View metadata, citation and similar papers at core.ac.uk
brought to you by CORE
provided by Nottingham Trent Institutional Repository (IRep)

STATUTORY EROSION OF SECURED CREDITORS' RIGHTS: SOME INSIGHTS FROM THE UNITED KINGDOM

*Adrian J. Walters**

As the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 considers the state of business bankruptcy in this country, the narrative on chapter 11 is well-established and oft-repeated. According to this narrative, whereas in the past firms filing for chapter 11 came into the bankruptcy process with at least some unencumbered assets, modern firms tend to have capital structures that are entirely consumed by multiple layers of secured debt. Moreover, as secured creditors have come to dominate capital structures, conventional wisdom has it that they have "captured" chapter 11 to the detriment of unsecured creditors. This development has justifiably troubled many scholars on both efficiency and distributional grounds. However, it remains an open question whether the perceived downsides of secured creditor control can be satisfactorily addressed through bankruptcy law reform.

In this Article, Professor Walters examines English attempts to use bankruptcy law to adjust the priority and control rights of secured creditors with the aim of improving the welfare of unsecured creditors. The Article starts from the premise that lenders that are powerful enough to bargain for superior control and priority rights inside or outside of bankruptcy will be equally capable of adjusting to legal changes that affect, or are perceived as affecting their interests. Four ways in which lenders will adjust to "adverse" bankruptcy reform are identified: (i) metabargaining; (ii) adjustments to prebankruptcy behavior; (iii) transactional innovation; and (iv) "shape shifting". In Parts II and III, the Article then illustrates how English lenders have successfully adjusted to statutory erosion of their priority rights through transactional innovation and to statutory attempts to curb their control rights through "shape shifting". Walters' conclusion on the efficacy of bankruptcy law reform is cautionary and skeptical. He assesses English attempts to improve the position of unsecured creditors by dampening the rights of secured creditors as a failed conceit.

TABLE OF CONTENTS

I. INTRODUCTION 544
II. STATUTORY CARVE-OUTS FROM FLOATING CHARGE COLLATERAL 548
  A. *The Fixed and Floating Charge: A Brief History* 548
  B. *Statutory Carve-Out Provisions: Origins and Expansion* 551
  C. *Reaction and Counterreaction* 552
  D. *The Rise and Decline of the Fixed Charge Over Receivables* 554
  E. *The Modern Carve-Out and the Rise of Asset-Based Receivables Finance* 557
  F. *Some Provisional Conclusions About Carve-Outs* 558
III. STATUTORY EROSION OF CONTROL RIGHTS 560
  A. *The Law Prior to the Enterprise Act Reforms* 560
  B. *Policy Objections to Secured Creditors' Formal Control Rights Under Pre-Enterprise Act Law* 561
  C. *The Formal Weakening of Secured Creditor Control by the Enterprise Act* 562
  D. *New Forms of Control: Post-Enterprise Act Practice* 565
  E. *Prepacks* 568
IV. CONCLUDING THOUGHTS 570

I. INTRODUCTION

> *I think it's fair to say that the way cases are financed and the way the Code treats secured creditors' rights is something that we are looking at very carefully. And this is something that needs to be frankly looked at carefully and calibrated very carefully because one of the things that we constantly have to remember is that changes that we make to the Bankruptcy Code with respect to creditors' rights, including lenders' rights, not only impact bankruptcy cases but have a ripple effect on the credit community as a whole.*

Robert J. Keach, cochair of the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11.[1]

This symposium is premised on a set of concerns about the capture of chapter 11 bankruptcy proceedings by secured creditors, and a search for solutions to address these concerns. The American Bankruptcy Institute's Commission to Study the Reform of Chapter 11, which is expected to report and make recommendations for the reform of U.S. business re-

* Ralph L. Brill Professor of Law, IIT Chicago-Kent College of Law. My thanks to participants in the ABI-Illinois Symposium on Chapter 11 Reform and, in particular, to Steve Harris and Ted Janger. Thanks also to Scott Vanderlin for research assistance. Any errors are mine alone.

1. *Examining Key Developments of ABI's Chapter 11 Commission During 2013 and the Steps to the Final Report for 2014*, AM. BANKR. INST. 26:16 (Dec. 9, 2013), *available at* http://bit.ly/1ebhBZz.

organization law by the end of 2014, has the issue of secured creditors' rights squarely on its radar. The narrative is now well-established and oft-repeated. Whereas in the past, firms filing for chapter 11 would come into the bankruptcy process with at least some unencumbered assets, modern firms tend to have capital structures that are entirely consumed by multiple layers of secured debt. And so, according to the prevailing conventional wisdom, chapter 11, in the general run of cases, has become little more than a glorified nationwide foreclosure process through which secured creditors can exit via a quick section 363 sale or an outright liquidation.[2]

Some are strongly inclined to lament this development. Professor Tabb, for example, worries that the use of bankruptcy as a de facto foreclosure mechanism distributes any going-concern value that the debtor's assets may have to secured creditors, while cutting off the prospect that other constituents, such as trade creditors, could share in the downstream value of a firm reorganized along traditional lines.[3] In their excellent article, Professors Jacoby and Janger do not doubt that there are occasions when a swift "all-asset" sale will be the best value maximization choice available, but they also recognize the potential for secured creditors and purchasers to appropriate going-concern value for themselves and so deny junior claimants the benefit of any increase in firm value that might accrue through a delayed sale or a reorganization.[4]

Secured creditor control thus implicates both efficiency and distributional concerns. Quick liquidating sales could be the wrong choice on both efficiency *and* distributional grounds. Or, even if they are the right wealth maximization choice in the aggregate, all-encompassing secured claims implicate the welfare of so-called nonadjusting (or weakly adjusting) creditors who have no, or no sufficient, bargaining power to collateralize their claims effectively ex ante. It follows that there are at least two kinds of concerns. First, a concern that secured creditor control may lead to inefficient and unfair outcomes because of an inbuilt bias towards quick sales in cases where a delayed sale or reorganization may prove the better choice for creditors collectively. This concern relates to the size of the "bankruptcy" pie. Second, a concern that security interests that are all-encompassing in scope tend to facilitate redistribution of wealth away

---

2. The literature is now extensive. For recent contributions see *Chapter 11 at the Crossroads: Does Reorganization Need Reform?—A Symposium on the Past, Present and Future of U.S. Corporate Restructuring*, 18 AM. BANKR. INST. L. REV. 365, 397–99 (2010); Charles J. Tabb, *Credit Bidding, Security, and the Obsolescence of Chapter 11,* 2013 U. ILL. L. REV. 103; Charles J. Tabb, *The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy*, 2015 U. ILL. L. REV.765 [hereinafter Tabb, *The Bankruptcy Clause*].

3. Tabb, *The Bankruptcy Clause*, *supra* note 2, at Part IV.

4. Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 866–67 (2014).

from nonadjusting creditors.[5] This concern relates, of course, to the question of how the "bankruptcy" pie is divided.

Even assuming we are persuaded that these concerns are normatively and empirically well founded, there is to my mind a persistent question about whether they can be satisfactorily addressed through bankruptcy law reform. And, if so, what types of reform might work? Should we just make procedural adjustments designed to diminish the control rights of secured creditors in an attempt to ensure that the "immediate sale versus delayed sale or reorganization" decision gets made in an aggregate value maximizing way?[6] Or, if it is the sheer breadth of blanket security interests to which we object, can we really hope to redistribute successfully in bankruptcy by, for example, carving out a portion of the senior claimants' collateral to finance a meaningful payout to junior claimants?

My contribution to this symposium is "different" insofar as I get to add an English twist. Otherwise, I make no great claims. The underlying theme of what I have to say is cautionary, skeptical, and mundane. My main point is a somewhat pessimistic variation on Bob Keach's theme in my opening quote. Lenders that are powerful enough to bargain for superior control and priority rights inside or outside of bankruptcy will invariably and inevitably adjust to legal changes that affect, or are perceived as affecting, their interests.[7] And so the risks from a reform standpoint are obvious. The more "adjustment proof" the reform proposal, the greater the likelihood it will be resisted and diluted through the political process.[8] Conversely, the more a reform proposal seeks to strike a fair "balance" among competing interests, the greater the likelihood that it will be susceptible to adjustment, possibly even outright avoidance.[9]

If we leave aside pricing (i.e., cost of credit) adjustments, there are at least four fairly obvious ways in which lenders will adjust to what they would characterize as "adverse" bankruptcy law reform. These are:

1. *Metabargaining.* One does not have to be an expert in interest group theory to understand that if we want to influence the behavior or affect the interests of a well-resourced and well-coordinated group through law reform, the group in question will seek to "bar-

---

5. For a useful summary of the long running debate among scholars about the efficiency or otherwise of secured credit, see Brian M. McCall, *It's Just Secured Credit! The Natural Law Case in Defense of Some Forms of Secured Credit*, 43 IND. L. REV. 7, 9–16 (2009).

6. I say "just," but the difficulties should not be underestimated. The imposition of procedural safeguards is far from cost free, and will tend to increase the scope for intercreditor conflict. *See generally* Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511 (2009).

7. *See* BRUCE G. CARRUTHERS & TERRENCE CHARLES HALLIDAY, RESCUING BUSINESS: THE MAKING OF CORPORATE BANKRUPTCY LAW IN ENGLAND AND IN THE UNITED STATES 32–33 (1998).

8. Lender resistance to repeated Congressional attempts to allow debtors to modify home mortgages in Chapter 13 is a case in point. *See* Juliet M. Moringiello, *Mortgage Modification, Equitable Subordination, and the Honest but Unfortunate Creditor*, 79 FORDHAM L. REV. 1599, 1601–02 (2011).

