Corporate rescues - a comparative study of the law and procedure in Australia, Canada and England

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CORPORATE RESCUES - A COMPARATIVE STUDY OF THE LAW AND PROCEDURE IN AUSTRALIA, CANADA AND ENGLAND

BY

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ABSTRACT OF THESIS

Corporate insolvency law reform in the mid 80's in the United Kingdom and the early 90's in Canada and Australia resulted in the introduction of new statutory regimes directed specifically towards facilitating the rescue of financially troubled companies or parts of their businesses. The Administration Order Procedure and Company Voluntary Arrangements in the U.K., Business Proposals in Canada and Company Voluntary Arrangements in Australia joined the ranks of Receivership under a Floating Charge, and the little used Statutory Compositions and Schemes of Arrangement. Thus, today it is usual to attempt to rescue or rehabilitate a company prior to subjecting it to a terminal insolvency regime.

Since the procedures, in particular the new, seek common goals there is a great degree of similarity amongst them. This thesis begins by tracing the history of the law of corporate rescues and how the various aspects of a rescue developed from the mid nineteenth Century to the present day. It identifies several common aspects of a corporate rescue. Every aspect is common to at least two regimes. It then examines, in detail, the manner in which each aspect is dealt with under each procedure. This detailed analysis discloses important differences which, it is submitted, affect the relative success or failure of the procedures. It is examined whether or not each rescue regime addresses every aspect of a rescue efficiently and whether any procedure could benefit from the experiences of the others. In conclusion it is determined whether, in the light of available empirical evidence on the use these rescue procedures in Australia, Canada and England, each regime eventually achieves or has the potential to achieve the objective of a corporate rescue.

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PREFACE

Corporate rescues is an aspect of insolvency law which has attracted much discussion and debate in England, Canada and Australia. Choosing such a "hot topic" has required keeping pace with the fast changing face of the law in these countries. The most recent changes took place in Australia and Canada within the last three years and the reform process continues apace in England.

While I am solely responsible for what is written between the two covers of this thesis, it could not have been accomplished without the assistance and support of many.

I have been fortunate to have had my research supervised by Prof. Ian Fletcher, Professor of Commercial Law and Director of the Centre for Commercial Law Studies, one of the foremost authorities in Insolvency Law in the U.K. I have enjoyed the many discussions we have had and am indebted to him for his guidance and inspiration at every stage. He has always been available to lend a critical ear to problems of an academic nature and a sympathetic one where it has been more personal.

Prof. Ross Cranston, former Professor of Banking Law and Director of the Centre for Commercial Law and now Cassel Professor of Commercial Law at the London School of Economics encouraged me in the first instance to embark on this project. I must thank him for his abiding interest and support throughout my research.

In March 1993, I attended the INSOL conference on corporate rescues held in Melbourne Australia. Mr. Gerry Wise and Mr. Neil Cooper of the Society of Practitioners of Insolvency, arranged for the conference fees to be waived and for this I thank them both. While in Australia, I was introduced by Prof. Fletcher to Mr. Ron Harmer, the architect of the insolvency law reforms in Australia. I am grateful to him for his hospitality and the great interest he has shown in my work, willingly giving me every assistance I sought, often, at short notice. While in Australia, I also made contact with Mr. David Crawford, one of that country's leading insolvency practitioners, who kindly gave of his time to discuss practical issues and continued to provide me with documents and other materials pertaining to this thesis.

Mildred Schofield, Stephanie Burkett, Jacaqueline Wingard, Jean Powell and Lorrain Mulpeter cheerfully assisted me in all my dealings with the college. The library staff at Queen Mary and Westfield College and the Institute of Advanced Legal Studies have always been very helpful.

Today, computers play a major role in the work of a research student. Ramesh Gohil, Director and Len López, Technical Support Manager of Micro Anvika Computers and Kapila

Theminimulla, Director, Turnkey Data Solutions Ltd never failed to provide me with backup computer hardware and software whenever my own equipment failed.

My parents, sisters and my wife's family have all been a constant source of encouragement from across the seas in Sri Lanka.

My wife, Sonali, worked and supported us both for most of our stay in the U.K. She sacrificed and endured much so that this thesis may be completed. To her it is dedicated.

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PASSWORD

"If as RABEL hinted there are any natives with arrows lying in wait for comparatists who venture into the thickets of their law the password is: every student serves the truth."

Zweigert, K., and Kötz, H., *Introduction to Comparative Law*, (2nd ed. Translated by Tony Weir), Clarendon Press, Oxford, 1987. vi.

CHAPTER ONE

CONCEPTS, BACKGROUND AND AIMS

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1.8.2.	*Criticisms of the existing regimes*
1.8.3.	*The new rescue procedures*
1.9.	*DIFFERENT VIEWS ON INSOLVENT COMPANY RESCUES*
1.10.	*SCOPE OF THIS THESIS AND THE METHODOLOGY OF THE STUDY*

INTRODUCTION

Insolvency and Liquidation.

> *"Annual income twenty pounds, annual expenditure nineteen nineteen six, result happiness. Annual income twenty pounds, annual expenditure twenty pounds ought and six, result misery. The blossom is blighted, the leaf is withered, the God of day goes down upon the dreary scene, and - and in short you are for ever floored. As I am!"*
>
> - [Mr.Micawber], Charles Dickens, (1812-1870), *David Copperfield*, 1849-50, Ch.12.

Mr. Wilkins Micawber ranks high among the best known (and best loved?) insolvent persons of all time. As the title suggests, this thesis is concerned with the "rescue" of insolvent companies. It is evident that the rudimentary law governing insolvent companies,[1] in force

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1 This was the *Joint Stock Companies Winding Up Act* 1848, 11 & 12 Vict. c.45. At this point, (continued...)

during the period when Dickens wrote *David Copperfield,* had no application to the fictitious Micawber. Further, since Micawber was not a "trader" he was also not subject to the law of bankruptcy in force at the time.[2] Nevertheless this, now famous, utterance is relevant in the context of this thesis because it concerns the single greatest problem faced by him throughout the tale of *David Copperfield* which is also the single common denominator of all insolvencies: debt.

Although he never appeared to abide by his own utterances, Mr. Micawber's above statement nevertheless accurately captures the inflexibility and harshness of an era where a person's inability to pay his debts, however small, had dire consequences.[3] Whilst Mr. Micawber himself never allowed his indebtedness to affect his spirits for too long,[4] the "misery" so eloquently described by him may be said to stalk the honest individual insolvent even today. "Misery", perhaps in some cases in an attenuated form, and, often, anger, is experienced by the insolvent's creditors as well. Today, an insolvency is also unwelcome from society's point of view since it often has, thereafter, to bear the cost of the insolvent person's reliance on the social security system.[5] Where no such social security system exists, and if destitution is to be avoided, the insolvent person has to depend on the goodwill of his, or her, family and friends.

The "misery" experienced by the persons affected by the insolvency of a company should

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1(...continued)
limited liability was not yet a feature of company law and a shareholder was liable to the full extent of his company's debt. Although other Dickensian characters suffered the consequences of rash speculation in joint stock companies of the era, (*e.g.* Mr.Pecksniff in *Martin Chuzzlewit* (1843-44) who was ruined by the collapse of *The Anglo-Bengalee Disinterested Loan and Life Insurance Company*) there is no evidence that this was Mr. Micawber's particular problem.

2 *Bankruptcy Act*, 1825, 6 Geo c.16 and the *Bankrupt Law Consolidation Act*, 1849, 12 & 13 Vict. c.106. Non traders became subject to the bankruptcy laws only when by the *Bankruptcy Act* 1861 24&25 Vict., c.134 it was provided that the law of bankruptcy would apply to all debtors whether traders or not. By this time however, Mr. Micawber was no longer burdened by debt and was a prominent and successful figure in Australia.

3 Dickens is reputed to have based Mr.Micawber's character on the life and experience of his own father and was thus personally acquainted with the distress experienced by the individual insolvent debtor. See also, on consequences of being insolvent in that era, Fletcher, Prof. Ian F., *The Law of Insolvency,* London, Sweet and Maxwell, 1990, p.7. (Hereafter Fletcher, *The Law of Insolvency,*).

4 Regarding the constant visits by creditors to the Micawbers' home, David Copperfield recalls: "At these times Mr. Micawber would be transported with grief and mortification, even to the length (as I was once made aware by a scream from his wife) of making motions at himself with a razor; but within half an hour afterwards, he would polish up his shoes with extraordinary pains, and go out humming a tune with a greater air of gentility than ever." *David Copperfield,* Ch.XI.

5 See Fletcher Prof. I.F. "Administration Orders under the Insolvency Act" *(1992) 2 Insolv LR* page 110. See also the *Colter Report,* p.49. Practically, however, the effect of a single case would be hardly noticeable.

be no more acute than in the case of an individual. However, the type and number of persons affected by corporate liquidation proceedings, which in the majority of cases invariably follow insolvency, are often multiplied many times over as is the total indebtedness involved.[6] Unlike an individual insolvent, a company, as an artificial legal person, feels nothing. However, its insolvency would affect its shareholders, who would see their investments wiped out before their eyes;[7] employees, who stand to lose their livelihood; unsecured creditors, who are likely to receive a very small dividend, if any, after payment is made to secured creditors, and preferential creditors;[8] dependant and inter-dependant businesses;[9] the local community,within which the company operates;[10] and today, society as a whole.[11] As Gibbs J.A of the British Columbia Court of Appeal pointed out in *Chef Ready Foods Ltd., v. Hongkong Bank of Canada*[12]:

"Almost inevitably liquidation destroyed the shareholders' investment, yielded little by

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6 This may also be the case if the insolvent has been a trader.

7 The shareholders' interest in a company comes to an end when it is insolvent. See *Kinsela and anor. v. Russell Kinsela Pty Ltd. (in liq.)* [1986] 4 NSWLR 722. See also *West Mercia Safetyware v. Dodd.* [1988] BCLC 250. Examples of dramatic losses of shareholder interests are the collapses of Polly Peck International, British and Commonwealth, Colorroll and the Maxwell Group. For a brief account of the events leading up to these collapses and the quantum of the shareholdings affected thereby, see Smith, T., *Accounting for Growth*, Century Business, London, 1992. Large shareholder interests are a feature of public quoted companies rather than of their smaller private counterparts where the number of shares allotted is nominal compared to its actual capitalization. In these companies "the 'participators', while holding shares as an instrument of control, become major creditors in their own company." See *Boyle & Birds' Company Law*,, (2nd ed.) Jordans, p.195. Thus, in the event of insolvency, the shareholders of such private companies *may* be able to recover some of their investment as creditors although not as members.

8 Even secured and preferential creditors may not receive payment in full. As far as secured creditors are concerned, the market or realisable value of the security may have diminished or the total indebtedness may have exceeded the value of the security. If the assets are insufficient to meet even preferential claims, such creditors will have to share in the assets ratably.

9 Such as suppliers and buyers of the product or service provided by the insolvent.

10 Whole communities are often built up around large companies, particularly those which employ large workforces. The community thrives on the survival of the company, not in the parasitic sense but on the wealth created by the company in paying for the goods and services it purchases from within the community and the employees paying to live within the vicinity of the company. The collapse of such companies have been known to destroy whole communities. See also the *Cork Report*, para.204.

11 Society picks up the tab when former employees and other dependant persons fail to secure alternative gainful employment and sign on to the social security system. Instead of being contributors to the system they become its dependants. The company itself is dissolved and ceases to require sustenance like an individual insolvent. For a vivid description of the catastrophic effects of a corporate insolvency see the opening paragraphs of Fletcher, Prof., Ian F., "Administration Orders under the Insolvency Act" *(1992) 2 Insolv LR* page 110.

12 [1991] 2 W.W.R. 136

way of recovery to the creditors, and exacerbated the social evil of devastating levels of unemployment"[13]

Mental anguish, if any, apart, a company's insolvency itself is not a condition to which legal consequences attach until some kind of formal procedure, such as liquidation is initiated.[14] If a company is insolvent, it has little control over when such formal procedure is initiated, apart from postponing the event by incurring debts to pay the creditors that press for payment (*i.e.* robbing Peter to pay Paul) and putting off those that do not. For the purpose of enabling a creditor or other authorised person to initiate a formal procedure, the law has devised two primary tests to determine whether or not a company is insolvent. They are the "cash-flow test",[15] which measures the ability of a company to meet its debts as and when they fall due, and the "balance sheet test",[16] which is a measure of assets against liabilities.[17] It should be noted that the mere fact that a company fails the "cash flow test" does not mean that it would necessarily fail the "balance sheet test" as well. For example, a company may have a strong asset portfolio but nevertheless face a temporary "liquidity crisis". However it may be argued that in such a case the company ought to be able to use its strong asset portfolio as security to obtain a "bridging loan" to prevent or overcome the crisis. The application of these principal tests of insolvency is often difficult since complex issues concerning the valuation of assets, the timing of the tests and the nature of the liabilities often arise.[18] There are also a number of other tests

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13 *ibid.*, at p.142.

14 See Goode, Prof., R.M., *Principles of Corporate Insolvency Law,* London, Sweet and Maxwell/Centre for Commercial Law Studies, 1990, 25.

15 *n.b* Since this thesis is concerned with the laws of England, Canada and Australia, where possible, reference will be made to the statutory provisions in all three jurisdictions. Thus, for the statutory enunciation of this test see s.123(1)(e) and s.8(1)(a), s.268(2)(a) 271(1)(b) IA 1986 [U.K.]; the definition of "insolvent person" (a) and (b) in s.2 BIA [Can.]; s.122(1) *Bankruptcy Act* [Aust.] ss.9, 95A CL [Aust.]. See also *R v. Grantham* [1984] BCLC 270.

16 See ss.123(2), 8(1)(a), 214(2), 240(2), 245(4) IA 1986 [U.K.]; the definition of "insolvent person" at (c) in s.2 BIA [Can.]. The "asset" test does not appear to have been enunciated under CL [Aust.].

17 An interesting aspect of the above quotation from *David Copperfield* which generally passes unnoticed is that it also encompasses the rudiments of a measure of a person's ability or inability, as the case may be, to pay his debts. If the subject of Mr. Micawber's test had no further assets other than his annual income, since his liabilities exceeded his assets, albeit by the smallest margin of 6d., (*i.e.* liabilities exceed assets by 0.03%) he would be unable to pay his debts in full and be, in Mr. Micawber's eyes, most miserable. On this basis, Mr. Micawber's test may be considered a crude exposition of the "balance sheet test".

18 It is not proposed to examine these issues any further here and reference should be made to Goode, *Principles,* p. 31 *et seq*; Milman, D., "Test of Commercial Insolvency Rejected" (1983) *Company Lawyer* 231

of insolvency which have specific statutory purposes.

As far as the creditors are concerned, it is generally unlikely they would have sufficient access to a company's records to determine whether it was insolvent on the basis of its "balance sheet test". The first warning that a creditor is likely to have of a company's insolvency would be failure on the company's part to meet its current obligations. Such a failure would ordinarily be met by each creditor concerned exercising such remedies as the law and contractual provisions permit for the purpose of enforcing payment. So long as no publicity attaches to a company's failure to meet its current obligations and the spectre of asset insolvency does not present itself, it may be that such steps would be taken only by the most impatient of creditors who have no on going trading relationship with the company. Any publicity concerning a company's general failure to meet current obligations would, however, invariably raise serious doubts in the minds of its creditors as to its asset solvency. In the event, the optimum result from a creditor's point of view would be to recover all or as much of its dues out of the company's potentially limited pool of assets before other creditors begin to take similar steps against the company and the pool is sucked dry. Thus, the slightest publicity about a company's insolvency would, almost invariably, be followed by a flurry of individual creditor activity. Professor Goode observes:

> "[I]nsolvency does not *per se* prevent creditors from taking steps to enforce payment: indeed, the strong support given by English Law [and to this may be added the laws of those Commonwealth countries which are based on English Law] to individual initiative means that almost always the race goes to the swiftest."[19]

The initiation of liquidation proceedings in respect of an insolvent company, however, has important consequences for some of these creditor initiatives. The following is a brief description of the procedure and its consequences.[20]

Insolvent liquidation proceedings, which may be either voluntary or compulsory, are called winding up in England[21] and Australia[22] and, in the majority of cases, bankruptcy in

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19 Goode, *"Principles"*, p.25.

20 It is not intended to examine the procedure or the many complex issues that arise in detail and for this purpose reference should be made to the many standard texts on the subject. See generally Fletcher, *"Law of Insolvency"*, (2nd Edition forthcoming); Rajak, H., *Liquidations* CCH Editions, Totty and Jordan, *Insolvency*, (Revised), Longmans.

21 The distinction is between voluntary winding up and winding up by court. See s.73 (1) IA 1986 [U.K.]. In principle a voluntary winding up may be either a members' voluntary winding up, (ss.84-96, 107-116 IA 1986 [U.K.] or a creditors' voluntary winding up, s.97 - 116 IA 1986 [U.K.] however a members' voluntary winding up by definition is a solvent liquidation procedure an inapplicable in the present context. The provisions governing a winding up by Court are ss.117 - 162, IA 1986 [U.K.].

22 The distinction is again between members' and creditors' voluntary winding up under Part 5.5 CL (continued...)

Canada.[23] The defining characteristic of these proceedings is that they are designed to replace the frantic dismantling of an insolvent company's assets with an orderly procedure under which the company's available assets may be got in by a person specially appointed for that purpose and distributed ratably among the creditors. This principle of ratable distribution has great antiquity and may be traced to the first English Bankruptcy Act enacted in 1542.[24]

For the purpose of ensuring the ratable distribution of assets the initiation of liquidation proceedings calls a halt to some of the creditor initiatives described above. No attachment, sequestration, distress or execution can be levied against the company after winding up or bankruptcy proceedings have commenced.[25] In England, a creditor is able to retain the benefit of an execution only if it is completed prior to the winding up being commenced.[26] Similarly, all actions taken against the company are stayed permanently, unless the court orders that they be continued.[27] Thus, curial remedies initiated immediately preceding the commencement of winding up proceedings are rendered otiose.[28] All purely personal rights a creditor may have against the company, including the aforementioned right to seek curial remedy, are replaced by a right to prove a claim before the liquidator in the winding up or the trustee in bankruptcy.[29]

If this creates the impression that there is something for every creditor in a winding up,

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22(...continued)
[Aust.] and compulsory winding up which is by court under Part 5.4, 5.4A and 5.4B CL [Aust.]. Again a members' voluntary winding up can take place only if the company is solvent.

23 It is possible to wind up a company under the Federal Winding Up Act, (R.S.C., 1985, c. W-11) however, such proceedings are not commonly encountered in practice. This is due to the fact that the commencement of any bankruptcy proceedings under BIA [Can.] abates proceedings under the Winding Up Act (see s. 231 BIA [Can.]) and also due to the fact that the procedure under the Winding Up Act is considered cumbersome. It is nevertheless used to wind up banks, and insurance and trust companies to which BIA [Can.] does not apply. See s.2 BIA [Can.] and Leonard, Bruce E., *Guide to Commercial Insolvency in Canada*, Butterworths, Toronto, 1988, p.21-1.

24 See s.1., Stat. 34 & 35 Hen.8, c.4. Today it is enshrined in England in s.107 IA 1986 [U.K.] (voluntary winding up) and r.4.181 IR 1986 [U.K.] (compulsory winding up); in Australia in s.555 CL [Aust.]; in Canada in s.141 BIA [Can.].

25 s.128 IA 1986 [U.K.]; ss.69.3 & 70(1) BIA [Can.]; s.468(4) CL [Aust.].

26 ss.183 and 184 IA 1986 [U.K.].

27 See s.130(2) IA 1986 [U.K.] (which applies in the event of a winding up by court), ss.69.3 read with 69.4 BIA [Can.], s.471B CL [Aust.]

28 One of the objectives of winding up proceedings is to eradicate the need for creditors to scramble individually to exercise purely personal rights by converting such rights into a right to prove for a dividend in the liquidation. See Goode, *"Principles"*, p.20.

29 rr.4.73-4.99 IR 1986 [U.K.]; s.121 BIA [Can.]; s.553(1) CL [Aust.].

it is misleading, for although this may be the professed objective of the law, in reality the position is very different. Creditors having rights in *rem*, as opposed to rights in *personam*, are not affected by the freeze that occurs on the initiation of liquidation proceedings. Such creditors are accorded a privileged position purely because they have either bargained for it, prior to the initiation of liquidation proceedings, or the law grants it. Therefore, such creditors and others may continue to exercise their rights in *rem* against the company notwithstanding the commencement of insolvent liquidation proceedings. In a similar position are persons who have supplied goods to the company under a contract providing for the retention of title to the goods until payment in full and persons whose property is held by the company on trust. Likewise persons who are parties to an executory contract with the company, but have acquired a proprietary right in property as opposed to a personal right, will be able to obtain specific performance of that contract.

