<sup>211</sup>

In deciding what a director “ought to have concluded”, the combined objective and subjective tests prescribed by ss.214(4)/246ZB(4) must be applied.

### *The statutory defence*

**14-44** The court may not make a declaration under s.214 with regard to any person if it is satisfied that after he first acquired deemed knowledge he took every step with a view to minimising the potential loss to creditors as (assuming him to have had that knowledge) he ought to have taken.<sup>212</sup> The onus is on the person concerned to show that he took the proper steps, not for the liquidator to prove that he did not.<sup>213</sup> So for the purpose of s.214, the duty to take steps to minimise loss begins once a person has acquired deemed knowledge while a director and the company thereafter goes into insolvent liquidation. Accordingly, it is not a breach of s.214 for directors to bring the company to the point where insolvent liquidation is inevitable; any breach of duty in that regard is a matter for the general law and is actionable either by ordinary proceedings, for example, for negligence or breach of fiduciary duty, or by summary misfeasance proceedings under s.212.

The reference in s.214 to minimising loss to “the company’s creditors” has been interpreted as a reference to creditors as a whole, or creditors as a class.<sup>214</sup> As such, a director who elects to privilege some creditors at the expense of others may not be able to make out the defence.<sup>215</sup> Crucially, however, the fact that a

<sup>210</sup> See below, para.14-44.

<sup>211</sup> See below, para.14-45.

<sup>212</sup> Insolvency Act 1986 s.214(3).

<sup>213</sup> Consistently with this, see the decision of Registrar Jones in *Brooks v Armstrong* [2015] B.C.C. 661 at [5]–[7] (successfully appealed from but only in relation to quantum), and of Lesley Anderson QC sitting as a deputy High Court judge in *Re Idessa (UK) Ltd (in liquidation)* [2012] B.C.C. 315 at [113].

<sup>214</sup> *Brooks v Armstrong*, above at [276].

<sup>215</sup> *Grant v Ralls* [2016] Bus. L.R. 555 at [245]–[246].

director cannot make out the defence does not necessarily mean that they will be liable to make a contribution under ss.214/246ZB: as noted above<sup>216</sup> and discussed below,<sup>217</sup> the contribution order is compensatory, and more specifically is directed to compensating the company for an increase in the net deficiency over the relevant time, and if it can be established that there was no such increase no compensation is payable under the wrongful trading provision.<sup>218</sup>

### **The standard of knowledge and skill required**

Section 214(4) and (5) provides as follows:

14-45

“4. For the purpose of subsections (2) and (3), the facts which a director of a company ought to know or ascertain, the conclusions which he ought to reach and the steps which he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both—

- (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company, and
- (b) the general knowledge, skill and experience that that director has.

5. The reference in subsection (4) to the functions carried out in relation to a company by a director of the company includes any functions which he does not carry out but which have been entrusted to him.”

Section 246ZB, applicable where the company is in insolvent administration rather than insolvent liquidation, is in the same terms.

Several points arise in relation to the above provisions:

- (1) The test of knowledge, skill and experience is a combination of the objective and the subjective. The minimum standard is what would have been ascertained, foreseen and done by a reasonably diligent person carrying out (or entrusted with) the same functions as those entrusted to the director concerned. A director who falls below this minimum standard cannot invoke the statutory defence even if he did his best. In deciding whether the minimum standard was observed, regard must be had to the particular company and its business, so that “the general knowledge, skill and experience postulated will be much less extensive

<sup>216</sup> Para.14-02.

<sup>217</sup> Paras 14-54 and 14-55.

<sup>218</sup> *Brooks v Armstrong* [2017] B.C.C. 99 at [120]; *Grant v Ralls* [2016] Bus. L.R. 555. Relief may, however, be available through a misfeasance action: see para.14-21 above.

in a small company in a modest way of business, with simple accounting procedures and requirements, than it will be in a large company with sophisticated procedures".<sup>219</sup> The standard to be applied is that of a reasonably prudent businessman acting without unwarranted optimism and on a realistic, factual basis.<sup>220</sup> But observance of the minimum standard is not necessarily sufficient. The director must also meet such higher standard as is appropriate to his own general knowledge, skill and experience. So while the minimum standard does not necessarily call for particular expertise or skill, only that of a reasonably diligent person, a real professional possessing a high degree of general knowledge, skill and experience must use it and act accordingly.