9. *See, e.g.*, John Armour, *Legal Capital: An Outdated Concept?* 7 EUR. BUS. ORG. L. REV. 5, 26-27 (2006).

gain" through the political process to resist or dilute any changes that it regards as unwelcome.[10] How the banking and secured-credit lobby exercises political power, how that power is configured, and how its scope, contours, and dimensions may have changed in the half decade since the global financial crisis, are matters that I do not have the space to get into here. Nevertheless, the point, which is essentially a rudimentary point of political economy, bears repetition.[11]

2. *Adjustments to prebankruptcy behavior.* If bankruptcy becomes less hospitable to secured creditors, we can expect them to exploit their bargaining and informational advantages to intervene sooner to protect their interests outside of bankruptcy.[12]

3. *Transactional innovation.* Insofar as they are able, using the legal resources and technologies available to them, sophisticated actors will devise new contract terms and transactional structures to work around unwelcome rules.[13]

4. *Shape shifting.* I use this as shorthand to try to capture a subtly different type of adjustment. Adjustments to prebankruptcy behavior are upstream adjustments that take place outside of, but in the shadow of, the bankruptcy system.[14] Transactional innovation in the main involves bargaining around inconvenient rules.[15] By "shape shifting," I mean that secured creditors are able to adapt over time so that old forms of functional control are asserted in new ways within the bankruptcy law framework even as that framework is changing.[16] In the present context, the implication is that changes to bankruptcy law regimes designed to curb secured creditors' power in the interests of other stakeholders may not work as intended.[17] Control may "change shape" within the interstices of a revised legal framework while functioning more or less in the same way.

I will try to illustrate the phenomenon of lender adjustment by brief reference to two sets of developments—one affecting lender priority, the other affecting lender control—that have occurred in my home jurisdiction of England and Wales.[18]

In Part II, I consider the recent history of lender responses to English statutory "carve-out" provisions—that is, provisions of bankruptcy

10. *See* CARRUTHERS & HALLIDAY, *supra* note 7, at 42–43.

11. On the phenomenon of metabargaining for favorable law in the Anglo-US bankruptcy law context, see *id.* at 15–44.

12. *See* Kara J. Bruce, *Rehabilitating Bankruptcy Reform*, 13 NEV. L.J. 174, 179–81 (2012).

13. *See generally* Daniel D. Prentice, *Bargaining in the Shadow of the Enterprise Act 2002*, 5 EUR. BUS. ORG. L. REV. 153 (2004).

14. *See supra* note 12 and accompanying text.

15. Prentice, *supra* note 13, at 154.

16. *Id.* at 154–58.

17. *Id.*

18. The title of my essay refers to the "United Kingdom." The U.K. is a unitary state currently made up of three distinct "law districts:" England and Wales, Scotland, and Northern Ireland. Of the three, England and Wales is comfortably the largest by population. For ease and economy (and with no offence intended to the Welsh) I will use 'English' throughout as shorthand for "English and Welsh."

law designed to carve out and redistribute a portion of lienholder collateral to unsecured creditors. These attempts to erode lender priority have largely failed because of transactional innovation. Lenders have persistently, and for the most part, successfully restructured and recharacterized their lending transactions to avoid the ambit of a series of iterations of redistributive legislation.

In Part III, I discuss how lenders have adjusted to statutory erosion of their control rights, notably the legislative abrogation in 2003 of a blanket lienholder's right to foreclose on the entire business assets of a debtor through the appointment of a special kind of receiver known in English law as an administrative receiver. In the decade since that reform, I suggest that secured creditor control has simply been reconfigured within the interstices of a revised bankruptcy law framework that Parliament intended to be a panacea for the perceived ills of administrative receivership. This process of adjustment is an example of functional substitution through "shape shifting" facilitated in considerable degree by features of the law that can be attributed to metabargaining. The end result is that old concerns about the harmful aspects of administrative receivership have been replaced by new, but strikingly similar, concerns about the implications of secured creditor control for the plight of unsecured creditors.

II. STATUTORY CARVE-OUTS FROM FLOATING CHARGE COLLATERAL

A. *The Fixed and Floating Charge: A Brief History*

In English secured transactions law, the main species of consensual nonpossessory security interest is the charge. There are, as is well known, two main subspecies of charge, namely, the fixed charge and the floating charge.[19] These transactional forms remain resolutely uncodified despite repeated attempts by reformers over the last fifty years to introduce a statutory personal property security regime into English law along the lines of Article 9 of the Uniform Commercial Code.[20] Although the creation, attachment, and other fundamental attributes of these security interests are governed by the common law, they are nevertheless affected by statute in various ways. So, for example, the perfection of fixed and

19. I am simplifying somewhat for purposes of the present discussion. For authoritative treatment see ROYSTON MILES GOODE, GOODE ON COMMERCIAL LAW 630, 721–37 (Ewan McKendrick ed. 2009) (1982); LOUISE GULLIFER & JENNIFER PAYNE, CORPORATE FINANCE LAW: PRINCIPLES AND POLICY 236–61 (2011). On the functional similarities between English and American secured transactions law notwithstanding the U.K.'s lack of a codified system of personal property security interests, see Lynn M. LoPucki et al., *Optimizing English and American Security Interests*, 88 NOTRE DAME L. REV. 1785 (2013). In the same vein, and from an international and comparative perspective, see also U.N. COMM'N ON INT'L TRADE LAW, UNCITRAL LEGISLATIVE GUIDE ON SECURED TRANSACTIONS, at 46–49, U.N. Sales No. E.09.V.12 (2010).

20. *See generally* THE REFORM OF UK PERSONAL PROPERTY SECURITY LAW: COMPARATIVE PERSPECTIVES (John de Lacy ed., 2010).

floating security in respect of corporate debtors is governed by the statutory registration regime set out in the Companies Act 2006.[21]

Both forms of security interest evolved during the Victorian era on a trajectory that enabled lenders to take effective security over the future assets of their debtors.[22] The fixed charge emerged as a species of security interest that enabled lenders to collateralize assets, such as a plant and equipment in a manufacturing business, that need to be replaced periodically.[23] A fixed charge attaches to specific assets on its creation, but also attaches to the replacement assets when they are acquired, without the need for any further security instrument or further perfection.[24] Moreover, a fixed charge over present and future property has priority from the date of its original creation.[25] In other words, as regards future property, there is a "relation back" effect. When the debtor acquires the replacement assets, the lender's security interest in those assets is backdated to the date of the original grant.[26]

The original genius of the floating charge from the perspective of lenders was that it expanded the reach of personal property security interests beyond assets that we would characterize in accounting terms as "fixed assets" to circulating assets, notably inventory and receivables.[27] In order to protect the lender's collateral, a debtor is only permitted to dispose of fixed charge assets with the lender's consent.[28] Unauthorized dispositions of collateral by the debtor will trigger default and acceleration provisions in the loan agreement and buyers who acquire collateral with notice of the charge will not take free and clear.[29]

Once the courts had blessed the concept of a present security interest over future property, a fixed charge over circulating assets became a theoretical possibility.[30] But it made no practical sense to require a debtor to seek the lender's consent every time the debtor wished to sell an item of inventory to a customer or to collect a receivable in order to improve cash flow.[31]

The floating charge therefore emerged as a form of equitable security interest that took the concept of a charge over present and future property to a new level. It increased the collateral available to lenders by enabling a lender to collateralize a constantly shifting fund of circulating assets. Yet, at the same time, it also allowed the debtor to dispose of the collateral freely in the ordinary course of the debtor's business for so

21. *See* Companies Act, 2006, c. 46, pt. 25 (U.K.).
22. GULLIFER & PAYNE, *supra* note 19, at 237.
23. *Id.*
24. *Id.* at 237–38.
25. *Id.* at 238.
26. *Id.*
27. *Id.* at 243.
28. *Id.* at 242–43.
29. *Id.*
30. *Id.* at 243.
31. *Id.*

long as the debtor remained a going concern.[32] The debtor can therefore liberate assets from the floating charge without the lender's consent in the ordinary course of business.[33] But, as soon as the debtor's business ceases or the lender takes enforcement action in response to an event of default, the floating charge is said to "crystallize" on specific assets within the fund of collateral at the relevant point in time.[34] Metaphorically speaking, the floating charge "floats" or "hovers" over the collateral, but remains inchoate until crystallization. Conceptually speaking, at the moment of crystallization, the floating charge is converted into a fixed charge over the specific assets that are in the fund at that time, and the debtor's power to dispose of those assets freely comes to an end.[35] As the charge does not attach to specific assets until crystallization, other parties—buyers, asset financiers, execution creditors, and the like—can gain priority over the lender in relation to floating charge assets.[36]

In tandem, the consolidation of the fixed and floating charge concepts during the Victorian era gave lenders the ability to collateralize the entire present and future assets of corporate debtors.[37] A parallel development was the emergence of the English version of what in the United States became known as "equity receivership."[38] As it was well-established that a lender could reserve a right in the security instrument to appoint a receiver to take possession of and sell the collateral for the lender's benefit, it made sense for lenders to insist on a package of security consisting of fixed charges over "fixed" assets and a blanket floating charge over the debtor's entire assets and undertaking.[39] The breadth of available security, coupled with the power to appoint out of court what we now call an administrative receiver, offered lenders a high degree of priority and, in the context of a nascent corporate bankruptcy system,[40] a large measure of control.[41]

The floating charge has never been quite as robust as the fixed charge as a priority-conferring device. The interests of buyers and execution creditors can easily trump it because of its core design features: the debtor's ability to liberate collateral from the ambit of the charge in the ordinary course of business and the inchoate nature of the charge prior to crystallization.[42] Nevertheless, given the extensive reach of the floating

32. *Id.*
33. *Id.*
34. *Id.* at 243–49.
35. This at least is the prevailing theory in the case law. *See, e.g.*, Evans v. Rival Granite Quarries Ltd., [1910] 2 K.B. 979, 999. For discussion of other theories, see GULLIFER & PAYNE, *supra* note 19, at 245–46.
36. *See* GULLIFER & PAYNE, *supra* note 19, at 272–78.
37. *Id.* at 237.
38. On equity receivership, see DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 56–69 (2001).
39. *See* GULLIFER & PAYNE, *supra* note 19, at 243–45, 272–73.
40. The first corporate bankruptcy provisions were enacted in the Companies Act, 1862, 25 & 26 Vict., c. 89 (U.K.). ROY GOODE, PRINCIPLES OF CORPORATE INSOLVENCY LAW 12 (4th ed. 2011).
41. GULLIFER & PAYNE, *supra* note 19, at 272–78.
42. *See, e.g.*, *In re* ELS Ltd. [1995] Ch 11.

charge, it originally had the potential to enhance the value of lenders' priority rights where their debtors ceased trading and ended up in bankruptcy.[43]