The erosion of the assets available for a rateable distribution does not cease at this point. The law allows a creditor to set off certain sums which it may owe the company against the company's own indebtedness to the creditor. Set off in this manner is possible only where there have been mutual dealings between the parties.[30] Indeed in England there is dicta of the highest authority to the effect that insolvency set off is mandatory.[31] Further, the law requires that the liquidator make full payment of certain payments, known as preferential payments, prior to making a distribution to the unsecured creditors.[32] Thus certain creditors, who would otherwise be categorised with unsecured creditors, thanks to a statutory privilege, may, if the assets prove sufficient, receive payment in full ahead of other unsecured creditors.

It is evident, therefore, that although the "misery" experienced in the event of an insolvency extends beyond the creditors to others, only the creditors have a right to have their

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30 *i.e.* "Mutual credits, mutual debts and other mutual dealings". See r.4.90 IR 1986 [U.K.] and s.553c CL [Aust.]. See also *Gye v.McIntyre* (1991) 98 ALR 393 at 398-399. Canada does not have a system of insolvency set off. See Wood, Philip R., *English and International Set Off,* (1989). Nevertheless BIA [Can.] provides for legal and equitable set off to apply in the event of a bankruptcy.

31 *National Westminster Bank v. Halesowen Presswork and Assemblies ltd.* [1972] A.C. 785. [H.L.] Lord Cross dissenting.

32 In England there is a distinction between liquidation expenses and preferential payments. The former are covered by s.115 (voluntary winding up) and r.4.218 IR 1986 [U.K.] (winding up by court). Ss.175 and 386 read with Schedule 6 IA 1986 [U.K.] deal with preferential debts. In Canada and Australia s.136 BIA [Can.] and s.556 CL [Aust.] set out a list of persons to be paid in priority to the unsecured creditors. Payment is made in the order in which the claims are ranked on the list. Thus unlike in England preferred creditors do not rank pari passu amongst themselves.

"misery" at least alleviated, if not eradicated, out of the company's assets. The main purpose of insolvent liquidation proceedings is to provide a framework within which the unsecured assets belonging to the company may be realised and distributed ratably among the unsecured creditors who have proved a claim before the liquidator. Despite the exclusive access to the unsecured assets of the company, the dividend eventually received by each unsecured creditor is, nevertheless, only a small fraction of its entire claim.[33]

In addition to providing a framework for distribution amongst creditors, however, the liquidation of a company generally provides the liquidator or trustee with an opportunity to investigate the company's directors' conduct in managing the business[34] and to review transactions entered into by the company in a defined period preceding its insolvency.[35] Depending on the findings the transactions may be set aside and director may be required to make a contribution towards the company's assets. Whether such action by the liquidator would result in greatly improving the lot of unsecured creditors is questionable since there is considerable controversy whether the holder of a floating charge is entitled to claim any payment recovered by the liquidator by the exercise of such powers.[36]

Whatever investigations are carried out once the distribution, if any, is made and the company has no further assets, it is dissolved,[37]

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33 If the company is solvent, a distribution is made to every creditor who files a claim and, and the surplus which remains is distributed amongst the shareholders in accordance with the memorandum.

34 Indeed this has been one of the professed objectives of English corporate insolvency law since the first *Joint Stock Companies Winding Up Act* 1844, 7&8 Vict. c.111. It was stated in the preamble of this statute that it "may also be for the Benefit of the Public to make better Provision for Discovery of Abuses that may have attended the [*] Management of the Affairs of any such Companies or Bodies, and for ascertaining the Causes of their Failure".

35 Namely, transactions at an undervalue, preferences, extortionate credit transactions, floating charges for past value etc. See ss.238-245 IA 1986 [U.K.]. In Australia, unfair preferences, uncommercial transactions, unfair loans to the company and certain floating charge may be avoided. See ss.588FA-588FJ, CL [Aust.] In Canada they are known as settlements, general assignments of book debts, fraudulent preferences, and reviewable transactions. See ss.91-95,100 BIA [Can.]

36 See *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569, *Re Anglo-Austrian Printing and Publishing Union* [1895] 2 Ch.891. *cf. Re Yagerphone Ltd.* [1935] Ch 392. See also Prentice, D.D., "Creditors' Interests and Directors' Duties" (1990) 10 *OJLS* 265; Oditah, F., "Wrongful Trading" (1990) *LMCLQ* 205; Hicks, "Advising on Wrongful Trading" (1993) 14 *Company Lawyer* 16 & 55.

37 As will be seen variations may take place within a winding up i.e. a scheme of arrangement between the company and its creditors and members. In a scheme the company or its business (continued...)

Corporate liquidation procedures contain little which help to alleviate the "misery" which is experienced at varying degrees by persons affected by the company's insolvency. At most, the unsecured creditors have the satisfaction of knowing that there is no need to compete with other unsecured creditors to rush to initiate costly legal proceedings for the purpose of making a recovery which is fraught with uncertainty and that, once the liquidation proceeding have been brought to a close, each creditor of a particular class would have received only a ratable share out of the available assets and not obtained any advantage over others of that class. Creditors may also derive some satisfaction if the directors of the insolvent company have been made to make a contribution to the company's assets or if transactions, which have conferred on their beneficiaries an unfair advantage, have been set aside. From society's and the business community's standpoint, liquidation proceedings would be beneficial if they served as a springboard for disqualification proceedings against directors of a company who have been guilty of misconduct. However these are largely in the nature of "consolation prizes" and not any real compensation for the "misery" which is suffered.

Insolvency and Rescue.

> *"If Mr. Micawber's creditors will not give him time, [*] they must take the consequences; and the sooner they bring it to an issue the better. Blood cannot be obtained from a stone, neither can anything on account be obtained at present (not to mention law expenses) from Mr. Micawber."-*
>
> [Mrs. Micawber] *David Copperfield, supra* Ch.11.[38]

Clearly in Mrs.Micawber's opinion, "time" was all that Mr.Micawber required to overcome his difficulties and it was the creditors, not Mr. Micawber, who stood to loose if they did not grant it to him. Given "time", Mr.Micawber's expectation of "something coming up" may have been realised and his family, and even his creditors, saved from the "misery" of insolvency. But, except for vain expectations, Mr.Micawber had no source of income nor any assets which he could put before his creditors to justify them giving him the time he so desperately desired. As Aristotle observed over two millennia ago, "Creditors have no real

37(...continued)
must survive. If the company is to survive then the winding up order must be discharged. If only the business of the company is to survive then the liquidator must carry out his functions to the end and the company must be dissolved.

38 To be fair by Mr.Micawber's creditors, fictitious though they may be, it must be noted that there is anecdotal evidence of a prior Deed of Composition having been entered into. Mr.Micawber appears to have been in breach of both this Deed and other subsequent financial obligations, when these words were spoken.

affection for their debtors, but only a desire that they may be preserved that they may repay."[39] It is not surprising that, shortly after Mrs.Micawber uttered these words, the Micawbers found themselves experiencing the rigours of a Debtors' Prison in London.

Like Mr.Micawber, a company which is insolvent, or on the threshold of insolvency, may, if given time, be able to drag itself out of the quagmire of insolvency and avoid going into an insolvent winding up. But, although an invaluable ingredient in the process of a company getting back on its feet again, extra time alone will not often result in a reversal of an insolvent company's fortunes.

The causes of corporate failure and insolvency are many and varied.[40] Corporate failure is often triggered by inefficient or incompetent management in one or more of the sectors of production,[41] marketing and finance.[42] An external factor such as an unexpected natural disaster[43] or the failure of an important business partner may also be the reason for a company's failure. It may also be due to recessionary conditions in the economy as a whole or a sudden and fundamental shift in governmental policy.[44] While some of these causes are within the company's control, others are without. But, whatever the cause, unless it is identified, acknowledged and steps are taken to remedy the position (if possible), the company will begin to slide down an increasingly slippery slope of insolvency. Whilst the gradient and length of the slope would vary from company to company, invariably at the foot of the slope lies liquidation and dissolution.

The mere fact that remedial action is directed at the cause(s) of failure does not mean that the company's troubles would immediately come to an end. If they do, it would rather be due to the fact that the company's management has had the wisdom, courage and, perhaps, even good

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39 *Nicomachean Ethics*, bk.IX, ch.7.

40 See generally Lingard, J.R. *Corporate Rescues and Insolvencies*, (2nd Ed), Butterworths, London, 1989, Chapter 1. See also causes of company failure identified by The Society of Practitioners of Insolvency in *Company Insolvency in the United Kingdom: The Third SPI Survey*, London, 1994, at p.10.

41 Where the company is engaged in the manufacture of goods.

42 Lingard, *Corporate Rescues and Insolvencies, Ibid.* p.1-2.

43 Such as earthquakes, floods and other risks which require special insurance cover.

44 Not necessarily the government in the country of incorporation. Eg. the Latin American debt crisis. The United Nations may also have such an effect. *e.g.* the United Nations' Sanctions against Iraq which triggered the collapse of the Irish company Goodman International which supplied meat to Iraq. See McCormack, "Rescue of Ailing Companies in Ireland" in Rajak, H., (ed.) *Insolvency Law: Theory and Practice,* London, Sweet and Maxwell, 1993, 267.

fortune to have identified the problems besetting or threatening the company at an early stage and taken the appropriate remedial step which enabled the company to avoid the treacherous slopes altogether. The immediate beneficiary in such circumstances would be the company's shareholders whose investments would be preserved.

In the majority of cases, however, the warning signs of failure and impending insolvency are either ignored, with the Micawberish hope that the company's fortunes will improve, or go unnoticed, until the consequences of failure begin to manifest themselves: delays followed by a failure to meet current liabilities (including employees' wages) and interest on borrowings.[45] Such companies have begun to slide down the slippery slope of insolvency and should, therefore, in addition to addressing the immediate causes of its failure, also address and overcome or enter into a compromise or arrangement regarding the payment of its debts before the company may be said to have halted the treacherous slide to the bottom.

If a company is able to do so, successfully, the result could truly be described as a "corporate rescue". The "blighted blossom" would bloom again, and the "misery" which the shareholders, employees, creditors, the community, and society as a whole, would have experienced in the event of an insolvent liquidation would be wholly averted. It is likely, however, that this ideal will not be achieved by every company that seeks a solution to a debt crisis. For this reason, it bears consideration whether any such company may, either enter into an arrangement with its creditors, or, dispose of its assets in such a manner, that as many of the persons affected by the company's insolvency are placed in a better position than they would have been had the company been placed in liquidation. Since, only the unsecured creditors are entitled to derive any benefit from an insolvent liquidation procedure, the scale against which the better return should be measured appears to be the dividend receivable by the unsecured creditors in a liquidation. It is submitted, however, that where the best efforts do not result in a better return for the unsecured creditors, if it is possible to achieve a better result for some of the other categories affected by the insolvency, then, provided the creditors' position is not adversely affected, that objective should be pursued. Thus, the minimum standard to be maintained would be to ensure that the unsecured creditors do not receive less than they would have in the event of a liquidation. Their interests in the "minimum liquidation return" should always be paramount and never, without their consent, be sacrificed for the sake of others.

It should be borne in mind, however that insolvency is an undesirable state of affairs with

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45 "Insolvency" on the basis of the "cash flow test". See the discussion at p.16 *supra*.

no perfect remedies. Even where this minimum standard of ensuring a "minimum liquidation return" to unsecured creditors is maintained there is no guarantee that a "rescue" will have permanently beneficial results. As Prof. Rajak observes:

> " [A] rescue in which the company is saved only to collapse into financial failure shortly afterwards, or one where the business is sold as a going concern only to be merged with the purchaser's business, resulting in much redundancy and the reduction of competition, is not a successful rescue."[46]

It is not possible to exhaustively describe the various methods whereby a company may address or seek to arrange its insolvent condition and achieve either of these objectives since such methods are limited only by the ingenuity of the company's financial and legal advisors and the need to be pragmatic concerning the requirements of the company's creditors. Nevertheless a few examples of techniques which could be used may be cited. A composition could be entered into, under which the creditors agree to accept a percentage of their claims in full satisfaction. The larger of the company's current debts may be rescheduled and paid off through continued trading or the sale of unsecured assets which are not critical to the running of the company's business. The creditors may be persuaded to agree to a debt equity swap with the new equity holders being given the right to a guaranteed preferential dividend.[47] In both these cases, new funding would have to be obtained to meet short term liabilities, and the providers of such funding (who may even be some of the creditors whose debts were rescheduled) could, ordinarily, be expected to demand security or guarantees of payment ahead of the senior creditors subject to the arrangement. Sometimes it may be possible to find a buyer for the company who is willing to take on the company's assets for the value of its liabilities.[48] Alternatively, the entirety of the company's business or the viable part(s) thereof may be hived off into a special purpose vehicle company and sold for the best possible price as a company with assets but no liabilities,[49] the sale proceeds being utilised to meet some or all the liabilities remaining to the name of its former shell. In this manner some or all the creditors may be paid in full or in part, all or some of the workforce may keep their jobs, thus avoiding further pressure on the dole queues, and even the company's shareholders may have cause to smile.

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46 Rajak, H., "The Challenges of Commercial Reorganizations in Insolvency: Empirical Evidence from England" in Ziegel, J., (Ed) *Current Developments in International and Comparative Corporate Insolvency Law*, Clarendon Press, Oxford, 1994, 192 at p.213.

47 *e.g.* The rescue of the Caledonian, London Chatham and Dover and Grand Trunk Railway Companies. See 1.2.4 *infra*.

48 *e.g.* The sale of Barings Bank after its much publicised collapse to ING Bank in the Netherlands.

49 *e.g.* See *Airline Airspares v. Handley Page* [1970] Ch. 193.

The identification and adoption of the most appropriate method of dealing with a company's business and property *vis à vis* the repayment of its debts, however, is not a matter that may be accomplished overnight. The Company's affairs would have to be examined, usually by expert accountants. If the company is to continue to trade a source of financing would have to be arranged. Complex and lengthy negotiations may be necessary to work out any arrangement with the creditors or buyers, all of which demand "time".[50] If any of these tasks are to be carried out before the initiation of liquidation proceedings, it would also be necessary to hold the creditors at bay, preventing them from dismembering the company's asset portfolio. This would include both secured and unsecured creditors.

The question that arises is whether the law does, or, if not, should, play a part in ensuring that insolvent liquidation is avoided or set aside either temporarily or permanently to enable or ensure the pursuit of any of the goals described above? If the answer is yes, should it prescribe the precise manner in which a pre-determined goal may be achieved or merely provide a "rescue" procedure which enables the achievement of the most appropriate objective? If it is a "rescue" procedure that should be provided, are there any minimum characteristics which it must mandatorily contain? For example, should its initiation call a halt to the exercise of each creditor's rights in *personam* and in *rem*? Alternatively, would it be possible to achieve a "rescue" through the medium of an insolvent liquidation proceeding?

Although the word "rescues" would appear to be most appropriate in the circumstances where a complete turn around of an insolvent company is achieved, in the ensuing discussion and indeed the rest of this thesis, it includes the achievement of any of the lesser objectives short of a full turn around which have been described above. Thus the terms "rescue procedure" and "rescue regime" mean a procedure which enables the achievement of any of these goals. Such terminology is consonant with the terminology used by academics and practitioners in Britain and Australia, two jurisdictions whose laws are examined during the course of this thesis. In Canada, however, it should be noted that the preferred word for "rescue" is "re-organizations".

Before proceeding to examine the policy and laws governing modern company rescues, however, it would be pertinent to step back into the mists of time and examine how the law of corporate rescues has evolved to the present day.

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50 In exceptional cases, if the company's business is readily saleable or it owns assets of high value, a buyer might be practically waiting to walk in and pick up a prize bargain. But even in such circumstances it will, nevertheless be necessary to negotiate and draft the terms of the sale of the business or property.

THE EMERGENCE OF CORPORATE RESCUE LEGISLATION

Recognition of the company as a legal entity

The limited liability registered company, be it small or large, private or public, is, arguably, the most efficient vehicle of commercial enterprise in use today. Although taken for granted by today's entrepreneur who is able to 'buy a company off the shelf', corporate legal status prior to the end of the first quarter of the 19th century could only be obtained via a Royal Charter or an Act of Parliament. Partnerships had long been acknowledged at Common Law but inherent limitations, such as those imposed by settled rules pertaining to joint and several liability, and parties to actions and suits, made them unsuited to be the driving force behind the rapid expansion of commercial enterprise. Attempts in the early 18th century to float unincorporated joint-stock companies "i.e partnerships with a joint stock divided into numerous transferable shares"[51] were frowned upon by Parliament which attempted to eradicate them altogether, with the passage of the notorious "Bubble Act" which provided that "the acting or presuming to act as a corporate body or bodies, the raising or pretending to raise transferable stock or stocks, the transfer or pretending to transfer or assign any share or shares in such stock or stocks without legal authority, either by Act of Parliament, or by any charter from the crown [*] shall be deemed to be illegal and void".[52] The unincorporated joint-stock company was seen as a vehicle for fraud which could do more damage than good. The common law too took a dim view of unincorporated companies. Lord Eldon in *Kinder v Taylor*[53] expressed the view that, acting as a body corporate while not being one was an offence at common law, independent of the statute. However, despite the attempts of Parliament, unincorporated joint-stock companies grew in number and in importance,[54] compelling the repeal of the Bubble Act in 1825.[55]

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51 Lindley, N., *A Treatise on the Law of Partnership including its application to Joint-Stock and other Companies,* London, William Maxwell, 1860, p.1164.

52 "The Bubble Act", 1720, 6 Geo.I.c.18. ss.18 & 19 prohibited joint-stock companies with transferable shares.

53 (1825), 3 L.J.Ch.68. See also *McIntyre v Connell,* 1 Sim. N.S. 233.

54 The Earl of Lauderdale addressing the House of Lords observed that a "fury" for Joint Stock Companies had "taken possession of the people". "There were at present placed at the command of directors and other managers of Joint Stock Companies, more than 200,000,000/; one fourth of which, he believed was more than the minister had raised by loan at once, during any year of the late war." *Hansard's Parliamentary Debates N.S.* 1825, Vol 1 at 1194.

55 (1825) 6 Geo.IV.c.91. Repealed 6 Geo.I.c.18 Sections 18 & 19. By Section 2 of c.91 the crown was empowered, when granting Charters of Incorporation, to provide that the members of the incorporated body should be individually liable for its debts. Hitherto it had been unable to impose such a liability.

The following quarter of the 19th century witnessed a period of reform in Parliament's attitude towards joint-stock companies.[56] It was a period[57] which culminated in 1844 with the first recognisable modern companies statute, the Joint Stock Companies Act receiving the Royal Assent.[58] Since then the registered company has developed into what it is today - a widely used and efficient vehicle of commercial enterprise. Unfortunately it has in the hands of the unscrupulous, particularly thanks to the cover of limited liability, also proved at times during this period to be an equally efficient vehicle of fraud. As such the law has been forced to keep apace resulting in the Companies Act (until 1862 the Joint-Stock Companies Act) growing from a statute of a mere 80 sections to a complex piece of legislation of over 700 sections.

It is intended in this part to examine the historical background to and development of statutory provisions which enable the rescue of insolvent companies incorporated under the Companies Acts, commencing with the Act of 1844. As has been pointed out, these statutory provisions are referred to as rescue provisions for the sake of convenient identification and not for the purpose of definition.

In tracing the development of the law it will be useful to first examine briefly the rescue procedures that were *available* for use by the predecessors of the early registered joint-stock company. What were the legal principles that underlay such rescue procedures? Were these procedures made use of? If not why? Were they of any use in framing later provisions for use by companies? Did Parliament learn from past mistakes, if any?

Rescue procedures in use prior to the Joint Stock Companies Act of 1844

The classes of *association of persons* formed for the purpose of engaging in commerce and sharing profits prior to the Joint-Stock Companies Act of 1844 were Chartered Companies, Companies established by Act of Parliament, Companies established by Letters Patent, (i.e. *corporations aggregate*) unregistered Joint Stock Companies (which were in effect partnerships

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56 (1834) 4 & 5 Wm.IV.c.94 - Authorised the Crown,by Letters Patent to empower Companies to sue and be sued by their Principle Officers. (1837) 7 Wm.IV. & 1 Vict.c.73 - The Companies Letters Patent Act. Repealed 6 Geo.IV.c.91 s.2 and 4 & 5 Wm.IV.c.94. Empowered the Crown to grant companies the privilege of suing and being sued in the name of an officer of the company, and to limit the liability of the shareholders to creditors.