- (2) The test of proper mitigating behaviour—"every step"—seems very stringent but when read with "reasonably diligent person" may mean no more than "every reasonable step".<sup>221</sup>
- (3) While there is no immunity for non-executive directors as such, *prima facie* a non-executive director is not expected to possess the knowledge and skill of an executive director, still less to give his continuous time and attention to the company's affairs.<sup>222</sup>
- (4) The knowledge and skill required of an executive director depends on the nature of the functions entrusted to him. Thus a director in charge of marketing and sales cannot be expected to possess the financial knowledge and skills of a finance director.

Finally, the court should take care to avoid being influenced by hindsight<sup>223</sup> and should not be too astute to find the directors at fault without taking account of the difficult choices that frequently confront them.

"An overall point which needs to be kept in mind throughout is that, whenever a company is in financial trouble and the directors have a difficult decision to make whether to close down and go into liquidation, or whether instead to trade on and hope to turn the corner, they can be in a real and unenviable dilemma. On the one hand, if they decide to trade on but things do not work out and the company, later rather sooner, goes into liquidation, they may find

<sup>219</sup> *Re Produce Marketing Consortium Ltd* (1989) 5 B.C.C. 569, per Knox J at 594.

<sup>220</sup> *Singla v Hedman* [2010] B.C.C. 674, per Kitchin J at [15].

<sup>221</sup> Consistently with this, see the decision of Registrar Jones in *Brooks v Armstrong* [2015] B.C.C. 661 at [8]–[10], noting that Parliament's decision to use "every step" rather than "every reasonable step" in the text of s.214(3) (despite a proposal to use the latter formulation) had to be read in the light of s.214(4), requiring the court to evaluate the director's actions by reference to the steps that ought to have been taken by a reasonably diligent director: at [10] (this aspect of the decision not appealed).

<sup>222</sup> See above, para.14–12.

<sup>223</sup> *Re Hawkes Publishing*, cited above fn.206, at [38].

themselves in the situation of the respondents in this case—being sued for wrongful trading. On the other hand, if the directors decide to close down immediately and cause the company to go into an early liquidation, although they are not at risk of being sued for wrongful trading,<sup>224</sup> they are at risk of being criticised on other grounds. A decision to close down will almost certainly mean that the ensuing liquidation will be an insolvent one. Apart from anything else liquidations are expensive operations, and in addition debtors are commonly obstructive about paying their debts to a company which is in liquidation. Many creditors of the company from a time before the liquidation are likely to find that their debts do not get paid in full. They will complain bitterly that the directors shut down too soon; they will say that the directors ought to have had more courage and kept going. If they had done, so the complaining creditors will say, the company probably would have survived and all of its debts would have been paid. Ceasing to trade and liquidating too soon can be stigmatised as the cowards' way out."<sup>225</sup>

#### No relief under s.1157

In *Re Produce Marketing Consortium Ltd*, Knox J held that a director who engages in wrongful trading contrary to s.214 of the Insolvency Act 1986 could not obtain relief under what is now s.1157 of the Companies Act 2006, on the basis that the subjective approach of that provision was inconsistent with the objective duty imposed by s.214(4) of the 1986 Act.<sup>226</sup> This holding predates, however, the decisions referred to above in which it was held that the standard in s.214(4) accurately reflected the standard of a director's duty of care, skill and diligence at common law, previously pitched in more subjective terms.<sup>227</sup> Given this, and the applicability of s.1157 in negligence cases,<sup>228</sup> it is possible that the holding in *Produce Marketing* might be revisited. The point may not, however, prove to be of enormous practical significance, given that s.214 is discretionary

14-46

<sup>224</sup> The basis of this statement is not clear. There seems to be no reason why ceasing to trade when the company, although insolvent, has a manifestly viable business could not constitute wrongful trading, although no doubt this situation would be unusual. See above, para.14–33.

<sup>225</sup> *Re Continental Assurance Co of London* [2001] B.P.I.R. 733 per Park J at [281]. See to similar effect Lewison J in *Re Hawkes Publishing*, *Re* cited above fn.206: "But directors are not clairvoyant and the fact that they fail to see what eventually comes to pass does not mean that they are guilty of wrongful trading" (at [41]); and "Of course, it is easy with hindsight to conclude that mistakes were made. An insolvent liquidation will almost always result from one or more mistakes. But picking over the bones of a dead company in a courtroom is not always fair to those who struggled to keep going in the reasonable (but ultimately misplaced) hope that things would get better" (at [47]); *Grant v Ralls* [2016] Bus. L.R. 555 at [172]–[173]; *Brooks v Armstrong* [2015] B.C.C. 661 at [36], [243]–[245] and on appeal (rejecting a challenge to the judge's findings on the alleged basis that they involve the impermissible use of hindsight) at [53]–[64].

<sup>226</sup> *Re Produce Marketing Consortium Ltd* [1989] B.C.L.C. 513.