B. Statutory Carve-Out Provisions: Origins and Expansion

Preferential claims—in English legal parlance, a defined category, or defined categories, of unsecured claims that enjoy some form of statutorily created priority[44]—first acquired prominence with the enactment of the Preferential Payments in Bankruptcy Act, 1888.[45] This Act conferred a limited priority on unpaid employee wage claims (capped at twenty-five pounds) and on unpaid assessed taxes and local rates that had fallen due within one year of the commencement of bankruptcy.[46] Courts interpreted the 1888 provision to give preferential claims priority over general unsecured creditors in a distribution of unencumbered assets.[47] As secured creditors could by this time collateralize and potentially absorb all of a corporate debtor's assets and undertaking, the statutory priority conferred by the 1888 Act did not achieve its desired effect.[48]

Parliament's response was to enact the Preferential Payments in Bankruptcy Amendment Act, 1897.[49] Section 2 of that Act contained our first bankruptcy carve-out provision. In circumstances where there were insufficient unencumbered assets to pay the 1888 Act's categories of preferential claim in full, those claims were given priority over the claims of secured creditors under a floating charge and made payable out of floating charge collateral.[50]

The main policy concern that animated the 1897 amendment was a familiar one. It was that overinclusive security led to uncompensated (and therefore unfair) wealth transfers from unsecured creditors, such as employees, who had contributed to the value of the collateral, only to have that value appropriated entirely by secured creditors.[51] Wider calls to subordinate all fixed and floating charge collateral to preferential claims and to extend preferential status to trade creditors were resisted.[52]

---

43. GULLIFER & PAYNE, *supra* note 19, at 276.
44. The analogue in U.S. bankruptcy law is the categories of priority unsecured claims in 11 U.S.C. § 507 (2012).
45. 51 & 52 Vict. c. 62 (U.K.).
46. *See id.*
47. Richards v. Overseers of Kidderminster, [1896] 2 Ch. 212.
48. *See* Buchler v. Talbot, [2004] 2 A.C. 298 at 305–06 (H.L.) (Lord Nicholls of Birkenhead) (Eng.).
49. 60 & 61 Vict., c. 19 (U.K.).
50. *Id.*
51. *See* John Armour, *Should We Redistribute in Insolvency?*, *in* COMPANY CHARGES: *SPECTRUM* AND BEYOND 189, 195 (Joshua Getzler & Jennifer Payne eds., 2006). The justification for extending the carve-out to preferential tax claims under the 1888 Act will at this point in history have rested on ancient Crown prerogative. *See* Barbara K. Morgan, *Should the Sovereign Be Paid First? A Comparative Analysis of the Priority for Tax Claims in Bankruptcy*, 74 AM. BANKR. L.J. 461, 463 (2000).
52. Armour, *supra* note 51, at 195.

There is some evidence that the 1897 amendment was followed by a relative decline in lender usage of the floating charge.[53] While the impact on bank lending is hard to assess, the emergence of the closed corporation following the House of Lords decision in *Aron Salomon v. A. Salomon and Company, Ltd.*,[54] together with the developments in secured transactions law that I have already outlined, provided the environment for a significant expansion in the availability of private credit, especially to small- and medium-sized enterprise, during the late-Victorian and Edwardian eras.[55] The best guess is that lenders initially rubbed along with the 1897 amendment.

Over time, however, the 1897 carve-out expanded in scope. This came about in two ways. First, the categories of preferential claim gradually expanded in step with developments in tax law.[56] Second, a 1970 decision of the English Court of Appeal read the language of the carve-out as encompassing administrative expenses incurred in a liquidation bankruptcy.[57] Overnight, lenders faced the prospect that liquidators would be able to recoup *all* their administrative expenses and remuneration from floating charge collateral, and not merely the costs associated with the realization of that collateral. At this point, the lending community appears to have decided that enough was enough.

C. Reaction and Counterreaction

Lenders reacted to the cumulative developments outlined in the previous paragraph by innovating. It was well-established before the 1970s that preferential claims arising in a corporate liquidation were not payable out of the lender's collateral where the lender had appointed a receiver some time before the commencement of the liquidation.[58] The reason was that the appointment of a receiver crystallized the floating charge and converted it into a fixed equitable charge over specific assets in the fund of collateral.[59] It followed that any claims in the statutory categories that accrued due between the appointment of a receiver and the commencement of liquidation fell outside the carve-out on the logic that the statute only required preferential claims to be paid from assets that

53. *Id.* at 196–97 (identifying a decline in debt securities issuance backed by floating charges).

54. [1897] A.C. 22 (H.L.) (Eng.) (holding that it was open to a sole trader to incorporate and thereby enjoy the benefits of limited liability for business debts).

55. This was reflected in an expansion of the commercial banking sector. *See* MICHAEL COLLINS, MONEY AND BANKING IN THE UK: A HISTORY 34–118 (1988). However, the extent to which the floating charge over circulating assets contributed directly to corporate expansion is contested. *See* Joshua Getzler, *The Role of Security Over Future and Circulating Capital: Evidence from the British Economy* circa *1850–1920*, *in* COMPANY CHARGES, *supra* note 51, at 227–31.

56. For a useful summary, see Andrew Keay & Peter Walton, *The Preferential Debts Regime in Liquidation Law: In the Public Interest?*, 3 COMPANY FIN. & INSOLVENCY L. REV. 84 (1999).

57. *See* Mathias and Davies (A Firm) v. Down (*In re* Barleycorn Enterprises Ltd.) [1970] 1 Ch. 465 at 470 (Eng.).

58. Joshua Tetley & Son, Ltd. v. Griffin Hotel Co., Ltd. (*In re* Griffin Hotel Co., Ltd.) [1941] 1 Ch. 129 at 135 (Eng.).

59. *See id.*

were subject to a *floating* charge.[60] As the charge had already ceased to float before the commencement of liquidation, the assets were subject to a *fixed* and not a floating charge.[61] So the first thing lenders did to mitigate the effect of the carve-out was to adjust their prebankruptcy behavior by appointing receivers as soon as there was any indication that their debtors might be heading for liquidation.[62]

In response to the extension of the carve-out to administrative expenses, lenders expanded the range of defined events in their standard loan documentation that would trigger automatic crystallization of the floating charge before the debtor entered bankruptcy and began to reserve the right to serve notice on the debtor converting the floating charge into a fixed charge at the first sign of financial trouble.[63] Notwithstanding the potential impact on preferential claimants, these transactional innovations generally found favor with courts in England and in the Commonwealth on grounds of freedom of contract.[64] Lenders could therefore use contract terms to accelerate crystallization in order to mitigate what, from their perspective, were the worst effects of the carve-out.

It was widely understood that this kind of bilateral contractual erosion of third-party statutory rights was vulnerable to policy objection and easy enough to outlaw.[65] Parliament duly obliged in 1985 by reenacting the carve-out to make preferential claims payable out of "a charge which, as created, was a floating charge."[66] If the charge started life as a floating charge it was within the carve-out regardless of whether or not it had been converted, via crystallization, to a fixed charge before bankruptcy. But, even as one door was closing, lenders were already innovating in other more radical ways.

60. *See id.*

61. *Id.*

62. *See, e.g.*, *In re* Christonette Int'l Ltd., [1982] 1 W.L.R. 1245 (Eng.). In *Christonette*, the lender appointed a receiver before the liquidation commenced and, in so doing, crystallized its floating charge. *Id.* at 1247. The court held that administrative expenses incurred by the liquidator during the course of the liquidation that would have been payable out of floating charge collateral under controlling precedent were not so payable because by the time the liquidation had commenced the charge was fixed not floating. *Id.* at 1250–52.

63. *Id.*at 1249.

64. *See, e.g.*, *In re* Brightlife Ltd., [1987] 1 Ch. 200 at 214–15 (Eng.).

65. The Review Committee under the chairmanship of Sir Kenneth Cork the recommendations of which led to the enactment of the U.K. insolvency reforms of the mid-1980s was originally appointed in January 1977. The Committee's positions on a range of matters affecting secured creditors were therefore well understood long before the publication of its final report in 1982. Perhaps the Cork Committee's most radical proposal was that a secured creditor should be compelled to give up ten per cent of the value of its floating charge for distribution among unsecured creditors. This was balanced by a proposal to eliminate some categories of preferential claim and reduce the scope of others. The banks succeeded in blocking the proposal for a "Ten Percent Fund" but the inference is that they had to make some concessions. *See* CARRUTHERS & HALLIDAY, *supra* note 7, 339–46; KENNETH CORK ET AL., INSOLVENCY LAW AND PRACTICE: REPORT OF THE REVIEW COMMITTEE 344–51 (1982).

66. Insolvency Act, 1986, c. 45, § 251 (U.K.).

D. The Rise and Decline of the Fixed Charge Over Receivables

As the 1980s dawned, clearing bank lenders had already begun, in earnest, to expand the reach of the fixed charge to encompass circulating assets.[67] Their motivation was straightforward: the more collateral that could be covered by fixed charges the better, because the statutory carve-out had only ever applied to floating charges.[68] Recall, however, that a core attribute of a fixed charge is that the debtor has no authority to deal with the collateral without the lender's consent.[69] Thus, for the same reasons that the floating charge emerged in the first place, a fixed charge over circulating assets, such as inventory, would prove elusive. Nevertheless, for a quarter of a century between the late 1970s and 2005, lenders did succeed in extending fixed charge coverage to accounts receivable.[70]

A typical modus operandi was as follows. The security instrument would be drafted to include a charge, expressly described as a "fixed" charge over book debts and other receivables.[71] A further clause would be added expressly prohibiting the debtor from assigning its intangible property interest in the uncollected receivables and further requiring the debtor to pay the proceeds, once collected, into its account with the lender.[72] The debtor would then usually be permitted to draw on the account as long as it kept within its existing overdraft limit.[73]

This transactional device rested on the theory that the debtor could only deal with the receivables and their proceeds with the lender's consent.[74] The theory was robust in so far as the debtor was prohibited from dealing with uncollected receivables without the lender's affirmative consent.[75] But, as regards the proceeds, it rested on the flimsier notion that the lender "controlled" the debtor's bank account and could always take steps to assert its lien, restrict the debtor's reuse of proceeds, and so protect its collateral.[76]

Nonclearing bank lenders that did not offer current account facilities were initially less successful in avoiding the carve-out.[77] They could easily restrict dealings with uncollected receivables, but a contractual stipulation that the debtor pay proceeds into a designated account maintained with a third-party clearing bank did not pass muster unless the debtor was blocked from drawing freely on the account.[78] In the absence

---

67. Armour, *supra* note 51, at 198–99.

68. Although CORK ET AL., *supra* note 65, proposed a "Ten Percent Fund," it did not propose to extend the carve-out to fixed charges.