57 For details see generally: Formoy, R.R., *The Historical Foundations of Modern Company Law*, London, Sweet and Maxwell Ltd, 1923; and Lindley, op.cit.supra.

58 7 & 8 Vict C.110. The preamble to which reads "Whereas it is expedient to make provision for the due registration of Joint Stock Companies during the formation and subsistence thereof; and also [*] to invest such Companies with the Qualities and Incidents of Corporations, with Modifications..."

with a joint stock divided into numerous transferable shares) and ordinary Partnerships. In the event of a member of a class becoming insolvent, and its creditors demanding the immediate repayment of their debts, the law that governed the distribution of its available assets among the creditors, and its subsequent existence, varied according to the law governing the class to which it belonged.

Since 1662 Parliament had excepted the members of companies incorporated periodically by Charter (and Act of Parliament) from the law of Bankruptcy.[59] This exception was introduced to protect "divers noblemen, gentlemen and persons of quality, no ways bred up to trade or merchandise", who did "oftentimes put in great stocks of money into the East India Company, or Guinea Company and the fishing trade, and such other public societies...by which means the trade of those companies is much encouraged, fishing and navigation increased, and the public good of those companies is much advanced"[60] Consequently the dissolution of a corporation could be achieved only by an Act of Parliament, the death of all its members, surrendering its franchises into the hands of the monarch (i.e. a voluntary dissolution) or forfeiting its charter through negligence or abuse of its franchise.[61] Of these methods of dissolution, the most likely to have applied in the event of an insolvency would be the first, mainly because it is the only one under which a distribution of the corporations assets could, if at all, have been achieved.

A similar state of affairs affecting a partnership or an unregistered joint stock company was governed by the law of Bankruptcy. Lindley expressed the view in the first edition of his work on the law of Partnership that "The ordinary bankrupt laws apply to trading partnerships, however numerous their members might be, and therefore also to ordinary unincorporated trading companies with transferable shares...Moreover the bankruptcy of an unincorporated company under the ordinary bankrupt laws necessarily involves the bankruptcy of the individual members

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59 14 Car.II, (1662), c.24

60 *Ibid.* Preamble. The exception was also extended to the members of the Bank of England, [8 & 9 Will.III (1696-7), c.20. s.47], the South Sea Company, [9 Anne (1710) c.15. s.45], The Royal Exchange and London Insurances [6 Geo.I,(1719-20), c.18. s.10] and the London Linen Company [4 Geo.III., c.37, s.13]. For the background to 14 Car.II, c.24 and further details see Cadwallader, F.J.J., *In Pursuit of the Merchant Debtor and Bankrupt: 1066 - 1732,* Thesis submitted for the degree of Doctor of Philosophy in the Faculty of Laws in the University of London, June, 1965.

61 Wordsworth, C.F.F.,*The law relating to Railway, Bank, Insurance, Mining and other Joint Stock Companies,* (2nd ed.), London, Butterworths, 1837, at p.6

of the company".[62] Wordsworth, writing 23 years earlier opines:

> "Every member of an *unincorporated* trading or other Company, no matter of what number of persons it consists, is answerable, to the full extent of his private property, for the whole of the debts of the Company."[63]

Since partnerships *"en commandite"*[64] were not at the time recognised under English Law every partner or shareholder in an unregistered joint stock company would have been considered a trader for bankruptcy purposes. At least in theory, therefore, Partnerships and unregistered joint stock companies, could have, through their partners/shareholders, made use of the provisions permitting arrangements and compositions, if any, available under the law governing bankrupts.

Prior to 1849, the only such provision available under statute was in s.133 of the Bankrupt Act 1825.[65] The introduction of the provisions contained in s.133 was first recommended before the Select Committee of the House of Commons appointed in 1817 to consider the working of the bankrupt laws.[66] Under s.133, after the bankrupt had passed his last examination, it was possible, at a meeting of the creditors, to make an offer of composition.[67] If nine tenths in number and value of the creditors assembled at the meeting agreed to accept the offer, another meeting of the creditors was called for the purpose of deciding on such offer. If nine tenths of the creditors present at the second meeting also agreed to accept the offer, and the acceptance was testified in writing by the creditors, the Lord Chancellor could be called upon to supersede the proceedings in Bankruptcy. It is interesting to note that in a composition under s.133, the sanction of court was not required. The Lord Chancellor had no discretion in suspending the Fiat in Bankruptcy once all the creditors had testified their acceptance.

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62 Lindley, op.cit.supra, at p.102

63 Wordsworth C F F, op.cit.supra. at p.110

64 "A society of this description consists of one or more partners, liable, without limitation, for the debts of the Company, - and one or more partners, or *commanditaires*, liable only to the extent of the funds they have subscribed." See the Preface in Wordsworth *The Law relating to Railway Bank, Insurance, Mining and other Joint Stock Companies*, London, Butterworths, 1836. Reproduced in the 2nd Edition. op cit,supra

65 6 Geo.IV.c.16.s.133. The Insolvent Debtors Act 1844 also provided for the arrangement of the affairs of insolvent individuals who were not traders.

66 *House of Commons Sessional Papers* 1818, Vol VI. See in particular the evidence of G Lavie at p.45 who suggested following the Scotch law where "a majority of creditors agreeing to a composition binds a small minority"

67 For the meaning of "composition" see *infra*.

It is unlikely, however, that large partnerships or unincorporated joint stock companies with a membership which could fluctuate would have made use of the procedure set out in s.133 for the purpose of ensuring its continued existence as an entity. The logistics of entering into a composition with all the creditors of each partner would have been quite phenomenal. Even in 1825, two thousand partners was "no very extraordinary number, if we may trust to the 'prospectuses' of the day."[68] Each partner or shareholder would have to make an offer of composition and the feasibility of such composition would depend on the financial standing of each partner/shareholder. The offer for composition would have had to be put before all the creditors of a partner/shareholder and this may have included creditors who were not creditors of the partnership/company, who may have differed from partner to partner. Since under s.133 it was not possible to enter into a composition only with a class or certain classes of creditors, the success of the composition depended on the common creditors of each partner/shareholder holding a nine-tenth majority in each case. If, for example, the composition offered by one partner/shareholder was not accepted then the prospects of the partnership/company continuing would have depended upon the consenting creditors of the entire partnership being able to buy out the dissentient creditors of that one partner/shareholder. The prospect of a successful composition would have been even more doubtful if the required majorities were not obtained by more than one partner.

Even if each partner successfully managed to obtain the required majorities the composition reached would have been of little practical use to the debtor partnership/joint stock company as the acceptance of the composition and the subsequent *supersedeas* did not discharge the debtor.[69] It is not surprising, therefore, that compositions under s.133 are said to have been largely inoperative due to the imperfect wording of the section.[70] Furthermore, under s.133 a bankrupt could only offer to enter into a *composition* with his creditors.

The word composition is not defined in the Act and as such assistance has to be sought elsewhere. It is defined by Montague, as "an agreement between a creditor and a debtor, that

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68 George, John, *A View of the Existing Law affecting Unincorporated Joint Stock Companies*, London, S Sweet, 1825, p.19.

69 Gregg, F., *Suggestions for some Alteration of the Present State of the Bankrupt Law*, London, Saunders and Benning, 1831, at p.33.

70 Views of the Incorporated Law Society on Arrangements between Debtors and Creditors in the Bankrupt Law Consolidation Bill adopted by the Society in May 1849, and presented to the Royal Commission on Bankruptcy. See *House of Commons, Sessional Papers*, 1854, Vol 23, p.86.

the creditor shall accept part of his debt in satisfaction of the whole debt."[71] The question arises whether in such an event a partnership or unincorporated joint stock company, whose partners/shareholders were all assured the requisite majority, could have entered into any other type of arrangement which was not *strictu sensu* a composition under section 133? A composition may have satisfied a creditor looking to get what he could out of the pool of assets, and although it may have avoided making a person bankrupt, it would not have left the debtor with very much to continue with his trade. Contemporary legal writings show however, that creditors of that era do not appear to have limited themselves to compositions under the statute, but entered into other private arrangements outside the statute which, as will be seen, sometimes enabled the debtor to continue in his trade.[72]

Forsyth observed in 1841:

> "When a man's affairs become embarrassed, so that he is unable to meet the demands of his creditors, in order to avoid the manifold inconveniences of bankruptcy, if he be a trader within the operation of the bankrupt laws, it is common practice for him to enter into certain terms with his creditors, whereby they agree either to take a certain dividend upon the amount of their respective debts in satisfaction of the whole, *or to give their debtor indulgence in point of time for the payment of their demands, consenting to receive the same by instalments, or otherwise, according to the nature of the agreement.*
> The term composition in strictness only applies to cases where the creditors agree to take *less* than the whole amount of their respective debts; but this treatise is intended to embrace *all voluntary arrangements between* a debtor and his creditors, whereby those who are parties to them agree to forego their legal rights, and the estate of the debtor is dealt with according to the terms of such agreement, and not according to the ordinary operation of the law." [italics added][73]

Except for Montague's work[74] no other legal treatise on compositions or any other type of arrangement appears to have been written in the 1820 and 1830s.[75]

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71 Montague, Basil, *A Digest of the Bankrupt Laws*, (2nd ed.) London, Joseph Butterworth & Son, 1819, at p.217; *A summary of the law of Composition with Creditors*, London, Joseph Butterworth & Son, 1823, at p.1 (unfortunately he does not cite any authority for this definition); Holdsworth, *A History of English Law*, 1937, London, at p.1

72 "[B]ut compositions and other modes of arrangement have very much increased. The increase of commissions of bankruptcy being in my opinion solely of petty traders" G.Lavie in his evidence before the *Commons Select Committee on Bankruptcy* 1818. *op.cit.supra* at 45. See also: Montague, *op.cit.supra*,

73 Forsyth, William, *A Treatise on the Law relating to Composition with Creditors*, London, Saunders and Benning, 1841, p.1.

74 *op.cit., supra.*

75 Forsyth states in the preface to the first edition "The only professed work on this subject, of which I am aware, is one entitled, "A Summary of the Law of Composition with Creditors," by Mr Basil Montagu, published in 1823."

The arrangements described by Forsyth were entered into by way of either an Assignment, a Deed of Inspectorship or a Letter of Licence. In the first category, which appears to have been in use even before the Bankruptcy Act 1825,[76] the debtor assigned all his property to one or more of his creditors as trustees for all the other creditors. Thus the debtor ceased to be in control of his property. The trustees sold the property and paid the creditors a pro rata share of the proceeds. It must be noted that if the assignment was executed by deed then it was until the expiration of a period of six months after execution a potential act of bankruptcy.[77]

In a Deed of Inspectorship (which may have evolved to circumvent the effect of section 4 above) the debtor was allowed to manage his property for a specified period under the inspection of persons appointed by the creditors. It was the inspectors' duty to see that the debtor's property was sold off in a manner that was most beneficial to the creditors. If the creditors wished for greater security, an assignment of the debtor's property was also made.[78] In such an event it is likely that the inspectors were also the trustees. In both these categories a release was usually given to the insolvent debtor which was either absolute or conditional. The objective of the creditors appears to have been to recover their dues by disposing of the debtor's property at the best possible price. The only difference between the two categories is that in the latter case the debtor has a semblance of control over his property. The creditors assumed the role of the Assignee in Bankruptcy, and achieved the same result without in fact running the risk of the debtor being made a bankrupt. It is unlikely, however, that the debtor was left with very much after all the creditors had been paid so as to enable him to continue with his trade. The advantage to the debtor may have been that the stigma of bankruptcy, which was greater at the time than now, was avoided.

It is the Letter of Licence that comes closest to the concept of rescuing the insolvent debtor. In this category of arrangement the creditors agreed to temporarily suspend their rights

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76 6 Geo IV c.16. s.4

77 Sec.4.ibid. Provided that the conveyance or assignment by deed to a trustee or trustees of all a trader's property for the benefit of all his creditors was not an act of bankruptcy unless a commission was issued against the trader within 6 months of the execution. It is interesting to note that in the 1818 Bill to alter and amend the Laws relating to Bankrupts (as amended by the committee) it was intended to make any delivery over or assignment, done in a manner as would have constituted an act of bankruptcy in case the same delivery or assignment had been made by or in pursuance of a deed, also an act of bankruptcy. *House of Commons Sessional Papers* 1818 Vol II, p.194

78 Forsyth, William, *A Treatise on the Law relating to Composition with Creditors*, (3rd ed.) London, William G Benning & Co., 1854, at p.2 & 3

and bound themselves not to sue or molest the debtor for a specified period, during which the debtor was permitted carry on his own business or trade at his own discretion.[79] Today such a suspension would be described as a moratorium. Clearly the creditors were to be paid off not from the sale of all the debtors assets but from the profits of his business.

A perusal of the contemporary treatise on the law of bankruptcy[80] and companies[81] does not reveal whether unincorporated joint stock companies and partnerships made use of such letters of licence or other modes of arrangements when faced with financial crisis. A clue to such companies position may be found in the report of the Royal Commission appointed to enquire into the operation of the Bankrupt Law Consolidation Act 1849.[82] The Commission reported that for a long period it had been felt as "a great grievance that a single creditor, contrary to the wishes of all the other creditors, could drive the affairs of a trader into an administration by Bankruptcy, when the other creditors as a body might prefer another mode of administration." By 1847 compositions and liquidations under inspectorship were found to be so advantageous in commercial failures, that even before clauses enabling them were enacted, "they were constantly entered into and preferred to Bankruptcy, though the machinery for working them was necessarily imperfect."[83] The logistical difficulties attendant in compositions under s.133, described above, would have applied equally to all arrangements outside the statute. But in these arrangements it may have been possible for the partnership/company to enter into the arrangement with a class of creditor.

Application of prevailing Bankrupt Laws to post 1844 companies

As much as there was a need to provide for the registration of joint stock companies, a parallel development in the law of bankruptcy was required to deal with the situation where the

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79 Forsyth, (3rd Ed) *op.cit.supra,* at p.3

80 Archbold, Montague, De Gex, etc.

81 Wordsworth, Lindley, etc.

82 Report of the Royal Commission appointed to enquire into the fees funds and establishment of the Court of Bankruptcy, and the operation of the Bankrupt Law Consolidation Act 1849, *Parliamentary Papers,* 1854, Vol XXIII

83 Report of the Royal Commission at p.xxi. The Law Society in a paper presented to the commission states that "out of one hundred and twenty commercial houses, large and small who suspended during or in consequence of the crisis of 1847, only nine went into the "Gazette". Of these nine, it is well known that the two largest were driven into the "Gazette" contrary to the general wishes of very large majorities of creditors, because the partners very properly refused to allow creditors forming a most inconsiderable minority (who had brought actions) to obtain thereby a preference over other creditors". See the Minutes of Evidence given before the Royal Commission at p.86

new species of registered joint stock companies became unable to meet their pecuniary engagements. To meet this need the Joint Stock Companies Winding Up 1844[84] was passed as a corollary to the Joint Stock Companies Act 1844.

The stated objectives of the Act were: to extend the remedies of creditors against the property of Joint Stock companies when unable to meet their pecuniary engagements and to facilitate the winding up of their concerns; to make better provision for the discovery of abuses that may have attended the formation or management of the affairs of such companies or bodies and to ascertain the causes of such failure.[85] To achieve these objectives, the statute defined a number of new acts of bankruptcy designed specifically to deal with financially embarrassed joint stock companies and provided that the commission of any such act was sufficient ground for the issue of a Fiat in Bankruptcy against the company. The Act applied to commercial and trading companies that had been incorporated by charter or Act of Parliament, established under the Letters Patent Act[86], registered under the Joint Stock Companies Act, 1844,[87] or had existed on 5 September 1844 and came within the definition of a Joint Stock Company contained in the Act of 1844.

There were two other very important features of this statute, both of which may be considered as heralding future developments in the law. First, there was the provision that the bankruptcy of a company was not to be construed as the bankruptcy of any member of the company.[88] This may be regarded as the first tentative step made towards limiting the liability of shareholders.[89] Secondly, provision was made that a company that had been adjudicated bankrupt could be wound up in Chancery for the purpose of compelling members of the company to raise by way of contribution whatever sums that were necessary for the full payment of all

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84 7 & 8 Vict c.111

85 See the preamble to 7 & 8 Vict c.111.

86 1837 7 William IV. and 1 Vict. c.73

87 7 & 8 Vict c.110.

88 *ibid.* s.2.

89 It must be noted that under s.10 a Fiat or proof of proceeding thereon did not affect any action by a creditor against the person, property or effects of any member or members of the company. Lindley says that "notwithstanding a winding up order, any shareholder might be, and frequently was, singled out and utterly ruined by a creditor of the company, although if the creditor could have been compelled to wait, he would have received his principle and interest in full from funds provided by a proper contribution from all the members of the company." See Lindley, *Treatise on the Law of Partnership,* 3rd Ed, 1871, at p 1260. However this section would not have applied to chartered companies and those established under an act of parliament.

debts and liabilities.[90] The task of the court of Chancery was to ascertain what each member's contribution should be, order its payment and to appoint a receiver to collect and receive such sums as were paid and finally to order payment in satisfaction of the creditors. No application could be made direct to the Court of Chancery. All applications had to come via the Court of Bankruptcy in which the creditors had to prove their claims. By this provision the first link between the High Court of Chancery and insolvent companies was forged.

No provision was made for the insolvent registered joint stock company to enter into compositions or other forms of arrangements with their creditors. However, a link with the existing law and practice of bankruptcy was provided in ss.1 and 11 as follows:

> "...that the Court authorised to act in the prosecution of such Fiat, and all Persons acting under such Fiat, may proceed thereon in like Manner as against other bankrupts subject always to the Provisions hereinafter made.
> And be it enacted, That the Law and Practice in Bankruptcy now in force shall extend so far as the same may be applicable to this Act, and to Fiats in Bankruptcy issued by virtue of this Act, and to all proceedings under such Fiats, save and except as may be otherwise directed by this Act."[91]

Was it possible, by virtue of this section, for the new *registered* joint stock companies to have made use of the composition provisions, imperfect though they were, in the Bankruptcy Act 1825? The answer depends on how much of the law and practice in bankruptcy was applicable to this Act.

In 1825 the bankrupt laws applied only to traders. In defining who was a trader in s.2 of the Bankrupt Act of 1825, it was provided that *no* member or subscriber of a company established by Charter or Act of Parliament was to be deemed a trader. As such, the companies established by charter and Act of Parliament came outside the scope of the Bankruptcy law. The Winding Up Act 1844 however, applied exclusively to the categories of companies hitherto excluded under the Bankruptcy Act 1825. It defined several acts of bankruptcy, (albeit modifications of acts of bankruptcy in the Act of 1825), on the commission of which the winding up of companies would take place. Under s.1 of the Winding Up Act 1844 a Fiat in Bankruptcy could issue against a company or body only if such company or body committed an act which, by *the Winding Up Act,* was deemed to be an act of bankruptcy.[92] Consequently, it may be said

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90 7 & 8 Vict c.111, s.20

91 7 & 8 Vict c.111, s.11

92 S.15 of the Winding Up Act 1844 also empowers the Court to summon any person, whether a member or not, to give information, "concerning the commercial Dealings or Trading of, or any *Act or Acts of Bankruptcy, within the Meaning of this Act,* committed by such Company or (continued...)

that the several acts of bankruptcy defined by the Bankrupt Law did not apply to the entities to which the Winding Up Act applied and to this extent the law of bankruptcy did not apply to the Winding Up Act.[93]

It therefore, appears that the law and practice in bankruptcy that was applicable to the Winding Up Act was the law and practice that applied in all the proceedings under the Bankruptcy Act. At least in theory then, since the composition provisions set out in s.133 of the Bankrupt Act was a part of the bankruptcy procedure, the new joint stock companies could have made use of them to enter into a composition. The criticisms that applied to s.133 in 1825, applied with equal force in 1844 and it would have been futile for a company to seek to enter into a composition as it would not have been granted a discharge for having done so. It is perhaps for this reason that none of the contemporary writers[94] on either Company Law or Bankruptcy make any reference to companies entering into compositions with their creditors.

As to whether the newly registered joint stock companies entered into any arrangements with its creditors outside the Bankruptcy provisions is also unknown. In order to enter into such arrangements, however, the company would first have had to be authorised to enter into compositions/ arrangements with its creditors in its Deed of Settlement.[95] If such authorization had been made in the Deed of Settlement, then, in theory, a company could have entered into a scheme of arrangement, such as either of those described by Forsyth and referred to above. Significantly, unlike in the case of unincorporated joint stock companies and partnerships, an assignment by a company of all its property would not have been a potential act of bankruptcy under the Bankruptcy Act 1825.