<sup>227</sup> Above, para.14–12.

<sup>228</sup> Above, para.14–19.

and in the exercise of the court's discretion the court may have regard to a wide range of factors, including the honesty of the director.<sup>229</sup>

### How to avoid liability for wrongful trading

14-47 What practical advice should be given to a director as to the steps he should take to minimise the risk of being found guilty of wrongful trading? Here is Professor Goode's list of 12 points for survival:<sup>230</sup>

- (1) Do not assume that the safest course is to stop trading. You have to take every step that can properly be expected of you to minimise loss to creditors. You can be faulted just as much for a premature cessation of trading as for continuing to trade while insolvent. This makes it essential to obtain competent outside advice as to whether to stop trading or continue.
- (2) Consider carefully with your fellow directors whether the business is viable. If it is, insist on the preparation<sup>231</sup> of:
  - (a) a business review;
  - (b) a sensible and constructive programme to reduce expenditure, increase income, ensure an adequate cash flow and restore the company to profitable trading, disposing of unprofitable or marginal parts of the business and dismissing staff who are surplus to the company's needs or are not doing their job.
- (3) Insist on frequent board meetings.
- (4) Make sure that there is a proper distribution of responsibility within the company.
- (5) Ensure that the accounts are being properly kept and up to date or if not, that prompt steps are being taken to do so, with outside help being brought in as and when necessary.
- (6) See that the board regularly receives an updated budget and a full, accurate and up-to-date picture of the company's trading, financial and cash flow position.
- (7) Get the company to take appropriate outside, professional advice on suitable remedial measures.<sup>232</sup>

<sup>229</sup> *Brooks v Armstrong* [2017] B.C.C. 99 at [138]–[140].

<sup>230</sup> Many of which are now reflected in the guidance recently provided by Registrar Jones in *Brooks v Armstrong*, cited above fn.221, at [259].

<sup>231</sup> With any necessary professional help. See below.

<sup>232</sup> Of course, the failure of the professional to identify a relevant option does not shield the director from liability where they failed to pursue it: *Brooks v Armstrong* [2015] B.C.C. 661 at [280].

- (8) Keep major creditors regularly informed and enlist their support for the continued operation of the company where this is likely to be of benefit to the general body of creditors. In this connection, it is just as important to have the support of major unsecured creditors as of secured creditors, for it is the former who are most likely to suffer loss and whose support makes it easier for you to show subsequently that you took every step available to you to minimise loss to creditors.
- (9) Ensure that you are kept fully in the picture and, so far as possible, that all directors agree on what needs to be done.
- (10) Consider the advisability of putting the company into administration in order to give it breathing space and prevent action by individual creditors. Such appointment has the further advantage of ending your management responsibilities, although you still have a duty to co-operate with the office-holder.<sup>233</sup>
- (11) Insist that all recommendations for remedial action made by the directors (and particularly by you), together with your dissent from any unwise actions or inactivity advocated by your fellow directors, are fully minuted or otherwise placed on record, for example, by the circulation of a memorandum to the other directors.
- (12) If you are in the minority and your recommendations are repeatedly rejected, so that the company is getting deeper into the mire, resign and record your reasons for doing so in a letter. But resignation is very much the last resort. A director who simply resigns without having taken every step he should have done to minimise loss to creditors will not escape liability. So do not resign before you have gone as far as you can in getting things put right.<sup>234</sup>

### Wrongful trading and misfeasance

There is no direct relationship between the remedies of the liquidator for wrongful trading and for misfeasance; he is entitled to pursue either or both. But the choice of remedy may have significant effects on the creditors. As we have seen,

14-48

<sup>233</sup> Failure to do this is an offence (Insolvency Act 1986 s.235).

<sup>234</sup> See *Secretary of State for Trade and Industry v Arif* [1996] B.C.C. 586; and *Re C.S. Holidays Ltd* [1997] B.C.C. 172, cases on the position of a director for disqualification purposes where he has resigned after his recommendations went unheeded by the rest of the board. In *Secretary of State for Trade and Industry v Taylor* [1997] 1 W.L.R. 407, Chadwick J rejected the contention that a director's failure to resign even after his views have gone unheeded was necessarily unfit to be concerned in the management of a company, although he did indicate (at 415) that a person who, having ceased to exert any influence over his colleagues, remained on the board for no purpose other than to draw his director's fees or preserve his status might well be found so lacking in appreciation of his duties as to be unfit to be concerned in the management of a company.

misfeasance is a remedy actionable in right of the company and any money or property recovered forms part of its general assets and is therefore capable of being captured by a prior assignment or charge covering future property. By contrast, sums paid under a contribution order made under the Insolvency Act 1986 in respect of wrongful trading are held for the creditors generally, and although preferential creditors have a prior claim to them they do not fall within a prior assignment or charge since they are not assets of the company.<sup>235</sup> Three questions now arise. First, to what extent does a recovery for misfeasance under s.212 reduce the amount of the director's liability under s.214?<sup>236</sup> Secondly, to what extent does a recovery under s.214 reduce his liability under s.212? Thirdly, where recovery under one section does not affect the amount recoverable under the other but the director's assets are insufficient to meet both claims in full, how should the claims and recoveries be dealt with?