69. GULLIFER & PAYNE, *supra* note 19, at 242–43.

70. *Id.*

71. *Id.*

72. *Id.*

73. *Id.*

74. *Id.*

75. *Id.*

76. *See In re* Brightlife Ltd., [1987] 1 Ch. 200 at 210 (Eng.) (explaining Siebe Gorman & Co. Ltd. v. Barclays Bank Ltd., [1979] 2 Lloyd's Rep. 142 (Eng.)).

77. *Id.* at 209.

78. *See id.*

of effective controls on the designated account, the debtor would be free to collect its debts, liberate them from the charge, and then dispose of the proceeds without restriction.[79]

However, in *In re New Bullas Trading, Ltd.*,[80] the English Court of Appeal put nonclearing bank lenders on the same footing as their clearing bank counterparts, by upholding as a fixed charge a security agreement which required the debtor to pay the proceeds of receivables into a designated account held with a third-party bank, and further stipulated that the debtor was to deal with the proceeds in accordance with directions made in writing by the lender.[81] The decision was controversial because the *New Bullas* "fixed" charge clearly contemplated that the debtor would be free to deal with the proceeds in the *absence* of a written direction from the lender.[82] In other words, it was powered by a theory of negative consent. The security instrument required the debtor to pay what it collected into the designated account, but it was only if the lender gave no directions that the debtor was then permitted to use the proceeds.[83] In practice, of course, lenders who used this arrangement never issued written directions, and so the debtor was free to collect the debts and recycle the proceeds as it pleased.[84] The provision for written directions was nothing more than a drafting device designed to create the appearance of control over an account held by the debtor with a third-party bank that was outside the debtor-lender contractual nexus.[85]

Clearing bank and nonclearing bank lenders thus managed to boost their priority by diverting receivables away from the statutory carve-out without excessively restricting the ability of borrowers to recycle their receivables into cash flow.[86] Although the "fixed" charge over receivables rested on the fiction that the debtor's ability to collect its debts and liberate them from the charge was restricted or, to express it differently, that the lender enjoyed dominion over both the intangibles and their proceeds,[87] the innovation held good for several years. One explanation for this is that English courts are prepared to treat questions of transactional

---

79. *See id.*

80. [1994] B.C.C. 36 (Eng.).

81. *Id.* at 38–39.

82. *See* Alan Berg, *Charges over Book Debts: A Reply*, 1995 J. BUS. L. 433, 449–63; Roy M. Goode, *Charges over Book Debts: A Missed Opportunity*, 110 L.Q. REV. 592, 596–603 (1994).

83. Berg, *supra* note 82, at 449–50.

84. *See id.*

85. *See id.*

86. Nat'l Westminster Bank plc v. Spectrum Plus Ltd. (*In re* Spectrum Plus Ltd.), [2005] 2 A.C. 680 at 718–19 (H.L.) (Lord Scott of Foscote); *id.* at 728–29 (Lord Walker of Gestingthorpe) (Eng.).

87. In the English law of security over receivables, the extent of the debtor's dominion over the collateral was relevant only to the question whether the lender's charge was fixed or floating it being beyond doubt that a debtor could grant a floating charge over receivables that left it in total control of the collateral in the ordinary course of its business. LoPucki et al., *supra* note 19, at 1805. This contrasts, of course, with pre-U.C.C. law in the United States, under which the debtor's freedom to control and dispose of receivables was apparently fatal to any kind of lien howsoever described. *See* Benedict v. Ratner, 268 U.S. 353 (1925); Edward J. Janger, *Brandeis, Progressivism, and Commercial Law: Rethinking* Benedict v. Ratner, 37 BRANDEIS L.J. 63, 66 (1998); G. Ray Warner, *The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy*, 9 AM. BANKR. INST. L. REV. 3, 9 (2001).

characterization almost exclusively as questions of construction, and thus defer to the intention of the parties as discerned from the security instrument.[88] At the same time, insolvency practitioners appointed as liquidators were seemingly reluctant to challenge the fixed charge characterization on behalf of preferential claimants for fear of upsetting lenders.[89] There is some evidence that during the period from 1996 to 2003 U.K. banks were lending between three and four times as much on the security of receivables than they were on other circulating assets, such as inventory.[90] Whether this pattern of lending would have occurred had a judicially sanctioned fixed charge over this asset class been unavailable is open to doubt. Not surprisingly, the evidence also suggests that recoveries on preferential claims were consistently and persistently low.[91]

What made the fixed charge over receivables so successful was the facility it gave lenders to work around the carve-out in a way that was commercially attractive from the *ex ante* standpoint of *both* lenders and borrowers. Lenders got priority without having to monitor the debtor closely.[92] Borrowers were not denied access to liquidity, which made sense for lenders and borrowers alike.[93] However, the commercial attractiveness of the fixed charge was significantly dampened by a decision of the Judicial Committee of the Privy Council in *Agnew*, a case on appeal from New Zealand,[94] and a similarly reasoned decision of the House of

88. This is not to say that transactional form always triumphs over substance in English commercial law. There are plenty of instances where English courts have recharacterized transactions because the rights granted by the agreement read as a whole were entirely at odds with the formal characterization applied by the parties to describe their legal relationship. For example, in *Street v. Mountford*, [1985] A.C. 809, the House of Lords held that an agreement described as a real estate "license" but which, on its face, conferred exclusive possession of the premises on the "licensee" for a fixed period of time was, in truth, a lease. *Id.* In that case, Lord Templeman famously opined that "'[t]he manufacture of a five-pronged implement for manual digging results in a fork even if the manufacturer, unfamiliar with the English language, insists that he intended to make and has made a spade.'" *Id*. at 819. But the approach taken in *Street v. Mountford* is still one of pure construction and English courts are extremely reluctant in the absence of a finding that the parties acted dishonestly to rely on the post-contractual conduct of the parties as an aid to defeating party intentions expressed in the contract itself. *See* GAVIN LIGHTMAN & GABRIEL MOSS, THE LAW OF ADMINISTRATORS AND RECEIVERS OF COMPANIES 47–51 (5th ed. 2011); Louise Gullifer & Jennifer Payne, *The Characterization of Fixed and Floating Charges*, *in* COMPANY CHARGES, *supra* note 51, at 69–73. Accordingly, it is unsurprising to an English lawyer that there was no sustained attempt in *New Bullas* to challenge the fixed charge characterization on the basis that, posttransaction, the lender never *in fact* gave any directions, with the consequence that the debtor was *in reality* always free to use the receivables proceeds as it pleased.

89. Insolvency practitioners who wished to be considered for potentially lucrative administrative receivership appointments needed to keep on the right side of the banks. *See* Gullifer & Payne, *supra* note 88. That said, in terms of the political economy of the fixed charge, there is a puzzle as to why Crown creditors were not more vigorous in fighting their corner. *See id.* In practice, virtually all the preferential claims during the era of the fixed charge over receivables were Crown claims, either for unpaid tax or, by way of subrogation, for employee claims that the government had met out of public funds. *See id.*

90. Sergei A. Davydenko & Julian R. Franks, *Do Bankruptcy Codes Matter? A Study of Defaults in France, Germany, and the U.K.*, 63 J. FIN. 565, 587 (2008).

91. *See* Armour, *supra* note 51, at 200 (citing Julian Franks & Oren Sussmann, *Financial Distress and Bank Restructuring of Small to Medium Size UK Companies*, 9 REV. FIN. 65, 83 (2005)).

92. *See id.* at 199.

93. *Id.*

94. Agnew v. Comm'r of Inland Revenue [2001] 2 A.C. 710 (P.C.) (appeal taken from N.Z.).

Lords in *In re Spectrum Plus Ltd.*,[95] a test case that the banks felt compelled to pursue in the light of *Agnew*.[96]

In these cases, a new generation of senior Chancery judges exposed the Achilles Heel of the standard forms of fixed charge that had emerged in the previous quarter of a century. Their message was clear. The freedom of the debtor to dispose of receivables through collection and reuse of the proceeds was wholly inconsistent with the nature of a fixed charge. Clearing and nonclearing bank "fixed" charges were therefore recharacterized as floating charges and the collateral brought back within the scope of the carve-out.[97] A fixed charge could only arise if the debtor's access to the proceeds of receivables was blocked.[98] *Agnew* and *Spectrum* left lenders who did not want to micro-manage their debtors' day-to-day spending decisions with a simple choice: Either lend against the security of a floating charge over receivables and share the collateral with preferential creditors in bankruptcy or find another way.[99]

E. The Modern Carve-Out and the Rise of Asset-Based Receivables Finance

Although the Enterprise Act of 2002 abolished Crown preferential claims, the same legislation reconfigured the carve-out so as to assign a portion of floating charge collateral, known as the "prescribed part," to the general unsecured creditors in a bankruptcy distribution.[100] The underlying policy goal was to redistribute realizations to unsecured creditors as a whole that would previously have gone exclusively to the Crown.[101] The rules for calculating the prescribed part are elaborate and

95. Nat'l Westminster Bank plc v. Spectrum Plus Ltd. (*In re* Spectrum Plus Ltd.), [2005] 2 A.C. 680 (H.L.) (Eng.).

96. The Judicial Committee of the Privy Council serves as the final court of appeal for the UK's overseas territories and dependencies, and for some Commonwealth countries. Although Privy Council decisions are apparently not binding on U.K. courts, they exert considerable influence over English law and practice because the core members of the Privy Council are all Justices of the U.K. Supreme Court. *See generally* Matthew D.J. Conaglen & Richard C. Nolan, *Precedent from the Privy Council*, 122 L.Q. REV. 349 (2006).

97. *See Spectrum Plus Ltd.*, [2005] 2 A.C. 680 at 722–25 (Lord Scott of Foscote).

98. *Id.* at 724 (Lord Scott of Foscote); *id.* at 730 (Lord Walker of Gestingthorpe).