It may be said therefore, that while neither the new Joint Stock Companies Act 1844 nor the Joint Stock Companies Remedies (Winding Up) Act 1844 made any provision for companies that could become insolvent to reorganize their debts, the existing compromise provisions in the law of Bankruptcy, at least until 1849, were not efficient enough to be of real use in the

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92(...continued)
Body,..." and to examine every such person "concerning ... any *Act or Acts of Bankruptcy, within the Meaning of this Act*"

93 It is interesting to note however that under the winding up act the right of a creditor to proceed against a member or subscriber was maintained. This section clearly could not have applied to members and subscribers of companies established by charter or act of parliament since they were not traders under the bankruptcy act. However, would it have applied to the members and subscribers of the new registered joint stock companies.

94 Wordsworth, Lindley, Archbold, Sheldon, Montague, etc

95 *i.e.* the company's constitution. Today the Articles.

alternative.

Further development of rescue procedures under the law of Bankruptcy

In 1847 a Bill was presented before the House of Lords for the purpose of once again consolidating the law on bankruptcy. In June 1848, a group of bankers, merchants and traders in the City of London petitioned the Attorney General, who was at the time willing to bring in a distinct Bill comprising clauses pertaining to arrangements. They stated that, in their judgement, the methods of liquidation at the time frequently adopted under deeds of trust, composition, or inspection were highly beneficial to creditors.

> "[W]e consider that it will be very advantageous to the mercantile community, that in all cases of commercial insolvency, any mode of liquidation which shall be approved of by a proper majority of the creditors, whether by trust, composition, inspection, or otherwise, shall be binding on the rest, and that a small number of dissenting creditors should not be able to frustrate such a mode of liquidation.
> We further think that a majority of six sevenths in number and value or nine tenths in value, or nine tenths in number, whose debts shall amount to twenty pounds, is a sufficient number to bind the rest."

When the Bill was before the Select Committee of the House of Lords, the Metropolitan Committee of Merchants and Traders lobbied for a series of amendments to make 'the administration of the Bankrupt Laws so efficient that they may be universally resorted to as well for the benefit of the Debtor as for the Creditor'. It was proposed in relation to compositions and other modes of arrangements that where an arrangement could not otherwise be effected, the concurrence of three fourths in number and value of the creditors should be made binding on the remainder, with the sanction of the Court.[96]

The Bankrupt Law Consolidation Act, 1849 law eventually provided for three types of arrangement. The first two operated outside the bankruptcy regime. This may be viewed as a significant step by the legislature in recognising and giving effect to voluntary arrangements entered into between a debtor and its creditors prior to bankruptcy.

Firstly, there was the arrangement between debtors and creditors *under the superintendence and control of court*[97] which appear to be the direct result of the merchant lobby.[98] Under this section a trader who was unable to pay his creditors could petition the

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96 Alterations and Amendments proposed by the Metropolitan Committee of Merchants and Traders on the Bankrupt Law Consolidation Bill, see the Appendix to the Minutes of Evidence taken before the House of Lords Select Committee, *House of Lords Sessional Papers and Bills* 1847-48 (263)

97 ss.211-223, Bankruptcy Act 1849, 12 & 13 Vict c.106, (hereafter BLCA 1849 [U.K.]).

98 The Attorney General, addressing the House of Commons on the Bankrupt Law Consolidation Bill (continued...)

court explaining the cause for this inability and praying that the court make an *order for the protection of his person and property from all process until further order.* If the trader was in prison or custody for debt the court also had the power, except in certain circumstances to order his immediate release, either absolutely or conditionally. After making such an order for protection, the court had to fix a private sitting. At the same time the court also appointed an Official Assignee to act in the matter of the Petition.[99] Notice of the private sitting had to be given in writing to each of the creditors fourteen days before the sitting was held. Ten days before the private sitting the trader had to file in court, the names, addresses and occupations of his creditors together with a full account of debts and estate and a proposal for their future payment or compromise.

At the private sitting the creditors had to prove their debts and the trader had to testify under oath to the truth of the accounts filed by him. Thereafter, if, at the same sitting or any adjournment of it, three fifths in number and value of the creditors who had proved debts to the value of ten pounds assented to the proposal, or any modification of it, the court had to fix another private sitting for its confirmation. This second sitting had to be held fourteen days after the first sitting, seven days notice of which had to be given to every creditor who had not, either personally or through an agent, attended the first.

At the second sitting the creditors who had not attended the first were able to still prove their debts. Thereafter, if again three fifths in number and value of those creditors who had proved debts to the amount of ten pounds (including those that had voted at the first meeting) agreed to accept the proposal that was assented to at the first sitting, then the terms of the proposal were reduced to writing and signed by the creditors. This agreement was, subject to confirmation by the court, "binding and of full force as well against the petitioning trader as against all persons who were creditors at the date of his petition *and who had notice of the several*

98(...continued)
on 25 July 1849 said, "[T]he House should give the Select Committee some credit for anxiety to do nothing to impede or injure the trade of this great country. There were no doubt introduced into the measure certain points of general improvement. Such were the clause introduced, at the unanimous desire of the retail traders of the metropolis, giving facilities for private arrangements without imposing upon the parties the necessity of coming into court. The Committee had deemed it to be their duty to accede to these alterations, being certain that at the worst they could do no harm". See *Hansard's Parliamentary Debates, N.S.* 1849 Vol 107 at p.956

99 At this stage the court could, upon sufficient cause being shown, direct that the estate and effects of the petitioner be possessed and received by the Official Assignee or by the Manager of Court. See s.212 BLCA 1849 [U.K.].

sittings of the court."[100] If, after hearing any argument for or against the agreement, the court was of the view that it was reasonable and proper that it be executed, the court had to approve and confirm the agreement and cause it to be filed and entered of record. The court also had to grant the petitioner trader a certificate of the filing and entering of record of the approval and confirmation and endorse on it a protection from arrest. The petitioner was then free from arrest at the suit of any person who was a creditor at the date of his petition and who had notice of the sittings.

It was also provided that from and after the date of the approval and confirmation the estate of the trader should vest in the Official Assignee and if it were required by the resolution, jointly with any persons mentioned in the resolution.

The most significant features of these arrangement provisions were, the ability of the debtor to present his own petition to the court outside the bankruptcy procedure and the court's authority to make an order protecting the trader from arrest or any other suit or process. It must also be noted that s.216 BLCA 1849 [U.K.] specifically restricts the binding nature of the agreement to those creditors who, besides being creditors at the date of the trader's petition, also had notice of the several sittings of the Court. The Court was also vested with a discretion in approving and confirming the agreement, before the exercise of which, it could hear argument both in favour as well as against the arrangement.

The second form of arrangement provided for in BLCA 1849 [U.K.] was for *Arrangements by Deed.*[101] Under s.224 of that Act, a deed of arrangement entered into between a debtor and his creditors, and executed by *six sevenths* in number and value of the creditors whose debts amounted to £10 and upwards, was to be binding on all - even those who had not signed the deed. Such a deed or memorandum when signed was not liable to be disturbed or impeached by any prior or subsequent act of bankruptcy. Such a deed however, had no effect on any creditor who had not signed it, until three months elapsed after the creditor receiving notice of the debtor's suspension of payment of his debts and of the deed of arrangement, (time beginning to run only upon the occurrence of both these events) unless the debtor obtained an order declaring that the deed had been duly signed by the requisite majority.[102] Even if such an order was obtained, a creditor who had not been given 14 days' notice of the application to

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100 s.214 BLCA 1849 [U.K.]

101 s.224 BA 1849 [U.K.]

102 s.225 BLCA 1849 [U.K.].

Court for such an order or certificate was not bound by it. A creditor who was completely ignorant of a deed of arrangement entered into by his debtor was, therefore, not bound by it.

It is interesting to note that unlike in the case of a judicially supervised arrangement, where the trader must have given notice of the sittings of Court to each creditor,[103] in an arrangement by deed, the trader was not required to give notice to his creditors of the signing of the deed. All that was required for a deed of arrangement was that six sevenths in number and value of those creditors whose debts amounted to ten pounds and upwards should have signed the deed. In addition to absence of all notice being a complete defence for a creditor against a deed of arrangement, there appear to have been other ways in which a creditor could impeach a deed of arrangement. S.224 BLCA 1849 [U.K.] provides that the Trustee or Inspector (under the Deed) or, failing the appointment of which, two creditors could, if so satisfied, certify in writing to the Court that the Deed had been duly executed. Every such certificate should have had annexed a full Account of the debts of the trader together with the names residences and occupations of the creditors. The Account should also have been accompanied by an affidavit verified by the same person. Any omission or insertion of a nonexistent debt which, appears to the Court to have been made through the culpable negligence or fraud of the trader with the intent to defraud any of his creditors will be sufficient to deprive him of the benefit of the provisions pertaining to arrangements by deed in the Act.

The final form of arrangement provided for in s.231 BLCA 1849 [U.K.] was an adaptation of the composition provisions in s.133 of the Bankruptcy Act of 1825. The difference between s.133 of the Act of 1825 and s.231 of the Act of 1849 was that in the latter provision the *debtor* was able to call the meeting of the creditors and the court was able to direct the debtor to pay a sum of money and annul the adjudication of bankruptcy and supersede or dismiss the fiat or petition for adjudication.

A Royal Commission was appointed in 1853 to inquire, inter alia, into the operation of BLCA 1849 [U.K.]. As regards arrangements under the supervision of court the Commission was of the view that the provisions pertaining to the giving of notices should be amended. It opined that the law as it stood required personal notice on each creditor which in many cases was "absolutely impractical" and that notice by publication in the gazette would be sufficient. The Commission also expressed the view that the arrangement when confirmed by the court should be binding on all the trader's creditors and not just those that had notice of the sittings.[104]

103 S.213 and 214 BLCA 1849 [U.K.].

104 Report of the Royal Commission appointed to enquire into fees, funds and establishment of a (continued...)

As regards Deeds of Arrangement the Commission drew attention to several defects in the law which required improvement. Under the existing provisions no public notice of an arrangement was required and private notice sometimes never reached a minority of creditors. The deed of arrangement entered into did not bind any creditor who had not signed it, until three months elapsed after he had notice of it, unless the trader, in the interim, had made an application to court to declare the deed duly executed. Since failure to give notice may have rendered the deed ineffectual, there was a risk that it may never become operative. The creditor who did not have notice also had the power within the three months to bring an action for his debt and thereby negative the arrangement arrived at. Finally the commission pointed out that in the cases of *Tetley v Taylor*[105] and *Bibby v Larpant*[106] it had been held that a Deed of Arrangement was valid under the relevant provisions of the Act only if it had provided for the distribution of *all* the estate belonging to the trader.[107] As a remedy it was suggested that the provisions in BLCA 1849 [U.K.] be extended to apply to all arrangements by way of trust, composition, inspectorship or otherwise.[108]

The Commission also recommended inter alia, that all deeds should be registered in the court of Bankruptcy so that the minority of creditors might know their contents and the extent to which they were bound. Furthermore, it said that notice of the registration of a deed of arrangement and the fact that a trader is unable to pay his dues must be given in the gazette for the benefit of the whole mercantile community.[109]

The Bankruptcy Act which ensued[110] from the Commissions' Report did not make any amendments to the provisions pertaining to composition and arrangements. Such changes were made only in 1861 when the next reforms to the Bankruptcy law occurred. By this time, however, drastic changes had been made to the law governing the liability of members of

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104(...continued)
Court of Bankruptcy and the operation of the Bankrupt Law Consolidation Act 1849, *Parliamentary Papers,* 1854, Vol.XXIII, p.xxii.

105 1 El & Bl.521 and 118 ER p.53

106 1El & Bl.p.55

107 These decisions were confirmed by the House of Lords in *Larpant v Bibby* in 1855 10 ER p.988

108 It is interesting to note that G Lavie in his evidence before the Commission states that when the Deed of Arrangement provisions were drafted for insertion in the 1849 Act it was the intention of the draughtsmen that the provisions should apply to all deeds of composition, inspectorship or otherwise.- Evidence op.cit. supra. at p.82

109 Evidence given before the Royal Commission, op.cit, supra at p.xxii

110 Bankruptcy Act of 1854 C.11

companies registered under the Joint Stock Companies Acts of 1844 and 1848 [U.K.].[111] Moves were also underfoot to establish a separate regime under which insolvent companies came within the jurisdiction of the Chancery Court.[112] A division was beginning to appear between the law and procedure governing the insolvency of individuals and companies. Eventually this division was closed to some extent only in 1985 with the enactment of the Insolvency Act 1985 [U.K.].

The provisions of the Bankruptcy Act 1861,[113] (hereafter BA 1861 [U.K.]) which permitted a debtor to enter into a binding arrangement with its creditors soon had no application to companies. Nevertheless, these provisions should be considered briefly for the reason that they marked a significant relaxation of Parliament's attitude towards such arrangements.

Under the BA 1861 [U.K.], a debtor could, without being made a bankrupt, agree to convey or *all or even part*[114] of his estate and effects for the benefit of his creditors or make any arrangement or agreement with his creditors for the distribution, inspection, conduct, management or winding up of his affairs, or his release or discharge from his debts or liabilities.[115] Subject to certain other statutory conditions being fulfilled, any deed or instrument to that effect entered into between a debtor and his creditors was binding on *all* the debtor's creditors if a majority in number representing three fourths in value of the creditors, to each of whom ten pounds or more was owed, assented to or approved of the deed or instrument in writing.[116] Particulars of the deed or instrument, which include a statement of its nature and effect had to be registered with the Chief Registrar, and a copy of the registered entry published in the London *Gazette*.[117] A copy of the deed or instrument was also required to be registered in court, failing which it could not be received in evidence by the court.[118] Once the deed or instrument had been registered and published, an automatic moratorium came into force. Thus,

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111 Joint Stock Companies Act, 1856, (19 & 20 Vict., c.47)

112 This occurred under s.81, Companies Act 1862, (25 & 26 Vict., c.89)

113 24 & 25 Vict., c.134.

114 This circumvented the difficulties experienced after the decision in *Tetley v. Taylor* 1 Ell & Bl 32.

115 See s.194 BA 1861 [U.K.].

116 s.192 BA 1861 [U.K.]. The other statutory conditions to be fulfilled are:
(1) the trustee(s) appointed under the deed or instrument should execute it; (2) the execution by the debtor should be attested by an Attorney or Solicitor; the deed should be stamped and registered within 28 days; the trustee should certify that the requisite majority of creditors have approved or assented to the deed or instrument and the value of the property comprised in the deed; and (4) the property *comprised in the deed* must be given to the trustee.

117 s.193 BA 1861 [U.K.].

118 s.194 BA 1861 [U.K.].

"no execution, sequestration, or other process against the debtor's property or person in respect of any debt was available to any creditor or claimant without the leave of court."[119]

There was no need to summon a meeting of the creditors for the purpose of obtaining their sanction to the deed, neither was there any requirement that the creditors should prove their claims or debts before becoming entitled to sign the deed or instrument. The scope for abuse was therefore considerable and, although the procedure was relaxed at the request of the mercantile community, it was not long before the very advocates of the new regime began to express their dissatisfaction with it.[120] As a result, a committee was appointed by the House of Commons both in 1864 and 1865 to consider the working of BA 1861 [U.K.].[121] The main complaint before the Commons' Committee was that it was possible under the prevailing system to make fraudulent statements of assets and liabilities which could not be checked by the creditors. It was, therefore, possible to manipulate the system , sometimes assisted by a "friendly" accountant, to obtain a result favourable to the debtor.[122] Based on the Committee's findings the government of the day sought to stem these abuses by requiring that every deed or instrument which discharged the debtor from his liabilities should comprise of all debtor's property, thus returning the law to the state it was in after the decision in *Tetley v. Taylor*[123]

Responding to this proposed amendment Mr. H.R. Droop, in a paper read before the *Juridical Society*, conceded that the criticisms made against the existing procedure were justified but pointed out that the "remedy proposed, the virtual abolition of compositions, seems [*] at once too sweeping and superficial."[124] In his view

> "The true remedy, [*] for the abuses which the majority's power to bind the minority has contributed to create, is to require compliance with the following conditions as regards all arrangement deeds, or at least regards all except simple administration deeds: (1.) That the state of the debtor's affairs should be investigated by some independent person on behalf of the creditors; (2.) that a reliable statement of the assets and liabilities, and of

119 s.198 BA 1861 [U.K.].

120 See Droop, H.R. "On Arrangements between a debtor and his creditors and the conditions under which the decision of a majority of creditors may properly be made binding on all" Vol 3, *Papers read before the Juridical Society,* 1863-1870, p.193.

121 See *Parliamentary Papers,* 1864, (House of Commons) Vol.5.

122 See the evidence given before the Committee by Mr.F.Nicholls, Mr. Lawrence and Mr. Lewis. *Parliamentary Papers,* 1864, (House of Commons) Vol.5.

123 1 Ell and Bl 32.

124 Droop, H.R. "On Arrangements between a debtor and his creditors and the conditions under which the decision of a majority of creditors may be properly be made binding on all" Vol 3, *Papers read before the Juridical Society,* 1863-1870, p.193 at 196.

all other material circumstances, should be furnished to each creditor before he is required to vote; (3.) that the arrangement should be approved by the Court of Bankruptcy, or what ever tribunal may be substituted for it, as substantially just and reasonable."[125]

Such views clearly had an impact on the government of the day since the *Bankruptcy Act* 1869[126] (hereafter BA 1869 [U.K.]) introduced a completely new procedure under which a debtor could enter into composition with his creditors.[127] By definition, the procedure was restricted to compositions only, which meant that the creditors accepted a specified amount in full and final settlement of their claims. The procedure leading to acceptance of the composition by the creditors was quite cumbersome, since it was designed to eradicate the abuses inherent in the previous regime under BA 1861 [U.K.].

The composition had to be approved by an extraordinary resolution of the creditors. This resolution required approval of the composition by a majority in number and three fourths in value of the creditors present at a meeting of the creditors summoned for the purpose, and a confirmation of this approval by a simple majority in number and value of the creditors at a separate meeting summoned within a specified period of the first meeting. In calculating the majority creditors with debts not exceeding £10/- were counted in the majority in value but not in the majority in number. The debtor was required to be present at the meetings and to produce a statement showing the whole of his assets and debts and the names and addresses of the creditors to whom the debts were due. By this, it was clearly hoped that the debtor would be unable to have a composition approved on the basis of fictitious assets and liabilities. The extraordinary resolution approving the composition along with the debtor's statement of assets and liabilities had to be presented to the Registrar. The Registrar was required to enquire whether the resolution had been passed in the manner provided, and if satisfied, to register the resolution and the statement of the assets and debts. The resolution acquired validity only upon such registration.[128]

The procedure under Part VII BA 1869 [U.K.] witnessed a return to a procedure which displayed some resemblance to the procedure relating to compositions under the BA 1825 [U.K.]. It sought to address some of the complaints made against the regime under BA 1861 [U.K.] which

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125 Droop, *op.cit., supra,* at p.198.

126 32 & 33 Vict., c.71.

127 Part VII, BA 1869 [U.K.].

128 s.126 BA 1869 [U.K.].

it replaced, but, nevertheless, the need to summon two meetings of the creditors would have made the composition more costly and difficult to achieve than it was under the statute of 1861.

Reflections on the emerging principles of Bankruptcy Rescue.

Although by the time BA 1869 [U.K.] was enacted the law of bankruptcy and corporate insolvency were developing virtually independently, it is useful to reflect on the basic principles contained in the early rescue procedures available under the various Bankruptcy Acts of the period for the purpose of determining whether they influenced the development of rescue procedures for insolvent companies. It is clear from the foregoing discussion that the law governing companies and their insolvency and the law governing bankruptcy reorganization were both in their infancy.

By 1861, however, it may be said that certain basic principles governing statutory bankruptcy reorganization were beginning to emerge. The most important of these was that all statutory regimes were based on an agreement between the debtor and his creditors. Except where it was required to be a composition, the law refrained from indicating the basis of this agreement. The agreement could be entered into either by a majority of the creditors signing the relevant deed or instrument[129] or a majority voting in favour of adoption at meetings of the creditors.[130] In the case of meetings it was necessary to obtain the creditors approval at two meetings instead of one. The majority required for approval reduced gradually from a high nine tenths in 1825 to a more realistic three fourths in 1861 where, as will be seen, it has remained for over a hundred years. It should be noted that the requirement for creditors to prove their debts before indicating their views by vote or signature, as provided for in an Arrangement under the Superintendence and Control of the Court under BLCA 1849 [U.K.] was yet to establish itself as an essential ingredient. The lack of such a requirement was clearly one of the main reasons the procedures were abused. The concept of a moratorium appears to have gained acceptance to the extent that it applied after the agreement had been entered into to those creditors who were bound by it. It was however relatively easy to upset most of these agreements on the basis that notice of the meeting or of the agreement had not been received.