Section 212 is not available to administrators, but it will be recalled that administrators enjoy a general power to bring actions in the name of the company,<sup>237</sup> including against directors for breach of a duty owed to the company, and the analysis below should also govern the relationship between such actions and the wrongful trading provision in s.246ZB for companies in insolvent administration.

(1) *Effect on s.214 claim of recovery under s.212*

14-49 Recovery from a director under s.212 will, of course, *pro tanto* reduce the company's net indebtedness, but it does not follow from this that the director's separate liability for wrongful trading will fall by the same amount or, indeed, at all. In considering the effect of a s.212 recovery on the amount chargeable to a delinquent director under s.214, two factors have to be taken into account. The first is whether the loss caused by the misfeasance is also the loss, or part of the loss, embodied in the claim under s.214 or is entirely unconnected. It is clear that loss resulting from a misfeasance committed before the commencement of the director's duty under s.214 to take steps to minimise loss cannot form part of the s.214 claim, so that no duplication is involved in allowing full recovery under both sections. Where, on the other hand, the misfeasance occurred after the start of the director's duty under s.214, it will usually constitute a breach of that duty as well as a misfeasance under s.212. In this case, the claims under ss.212 and 214 will be duplicated, and any recovery under s.212 will at the same time reduce the loss chargeable to the director under s.214,<sup>238</sup> although in the unlikely event

<sup>235</sup> *Re Oasis Merchandising Ltd* [1997] 1 All E.R. 1009. See below, para.14-57.

<sup>236</sup> The question was raised in *Re Purpoint Ltd* [1991] B.C.L.C. 491, where the application under s.214 was stood over. The outcome is not known.

<sup>237</sup> See above, para.14-15.

<sup>238</sup> This was the case in *Re DKG Contractors Ltd* [1990] B.C.C. 903, where it was rightly held that recoveries under ss.212 and 239 were to be taken as *pro tanto* satisfying the order under s.214.

that the recovery under s.212 tops the recovery under s.214, the excess will form part of the company's general assets. The second factor is that a director's liability to contribute under s.214 cannot exceed the amount of the net deficiency in the company's assets available for creditors.<sup>239</sup> To the extent that recovery for unconnected loss under s.212 is sufficient to extinguish that deficiency, his liability under s.214 will abate.<sup>240</sup> Where this is not the case, the recovery under s.212 will not reduce the director's liability for unconnected loss under s.214. Two examples will make this clear.

*Example 1*

(a) Amount recovered under s.212:	£100,000
(b) Unconnected loss due to breach of s.214:	£75,000
(c) Net deficiency of assets before s.212 recovery:	£150,000
(d) Maximum liability under s.214 ((c)-(a)):	£50,000

In this example, the loss caused by the director through his breach of s.214 (£75,000) is partially offset by the recovery under s.212, which reduces the net deficiency, and thus the director's maximum s.214 liability, to £50,000.

*Example 2*

(a) Amount recovered under s.212:	£100,000
(b) Unconnected loss due to breach of s.214:	£75,000
(c) Net deficiency of assets before s.212 recovery:	£500,000
(d) Maximum liability under s.214:	£75,000

In this example, the net deficiency remaining after the recovery under s.212 (i.e. £500,000 - £100,000 = £400,000) still exceeds the maximum contribution liability under s.214, which accordingly is not reduced by the s.212 recovery.

In summary, a s.212 recovery will reduce the director's maximum liability under s.214 only to the extent that: (i) the s.212 claim also forms part of the loss for which the director is answerable under s.214; or (ii) the s.212 recovery reduces the net deficiency to an amount below the loss attributable to the breach of s.214.

(2) *Effect on s.212 claim of recovery under s.214*

It will be clear from what has been said above that there cannot be a double recovery for the same loss. To the extent that the misfeasance also constitutes a

<sup>239</sup> As stated earlier, the members of the company do not benefit from recoveries under ss.213 or 214.

<sup>240</sup> Consistently with this, see *Re Idessa (UK) Ltd (in liquidation)* [2012] B.C.C. 315 at [128(v)].