99. Armour, *supra* note 51, at 202–25.

100. Insolvency Act, 1986, c. 45, § 176A(2)(a) (U.K.). The prescribed part requirement prima facie applies to distributions via a liquidation, administration, or administrative receivership.

101. DEPARTMENT OF TRADE AND INDUSTRY, INSOLVENCY—A SECOND CHANCE: THE INSOLVENCY SERVICE, 2001, CM 5234, ¶ 2.19 (U.K.).

it is subject to a £600,000 cap.[102] Parliament also formally extended the carve-out to administrative expenses in a corporate liquidation.[103]

There is, as of yet, no compelling empirical evidence to suggest that the modern carve-out has improved returns to the unsecured creditor constituency it is designed to benefit.[104] Indeed, there are reasons to think that lenders have found effective ways to work around the *Spectrum* decision, and so mitigate the effect of the carve-out by shifting away from overdraft lending secured by a charge over receivables in favor of asset-based financing techniques such as invoice discounting.[105]

In an invoice discounting arrangement, the debtor assigns its receivables to the lender in return for immediate financing, and then collects the receivables for the lender's account.[106] Although invoice discounting functions as a form of title-based security, the substitution of an outright assignment for a charge has the effect of taking the receivables outside of the carve-out.[107] For the time being, it appears, once again, that lenders have managed to circumnavigate the carve-out, and reduce their costs of providing short-term cash flow finance to small-and medium-sized enterprises.[108] Viewed in a wider context, the combination of the carve-out and the *Spectrum* decision appears to have accelerated a shift from relational (overdraft) lending to asset-based lending.[109]

F. Some Provisional Conclusions About Carve-Outs

The statutory carve-out has powerfully influenced English jurisprudence on the fixed and floating charge and, in turn, shaped the standard form transactional structures and legal technologies that lenders use.

102. The Insolvency Act 1986 (Prescribed Part) Order 2003, 2003, S.I. 2097, art. 3 (U.K.). Where floating charge collateral does not exceed £10,000, the prescribed part is fifty percent of the value of the collateral. Where floating charge collateral exceeds £10,000, the prescribed part is fifty percent of the first £10,000 and twenty percent of the excess. Case law has established that secured creditors cannot participate in the prescribed part as regards any unsecured deficiency unless they surrender their security. *See* Horton v. Dawson (*In re* JT Frith Ltd.), [2012] B.C.C. 634 at 639 (Eng.); Thornily v. HM Revenue and Customs (*In re* Airbase (UK) Ltd.), [2008] 1 W.L.R. 1516 at 1521–22 (Eng.); *In re* Permacell Finesse Ltd., [2008] B.C.C. 208 at 211 (Eng.).

103. Insolvency Act, 1986, c. 45, § 176ZA. Administrative expenses in an administration proceeding are also payable out of floating charge collateral.

104. THE INSOLVENCY SERVICE, ENTERPRISE ACT 2002—CORPORATE INSOLVENCY PROVISIONS: EVALUATION REPORT 136–42 (2008); *see also* Louise Gullifer, *The Reforms of the Enterprise Act 2002 and the Floating Charge as a Security Device*, *in* CURRENT ISSUES IN EUROPEAN FINANCIAL AND INSOLVENCY LAW: PERSPECTIVES FROM FRANCE AND THE UK 17, 28, 42–43 (Wolf-Georg Ringe et al. eds., 2009) (casting doubt based on the available evidence on whether the prescribed part will improve the position of unsecured creditors).

105. Armour, *supra* note 51, at 205. The annual reports of the Asset Finance Based Association (formerly the Factors and Discounters Association) chronicle the exponential growth over the last fifteen years in the volume of lending by bank-owned and independent asset based lenders under invoice discounting facilities. *Annual Reports*, ASSET BASED FIN. ASS'N., http://www.abfa.org.uk/members/annual-reports.asp (last visited Oct. 27, 2014).

106. Armour, *supra* note 51, at 204.

107. *Id.* at 205.

108. *Id.* at 205.

109. Gullifer, *supra* note 104, at 42 n.156 (citing research which suggests that the trend away from overdraft lending towards asset-based lending had already begun by the mid 1990s).

Lenders have effectively conceded that the floating charge has limited value as a priority device, but continue to use so-called "lightweight" floating charges, emptied of meaningful collateral, for purposes of control.[110] Where possible, they take fixed charges and, for assets where fixed charges are unavailable or unlikely to work in a commercially feasible manner, they have increasingly resorted to asset-based lending through specialist subsidiaries.[111]

Throughout its history, the English carve-out has only ever applied to the floating charge.[112] No attempt has been made to extend it to fixed charges or to other forms of functional security.[113] This has left the way open for lenders to exploit first the fixed charge and, more recently, title-based forms of security to escape its clutches.[114] The fact that no such attempt has been made indicates that it has not yet been thought politically feasible.[115] Thus, while a comprehensive bankruptcy carve-out *could* be drafted that would be "adjustment proof" against transactional innovation, it will either be resisted or diluted through metabargaining or accommodated in other ways.[116]

In the English context, it therefore makes political sense to stick with a fairly modest carve-out. But, as we have seen, a carve-out that applies to only one species of functional security is easy to avoid. A more far-reaching carve-out in terms of coverage[117] would likely only be politically acceptable were its value to be capped at a modest level. The smaller the cap, the greater the risk that any "carve-out" fund would be absorbed by the costs of administering and distributing it.[118] The bigger the cap, the greater the likelihood that lenders would be even more aggressive than they already are in managing and reducing their exposure pre-bankruptcy through their "turnaround divisions" and "intensive care units."[119] In a policy climate reflective of political and economic concerns

110. *Id.* at 43; Rizwaan Jameel Mokal, *The Floating Charge—An Elegy*, *in* COMMERCIAL LAW AND COMMERCIAL PRACTICE 479, 483–84 (Sarah Worthington ed., 2003).

111. *See* Mokal, *supra* note 110, at 480–81.

112. *See* John Armour, *The Chequered History of the Floating Charge*, 13 GRIFFITH L. REV. 25, 33–35 (2004).

113. *Id.*

114. Gullifer, *supra* note 104, at 43; Mokal, *supra* note 110, at 483–84.

115. Parliament did debate whether to extend the carve-out to fixed charges in 1897 but concluded that it was too radical a step. *See* Armour, *supra* note 51, at 195.

116. *See* CARRUTHERS & HALLIDAY, *supra* note 7, at 15.

117. For example, extended to all types of functional security or, more modestly, applied to functional security, regardless of legal characterization, over specified types of collateral such as inventory or receivables. For discussion of a range of alternative "carve out" triggers none of them dependent on the fixed versus floating charge distinction see Gullifer & Payne, *supra* note 88, at 87–101.

118. The existing requirement to set aside the prescribed part can be disapplied if the insolvency practitioner thinks that the cost of making a distribution to unsecured creditors would be disproportionate to the benefit. Insolvency Act, 1986, c. 45, § 176A(3)(b) (U.K.).

119. On the emergence of processes for informal management of distressed firms inside U.K. banks, see John Armour & Sandra Frisby, *Rethinking Receivership*, 21 OXFORD J. LEGAL STUD. 73, 91–95; Davydenko & Franks *supra* note 90, at 567; Franks & Sussman, *supra* note 91, at 84–93. For concern about the alleged recent practices orchestrated by one U.K. clearing bank through its turnaround division see LAWRENCE TOMLINSON, BANKS' LENDING PRACTICES: TREATMENT OF

about contraction in lending to small- and medium-sized enterprises,[120] the prospects for radical reform are, to my mind, remote. It should also not be forgotten that a "larger" carve-out would increase the exposure of business owners from whom lenders extract personal guarantees. The small business and banking lobbies would make common cause against such a proposal in defense of the U.K.'s "enterprise culture."[121]

It is an open question whether the English experience with statutory carve-outs can shed much light on concerns about overinclusive security interests in the United States. Of course, carve-outs have been debated extensively in the United States before in the context of proposals to revise Article 9 of the Uniform Commercial Code.[122] I take no normative position in the "full versus partial" priority debate, but offer the modest suggestion that the English experience may give some credence to the arguments of those scholars and commentators on this side of the pond who doubt that a "partial priority" scheme in bankruptcy would deliver its intended benefits without unintended consequences.

III. STATUTORY EROSION OF CONTROL RIGHTS

A. The Law Prior to the Enterprise Act Reforms

On paper, the Enterprise Act 2002 ("Enterprise Act") weakened the control of secured creditors over the governance of financially distressed companies. Before the Enterprise Act, bankruptcy and secured transactions law were structured so as to confer significant formal control rights on secured creditors. We have seen already in Part II that English law permits secured creditors to collateralize all of the business and assets of a corporate debtor through a combination of fixed and floating charges. Although, as we have also seen, the statutory carve-out had undermined the blanket floating charge as a priority-conferring device long before the turn of the twenty-first century, it remained very useful as a control device. This was because a secured creditor holding a blanket floating charge covering the whole, or substantially the whole, of the debtor company's assets could freely contract for the right to appoint a licensed insolvency practitioner as an administrative receiver,[123] and could make such an appointment swiftly without the need for an applica-

---

BUSINESSES IN DISTRESS 10–12 (2013), *available at* http://tomlinsonreport.com/docs/tomlinson Report.pdf.

120. *See, e.g.*, ORG. ECON. CO-OPERATION & DEV., FINANCING SMES & ENTREPRENEURS 2013: AN OECD SCOREBOARD 27–39 (2013).

121. On the origins and development of the 'enterprise culture' in U.K. public discourse, see Patricia Carr & Graham Beaver, *The Enterprise Culture: Understanding a Misunderstood Concept*, 11 STRATEGIC CHANGE 105 *passim* (2002).

122. *See, e.g.*, Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy: Further Thoughts and a Reply to the Critics*, 82 CORNELL L. REV. 1279 (1997); Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 859 (1996).