Insolvent railway companies and early attempts at corporate rescue

Railways had been used in Britain by the mining industry to transport coal since the early 17th Century[131] However, the full potential of railways to transport people and goods was not

129 As in an Arrangement by deed under either BLCA 1849 [U.K.] or BA 1861 [U.K.].

130 As in a composition under BA 1825 [U.K.] or BLCA 1849 [U.K.].

131 See in general Parris, H., *Government and the Railways in Nineteenth Century Britain*, (continued...)

fully exploited until an extensive country wide network was constructed during the middle decades of the 19th century.[132] A significant feature of the expansion of railways in Britain, was that it took place entirely at the instance of private commercial enterprise.[133] However, private commercial enterprise in the form of partnerships and unincorporated joint stock associations were wholly unsuited for the purpose of building and managing a railway. In building a railway the power to take possession of private property was essential. Such power could only be granted by Parliament. The result was that every railway built in the United Kingdom during this period had first to be approved by Parliament, and the association of persons carrying out the construction and management incorporated under a Private Act with powers to acquire land.

The first railway companies were incorporated by Parliament, shortly after the repeal of the "Bubble Act", well before the Joint Stock Companies Act of 1844. This was still an era in which the raising of capital for a venture by the issue of transferable shares in the venture was frowned upon by the legislature. Consequently, limits were imposed upon the amount of capital that could be raised and the use to which that capital could be put.[134]

131(...continued)
London/Toronto, 1965, Chapter 1.

132 "The great railway building boom - the largest single domestic investment project of the 19th Century": see Boot, *The Commercial Crisis of 1857*. "[A]part from the Marylebome line, parts of the St Pancras Scotland route, and certain extensions at the extremities, the system was complete by 1852": see Mitchell, R.R., "The Coming of the Railway and United Kingdom Economic Growth" in Reed M C (Ed) *Railways in the Victorian Economy - Studies in Finance and Economic Growth*, London, 1969, at p.14

133 "Our railways are in the sole possession of companies, that, with certain limitations, which are very wide, and exceptions, which are very few, have the complete control and management of our inland transport. They fought very hard to attain their present position, in and out of Parliament, with landowners and each other, till they obtained their respective bills, and they never have been on the best terms with the public. Thirteen large companies monopolize about three fourths of the railway traffic of the kingdom, and above sixty smaller ones divide amongst them the remaining fourth. All these companies are managed by boards of directors... The companies are under no pecuniary obligation whatever to the State; they have received neither subvention from the Legislature, nor assistance or special protection from the Government...": see Galt, William, *Railway Reform : Its Importance and Practicability considered as affecting the Nation, the Shareholders and the Government*, London, Longman, Green, Longman, Roberts & Green, 1865, at p 5 & 6

134 "It is the custom of Parliament when granting to railway companies the powers necessary for carrying out their undertakings, to limit the amount of money they should be permitted to borrow, and to prescribe the conditions under which such borrowing powers should be exercised; and it is evidently the intention of the legislature that no bonds, or other negotiable securities, other than those created under limited and conditional powers, should be issued by the directors of railway companies": see "The Report from the Select Committee of the House of Lords on Railway Companies' Borrowing Powers", *House of Lords Sessional Papers*, 1864, Report No 127. Origins
(continued...)

The acuteness of the "railway mania" that gripped Britain during the mid 1840's is vividly described by Mitchell who states that "expenditure on railway building was, at its peak, about two thirds the value of all domestic exports ...or, to find another yardstick it was over twice as great as the maximum level of the Bank of England's bullion reserve in the decade".[135] As in all matters there was a negative aspect to this "mania" as well. Railways attracted speculators from across the country. As the number of railways grew the risk of loss became greater.[136] Applications were made to build new railways along routes almost parallel to existing railways, compelling the established railway to buy out the new or to search for feeders to remain competitive.[137] Some railway companies flouted borrowing restrictions and provisions limiting the use of their capital and borrowings, imposed upon them by Parliament.[138] Certain contractors found it to their advantage to encouraged the construction of railways. If the company failed to raise the entirety of the required capital by the issue of shares the contractor would build

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134(...continued)
perhaps of "The authorised share capital" and the "Objects clause" in the Memorandum of Association of the Registered Joint Stock Company.

135 Mitchell, R.R., in Reed, M.C., (ed) *Railways in the Victorian Economy - Studies in Finance and Economic Growth*, *supra* at p.18. The peak period being between 1845 and 1849. See further Lewin, H.G., *The Railway Mania and its Aftermath*, The Railway Gazette, London, 1936, in particular Chapter VII. "The height of the mania"

136 "[*Q.*]Have persons of late years engaged in other Species of trading, namely speculating in Shares of Railways? [*A.*] To a very great Extent. [*Q.*] Have you found many Bankrupts have been engaged in such Speculations? [*A.*] I have very seldom found any who have not been of late. [*Q.*] You say there are very few Instances in which People who have come before you as Bankrupts have not more or less speculated in Railway Shares? [*A.*] Very few." H.P.Hope, Official Assignee at Leeds in his evidence before the Select Committee of the House of Lords on the Bankruptcy Law Consolidation Bill on 21 July 1848. *House of Lords Sessional Papers* 1847-48 Vol XXIII.I, Paper No.263. See the Minutes of Evidence at p.75. Para.484.

137 See the evidence given by the Chairman of the Caledonian Railway Company before the Select Committee of the House of Lords. *House of Lords Sessional Papers* 1849 XXIX (21-III) particularly paras 3537 - 3541

138 Report of the Select Committee of the House of Lords appointed to continue the inquiry on Railway Companies Borrowing Powers. *House of Lords Sessional Papers* 1864, Vol.XXVII (127). See also the First, Second and Third Reports from the Select Committee of the House of Lords appointed to consider "Whether the Railway Acts do not require amendment, with a view of providing for a more Effectual Audit of Accounts, to guard against the Application of the Funds of such Companies to Purposes for which they were not subscribed under the Authority of the Legislature" *House of Lords Sessional Papers* 1849 Vol.XXIX, (21-I), (21-II) & (21-III). Concluding its Third Report the Committee recommended: "The magnitude of the capital at stake, the importance of the interests involved, the spirit of gambling and rash speculation which the present state of the Law has produced, and is calculated to encourage render a remedial measure of this description, in the judgement of the Committee, not only expedient and salutary, but pressing and indispensable"

the railway and accept heavily discounted shares in the railway in place of payment. These shares were then used as security to obtain loans, or held back to be sold once the railway was completed and making profits. The advantage to the contractor was that his plant machinery and workmen were never idle. Also he had access to capital by virtue of a security which had no solid foundation. In some instances the contractor agreed to obtain finance for the company at a high interest. Such lines became known as "contractor's lines".[139] The Private Bill mechanism of Parliament proved to be unsatisfactory in handling the hundreds of applications made to construct railways. Railways which had been approved in the early 1840's on the basis of a report of the Board of Trade that they were viable only in a monopolistic situation found themselves facing competition from other railways that had later obtained their statutes.

Inevitably, certain railways became insolvent. When they did so, it appears that in the eyes of the law they were treated very differently to any other corporation, registered or unregistered joint stock company or partnership. Between 1825 and 1844 railway companies were excluded from the ambit of the Bankruptcy Act 1825.[140] Section 2 of the Joint Stock Companies Act 1844 also excluded railway companies from the scope of that Act. Section 1 of the Winding Up Act 1844 however extended that statute to all "commercial or trading companies now or at any time hereafter incorporated by Charter or Act of Parliament." Contemporary writers have however expressed doubt as to whether a railway company was a "trading or commercial" company within the meaning of the statute.[141] However even if a railway company did fall within the scope of the Winding Up Act of 1844, the Joint Stock Companies Winding Up Act (1848) Amendment Act 1849[142] excluded Railway Companies from the scope of the 1848 Act. In 1850 the Abandonment of Railways and the Dissolution of Railways Act[143] was passed. Under this Act if it were found that a railway or even parts of it could not be carried on with any advantage either to the promoters or the public, three fifths of the shareholders could

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139 With regard to "Contractors Lines" see Pollins, H. "Railway Contractors and the Finance of Railway Development in Britain" in Reed (Ed) *Railways in the Victorian Economy* op cit. supra p.212

140 6 Geo. IV. 1825. C.16. S.2. (based on the principle - *cujus est instituere, ejus est abrogare*)

141 Hodges, Sir William, *A treatise on the Law of Railways, Railway Companies and Railway Investments,* London, S Sweet, 1847, p.665. Hodges expresses the view that a railway company acting under a special act of parliament, is constituted a body corporate and can only be dissolved by an act of parliament.

142 11 & 12 Vict 1849 c.45

143 13 & 14 Vict 1850 c.83

apply to the Commissioners of Railways, to authorise the abandonment of that railway. This Act was of very restrictive use in that it applied only to railway companies incorporated before the passage of the Act. Furthermore, the commissioners could do no more than authorise an abandonment.

In addition to the principle of *cujus est instituere, ejus est abrogare* there appears to have been another factor which affected the treatment of insolvent railway companies. The British public appear to have, over the years, acquired a strong inviolable interest in this creature of private commercial enterprise. Wills J describes one aspect of it in *Hall v. L B & C R Co*, as follows:

> "It was originally in the contemplation of the legislature to treat a railway as a common highway, open alike to all persons who might choose to put carriages thereon. The Railway Clauses Act of 1845 enacts (sect 92) that on payment of the tolls demandable, all companies and persons shall be entitled to use the railway, with engines and carriages properly constructed, subject to 5 & 6 Vict c.55 and to the regulations made by the Company, and further provides (sec. 108) that no regulations made by the company shall authorise the closing of the railway, or prevent the passage of engines or carriages thereon, at reasonable times. In fact the notion of the railway being a highway for the common use for the public, in the same sense that an ordinary highway is so, was the starting point of railway legislation. It is deeply engrained in it."[144]

In addition, railway companies were obliged by statute[145] to convey the mails, and by a clause always inserted in each special railway Act each company was made liable to the provisions of these general Acts. It was further enacted that "...no company can make by-laws repugnant to these Acts." [146] All companies that were incorporated, or obtained an extension of their powers, in 1844, or thereafter were required[147] to provide conveyance for Her Majesty's troops at a fare which could not exceed a given ceiling.[148] By another Act passed in the same year all passenger railway companies were required to provide thereafter at least one train each weekday running the full length of the track for the conveyance of third class

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144 LR 15 QBD at p.536. See also Hodges, Sir William *A treatise on the Law of Railways, Railway Companies and Railway Investments,* (7th Ed by Lely, J M), London, H Sweet & Sons, 1888, p.440-444.

145 1 & 2 Vict c 98; 7&8 Vict c.85 s.11; 10 & 11 Vict c 85, s.16; 31 & 32 Vict c. 119,36,37 and 36 & 37 Vict c.48 ss.18-20(f)

146 s.1, 1 & 2 Vict c.98

147 s.12, 7 & 8 Vict 1844 c.85.

148 "Legal Intelligence", *Joint Stock Companies Law Journal* (W.Cox Ed) No.8. Vol.1. March 15 1949 at p.11

passengers.[149]

A Select Committee of the House of Lords in considering, inter alia, the possible right of a railway debenture holder to appoint a receiver, recognised the overriding nature of the public interest in the railways of Britain, and reported that:

> "The property is of a different character to other property. The public have a right to the use of the railway, and would be seriously inconvenienced by the stoppage of even a short line. It appears, therefore, to the Committee, that this power [i.e. the power to appoint a receiver] ought not to be allowed to the creditors of railway companies."[150]

In handling the crises brought about by railway insolvency from time to time Parliament had to deal with two diametrically opposed interests. The public interest discussed above and the right of a creditor, jealously guarded by the Common Law Courts, to proceed against his debtors property to recover his debt. In responding to each crisis Parliament displayed a reluctance to erode the common law rights of creditors. But eventually just as in the law of Bankruptcy the wishes of a majority of creditors were allowed to override a dissenting minority, the public interest in railways prevailed.

The Caledonian Railway Crisis

The crisis which *The Caledonian Railway Company* (hereafter *The Caledonian*) faced in 1849 and 1850 was, as will be seen, due mainly to one of the causes of railway insolvency mentioned earlier. *The Caledonian* was incorporated by the Caledonian Railway Act, 1845 with powers to make and maintain the railway "from Carlisle to Edinburgh and Glasgow and the North of Scotland".[151] When the line was proposed in 1844, the Government Commissioners, after a thorough examination, recommended the line "as the best and most direct route from the south and west of England into Scotland." In Parliament, The Caledonian Railway Bill was strongly opposed by the promoters of two competing lines, *The North British* and *The Nithsdale Railways*. Eventually *The Nithsdale* project was rejected and *The Caledonian* granted its Act. In the very next session however, Parliament, acting contrary to its decision in the previous session and the report of the commissioners, passed *The Nithsdale Railway* which ran parallel to and competed directly with *The Caledonian*. A clause which empowered *The Caledonian* to lease in self-defence the southern portion of *The Nithsdale* line was also repealed the next year. Upon learning

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149 "The Cheap Trains Act", 7 & 8 Vict 1844 c.85.

150 Report of the Select Committee of the House of Lords appointed to continue the inquiry on Railway Companies Borrowing Powers. *House of Lords Sessional Papers* 1864, XXVII (127). The Railway Clauses Act 1845.

151 (1845) 8 & 9 Vict. c.162

of these events the Chairman of *The Caledonian* is alleged to have stated that "if he could have supposed another Act for a competing line like the Nithsdale could have been obtained, instead of proceeding under their Act, he would have taken measures for repealing it; but having entered into various contracts and commenced operations, he felt bound to proceed with it."[152] It appears from the report of the committee appointed by the shareholders of *The Caledonian* to enquire into its affairs that "From this period the attention of the Directors was anxiously turned to acquire feeders to their line in every direction, and to buy off opposition almost at any price"[153] Between 1846 and 1849 *The Caledonian* entered into a series of agreements, each of which was sanctioned by an Act of Parliament, whereby it purchased, amalgamated with and leased other railways.[154]

As consideration *The Caledonian* agreed to pay the shareholders of such companies various sums of money, in one instance by way of an annuity and in the others by way of guaranteed and preferential dividend out of the general funds or profits of *The Caledonian*. In addition the beneficiaries of the annuity and the several guaranteed dividends were secured by a lien over the railways transferred to *The Caledonian* and their revenues. By a number of enactments[155] Parliament also authorised *The Caledonian* to raise further sums of money by borrowing on mortgage or bond, or by the creation and issue of shares, and these powers had been exercised to full extent. Large sums had also been borrowed on the security of some of the railways acquired by *The Caledonian*, the lenders having priority over the liens held by the original proprietors.

By 1849/50 *The Caledonian* was in dire financial straits. A committee was appointed by the shareholders to inquire into the companies affairs. It was discovered that the annual sum

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152 Report of the Committee of Investigation to the Shareholders of the Caledonian Railway Company. *House of Lords Sessional Papers* 1850, XV, (62).

153 ibid

154 "The *Caledonian* Railway (*Glasgow, Garnkirk, and Coatbridge* Railway Purchase) Act, 1846" 9 & 10 Vict. c.329, "The *Caledonian, Polloc, and Govan* and *Clydesdale Junction* Railways Amalgamation Act, 1846" 9 & 10 Vict. c. 379, "The *Caledonian* and *Glasgow, Paisley, and Greenock* Railways Amalgamation Act, 1847" 10 & 11 Vict. c.169, "The *Caledonian* Railway (*Wishaw and Coltness* Railway Purchase) Act 1847" 12 & 13 Vict. c. 67, "The *Caledonian* Railway (*Glasgow, Barrhead, and Nielston Direct* Railway Lease) Act, 1849 12 & 13 Vict. c.90.

155 "The *Caledonian* Railway (*Glasgow, Garnkirk, and Coatbridge* Branch) Act, 1846" 9 & 10 Vict. c.229, "The *Caledonian* Railway (*Glasgow, Garnkirk, and Coatbridge* Railway Purchase) Act, 1846" *supra*, "The *Caledonian* Railway (*Clydesdale Junction* Railway Deviations) Act, 1846" 9 & 10 Vict. c.395, "The *Caledonian* Railway (*Garnkirk* Station) Act, 1847" 10 & 11 Vict. c.82 and "The *Caledonian* Railway (*Edinburgh* Station and Branches) Act, 1847" 10 & 11 Vict. c.23

payable in perpetuity by *The Caledonian* in respect of the annuity and guaranteed dividends amounted to £108,708.s.8.d.4. The annual preferential dividend payable in perpetuity to the holders of the preferential shares amounted to £44,710.s.16. These sums together with the interest payable on the borrowed capital for which the company was liable exceeded the available annual revenue of the company. Some of the dividends were in arrear. Money was also owed to unsecured creditors on account of land, cost of works and plant, working expenses, furnishings and the like.[156] The committee was strongly critical of the conduct of the directors in the management of the company. It stated that "They [the directors] were from the commencement beset with difficulties requiring the greatest prudence and caution in their management, yet with a capital barely sufficient for their original undertaking, their over-zeal induced them to embark on schemes and speculations to an extent seriously compromising the safety of the company." The only solution, in the eyes of the committee, was to obtain a reduction in the terms of the guarantees and other preferential claims, otherwise the entire earnings of *The Caledonian* would not be sufficient to meet them.[157]

In order to extricate itself from the hopeless position it found itself in, *The Caledonian*, following the advice of the committee, applied to Parliament seeking confirmation of an arrangement with the proprietors entitled to the guaranteed and preferred dividend to "abate a portion of the sums so annually payable to them on certain conditions".[158] It also sought permission to raise a further sum of money on mortgage or bond and to increase its capital by the creation of additional stock. The first portion required Parliament's sanction because the arrangement entailed a reconstitution of the capital structure and the Board of Directors of *The Caledonian*, fundamental changes to the terms of contracts drawn up by Parliament between *The Caledonian* and third parties and because of the refusal by the proprietors of the Caledonian Railway (Glasgow, Paisley and Greenock) Guaranteed Preference Shares, to enter into the proposed arrangement. Parliamentary approval for the second portion of this scheme was required in any event because the right of all railway companies to increase their capital and to raise money was strictly limited.

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156 For a synopsis of all CRC's liabilities see the preamble to the Caledonian Railway Arrangement Act, 1851, 14 & 15 Vict. c.134

157 ibid. at p.11

158 See the preamble to the Caledonian Railway Arrangement Act, 1851. op.cit,supra. The persons that refused abate their claims were the proprietors of the *Caledonian* Railway *(Glasgow, Paisley and Greenock)* guaranteed preference shares.

It is not proposed to examine the details of the financial restructuring effected by the *Caledonian Railway Arrangements Act 1851* (hereafter CRAA 1851).[159] The principles, relevant to the development of the law of corporate reorganization, upon which it was founded must however, be noted. In so doing it is necessary to distinguish between those aspects of the scheme which required Parliamentary sanction because they concerned either the determination or modification of Parliamentary contracts or an increase in the railway's restricted right of borrowing, and those aspects which similarly required Parliamentary approval because they either affected a creditor's common law right of reclamation or priority rights between creditors or provided relief not otherwise available and essential for the rehabilitation of a debtor. It is the latter that will be scrutinized as relevant to this study.

At the second reading of the Bill before the House of Commons, Mr Gladstone drew the attention of the House to the "magnitude" of the question before it. He pointed out:

> "According to the law of debtor and creditor in this country, creditors are entitled to have insolvent concerns delivered over to them; but this Bill absolutely repealed the money rights and privileges of some of those parties without any reference to their consent whatever. One of the companies not only held an interest in the net profit of the line but was a creditor for the redemption money of its rights at a fixed rate and yet the Bill proposed to repeal the clauses affecting that creditor's claim altogether. So far as the measure was permissive it was wholly unsound in principle because it sought for a settlement between debtor and creditor not upon equitable terms. It involved the important question whether the House would sanction the principle that Parliamentary contracts on specific terms were to be dissolved in the face of the reclamation of the parties interested in these contracts."[160]

It is submitted that Mr Gladstone's criticism that the scheme was unsound in principle appears, to use a judicial phrase, to have been made "per incuriam". It may be recalled that since 1825, Parliament had, albeit in a very rudimentary manner, at the instance of the mercantile community, recognised and given statutory effect to the commercial necessity, where a composition was proposed by a bankrupt, for a majority in number and value of the creditors to bind a dissentient minority by its decision. The debt reorganization provisions introduced by the Bankrupt Consolidation Act 1849, as it has been seen, further refined and developed this principle. By 1850 however, the law of Bankruptcy had not yet distinguished between classes of creditors and the subtle differences in interest that might exist. Consequently as the proprietors of the Caledonian Railway (Glasgow, Paisley and Greenock) Guaranteed Preference Shares were in a minority among the creditors both in number and value the scheme of arrangement appears,

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159 The Caledonian Railway Arrangements Act, 1851, 14 & 15 Vict. C.13

160 Hansard 3rd Series, CXIV, 14 March 1851, at columns 1313 and 1314

contrary to Mr Gladstone's opinion, to have been in consort with prevailing commercial and legislative policy.