123. Insolvency Act, 1986, c. 45, §§ 29(2), 388(1)(a). In the text hereafter, I abbreviate "administrative receiver" and "administrative receivership" to "receiver" and "receivership" respectively.

tion to the court, or for any kind of showing that the debtor was formally insolvent.[124] The right to appoint a receiver could be triggered merely by the debtor's breach of covenants in the loan agreement.[125]

Other structural features of the pre-Enterprise Act law further enhanced the attractiveness of receivership to lenders as a method for enforcing their security. A receiver could be given full plenary powers to manage the debtor and realize its assets.[126] Although a receiver was deemed to be the agent of the debtor,[127] rather than of the appointing creditor, his main function was to enforce the security and maximize the appointing creditor's recoveries. Accordingly, it was well-established that a receiver's duties to anyone other than the appointing creditor were very limited.[128] So, for example, a receiver was free to determine the timing of asset realizations without regard to likely changes in market conditions. He was under a duty (enforceable by a subsequently appointed liquidator on behalf of unsecured creditors) to procure the best price for assets available in the market at the time he decided to sell.[129] But, he owed no duty to maximize asset values over and above what was necessary to repay the appointing creditor and preferential claims falling within the scope of the statutory carve-out. Thus, even if he could have taken steps to increase asset values, for example, by delaying a sale in anticipation of a rising market, he was not obliged even to consider, let alone take, those steps.[130] Prima facie, receivers had little or no meaningful accountability to junior creditors. Furthermore, under pre-Enterprise Act law, secured creditors who were entitled to appoint a receiver had the statutory right to veto the debtor's entry into administration, English bankruptcy law's main formal collective "rescue" procedure.[131] The structural hegemony of secured creditors over the realization of distressed firms' assets was about as absolute as it could be.

B. Policy Objections to Secured Creditors' Formal Control Rights Under Pre-Enterprise Act Law

The main policy objections to the formal legal framework for the enforcement of secured creditors' rights as it stood before the Enterprise Act were that it created value destructive perverse incentives and rendered a receiver insufficiently accountable to junior creditors.[132] First, it

124. Prentice, *supra* note 13, at 156–57.
125. *See* GOODE, *supra* note 40, at 333–34; LIGHTMAN & MOSS, *supra* note 88, at 212–13.
126. LIGHTMAN & MOSS, *supra* note 88, at 26–27.
127. *Id.* at 28; Armour & Frisby, *supra* note 119, at 76–78.
128. LIGHTMAN & MOSS, *supra* note 88, at 28, 381–82, 384–92.
129. Cuckmere Brick Co. v. Mut. Fin. Ltd [1971] 1 Ch. 949 (Eng.).
130. Silven Props. Ltd. v. Royal Bank of Scot. [2004] 1 W.L.R. 997 at 1005 (Eng.); Bell v. Long [2008] EWHC (Ch) 1273, [14] (Eng.).
131. *See infra* Section III.B.
132. See, for example, John Armour, Audrey Hsu, & Adrian Walters, *Corporate Insolvency in the United Kingdom: The Impact of the Enterprise Act 2002*, 5 EUR. COMPANY & FIN. L. REV. 148, 158–59 (2008) and literature therein cited. For a U.S. perspective on this incentive problem see also Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 844–52 (2004).

was said that the law had a built-in liquidation bias. If secured creditors, generously endowed with the comprehensive package of collateral that the English law of consensual security permits, were fully or oversecured on the break-up value of the assets, they had every incentive to close down and prematurely liquidate potentially viable firms that might have considerable going-concern value. In a similar vein, it was said that receivers had no incentives to maximize realizations because of the highly circumscribed nature of their legal duties to junior creditors.[133] A further claim was that lenders and receivers lacked the correct incentives to minimize their enforcement costs in cases where unsecured creditors, but for those costs, might be in the money.[134] The conventional wisdom that took root among policymakers was that the ability of secured creditors, through receivership, to control their exit without formal regard to the interests of other constituencies was inefficient, unfair, and wasteful.[135]

After the Labour Party's landslide victory in the 1997 general election, the Blair government heeded this conventional wisdom, and reform of receivership became one strand of Labour's extensive modernization agenda.[136] A government White Paper, *Productivity and Enterprise: Insolvency—A Second Chance*, published in July 2001, echoed the concerns about administrative receivership outlined in the previous paragraph.[137] It was widely perceived that Labour's political aim was to "punish" the banks for their role in the economic recession of the early 1990s. As the White Paper put it: "There was also widespread concern that the large number of administrative receivership appointments in the early 1990s may have represented precipitate behaviour on the part of lenders, causing companies to fail unnecessarily."[138]

C. The Formal Weakening of Secured Creditor Control by the Enterprise Act

The Enterprise Act reconfigured corporate bankruptcy law in two complementary ways. First, it prospectively abolished receivership "in all but a handful of exceptional" financing scenarios.[139] Second, it elevated the collective administration procedure to a position of much greater structural prominence within bankruptcy and secured transactions law than it had hitherto enjoyed.[140] In order to explain these formal changes in the structure of English law fully, I need to say something first about administration.

133. Armour, Hsu, & Walters, *supra* note 132, at 159 n.41.
134. *Id.* at 158.
135. *See id.* at 161.
136. On Labour's modernization program generally, see JANET NEWMAN, MODERNIZING GOVERNANCE: NEW LABOUR, POLICY AND SOCIETY (2001).
137. INSOLVENCY—A SECOND CHANCE: THE INSOLVENCY SERVICE, *supra* note 101, at 2.1–2.3.
138. *Id.* at 2.1.
139. Armour, Hsu & Walters, *supra* note 132, at 160.
140. *Id.*

Administration was a product of the U.K.'s bankruptcy law reforms of the 1980s. In its first incarnation, administration could only be commenced by court order.[141] It provided debtors with a comprehensive stay, together with a statutory "breathing spell" in which to formulate, and seek creditor approval of, proposals for business continuation.[142] Ironically enough, administration was originally conceived as a mechanism for extending the perceived *benefits* of receivership to debtors who had not granted blanket floating charges,[143] especially the facility that receivership provided for quick going-concern sales.[144]

A point sometimes lost sight of in comparative discourse is that administration, in and of itself, has never been a *reorganization* procedure akin to a classic Chapter 11 in which creditors' claims are substituted by rights under a confirmed plan. It has always functioned principally as a procedure designed to facilitate a better (i.e., a going-concern) realization of business assets than could be achieved through a piecemeal liquidation.[145] Although it is now possible for an administrator to distribute proceeds of a business sale without first having to convert an administration to a liquidation,[146] there is no facility for a debtor to seek and obtain confirmation of a binding restructuring plan unless an administration is combined with another formal procedure.[147] Thus, to accomplish something approximating a Chapter 11 reorganization, an administrator will need to procure the debtor's exit from administration into a separate voting procedure that allows debts to be restructured in accordance with the wishes of a majority of the creditors, such as a company voluntary arrangement,[148] or a Companies Act scheme of arrangement.[149]

There were two main differences between administration and receivership that the architects of the Enterprise Act reforms sought to exploit. First, administration was (and remains) a *collective* proceeding, with the consequence that the administrator has a duty to act in the interests of creditors as a whole.[150] So, while a receiver was entitled to prioritize the interests of his appointing creditor, and this entitlement constrained his fiduciary obligations to other constituencies, an administrator has always had a higher duty to maximize the realizable

141. Insolvency Act, 1986, c. 45, §§ 9–27, *repealed by* Enterprise Act, 2002, c.40 (Eng.).

142. *Id.* § 11(3), *repealed by* Enterprise Act, 2002, c. 40 (Eng.).

143. CORK ET AL., *supra* note 65, at 117–22.

144. Armour & Frisby, *supra* note 119, at 86–91. Administrators, like receivers, have wide powers to manage the assets they control including powers to carry on and sell the debtor's business. *See* Insolvency Act, 1986, c. 45, sched. 1 (U.K.) (repealed 2009).

145. *See* SANDRA FRISBY, REPORT ON INSOLVENCY OUTCOMES 57–61 (2006), *available at* http://webarchive.nationalarchives.gov.uk/+/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/research/corpdocs/InsolvencyOutcomes.pdf; Sandra Frisby, *In Search of a Rescue Regime: The Enterprise Act 2002*, 67 MOD. L. REV. 247, 249–50 (2004).

146. Insolvency Act, 1986, c. 45, sched. B1, ¶¶ 65–66.

147. Armour, Hsu & Walters, *supra* note 132, at 154.

148. Insolvency Act, 1986, pt. 1.

149. Companies Act, 2006, c. 46, §§ 895–901 (Eng.).

150. INSOLVENCY—A SECOND CHANCE: THE INSOLVENCY SERVICE, *supra* note 101, at ¶ C.23.

value of the debtor's assets and business.[151] Second, an administrator (in stark contrast to a receiver) must submit his proposals for dealing with the debtor's business to a creditors' meeting and seek creditor approval.[152] Administration offered unsecured creditors a bundle of formal rights. But before the Enterprise Act it had been used relatively infrequently,[153] not least because secured creditors had the statutory right to block the appointment of an administrator so that they could appoint a receiver instead.[154]

The aim of the Enterprise Act reforms was to curtail the power of secured creditors to appoint receivers,[155] and to increase usage of administration by channelling debtors who would otherwise have been candidates for receivership into a substantially remodelled version of the administration procedure.[156] The underlying policy goal was to improve net outcomes for unsecured creditors by maximizing asset realizations and reducing costs.[157] Policymakers thought that the greater accountability of an administrator would address the perverse incentive problem associated with receivership, and thereby increase asset realizations, and that various "streamlining" changes to the administration procedure, including provision for out-of-court entry routes, would make administration less costly.[158]

At first blush, the reforms seemed radical. In truth, however, lenders appear to have accepted that the writing was on the wall for receivership,[159] and to have devoted most of their energy into making the post-Enterprise Act administration procedure as "bank friendly" as they possibly could.[160] The government made several concessions during the reform process. The statutory retraction of the power to appoint a receiver only applied prospectively to floating charges created on or after September 15, 2003, the date the legislation came into effect.[161] Secured creditors holding "grandfathered" security created before that date could (and can still) appoint a receiver as before, should they be so inclined.[162]

---

151. *See, e.g.*, *In re* Charnley Davies Ltd., [1990] B.C.C. 605 at 618 (Eng.).

152. *See* Insolvency Act, 1986, c.45, sched. B1, ¶¶ 49–55.

153. INSOLVENCY—A SECOND CHANCE: THE INSOLVENCY SERVICE, *supra* note 101, at ¶ 2.1.

154. *See supra* notes 130–31 and accompanying text.

155. *See* Insolvency Act, 1986, c. 45, § 72(1).

156. *Id.* § 8, sched. B1.

157. INSOLVENCY—A SECOND CHANCE: THE INSOLVENCY SERVICE, *supra* note 101, at ¶ 2.1–2.18.

158. *Id.* at ¶¶ 2.3, 2.8, 2.12.

159. *See, e.g.*, Alan Katz & Michael Mumford, *Comparative Study of Administration and Administrative Receivership as Business Rescue Vehicles (Executive Summary)* 5–13 (Lancaster Univ. Mgmt. Sch. Working Paper 2003/097, Aug. 2003), *available at* http://eprints.lancs.ac.uk/48696/1/Document.pdf (finding that lenders were already beginning to make the switch from receivership to administration before the Enterprise Act changes became effective).

160. As a consequence, some have argued that the Enterprise Act changed very little even on a *formal* basis. *See, e.g.*, Robert Stevens, *Security after the Enterprise Act*, *in* COMPANY CHARGES, *supra* note 51, at 153.

161. *Id.* at 154.

162. JOHN ARMOUR, AUDREY HSU & ADRIAN WALTERS, THE IMPACT OF THE ENTERPRISE ACT OF 2002 ON REALISATIONS AND COSTS IN CORPORATE RESCUE PROCEEDINGS 16 (2006), *available at* http://www.researchgate.net/publication/242155506_The_Impact_of_the_Enterprise_Act_2002_on_Re

The prohibition on the appointment of a receiver is also subject to a limited number of exceptions designed to protect investors in a narrow range of exotic, high value lending transactions, such as capital market arrangements, involving sums of at least £50 million, and various types of project and infrastructure financing.[163]

More significantly, the new out-of-court entry routes were configured so as to give the holder of a "qualifying floating charge"[164] a power to appoint an administrator[165] and a power to veto the choice of administrator in cases where the debtor or its directors make the appointment.[166] Secured creditors may have lost their right to appoint a receiver under post-Enterprise Act security, but they still formally control the selection and appointment of the licensed insolvency practitioners who act as administrators.[167] Lenders had already managed to adapt to the impending new reality through metabargaining within the political process.[168]

D. New Forms of Control: Post-Enterprise Act Practice

The formal position after the Enterprise Act can be summarized thus. The scope for secured creditors to enforce their security without paying due regard to junior creditors has been reduced, and the governance rights of unsecured creditors have been correspondingly increased through the reform of the administration procedure.[169] There is no question that, as a formal matter, an administrator is much more widely accountable than a receiver. He must perform his functions with a view to achieving a hierarchy of objectives: first, to rescue the *company* as a going concern; failing that, to achieve a better result for the creditors as a whole than would be likely in liquidation; and, failing that, to realize collateral in order to make a distribution to secured and preferential creditors.[170] Thus, in stark contrast to a receiver, an administrator is statutorily obliged to prioritize a value maximizing "rescue"—either of the *company* or the *business*—if he thinks it is reasonably practicable to do so.[171] The formal commitment to value maximization is further reinforced by the administrator's express statutory duty to perform his functions in the in-

alisations_and_Costs_in_Corporate_Rescue_Proceedings_A_Report_Prepared_for_the_Insolvency_Service_by.

163. Insolvency Act, 1986, c. 45, §§ 72B–72GA (U.K.).

164. Defined as a floating charge which relates to the whole or substantially the whole of the company's property. *Id.* at sched. B1, ¶ 14(3).

165. *Id.* at sched. B1, ¶ 14(1), (2).

166. *Id.* at sched. B1, ¶¶ 26(1), 36.

167. OFFICE OF FAIR TRADING, THE MARKET FOR CORPORATE INSOLVENCY PRACTITIONERS: A MARKET STUDY 30–35 (2010), *available at* http://webarchive.nationalarchives.gov.uk/20140402142426/http:/www.oft.gov.uk/shared_oft/reports/Insolvency/oft1245.

168. Vanessa Finch, *Re-invigorating Corporate Rescue*, 2003 J. BUS. L. 527, 534–35.

169. Armour, Hsu, & Walters, *supra* note 132, at 151.

170. Insolvency Act, 1986, c. 45, sched. B1, ¶ 3(1).

171. *Id.* at sched. B1, ¶¶ 3(3), (4). English courts are traditionally deferential to the business judgments made by regulated professionals such as licensed insolvency practitioners. This is reflected in the statutory language, which defers in several instances to what the administrator "thinks." *See* LIGHTMAN & MOSS, *supra* note 88, at 341–45, 349–51.

terests of the debtor's creditors as a whole.[172] In addition, there are several other mechanisms that confer control rights on unsecured creditors.[173] But, as practice since the Enterprise Act bears out, the fact that we choose to give unsecured creditors enhanced statutory control rights does not guarantee that they will use them.

Lenders quickly adapted to the new law using their remaining formal control rights over the selection and appointment of the administrator to reassert their economic power in new ways.[174] Administration became the procedure of choice, even in cases where lenders could still have appointed receivers under "grandfathered" security, accelerating a trend that had already begun before the Act became effective.[175] The most plausible explanation for this is that lenders have chosen to distance themselves from the adverse public perception of receivership as a mechanism through which banks close down good businesses.[176]

For similar public relations reasons, it is comparatively rare for lenders to exercise their statutory power to appoint an administrator.[177] Lenders prefer instead to "invite" their customers to appoint an administrator that they (the lenders) nominate from a preselected "panel" of their preferred appointees.[178] The large-and medium-sized accountancy firms, whose insolvency practitioners had been the "go to guys" for receivership appointments, populate these bank panels.[179]

The degree of control that lenders have over the market for administration appointments, and the way in which they exercise that control to allocate work among the charmed circle of insolvency practitioners on their panels, has attracted regulatory scrutiny arising from antitrust concerns.[180] So, while the Enterprise Act may have disrupted the *formal* control rights of secured creditors, the processes and networks that the main lenders had previously used to originate receivership appointments in

172. *Id.* sched. B1, ¶ 3(2). In cases where the administrator is simply realizing collateral to make a distribution to secured or preferential creditors under § 3(1)(c), the duty to act in the interests of creditors as a whole is relaxed and substituted by a duty not to cause unnecessary harm to the interests of creditors as a whole. *See id.* at sched. B1, ¶ 3(4)(b). An administrator will only consider pursuing this alternative where he concludes that the secured creditor is hopelessly under-secured and there is no prospect of a return to unsecured creditors.

173. *Id.* at sched. B1, ¶¶ 51–53 (requirement for unsecured creditor approval of the administrator's proposals unless the administrator concludes that unsecured creditors will be out of the money); *id.* at sched. B1, ¶¶ 74–75 (statutory rights to challenge the administrator's conduct while in office and hold him to account that are directly enforceable by unsecured creditors).

174. THE INSOLVENCY SERVICE, *supra* note 104, at 14.

175. *Id.* at 16–23, 126–30.

176. *Id.* at 129.

177. *Id.* at 129.

178. OFFICE OF FAIR TRADING, *supra* note 167, at 30–35.

179. *Id.* at 32–35.

180. The Office of Fair Trading's market study was a product of these concerns. The OFT's principal findings were that the market for administration appointments operates reasonably competitively notwithstanding the existence of bank panels, but that unsecured creditors suffer harm in cases where the primary lender is fully or over-secured because unsecured creditors are far less effective than the lender at controlling the level of costs and fees incurred by insolvency practitioners. *See id.* at 3–9.

cases of any size[181] have been substantially replicated within the current legal framework.

Meanwhile, the preponderance of the available evidence suggests that the stronger formal rights conferred on unsecured creditors by the Enterprise Act have proved to be *functionally* weak.[182] Indeed, if anything, the evidence indicates that secured creditor control serves unsecured creditors passably well in cases where lenders are under-secured.[183] Insolvency practitioners on bank panels have good legal, commercial, and reputational incentives to pursue strategies that will maximize value, and lenders appear to do a good job of controlling costs by leveraging their relationships with "panel" practitioners to negotiate discounted fees in return for the prospect of future work.[184]

The impression is different where the bank is fully or oversecured. In these cases, the evidence suggests that once the primary lender is out of the picture, costs increase, and returns to creditors correspondingly diminish.[185] The standard explanation for this is that unsecured creditors are for the most part "one shot" players who are weakly coordinated and rationally apathetic.[186] In other words, they suffer from collective action problems, and, accordingly, do not exploit the (quasi-private) formal control mechanisms available to them in the legislation.[187] It appears that, as a consequence, insolvency practitioners can charge their standard rates in the "fully/over-secured" cases without any effective market or legal control.[188] Banks benefit from fee discounts. Unsecured creditors who are in the money do not.[189]

In practice then, the Enterprise Act reforms have done little to disrupt secured creditors' functional control of distressed firms.[190] Having metabargained for continuing control rights over the appointment of administrators, the main lenders have seamlessly adapted their existing processes and professional networks to the new legal regime: a case of

181. *Id.* at 32 (suggesting that banks generally use panels to select insolvency practitioners in cases where their exposure exceeds £200,000).

182. *Id.* at 43.

183. *Id.* at 41.

184. *Id.* at 37–41.

185. *See* John Armour, Audrey Hsu, & Adrian Walters, *The Costs and Benefits of Secured Creditor Control in Bankruptcy: Evidence from the U.K.*, 8 REV. L. & ECON. 101, 108–11 (2012) (reporting on an empirical study the findings of which were subsequently validated in further work by the OFFICE OF FAIR TRADING, *supra* note 167, at 41–66). The basis on which practitioners charge fees is a matter for creditor rather than court approval in the first instance, although there are formal mechanisms in the Insolvency Act 1986 through which court scrutiny can be triggered. *See A Creditors' Guide to Administrators' Fees*, INST. CHARTERED ACCTS ENG. & WALES, http://www.icaew.com/~/media/Files/Technical/Insolvency/creditors-guides/creditors-guide-to-administrators-fees-england-and-wales-apr-10.pdf (last visited Oct. 28, 2014).

186. *See* Armour, Hsu, & Walters, *supra* note 185, at 111.

187. *Id.*

188. *See id.*; *see also* OFFICE OF FAIR TRADING, *supra* note 167, at 41–66 (validating findings of journal article with further empirical evidence).