The rights of the proprietors of the annuity and the guaranteed and preferred dividend were extinguished and replaced by a new right to a fixed annuity, payable half yearly commencing six months after the passage of the Act. Arrears of the said extinguished right to the annuity and guaranteed and preferred dividend were to be paid by the issue of mortgages or bonds payable at the expiration of three years from the 1st of August 1851. By sanctioning the moratorium granted to *The Caledonian* Parliament once again articulates prevailing commercial and legislative policy set out in the Bankrupt Consolidation Act 1849 that in reorganizing mercantile debt the hand of creditors must be stayed and the debtor granted a period of respite in order to enable him to get his business enterprise back on stream: essential relief if the reorganization is to be successful.

This method of reorganising the affairs of insolvent railway companies by passing special private Acts was used by Parliament despite the Select Committee of the House of Lords[161] having opined that the practice by which the affairs of companies practically bankrupt were patched up by successive Acts of Parliament was injurious to the public, and frequently of no real benefit to the shareholders.

Change was to follow, but only in 1866 after the debacle of *The London Chatham and Dover Railway Company*. Across the Atlantic, however, the legislature of the Province of Canada preempted the Imperial Parliament in 1862 by sanctioning a scheme of arrangement wherein the creditors were given an opportunity to express their views.

The Reorganisation of the Grand Trunk Railway of Canada

The Grand Trunk Railway Company of Canada (hereafter *The Grand Trunk*) was incorporated in 1852 for the purpose of constructing and managing a railway from Toronto to Kingston and from there to Montreal. By the end of the Session of the Parliament of the Province of Canada for the period 1853-54, legislation[162] had been passed which expanded the

161 Report of the Select Committee of the House of Lords appointed to continue the inquiry on Railway Companies Borrowing Powers. House of Lords Sessional Papers 1864, XXVII (127)

162 (1852 -53)16 Vic c.39 - Authority to unite small Railway Companies into one Company to build Main Trunk Line through the province and to repeal incorporations of *Montreal and Kingston Ry. Co.* and *Kingston and Toronto Ry. Co.*; 16 Vic c.75 - Provides for the construction of "Victoria Bridge" over St Lawrence River at Montreal; 16 Vic c.76 - Extends provisions of 16 Vic c.39 to railways intersecting Main Trunk Line; (1854-53) 18 Vic c.33 - Amalgamation of the *Grand Trunk Ry. Co. of Canada East; Toronto and Guelph Ry. Co.* the *St.Lawrence and Atlantic Railroad Co,;* (continued...)

milage covered by the railway from approximately 330 miles to 1,100 miles.[163] A "glittering colossus" which had the distinction of being, at the time, the longest railway in the world, was later characterized as "the worlds worst commercial failure".[164] *The Grand Trunk* faced severe setbacks from the very outset, the complicated causes of which are outside the scope of this study to examine in detail. Suffice it to say that deteriorations in the London Money Market, where *The Grand Trunk* bonds and shares were first offered, resulted in failure to sell the securities as planned and raise the capital required. Inflation led to a rise in the costs of construction. Consequently *The Grand Trunk* never had sufficient money to pay its contractors for work completed and repeatedly sought aid from the Provincial Government. Once the railway commenced operations, although the claims of contractors were satisfied it was desperately short of working capital. Poor design and construction which became evident during running led to increased operating costs and long delays in running. This, together with the railway's inability to compete effectively with water borne transport on Lakes Erie and Ontario and with established channels of trade along the American Railways, contributed towards *The Grand Trunk*'s earnings being insufficient to cover interest payments due on its preference and ordinary bonds, railway lease rental and dividends on shares.[165]

In 1860 the Government of Canada appointed a Royal Commission under the Chairmanship of J Langton to inquire into the affairs of *The Grand Trunk*. The Commission exposed a number of defects in *The Grand Trunk* and its operations, but made only one major recommendation. After contrasting the meagre income of *The Grand Trunk* with its huge liabilities[166] the Langton Commission opined in the concluding paragraphs of its report that,

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162(...continued)
the *Quebec and Richmond Ry. Co.* and the *Grand Junction Ry. Co.* with the *Grand Trunk Ry. Co. of Canada*; the lease of the *Atlantic and St.Lawrence Railroad Co.* and the Provincial Guarantee of Loan.

163 It extended from Sarnia on the shores of Lake Huron to Montreal and Quebec on the banks of the River St. Lawrence and from there to Portland, Main, on the Atlantic sea board. For a details see Currie, A.W., *The Grand Trunk Railway of Canada*, Toronto, University of Toronto Press, 1957.

164 Currie, *supra,* at pp.13 and 3 respectively.

165 For a detailed account of the causes of the early financial troubles and other difficulties faced by the GTRC see Currie, supra, Chapters 1, 2, 3 and 4. He observes at p 71 that "The Company's credit was so bad that it was able to sell only £84,000 out of the issue of £1,111,500 second preference six per cent bonds. Even then, it disposed of them at a discount of 2 1/2 per cent so that the cost of the money to maturity in 1879 9 per cent per annum."

166 "We have thus an *annual* charge upon the revenue of double the amount of the *aggregate net*
(continued...)

> "[I]t is impossible to be blind to the fact that nothing but the sacrifice of a large part of the capital invested can justify a hope of saving any of the reminder...
>
> The complicated position of the Company with various classes of creditors must render any such arrangement very difficult, and the ordinary Courts of Law may be insufficient to deal with a concern of such magnitude, and whose property is spread over six different jurisdictions...the interest of the public, can hardly be left in the hands of legal tribunals alone, and the interference of the legislature may be necessary to facilitate the reconstruction of the Company. But the success of any attempt to give the Company a fresh start must depend mainly upon the cooperation of the various classes of creditors themselves...
>
> The first and greatest consideration therefore, is by the united action of the various creditors and the Legislature, to make such a compromise amongst all parties interested, as will make solvency possible."[167]

This recommendation by the Langton Committee was criticised and rejected at a meeting of investors held in London on the grounds that it amounted to a confiscation and would permanently sacrifice half the invested capital. A committee appointed by the investors had reported that *The Grand Trunk* needed a moratorium of five years to pay off its floating debt and to bolster its physical assets and earning power. Further, each category of creditors would have to make concessions in the short term so that *The Grand Trunk* could extricate itself from the difficulties it had faced from the beginning.[168] The investors accepted, with minor amendment, the proposals made by its committee and shortly after in June 1862, based on these lines, the Parliament of the Province of Canada passed the *Grand Trunk Arrangements Act, 1862* (hereafter GTAA 1862).[169]

Once more, the strong vein of public interest, that was common in railways on both sides of the Atlantic, is seen, in the preamble from the point of view of the Canadian Parliament, to be the *raison d'etre*, for the passage of this Act. The fact that several creditors had obtained judgement against *The Grand Trunk* and that much litigation was also pending against it, is said

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166(...continued)
earnings during the eight years the road has been open". *Report of the commission appointed to enquire into the affairs of the Grand Trunk Railway* - Quebec, Stewart Derbyshire & George Desbarats, Printer to the Queen, 1861. p.61

167 ibid. pp.61 & 62

168 Currie, op.cit.,supra pp.79-83

169 25 Vict.1862.C.56. Unfortunately there are no debates of the Legislative Assembly of United Canada for the period 1861-2, The Canadian Assemblies and Legislative Councils appear to have kept only journals as the sole official records of their proceedings. - Nish E (Ed) Debates of the Legislative Assembly of United Canada, (currently being reconstructed out of contemporary newspaper reports.) Vol 1 1841, 1970, Quebec, C.I p.XI

to imperil the "keeping open of the Railway for traffic which is of the utmost importance to the interests of the Province".

As in relation to the CRAA 1852 it is not proposed to examine in detail all the provisions in the scheme of arrangement effected by the GTAA 1862 except from the point of view of its effect on the development of the law of corporate reorganization.

Under the GTAA 1862, the status and rights of creditors were altered. The first and second preferential bond holders were given an option, within 5 years of the passage of the Act, of converting their bonds into First and Second Preference Stock, respectively, of "equal nominal amount" in *The Grand Trunk.*[170] The aggregate of the moneys secured by the Ordinary Bonds of the Company was converted without such option to the holders into perpetual stock of the Company.[171] The conversion of Ordinary Bonds into Stock was enforced in section 15 by extinguishing all rights of action and remedies upon and in respect of such bonds, thus enforcing a moratorium on the debt due to the Ordinary Bond holders. Arrears of interest due on all bonds as well as on other debts carrying interest was capitalized and converted into stock[172] which began to bear interest after two years.[173] It was further enacted that no proceedings could be brought against *The Grand Trunk* for the recovery of any arrears of interest due on any bond or debt bearing interest that had accrued prior to 31st December 1862.[174] If during the next ten years any interest or dividend payable on any preferential bonds or shares were to be in arrear no action could be brought in respect of such arrear. Nor could any judgement for the payment of such arrears be enforced against the company.[175]

Those creditors other than the bondholders and the holders of Notarial Mortgages registered in Lower Canada were to be paid out of the moneys received from the Province and the Imperial Government for postal services and the carriage of troops and munitions.[176] *The Grand Trunk* was also authorised to issue Bonds on the security of such moneys and to issue

170 ibid. s.6,7,10 & 11

171 This is probably the earliest occurrence, in a rudimentary manner, of a debt-equity conversion. It will be recalled that in the CRAA 1852 what took place was the reverse. Equity was dissolved and the holders reconstituted as a separate company with a right to an annuity instead of a guaranteed preferential dividend.

172 Bonds or stocks in the case of the first and second preferential bond holders

173 GTAA s.1

174 S.18

175 ibid.s.21

176 ibid. s.1. These included the trade creditors

bonds in favour of the said creditors or dispose of them and use the proceeds for the payment of the creditors.[177] The rights of these creditors were also sought to be curtailed. Under section 25 no execution could issue against *The Grand Trunk* on any judgement recovered or to be recovered for any existing debt owing to the creditors falling within section. 1 & 2.

These provisions described in the preceding two paragraphs were intended to impose a moratorium, at its longest extending for ten years, on the payment of interest on the bonds of *The Grand Trunk*. A slight difference in the extent to which the rights were curtailed must be noted. In the case of the bond holders no action could be brought against the Company. In the case of the other creditors what was restricted was the enforcement of any judgement.

The significant difference between the Caledonian Railway Arrangements Act 1852 and the GTAA 1862 was that the GTAA 1862 had to be accepted by a majority consisting of two thirds in number and amount of the bond and shareholders of the company, present in person or by proxy at a meeting of such bond and shareholders, in which event it took effect retroactively from January 1861.[178] Three fourths of the American and English creditors respectively, whose rights to sue *The Grand Trunk* were restricted under s.23, also had to consent to the alterations to their rights before the relevant provisions became operative against them. The Colonial Parliament here acknowledged, as had the Imperial Parliament in the Law of Bankruptcy that a majority of creditors could and ought to bind a dissentient minority. It must be noted, as in the CRAA 1852, that no distinction is made between classes of creditors.

The question arises however, why the Parliament of Canada, after having given its seal of approval to the scheme of arrangement, left it to the bond and shareholders to determine whether it should be proceeded with or not. The reason, perhaps lies in the transnational nature of *The Grand Trunk's* operations and the multi-nationality of its creditors. Although the Parliament of Canada may have legislated for a mandatory stay of execution against the assets of *The Grand Trunk* within the Province of Canada, such legislation would have had no mandatory binding effect on courts in the State of Maine in America into which the rolling stock of *The Grand Trunk* necessarily ran. What may have been expected, however, was that in the event of execution being sought in Main, owing to the fact that the Courts in Main would take judicial

177 ibid. s.2 The proceeds of these bonds were to be applied to pay a dividend on all debts of the Company (whether judgement or other debts) subsisting at the date of the passing of the Act, other than Bond debts, arrears of rent and interest, of notarial mortgages registered in Lower Canada, and debts (if any) incurred in respect of working expenses subsequent to 31/12/1861. - s.22.

178 ibid. s.39

notice of the GTAA 1862, *The Grand Trunk* would not have to engage in the costly exercise of proving the terms of the arrangement and be able to speedily obtain a stay. This clearly indicates that what was expected to protect the assets of *The Grand Trunk* outside the territory of Canada was not the Statute itself but the agreement on the part of a three fourths majority of creditors to accept the terms of the arrangement embodied in the Statute. This further presumes that the Courts in Main and even in England would uphold the principle of majority rule among creditors.

The GTAA 1862 was soon put to the test in *The Eastern Townships Bank v. The Grand Trunk Railway Co of Canada.*[179] The Plaintiff was a creditor which came within S.1 of the GTAA 1862 who had filed action on a promissory note made by the Defendant, *The Grand Trunk*. *The Grand Trunk* had pleaded that the GTAA 1862 was in force all the formalities having been complied with, and that under the Act no action could be brought against it on the promissory note. No evidence had been led by *The Grand Trunk* in support of the plea and judgement had been entered for the Plaintiff. The Plaintiff had seized a locomotive engine in execution and *The Grand Trunk* filed an opposition to the seizure on the ground, inter alia, that it had not made payment under S.1 of the GTAA 1862 because it had not received the postal monies and that therefore it was unable to make payment as specified in the Act. The Court construed the act as obliging *The Grand Trunk* to make payment of "the proportion of postal monies or postal bonds and to offer fourth preference stock for the balance before they could pretend that the judgement debt of the plaintiffs was extinguished, or their right to an execution taken away."[180] This judgement demonstrates how jealously the Courts guarded a creditor's right to recover his debt and how restrictively any statute seeking to restrict it was interpreted.

The Debacle of the London Chatham and Dover Railway Company and The Railway Companies Act 1867

Back in England, the sixth decade of the 19th Century witnessed important developments in the statute law relating to the reorganization of insolvent companies, a process set in motion by the collapse of the London Chatham and Dover Railway.

Overend, Gurney & Co, Credit Foncier & Mobilier, Imperial Mercantile Credit, Peto, Betts & Crampton (Contractors), the London Chatham & Dover Railway Company were some of the more famous names in British banking, commerce and the railway industry that were driven into insolvency in the year 1866 together with a host of others. Of these only the London

179 (1863) 13 Lower Canada Reports, p.455

180 ibid. p.45

Chatham & Dover Railway Company (hereafter the *LCDR*) survived, owing to a compromise and arrangement with its shareholders. It is not proposed to, nor is it necessary, to examine the causes of its insolvency and the arrangement arrived at with its creditors, as in the case of *The Caledonian* and *The Grand Trunk*, except for the purpose of ascertaining how it served as the catalyst in the reform of Parliament's method of dealing with insolvent railway companies.

When the LCDRC defaulted on the payment of interest and principle on its debentures, several debenture holders made applications to the Court of Chancery for the appointment of a receiver and manager to take over the management and running of the railway and to sell some of the surplus land that it owned, which applications were granted. [181] These orders were discharged on appeal on the grounds that they were "beyond the authority and at variance with the practice of this Court". Elaborating on this statement, Cairns L.J. identified two main reasons for the discharge of the orders. Firstly, he took the view that:

> "...this Court does not assume the management of a business or undertaking, except with a view to the winding up and sale of the business or undertaking. The management is an interim management; its necessity and its justification spring out of the jurisdiction to liquidate and to sell; the business or undertaking is managed and continued in order that it may be sold as a going concern, and with the sale the management ends. To the management of the undertakings of the [*], assumed by the Vice Chancellor's orders ... no limits short of repayment of the whole debenture debt could be assigned, for it has not been and could not be contended that there would at the hearing of the cause be any power of selling the undertakings."

The inability on the part of the Court, under the law as it then prevailed, to wind up a railway company underlies this reasoning. Cairns L J however, adduced another reason which is based on the limitations inherent in companies incorporated by Parliament:

> "But in addition... there is that peculiarity in the undertaking of the railway, which would,...make it improper for the Court of Chancery to assume the management of it at all. When Parliament acting in the public interest authorises the management and construction and maintenance of a railway...it confers, powers and imposes duties of the largest and most important kind, and it confers and imposes them upon the company which Parliament has before it, and upon no other body or person. These powers must be executed, and these duties discharged by the company. They cannot be delegated or transferred. The company could not by agreement hand over the management of the railway to the debenture holders. It is impossible to suppose that the Court of Chancery can make itself or its officer, without any Parliamentary authority, the hand to execute these powers, and all the more impossible, when it is obvious that there can be no real

181 Details of the application for and the appointment of the Receiver and Manager are found in (1867) 15 WR (Ch) 325. The appointment of the Receiver and Manager was also adverted to with some concern by the then President of the Board of Trade in the House of Commons. 1866 CLXXIV Hansard (3rd Series) 1902

and correlative responsibility for the consequences of any imperfect[182] management.

However, while the matter was still *sub judice,* the LCDRC put forward a scheme of arrangement which it proposed to enter into with its debenture holders, for which it hoped to obtain Parliamentary approval.[183] Under the proposed scheme the LCDRC sought the power to raise a further sum as capital with a *preference over its existing mortgage debt.* The scheme was severely criticized in the press on the grounds, firstly, expressing the wider principle, "that bankrupt companies should not be allowed to bring in Bills providing new laws for themselves," secondly, that "creditors should not be subjected to the expense of resisting arrangements framed by the bankrupts for their own advantage" and finally, that if the scheme were approved by Parliament it would seriously prejudice the credit of railway debentures.[184] The Board of Trade took notice of these criticisms and, shortly thereafter, introduced into Parliament a Bill to make better provision for the arrangement of the affairs of Railway Companies unable to meet their engagements.[185] This Bill however was not intended to interfere with any pending arrangements and consequently the LCDRC was allowed to proceed with its Bill[186]

182 (1867) 15 WR (Ch) 325 at pp.327 & 328

183 London Chatham and Dover Railway Company - Report of the Committee of the Main Line Shareholders; London Chatham and Dover Railway Company -Complication made clear. 1866 and London Chatham and Dover Railway Company - A few remarks on reconstruction. 1869.

184 Lord Redesdale who publicly argued in favour of the debenture-holders in letters published in ***The Times***, of 28 November and 15 December 1866. The proponents of the scheme argued that these objections were contrary to the practice with other bankrupts, subject to the general law of bankruptcy which allowed voluntary settlements and private arrangements with the assent of a certain proportion of the creditors. Lord Redesdale countered stating that "the private arrangements...are for an economic division of assets honestly given up, in which the priority rights such as those possessed by the debenture-holders would be duly recognized, whereas in the London Chatham and Dover case the bankrupt does not surrender his property and pays no regard to priorities." - ***The Times***, 29 December 1866

185 In seeking leave of the House of Commons to introduce the Bill, the President of the Board of Trade said, "there is one urgent question of great magnitude, ...that is the question of the arrangements that should be made in the case of railway companies which are unfortunately unable to meet their engagements." Adverting to the public interest in the railways as the grounds for the Bill he further said "We must look on railways as undertakings which have been specially favoured by Parliament - not for the sake of the persons who undertake to construct them - not for the sake of the shareholders, the creditors, or any other class of persons interested in them, but as undertakings to which Parliament has afforded great facilities, because they were considered to be of importance to the communication of the country, and for various public purposes...and whilst we are prepared to give all due attention and consideration to the rights of individuals, we have a right to demand that some arrangement shall be made for securing the rights of the public. - 1867 Hansard 3rd Ser Vol.CLXXXV 89

186 This culminated in the London Chatham and Dover Arrangement Act 1867 and the London Chatham and Dover Arbitration Act 1867

The Bill, as introduced, proposed to invest the Board of Trade with the power, upon application from the creditors or the shareholders of a railway company, to appoint inspectors to investigate into the affairs of the company and to prepare a scheme of arrangement to be ratified by Parliament for which the Board would make itself responsible.[187] Much amendment, however, was made to the Bill at the Select Committee stage.