189. *See* Armour, Hsu & Walters, *supra* note 185, at 111.

190. *Id.* at 132.

"old wine in new bottles."[191] The main change in the landscape has been the rise of asset-based finance alongside more traditional forms of bank lending, with the result that there are now more varieties of secured finance and greater fragmentation.[192] This change in financing patterns raises the potential for costly conflicts for control among secured creditors that are unlikely to do much good for the constituents whose interests the Enterprise Act reforms were designed to promote. In the meantime, in the light of the evidence that unsecured creditors' formal control rights are functionally weak, the attention of policymakers has turned to the regulation of insolvency practitioners and their fees.[193] The search is on for a workable proxy that could represent the interests of unsecured creditors and coordinate the exercise of their existing control rights more effectively.[194]

E. Prepacks

The persistence of lenders' functional control over distressed firms in the post-Enterprise Act era, coupled with the facility that administration provides for swift going-concern business sales, has accelerated other changes in market practice.[195] One such change—the rise in the use of prepackaged administrations or "prepacks" as they are more commonly known—has provoked fierce debate.[196]

"Prepacks" provide lenders with a quick and controlled exit. The sale of the distressed firm is negotiated in advance and then completed

---

191. *See* Sandra Frisby, *The Effect of the Enterprise Act 2002: Empirical Research into Corporate Insolvency*, *in* CURRENT ISSUES, *supra* note 104, at 59.

192. FRISBY, *supra* note 145, 9–10, 33–35; OFFICE OF FAIR TRADING, *supra* note 167, at 40–41.

193. OFFICE OF FAIR TRADING, *supra* note 178, at 37–39. *See generally* ELAINE KEMPSON, REVIEW OF INSOLVENCY PRACTITIONER FEES: REPORT TO THE INSOLVENCY SERVICE (2013), *available at* http://www.bristol.ac.uk/media-library/sites/geography/migrated/documents/pfrc1316.pdf; THE INSOLVENCY SERVICE, STRENGTHENING THE REGULATORY REGIME AND FEE STRUCTURE FOR INSOLVENCY PRACTITIONERS (2014), *available at* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/280880/Strengthening_the_regulatory_regime_and_fee_structure_for_insolvency_practitioners.pdf.

194. The government would like Crown creditors to be more proactive on behalf of their fellow unsecured creditors. THE INSOLVENCY SERVICE, *supra* note 193, at 25. There is a puzzle over why Crown creditors, as repeat players, have not been more effective in exercising unsecured creditors' control rights to this point. It appears that, of late, some of this has to do with budgetary constraints. *See* KEMPSON, *supra* note 193, at 45. Another partial explanation might be that Crown creditors expend most of their available resources on other upstream collection strategies, including the use of involuntary bankruptcy. *See, e.g.*, Jason Kilborn & Adrian Walters, *Involuntary Bankruptcy as Debt Collection: Multi-Jurisdictional Lessons in Choosing the Right Tool for the Job*, 87 AM. BANKR. L.J. 123, 149–53 (2013).

195. *See, e.g.*, Frisby, *supra* note 191, at 60 (describing how the use of pre-packs has sharply increased after the introduction of the Enterprise Act).

196. *See, e.g.*, Kate Creighton-Selvay, *Pre-Packed Administrations: An Empirical Social Rights Analysis*, 42 INDUS. L.J. 85 (2013); Vanessa Finch, *Corporate Rescue: Who is Interested?*, 2012 J. BUS. L. 190; Vanessa Finch, *Pre-Packaged Administrations: Bargains in the Shadow of Insolvency or Shadowy Bargains?*, 2006 J. BUS. L. 568; Sandra Frisby, *Insolvency Law and Insolvency Practice: Principles and Pragmatism Diverge?*, 64 CURRENT LEGAL PROBS. 349 (2011); Peter Walton, *Pre-Packaged Administrations—Trick or Treat*, 19 INSOLVENCY INTELLIGENCE 113 (2006); Peter Walton, *Pre-Packin' in the UK*, 18 INT'L INSOLVENCY REV. 85 (2009); Bo Xie, *Regulating Pre-Packaged Administration: A Complete Agenda?*, 2011 J. BUS. L. 513.

quickly by the lender's chosen insolvency practitioner within the shelter of the administration procedure.[197] The standard justification for prepacks is that a quick, planned sale, implemented through a short lived formal proceeding, may be essential if value is to be preserved in a "melting ice cube" scenario.[198] Indeed, English bankruptcy law has generously accommodated emergency asset sales for many years on exactly this rationale.[199] The upshot is that the administrator can consummate a prepack sale under his statutory powers without first seeking creditor approval as long as he thinks that the sale will produce a better outcome for creditors than a liquidation.[200] Unsecured creditors, presented with a *fait accompli* may, of course, challenge the administrator's conduct as a breach of duty *ex post*.[201] But, as we have seen, unsecured creditors are not known for exercising the statutory rights at their disposal.

The litany of criticisms leveled at prepacks echo earlier criticisms of receivership. The critics worry that prepacks lack transparency, disenfranchise unsecured creditors, give rise to potential conflicts of interest for lender-nominated insolvency practitioners, are not properly market tested, and therefore lead to sales that undervalue the business.[202] These worries are exacerbated by the fact that the majority of prepacks result in sales to connected parties.[203] The empirical reality is difficult to gauge[204] and proponents argue that prepacks do the best job possible of realizing value in less than propitious circumstances.[205] What is clear is that, notwithstanding the administrator's duty to perform his functions in the collective interests of creditors as a whole, secured creditors are able to use prepacks as a means of dictating the method and timing of asset realization, much in the same way that they previously used receivership. In other words, prepacks are little more than a functional substitute for receivership sales. Not surprisingly, as modern adaptations of old practices

197. OFFICE OF FAIR TRADING, *supra* note 167, at 23.

198. *See generally* David A. Skeel, *Competing Narratives in Corporate Bankruptcy: Debtor in Control vs. No Time to Spare,* 2009 MICH. ST. L. REV. 1187.

199. *See, e.g.*, *In re* T&D Indus. PLC, [1999] 1 W.L.R. 646 at 657 (Eng.); *In re* Transbus Int'l Ltd., [2004] 1 W.L.R. 2654 at 2656 (Eng.); DKLL Solicitors v. Her Majesty's Revenue and Customs, [2007] B.C.C. 908 (Eng.); *In re* Kayley Vending Ltd, [2009] B.C.C. 578 (Eng.); *In re* Hellas Telecomms. (Lux.) II SCA, [2010] B.C.C. 295 (Eng.).

200. *In re* Hellas Telecommunications, [2010] B.C.C. 295 (Eng.).

201. *Id.*

202. SANDRA FRISBY, A PRELIMINARY ANALYSIS OF PRE-PACKAGED ADMINISTRATIONS 8–9 (2007), *available at* http://www.r3.org.uk/media/documents/publications/press/preliminary_analysis_of_pre-packed_administrations.pdf; OFFICE OF FAIR TRADING, *supra* note 178, at 62–63.

203. THE INSOLVENCY SERVICE, REPORT ON THE OPERATION OF STATEMENT OF INSOLVENCY PRACTICE 16 1 JANUARY TO 31 DECEMBER 2011, at 11 (2011) (suggesting that twenty-five perccent of the 2808 companies that went into administration during 2011 used prepacks, and that seventy-nine percent of these prepacks resulted in sales to connected parties).

204. Whether some alternative asset realization strategy, such as a delayed sale, would have produced better returns for unsecured creditors across a run of pre-pack cases raises a problem of counterfactuals.

205. *See* HOUSE OF COMMONS BUS., INNOVATION AND SKILLS COMM., THE INSOLVENCY SERVICE: SIXTH REPORT OF SESSION 2012-13 21–23 (2013), *available at* http://www.publications.parliament.uk/pa/cm201213/cmselect/cmbis/675/675.pdf.

and processes have emerged, familiar concerns that unsecured creditors are being short changed have resurfaced in new guises.[206]

IV. CONCLUDING THOUGHTS

In sum, my Article tells two related stories of lenders adjusting to statutory erosion of their rights. In both cases, the relevant statutory provisions were tempered by concessions to lenders that made them reasonably amenable to adjustment. The United Kingdom has a legal culture that strongly privileges contract and property rights. Accordingly, a statutory carve-out that has only ever applied to the floating charge has proved highly susceptible to transactional innovation. The Enterprise Act left lenders firmly in control of administration appointments, and this has enabled them to reproduce old practices and processes within the interstices of a legal regime that ostensibly weakens their formal control rights.

Whether we can meaningfully generalize from the U.K. experience and extract useful lessons for U.S. bankruptcy law reformers is an open question. But I venture this: It is likely that for reasons of political expediency any reform package will have to be "balanced." And, once lenders have metabargained their way to a "balanced" set of reforms, the U.K. experience indicates, perhaps not surprisingly, that they are able to work around them quickly.

This is not to say that we should give up. For example, if it is true (as seems plausible) that section 363 of the Bankruptcy Code provides secured creditors with a nationwide federal foreclosure mechanism that is vastly superior to state-by-state foreclosure under nonbankruptcy law,[207] perhaps secured creditors could be persuaded to give up just a little of the upside on the argument that the benefits would still exceed the costs. But, we should proceed with our eyes wide open.

The next round of U.K. bankruptcy law reforms will likely be reforms designed to further bolster the regulation of insolvency practitioners.[208] That U.K. policymakers are now concentrating on how to devise more effective mechanisms for curbing professional fees and for enforcing the existing legal duties of administrators, especially in relation to prepacks, appears to be a tacit admission that prior attempts to use bankruptcy law to improve the position of unsecured creditors by dampening the rights of secured creditors were little more than a failed conceit.

---

206. *See supra* note 202 and accompanying text.

207. One implication of Ted Janger's contribution to this symposium. *See* Edward J. Janger, *The Logic and Limits of Liens*, 2015 U. ILL. L. REV.589.

208. HOUSE OF COMMONS BUSINESS, INNOVATION AND SKILLS COMMITTEE, *supra* note 205, at 28–34; THE INSOLVENCY SERVICE, *supra* note 193, at 12; OFFICE OF FAIR TRADING, *supra* note 167, at 91–104.