The Railway Companies Act 1867[188] enabled the Directors of a railway company unable to meet its engagements with its creditors, to prepare a scheme of arrangement between the Company and its creditors, and to file it in the Court of Chancery having jurisdiction over it, together with a declaration in writing under the Common Seal of the company that it was unable to meet its engagements, supported by an affidavit of the Chairman of the Board of Directors of that company to that effect.[189] Once the scheme had been filed the company could apply to the Court to restrain any action against the company. Notice of the filing of the scheme had to be published in the Gazette, and on publication, no execution, attachment or other process against the property of the company was available without the leave of Court.[190] By this provision Parliament recognised, as it did in earlier Bankruptcy arrangement provisions with regard to individual bankrupts, that the automatic stay of final process against the company and the ability to apply for a stay on actions against the company was an essential step in the reorganization of its affairs.

This act further refined the principle that in deciding whether to enter into an arrangement a majority of creditors ought to be able to bind a dissentient minority.

Schemes of Arrangement attempted under the Companies Act 1862

The *Companies Act* 1862, empowered a company's liquidators generally to enter into any compromise or other arrangement as they deemed expedient with the creditors[191] of the company.[192] Provision was also made for the liquidators to compromise all calls, debts, liabilities and claims, which subsisted or were supposed to subsist between the company and any

187 1867 Hansard 3rd Ser Vol.CLXXXV 98

188 30 & 31 Vic c.12

189 *ibid.* s.7.

190 ibid. ss. 8 and 9

191 The term creditors was defined widely and included persons having or alleging themselves to have a claim present or future, certain or contingent, ascertaining or sounding only in damages against the company or whereby the company may be rendered liable.

192 s.159 CA 1862 [U.K.].

contributory or other debtor or person apprehending liability to the company and to give a complete discharge in respect of such calls, debts or liabilities.[193] Clearly the former applied to creditors and the latter to contributories and persons indebted to the company. The only requirements that the liquidators had to comply with were: to obtain the sanction of the Court if the company was being wound up by the Court, or subject to its supervision, or the sanction of an extraordinary resolution of the company, if it was being wound up voluntarily. It is not entirely clear whether the relevant sanctions had to be obtained before each creditor's agreement was obtained or thereafter. The courts however acted on the basis that the sanction had to be obtained after the compromise or arrangement had been procured.[194] There was no provision for meetings of the creditors to be summoned to consider the compromise or arrangement and no indication that the creditors assent could be obtained collectively or that any majority of creditors who assented to the compromise or arrangement would bind the dissentient minority. It appears that the agreement of each creditor had to be individually obtained, and only those creditors who assented were bound. Although the provision did enable a compromise or arrangement it did not expressly enable compromise or arrangement to be entered into which bound a dissentient minority and restricted them from seeking to render the agreement null by insisting on the payment of their debts and having the company wound up nevertheless.

There are however at least two decisions, one of the Privy Council and the other of the Chancery where a creative and progressive approach was taken in making a compromise or arrangement entered into by the liquidator under these provisions binding on the dissentient minority of creditors. *Re The Eastern Financial Association (Ltd.): The Bank of Hindustan, China and Japan v. The Eastern Financial Association*[195] was a case which arose under the identical provisions contained in the *Indian Companies Act* 1866.[196] The liquidators had entered into a compromise with the contributories which limited the amount payable by them on the liquidators' calls. This compromise was apparently required because of difficulties in constituting

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193 Calls included liabilities to calls, debts included liabilities capable of resulting in debts and claims included contingent and prospective claims. See s.160 CA 1862 [U.K.].

194 See *Re The Risca Coal and Iron Co.* (1862) 3 LJR (N.S.) CH & B 283 (A case which was decided under the provisions of the *Joint Stock Companies Act* 1857, 20 & 21 Vict., c.14.); *Re The Commercial Bank Corporation of India and the East* (1869) 38 LJR (N.S.) CH & B 525, (1868-69) 17 WR 840. See also *Re The Eastern Financial Association (Ltd.): The Bank of Hindustan, China and Japan v. The Eastern Financial Association* (1868-69) 17 WR 554 (Decision of the Judicial Committee of the Privy Council, on appeal from the High Court of Judicature, Bombay, India.)

195 (1868-69) 17 WR 554.

196 ss.173 and 174, Act No.10 of 1866.

the list of contributories and the expense which would be incurred in litigation in the process. The compromise appeared to have the approval of contributories and the consent of the "larger number of creditors". Only the Appellant Bank being creditors for a large amount opposed the compromise which was sanctioned by the High Court, in the exercise of its original jurisdiction and on appeal thereafter. The question before the Privy Council was whether the court had the jurisdiction to sanction such an agreement.

It is not entirely clear why the liquidators of the company sought the approval of the creditors. There was no statutory obligation placed on them to do so since the creditors were not parties to the compromise entered into with the contributories. The sanction of the court as required by statute would have protected the liquidators from any action for misfeasance under the statute.[197] Since payment had to be made to the creditors only ratably and not in full,[198] the creditors would have been bound to accept the dividend paid by the liquidators. Nevertheless, the liquidators did seek the views of the creditors and it is perhaps equitable that they did so. The Privy Council, took the view that the Indian Courts had the discretion to sanction such an agreement thus binding the contributories and creditors. It also formed the opinion that the compromise agreed to was in the best interests of the creditors. Whilst it would appear that, in the absence of a statutory provision which provides for a specified majority to bind the minority, this decision is indefensible, it certainly was progressive, creative and foreshadowed the legislative developments to come. Although it set no precedent which is binding on English Courts, it was not long before Lord Romilly M.R was persuaded to apply this reasoning to the case of *Re The Commercial Bank Corporation of India and the East*[199] which arose in the English Court of

THE JOINT STOCK COMPANIES ARRANGEMENTS ACT 1870

Although railway companies could now come to a compromise or arrangement with their creditors under the Railway Companies Act 1867, the lot of other companies facing financial difficulties remained unchanged to the extent that no innovative uses of ss.159 and 160 of CA 1862 [U.K.] were made. As with railway companies, the financial difficulties facing the Albert Life Assurance Company and other insurance companies were the subject of much discussion and comment in the newspapers of the day. Interestingly the initiative to assist these companies overcome their difficulties was taken, not by the Board of Trade of the time, but by a member

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197 Under s.165 CA 1862 [U.K.].

198 s.133 read with s.150 CA 1862 [U.K.].

199 (1869) 38 LJR (N.S.) 525; (1868-69) 17 WR 840.

of Parliament, Mr Henry B. Sheridan who, together with Mr. Sergeant John Simon, (Later Sir John), presented a Private Member's Bill entitled the *Joint Stock Companies Arrangements Bill.*[200] The purpose of this bill was to facilitate compromises and arrangements between creditors *and* shareholders of joint stock companies in liquidation. Unfortunately, the measure died on the order paper that year. However, undeterred, the promoters of the Bill, supported by Mr.Brogden, presented the same bill the next year as well. On the day it received Royal Assent, *The Times* reported:

> Mr.Sheridan's Bill to facilitate compromises and arrangements between creditors and shareholders of Joint Stock Companies in liquidation has passed through parliament. It was supported by all the law officers of the Crown and also by the Board of Trade. The Bill applies not only to all companies that may come into liquidation, but to all now in liquidation. It can therefore be resorted to in the case of the Albert Life Assurance Company, which the Vice Chancellor James recently avowed his inability to deal with, owing to the existing law giving him no power to authorise the required reconstruction."[201]

The principles which were developed under the law of bankruptcy and extended to railway companies in 1867, were finally made available to the companies as a whole.[202]

The Joint Stock Companies Arrangement Act 1870 (hereafter the JSCAA 1870 [Eng.]) was spartan in appearance, containing a mere three sections the most important provisions being contained in one of them. A notable difference between the Bill as presented and the Act as passed was that the latter enabled compromises and arrangements only between the company and its creditors or class thereof. It had no application to the shareholders. It also applied only to companies which were at the time the act was passed or afterwards, in the course of being wound up either voluntarily or by or under the supervision of the Court, under the Companies Act 1862 and 1867. Although the Act may be described as remedial, since companies that were already in financial difficulty and being wound up could make use of its provisions, it did not permit a scheme of arrangement to be made outside the confines of a terminal liquidation procedure.

If a compromise or arrangement had been proposed between a company and the creditors of such company or any class of such creditors, the court was given the power on the application on the summary way of any creditor or the liquidator, to order that a meeting of creditors or a

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200 Parliamentary Papers (H.C.) 1868-69, Bill No.140, 111.253.

201 Wednesday 10th August 1870, p.7, cl.a.

202 It is interesting to note that a scheme of arrangement is the preferred method of reorganizing troubled insurance companies even today. See: Wilkinson and Sutherland, "Creditors' Schemes of Arrangements: Their use for troubled Insurance Companies in the London Market." (1993) 2 *Int.ILR* 30.

class of creditors be summoned. If a majority in number representing three fourths in value of such creditors or class of creditors present either in person or by proxy at the meeting agreed to any arrangement or compromise, arrangement would become effective if sanctioned by an order of the Court, binding on all creditors or class of creditors as the case may be, and also on the liquidator and contributories of the company. The Court it would appear had no jurisdiction to amend the compromise or arrangement approved by the creditors. All it could do was to sanction or reject the scheme.

The wording has changed very little in the its present incarnation as section 425 of the Companies Act 1985. The procedure, has today been described as arduous, and there is nothing to indicate that it was not so in the 19th Century, since little use appears to have been made of it. Even in the case of the Albert Assurance Company the proposed scheme of arrangement was not successful because the meetings of classes of creditors had not been held.[203] At the time the moratorium itself was not a problem, in that voluntary or compulsory winding up proceedings had to be commenced before a company was entitled to use the procedure. However the initiation of such a procedure was accompanied by all the disadvantages usually associated with winding up.

Although the Act itself remained silent as to the effect a sanctioned scheme of arrangement would have on the winding up proceedings, clearly it was expected that in some cases such proceedings should be discharged since the compromise or arrangement was made binding upon the contributories to whom the company would revert when solvent.

TRANSPLANTING THE JSCAA IN AUSTRALIA AND CANADA

Transplanting the JSCAA in Australia

Legislation on the lines of the English Joint Stock Companies Arrangements Act, 1870 [JSCAA, 1870 (Eng.)] was passed by the parliaments of several Australian Colonies in the late 19th Century,[204] shortly before the coming into being of the Commonwealth of Australia.[205] The first colony to do so was Queensland, which in 1889,[206] adopted s.2 of the JSCAA, 1870

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203 See (1871) 40 LJR (N.S.) CH & B 505.

204 Statutory provisions which permitted companies under going a voluntary winding up to enter into a compromise or arrangement with its creditors already existed. The Companies Act, 1874, (N.S.W.) 37 Vict. No.19. ss.187 & 188. But since a company had to be solvent for the purposes of a members voluntary winding up (a creditors voluntary winding up not being available at the time) such provisions will not be examined.

205 Commonwealth of Australia Constitution Act, 1900, (U.K.) 63 & 64 Vict., c.12

206 The Companies Act Amendment Act, 1889, (Qld) 53 Vict., No.1

(Eng) as part of its Company Law. New South Wales followed suit with its own Joint Stock Companies Arrangements Act in 1892.[207] [JSCAA, 1892 (NSW)].

The New South Wales statute, while copying s.2 of the JSCAA, 1870 (Eng.) added a new dimension to the compromise and arrangement procedure. It may be recalled that the JSCAA, 1870 (Eng.) as at this date applied only to Companies that were undergoing a winding up. Under the New South Wales statute the Court was given the power, even where the company was not in liquidation, and a compromise or arrangement had been proposed between the company and its creditors or any class of them, on the application of the company or of any creditor, to restrain further proceedings in any action, suit, petition, or proceeding against the company.[208] The Court was authorised to order a meeting of the creditors, or class of them, to be summoned. If, as in s.2 of the JSCAA, 1870 (Eng.) a majority in number representing three fourths in value of the creditors, or class of them, present, either in person or by proxy or attorney, at the meeting, agreed to any arrangement or compromise, the arrangement, once sanctioned by an order of the Court, was binding upon the company and its shareholders, and upon all the creditors or class of creditors.

Further, the Court was given the power before sanctioning any arrangement or compromise, on the application of the company or of any creditor or person interested in the company, to order meetings to be summoned and inquiries to be made as it thought fit, and most importantly, to alter or vary the arrangement or compromise, and to impose any conditions in its execution.[209]

Both these sections may be viewed as introducing significant developments in the compromise and arrangements procedure. Not only did s.3 extend the ability to enter into a compromise or arrangement to companies that had not gone into a winding up, it also gave the protective moratorium that a winding up order brought without the attendant disadvantages. A moratorium is perhaps the most essential requirement for a successful rescue/reorganization. If it is not available the entire scheme of compromise or arrangement is always at risk, for a single creditor has the ability to destroy a carefully negotiated scheme by putting the company into liquidation. An unscrupulous creditor may also make use of its nuisance value to obtain a preferred status for itself by threatening to scuttle the scheme.

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207 (N.S.W.) 55 Vict.,No.9.

208 Ibid. s.3 The extension of the JSCAA 1870 (Eng.) to apply outside a winding up was made only in 1906, although no power to concurrently stay proceedings against the company was given

209 Ibid. s.4

It was seen that when it came to sanctioning a scheme in England, the Court had no authority, to hear the company or any creditors that opposed the compromise or arrangement that had been ratified by the required majority, or to modify the agreement if it so wished. The New South Wales Statute conferred upon its Court the power to do so, and invested not only the company and the creditors but also any third person interested in the company with the *locus standi* to make such an application. This may be viewed as an erosion of the democratic principle, so hesitantly adopted into English bankruptcy and insolvency law, that a determination by a majority of creditors in relation to a compromise or arrangement proposed by a debtor, should bind the minority, and a further erosion of the principle that Courts and, more importantly, third parties should not interfere with creditors' contractual rights. But it may be argued that the New South Wales Courts would have interfered, at the behest of the company, a minority or individual creditor or even an interested third party, only if, for example, the arrangement was *mala fide* or there was any impropriety in the obtaining of the majority vote[210] and as such it was really in fact a refinement of the procedure to safeguard the parties original contractual rights.

The power to stay proceedings was widely drawn and would have included in its scope the stay of actions brought by persons having unliquidated claims for damages in tort. If such a person's action was stayed he may not have been able, as of right, to attend the meeting because he was not by definition a creditor and had no right to be summoned. Such a person may have petitioned the Court under this section if his claim was threatened by the scheme of arrangement approved of at the meeting.

Further a "majority in number representing three fourths in value present, either in person or by proxy or attorney, *at the meeting*," must be distinguished from a majority of three fourths in value of the entire body of creditors. The views of the former may not necessarily accurately represent the views of the latter. Under the English provision which applied only in a winding up all the Court had to do was to decline to sanction the arrangement arrived at.[211] Although this may have been sufficient and appropriate where the creditors were already before the court and a liquidator, an officer of the Court, had been appointed, the extension of the arrangements procedure to companies outside a winding up necessitated an extension of the Court's powers as

210 Eg. "Overruling a majority [physically present] by proxies." -*In re Anglo-Australian Investment, Land and Finance Company, Limited.* 1892 13 N.S.W.R. p.3

211 S.2 of the JSCAA, 1870 states "...such agreement shall *if sanctioned by an order of Court,* be binding on all such creditors..." (italics added).

well. Even if the manner in which the scheme had been arrived at was perfectly proper there may have been an important minority, which had not been present, or had been out voted at the creditor's meetings. A slight amendment of the scheme might satisfy this minority plus keep the majority happy without having to incur the expense of calling another meeting of the creditors. The ability of the Court to amend the scheme enabled the reorganization process to be kept alive.

An application for the varying of an arrangement or compromise outside a winding up, acceded to by the requisite majority of creditors was made in the case *In re Anglo-Australian Investment, Land and Finance Company, Limited.*[212] on the grounds that it would work hardship for one of the creditors. The Court while viewing the applicant's case with sympathy held that it was not justified in interfering with a general arrangement merely because it would work individual hardship.[213] In his Order the judge also reserved leave to all parties to apply to the Court to consider any matter that may have arisen after the sanction of the scheme without having to file a suit in equity.[214] A safeguard, omitted by the legislature. made necessary because of the stay operating on any action, suit, petition, or proceeding against the company.

Far reaching though the alterations and additions to the procedure were, their application was restricted in time by an amendment to the bill made by the Legislative Council. No application could be made to the court, nor could any order made under section 3 after the 1st of January, 1896.[215] This proviso took away the power of companies to enter into an arrangement with their creditors prior to the commencement of a winding up and brought the law back in line with the Imperial Statute of 1870. The only difference was that the Court continued to have the powers conferred by s.4.

It appears from the relevant Parliamentary Debates[216] that these provisions were

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212 1892 13 N.S.W.R. p.3

213 Ibid at p.40

214 Ibid at p.41

215 Proviso to s.3

216 All standing orders of the Legislative Council were suspended and the Joint Stock Companies Arrangements Bill (N.S.W.) passed through all its stages at one sitting. Mr. R.E.O'Conner who introduced the measure into the Legislative Council urged as grounds for suspending such standing orders: "Hon members are no doubt aware that in this country there are a very large number of land, building, investment and banking companies...It is because these companies and the investors in them are placed in a peculiarly delicate position at the present time that I urge these measures should now be passed...the precipitation of the liquidation of any one or two of the important companies would very probably lead to a financial panic, and it is very likely that if one, two or three of the companies were wound up, or if proceedings were taken to wind them up, the result (continued...)

introduced and rushed through parliament, as indeed have been most insolvency and rescue laws, at a time of commercial and financial crisis. The same crisis seems to have affected both Queensland and Victoria around this same period.

Queensland's response was, by an amendment to the Companies Acts 1863 to 1892 to extend, like New South Wales, the power of Court to stay proceedings and sanction a compromise before a winding up.[217] The new provisions were substantially the same s.3 of the New South Wales' statute except for the fact that the Queensland Act applied only after a petition for the winding up of a company had been presented but before the winding up order had been made and that there was no restricting proviso which limited its application to three years. Limiting provisions were however introduced within three years in 1896, but they only withdrew the power of Court to restrain further proceedings in any action, suit, petition, or proceeding against the company.[218] Consequently, Courts in Queensland had the power to sanction a compromise or arrangement after a petition for winding up had been presented but before a winding up order had been made. The 1896 amendment also extended s.35 of *"The Companies Act Amendment Act of 1889"* (Qld.) to apply not only as between the company and the creditors or any class of them but as between the company and the members or any such class as well[219] thus preempting the English Companies Act amendment of 1900.[220]

In Victoria the crisis of the early 1890's was dealt with in a completely different manner.[221] The Companies Act 1890 provided that no petition for the winding up of a company could be presented by a creditor to Court unless the consent in writing of one third of the company's creditors had been obtained for the presentation. The burden placed upon the creditor by this provision was heavy as he may not have known who the company's other creditors were and may have had difficulty getting access to such information. It also opened the door for the

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216(...continued)
would be a commercial panic probably more disastrous than has occurred in this city for many years." - New South Wales Parliamentary Debates 1st Ser, 1891-92, Vol LV, pp.3800 & 3801

217 The Companies Act of 1893. (Qld) 57 Vict.No.3. The preamble states: "Whereas doubts have arisen whether the provisions of the thirty-fifth section of *"The Companies Act of 1889"* are applicable to companies where no order has been made or resolution passed for the winding up of such companies, and it is expedient to remove such doubts..."

218 An Act to Amend "The Companies Acts, 1863 to 1893., 1896 (Qld) 60 Vict. No.21. s.2

219 Ibid.s.3

220 63 & 64 Vict. c.48

221 The Companies Act 1890, (Victoria) 54 Vict. No.1074

company being wound up to raise technical objections as to whether the creditors whose consent had been obtained were creditors at all. It threw the burden of establishing and perhaps proving a debtor creditor relationship upon a third party.

It may be said that in the Australian Colonies of New South Wales and Queensland, the compromises and arrangements procedure had by the end of the 19th Century taken two steps forward and one step back. they had copied and made changes to the provisions first introduced by the Imperial Parliament. They were ahead, but only just.

Transplanting the JSCAA in Canada

Canada by this time had long been a Federal State with a Federal Constitution, styled the *British North America Act.*[222] Under this constitution, bankruptcy and insolvency are matters over which the Dominion Parliament has exclusive legislative authority. Consequently, statutory provision for an *insolvent* corporation to reorganize its affairs with its creditors and members could only be made by the Dominion Parliament.[223]

Within two years of the promulgation of the *British North America Act* the Dominion Parliament of Canada enacted the *Insolvent Act*, 1869.[224] Six years later this Act was repealed and replaced with a new statute on the subject.[225] This too did not last long, being repealed in 1880. From that date onwards until 1919[226] the sole Dominion statute governing the subject of bankruptcy and insolvency was the *Winding Up Act.*[227]

Statutory provisions in the nature of those contained in the *JSCAA* 1870 (U.K.) were first introduced into Canada in 1899 by an amendment to the *Winding Up Act*[228] in 1899.[229] The

222 1867, 30 Vict. c.3

223 For a detailed analysis see Ch.2 supra

224 32-33 Vict. Chap.XVI, 1869.

225 *Insolvent Act,* 1875, 38 Vict., Chap.XVI.

226 (effectively 1920 because the *Bankruptcy Act,* 1919 became operative only on the 1st of July 1920)

227 (1886) R.S.C. c.129, amended in 1889. See generally Houlden, L.W., "Bankruptcy in Canada" in *Special Lectures of the Law Society of Upper Canada: 1956,* (Part 1 Bankruptcy), Richard De Boo Ltd., Toronto, 1956, p.1.

228 (1886) R.S.C. c.129. When enacted in 1882 the Winding Up Act 45 Vict. c.23 contained in s.64 provision for the liquidator to make compromises or arrangements with creditors. But such compromises or arrangements would have bound only the creditor/s concerned and not those who dissented. These provisions still survive as s.38 in the Winding Up Act R.S.C. 1985 W-11

229 The Winding Up Amendment Act 1899, 62-63 Vict. c.43

amending provision[230] was in all material particulars identical to section 2 of the JSCAA 1870 (U.K.).[231] As in England, at this date, this section applied only in the event of a winding up.

The law governing companies in Canada, unlike bankruptcy and insolvency, may be either federal or provincial.[232] Due however, to the federal nature of bankruptcy and insolvency law, a company incorporated under provincial legislation could be liquidated under the Federal Winding Up Act only if it was insolvent.[233] Consequently, a provincial company could enter into a compromise or arrangement with its creditors only if it was undergoing an insolvent winding up under the Federal Act. The position for companies incorporated under federal companies legislation appears to be different. Since, under the federal Winding Up Act, both solvent and insolvent liquidations are possible, such companies could in theory enter into an arrangement with its creditors if it was being wound up for reasons other than insolvency. However, by its very nature, a compromise or arrangement with creditors implies the insolvency of the debtor, and therefore the practical effect of this distinction, if any, would be slight.

Similar provision permitting compromises and arrangements between a company and its shareholders was first introduced into the federal Companies Act in 1923[234] Such a scheme

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230 The Winding Up Amendment Act 1899, supra, s.3.

231 There is however a difference in that in the Canadian statute the words "...compromise or arrangement is proposed between a company... and the creditors of the company, *or by and between any such creditors* or any class or classes of such creditors and the company," is used instead of "compromise or arrangement shall be proposed between a company...and the creditors of such company or any class of such creditors" as used in the English statute. A moot question arises whether the Canadian section lends itself to the interpretation that under it creditors may enter into an arrangement between themselves without any reference to the debtor company

232 "As a matter of constitutional law,the federal government has the sole jurisdiction to incorporate companies with other than provincial objects, and companies incorporated under the federal act have the power to carry on business throughout Canada subject to compliance with the laws of general application of any province in which they so carry on business. A province on the other hand can only confer, on companies incorporated by it, actual powers and rights exercisable within the province." See Sutherland H. & Horsley D.B. (Eds),*Fraser's Handbook on Canadian Company Law (6th Ed)*, Toronto, The Carswell Company Ltd., 1975. p. 2

233 Sutherland H. & Horsley D.B. (Eds), *Fraser's Handbook on Canadian Company Law(6th Ed)*, Toronto, The Carswell Company Ltd., 1975. p 495; Mitchell V.E. *A treatise on the law relating to Canadian Commercial Corporations*, Montreal, Southam Press Ltd, 1916 expresses a contrary view at p.1441.

234 S.C 1923 c.39.s.4 first consolidated in R.S.C.1927, c.27.ss.144,145. Following the English amendment to the Joint Stock Companies Act, 1870 in 1901. Sec 144 governed compromises and arrangements entered into between the company and its shareholders outside a winding up. Once winding up proceedings had been commenced such arrangements were governed by s.145. An amendment to s.144 in 1930, 20-21 Geo.V. c.9. s.38., which extended the construction of the (continued...)

between a company and its members was considered a matter of "Property and Civil Rights" and not one of "Bankruptcy and Insolvency" and was, consequently within the legislative jurisdiction of the provinces and also available outside a winding up under the federal companies legislation. These provisions closely mirrored the provisions in the Companies Act 1908 (Eng.) and were transferred to the Business Corporations Act. Today, however, although an arrangement with the members may be made under the same part of the Canadian Business Corporations Act the means of arriving at one has been substantially altered. The section providing for compromises and arrangements with the creditors of a company however, remains almost intact in the current Winding Up Act.[235]

The question is whether these provisions in the Winding Up Act were a satisfactory means of rescuing a company's business? If after entering into a compromise or arrangement under this section a company was able to resume its business, then it may have been worth while dealing with the disadvantages that follow a company undergoing a winding up even temporarily. This appears to have been the case in England. In the Canadian case of *Beauchemin v. Canadian Navigation of the St Lawrence Co.,*[236] a company which was being wound up entered into a compromise with over three fourths in value of the creditors, and the compromise was sanctioned by the Court. It was held that the Company was to have been regarded as having resumed the direction of its affairs and the powers of the liquidator as having ceased.

Thus, at the turn of the century, the position in Canada as regards corporate rescue by way of a scheme of arrangement was identical to the position in England at the same time. The provision in the Winding Up Act (Can.) could not be amended to apply to circumstances other than a winding up not due to a reluctance on the part of the Canadian legislature to extend the procedure, but due to the limiting influence of the British North America Act, 1879.

234(...continued)
term "arrangement" to re-organization of share capital, incorrectly describes s.144 as giving "power to a company to make compromises and arrangements with its *creditors* and members". This perhaps lead Duncan & Reilley to state "...*The Winding Up Act* provides for a rearrangement before a winding up order has been made brought" [*Bankruptcy in Canada (Being the 2nd Edition of Duncan on Bankruptcy)* -Toronto, Canadian Legal Authors Ltd., 1933. p.190.] In the foot notes however, Duncan & Reilley incorrectly describe the amendment as one to the Winding Up Act. The present provisions pertaining to schemes of arrangements with shareholders is contained in Part XV of the Canadian Business Corporation Act R.S.C

235 1985 R.S.C. W-11 ss.65 & 66

236 10 Que.P.R. 41

THE LOREBURN COMMITTEE'S PROPOSALS RE ENGLISH SCHEMES OF ARRANGEMENT

By s.24 of the Companies Act 1900,[237] the application of s.2 of the JSCAA, 1870 was extended to apply not only between the company and its creditors but as between the company "and the members, or any class thereof". This amendment enabled the members of the company to be joined in the reorganization process. However, many imperfections in the procedure remained and a further attempt was made to remedy them shortly thereafter when English Company Law came under the scrutiny of the Loreburn Committee.

The Companies Act 1907[238] was passed as a result of the recommendations made by the Loreburn Committee.[239] With reference to arrangements and reconstructions under the JSCAA, 1870 (Eng.) the Committee observed that, under the law as it then stood, no remedy other than liquidation was available to a company in difficulties. Since the JSCAA, 1870 applied only to a company in the process of being wound up, a liquidation, with its attendant disadvantages, was required even where a majority of creditors and shareholders were willing to enter into an arrangement to rehabilitate the company. The Committee opined:

> "It seems anomalous, and in practice found inconvenient, that a winding up should be required as a preliminary condition to an arrangement between the company and its creditors. We think that the provisions of the Joint Stock Companies Arrangement Act, 1870, should be extended so as to enable a company, without going into liquidation, to effect an arrangement with its creditors, subject to the sanction of the Court, and with the safeguards imposed by the Acts."[240]

By s.38, the 1907 Act extended the application of the 1870 Act to companies not in the course of being wound up. Sir Francis Palmer, a member of the Loreburn Committee, commented on the extension of application of the 1870 Act:

> "This section came into operation on 1st July, 1908. It will effect a much needed amendment of the law. Under the law as it stands, it is necessary, before invoking the assistance of the court under the Act of 1870, at least to pass an effective resolution for winding up. Next day a summons can be taken out for the convention of meetings under the act to consider a scheme and on proper evidence an order will be made, and when the scheme has been approved by the meetings the Court can give its sanction and stay the winding up. To wind up even temporarily is in some cases perilously inconvenient, and there seems to be good reason for enlarging the jurisdiction of the court to enable it to sanction a scheme without a winding up. Hence the above section."[241]

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237 63 & 64 Vict. c.48.

238 7 Edw.VII. c.50.

239 Cd.3052 Parliamentary Papers 1906. Vol.XCVII.

240 Cd.3052 Parliamentary Papers 1906 Vol XCVII

241 Palmer, Sir Francis B., *The Companies Act, 1907, and the Limited Partnerships Act, 1907* (2nd (continued...)

As to whether the Loreburn Committee's expectations were realised and the amendment itself was adequate would be demonstrated by the extent to which companies have since this date resorted to this procedure to rescue itself from an insolvent state.

The period 1907 to 1985 saw these provisions being consolidated with the rest of companies legislation in 1908[242] and then passed down through successive Companies Acts in a substantially unaltered form.[243]

THE CANADIAN COMPANIES CREDITORS ARRANGEMENTS ACT 1933

Out of the great depression that gripped North America in the 1930's was born the *Companies' Creditors Arrangements Act*,[244] (hereafter the CCAA [Can.].) Since "legislation in respect of compositions and arrangements is a proper component of a system of bankruptcy and insolvency law" and as the CCAA [Can.] created powers exercisable "in case, and only in case, of insolvency" it was within the legislative jurisdiction of the Federal Parliament.[245]

The CCAA [Can.] followed very closely the wording in s.153(1) of the Companies Act, 1929 [U.K.].[246] It provided that where a compromise or arrangement was proposed between

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241(...continued)
ed.), London, Stevens, 1908, p.44

242 The Companies (Consolidation) Act, 1908 incorporated at s.120 the provisions of the Joint Stock Companies Arrangements Act, 1870, as amended, and repealed that Act. See Part 1 of Schedule VI.

243 Section 425 replaced s.206 of the 1948 Act, which replaced s.153 of the 1929 Act which in turn extended s.120 of the 1908 Act.

244 S.C.1932-33. C.36. Presently contained in R.S.C. 1985 c.C-36. The Hon C H Cahan, who introduced the bill in the House of Commons said "At the present time some legal method of making arrangements and compromises between creditors and companies is perhaps more necessary because of the prevailing commercial and industrial depression, and it was thought by the government that we should adopt some method whereby compromises might be brought into effect under the supervision of the Courts without utterly destroying the company or its organization, without loss of good-will and without forcing the improvident sale of the assets." - Debates of the House of Commons of the Dominion of Canada, 1933, 4th Sess.,Vol.IV, p.4091. Moving the second reading of it in the Senate the Rt. Hon. Mr. Meighan said "The depression has brought almost innumerable companies to the pass where some arrangement is necessary in the interest of the company itself, in the interest of the employees - because the bankruptcy of the company would throw the employees on the street - and in the interest of the security holders, who may decide it is much better to make some sacrifice than run the risk of losing all in the general debacle of bankruptcy." Debates of the Senate of the Dominion of Canada, 1932-33, 4th Sess., p.474.

245 Per Duff.C.J.C. in *The Matter of a Reference Concerning the Constitutional Validity of the Companies' Creditors Arrangements Act, 1933, A.G. of Canada v. A.G. for Quebec and A.G. for Ontario*. 1934 16 C.B.R. p.1. at pp.1 & 2.

246 Presently s.425(1) of the Companies Act 1985.

a debtor company and its unsecured creditors or any class of them,[247] or its secured creditors or any class of them[248] the Court could, like in England, on the application of the company, or of any creditor or the trustee in bankruptcy or the liquidator of the company, order a meeting of the creditors or such class, and if it thought fit, the shareholders of the company, to be summoned in the manner directed by the Court.

The CCAA [Can.] makes heavy weather of emphasising the fact that it applies to both secured and unsecured creditors by having two separate sections to set out otherwise identical provisions for each category. No reason for this is adduced in any of the debates of either House of the Dominion Parliament nor in any of the commentaries on the statute. The English provision clearly applies to both categories and reason for so dividing the two sections is made more inexplicable by the treatment of both categories of creditors together in the very next section.

The significant difference between the English provision and the CCAA [Can.] is the fact that the English provision encompasses schemes of arrangement with shareholders as well. The reason for their exclusion from the scope of the CCAA [Can.] is constitutional. That an arrangement with the members of a company is often part and parcel of one with creditors was recognised by the Dominion Parliament which made provision for the CCAA [Can.] to be applied together with provisions in Dominion or Provincial legislation which authorises or makes provision for the sanction of arrangements between a company and its members or a class of them.[249] Under the CCAA [Can.] an application to Court under s.4 or 5 may be made by the trustee in Bankruptcy. This is possible because, unlike in England, insolvent Canadian companies may make use of the Bankruptcy Act as well as the Winding Up Act.

Section 6 of the CCAA [Can.] provides that, as in England, if a majority representing three-fourths in value of the creditors, or a class of them present and voting either in person or by proxy at the meeting summoned by the Court under sections 4 and 5 or either of them agree to any compromise or arrangement, as proposed or as modified or altered at the meeting or meetings, the compromise or arrangement may be sanctioned by Court. If so sanctioned, it binds all the creditors or class of them and any trustee for any class of creditors whether secured or unsecured and the company. If the company has made an assignment under which a receiving order has been made under the Bankruptcy Act or is in the course of being wound up under the

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247 R.S.C.1985, c.C-36, s.4.

248 R.S.C.1985, c.C-36, s.5.

249 Ibid s.20.

Winding Up Act, it also binds the trustee in bankruptcy or liquidator and the contributories of the company.[250] The contributories are bound by the Court's sanction under the CCAA [Can.] only if the arrangement is entered into in the course of specific proceedings under the *Bankruptcy Act* or the *Winding Up Act*. If the contributories are to be bound otherwise then, constitutionally, it must be under the applicable Companies Act, provincial or federal. Once again this section was originally based on section 153(2) of the *Companies Act* 1927 [U.K.].[251]

It is at this point that the CCAA [Can.] as originally drafted parts company with the English statute. Since it was a statute introduced to remedy a particular state of affairs the federal parliament was able to make the procedure complete.[252]

By an amendment in 1953 the scope of the CCAA [Can.] was severely curtailed by the introduction of what is now section 3. This section provided that arrangements and compromises could be entered into only if the debtor company had an issue of debentures and the arrangement or compromise included one with the debenture holders. This catapulted the CCAA [Can.] procedure into one that could be made use of mainly by large companies, able to launch debentures in the Capital Markets.

Section 7 of the CCAA [Can.] empowers the Court to direct adjournments of meetings that have been summoned to accommodate any alteration or modification of any scheme. The Court is also empowered to direct that it is not necessary to adjourn or convene any meeting of any class of creditors or shareholders, which, in the opinion of the Court, is not adversely affected by the alteration proposed, and also to sanction any altered or modified scheme. The Court is not permitted to make any alteration to the scheme. Such alteration must flow from the company or creditors.

The CCAA [Can.] it is said to extend and not limit the provisions of any instrument that governs the rights of creditors or any class of them. It is also not possible to contract out of the application of the CCAA [Can.] since it takes effect notwithstanding anything to the contrary contained in an instrument which governs the rights of creditors.[253]

What is perhaps the most important feature of the CCAA [Can.] is the fact that the Court is empowered on the application of any person interested in the matter, with or without notice to

250 Ibid. s.6.

251 Now s.425(2) of The Companies Act 1985.

252 See the extracts from the Commons and Senate Debates in f.n. 47 supra.

253 Ibid.s.8

any other person, to order a moratorium. It may stay all proceedings taken or that might be taken under the Bankruptcy Act and/or the Winding Up Act; restrain further proceedings in any action, suit or proceeding against the company on such terms at it sees fit; and order that no suit, action or other proceeding be proceeded with or commenced against the company except with the leave of, and subject to such terms imposed by Court.[254] This power may be exercised notwithstanding anything to the contrary in the *Bankruptcy Act* or the *Winding Up Act*.

A claim is defined as any indebtedness liability or obligation of any kind that if unsecured would be a debt provable in bankruptcy within the meaning of the Bankruptcy Act.[255] The procedure to be used in determining the amount of a claim of any secured or unsecured creditor is also set out. If the claim is unsecured and proceedings are pending under the Winding Up Act or if the Company has made an authorized assignment or if a receiving order has been made against it in the Bankruptcy Act then proof must be made according those statutes.[256]

Duncan writing in the year the CCAA [Can.] was enacted opined that, from the point of creditors, the scheme introduced by this statute marked a definite retrogression in Dominion legislation on insolvent corporations. He stated:

> "Whatever may be the experience in other jurisdictions, ample experience in Canada has demonstrated that creditors are not able to protect themselves when a company makes a proposal of compromise under an Act of Parliament unless they have first had an opportunity of examining the books and transactions of the debtor company through their own trustee."[257]

A commentator writing in 1947[258] expressed the view that although the CCAA [Can.] has "great potential importance...it has received little attention in either Canadian legal literature or the decisions of the Courts". Although this may have been the position in 1947 another commentator writing in 1993 says that the failure of the old Bankruptcy Act[259] as a tool for reorganization resulted in "once obscure statutes such as the [CCAA] being widely used as the

254 Ibid.s.11

255 Ibid.s.12(1)

256 Ibid.s.12(2).

257 Duncan & Reilley, *Bankruptcy in Canada (2nd Ed of Duncan on Bankruptcy)*, 1933, Toronto, Canadian Legal Authors Ltd., p 1108. See also Biddell, J.L., "Proposals under the Bankruptcy Act and the Companies' Creditors Arrangements Act" in *Special Lectures of the Law Society of Upper Canada: 1956*, (Part 1 Bankruptcy), Richard De Boo Ltd., Toronto, 1956, p.80.

258 Edwards, Stanley E, "Reorganizations under the Companies' Creditors Arrangement Act", (1947) 25 *Canadian Bar Review*, p.587.

259 Replaced in November 1992.

reorganization statute of choice."[260]

Other rescue procedures in Australia and Canada

Proposals with unsecured creditors under the Canadian Bankruptcy Act

Attention has been drawn to the fact that in the years between 1880 and 1920 the sole piece of Federal legislation governing matters of bankruptcy and insolvency in Canada was the *Dominion Winding Up Act*.[261] Any arrangement between the company and its creditors had to be entered into under this statute, as discussed above, after placing the company in winding up. With the passage of the *Bankruptcy Act*, 1919 [Can.][262] an insolvent debtor, (which term also included an insolvent company) could, for the first time, make a proposal to its creditors without going into a terminal insolvency proceeding. This privilege did not last long, because the provision which enabled such a proposal was repealed in 1923. The right to make a proposal remained but it could be utilised only after a debtor who had been made bankrupt. According to Biddell:

> "The difficulty with this arrangement was the natural reluctance on the part of any person to be adjudged bankrupt with the result that he usually continued business far past the point where any compromise arrangement with creditors was possible."[263]

In effect the law returned to the pre-1919 position and remained so until the passage of the CCAA [Can.] in 1933.

A few years later in 1949, a new *Bankruptcy Act* was passed.[264] This statute consolidated all amendments made to that date, and made some significant changes as well. One of these significant changes was the re-extension of proposal procedure under the BA [Can] to insolvent persons outside a bankruptcy.[265]

Thus far, only matters concerning the enactment and applicability of the procedure have

260 Tay, Derrick C, "Canadian Bankruptcy Reform - The move from liquidation to rehabilitation", (1993) 1 *IILR* 45.

261 R.S.C. 1906 c.144. *n.b.* since this act was limited to companies, this meant that between this period there was no federal bankruptcy or insolvency law which regulated the affairs of an insolvent individual.

262 9-10 Geo. V, c.36.

263 Biddell, J.L., "Proposals under the Bankruptcy Act and the Companies' Creditors Arrangements Act" in *Special Lectures of the Law Society of Upper Canada: 1956*, (Part 1 Bankruptcy), Richard De Boo Ltd., Toronto, 1956, p.81.

264 13 Geo. VI c.7.

265 See Houlden, L.W. "Bankruptcy in Canada" in *Special Lectures of the Law Society of Upper Canada: 1956*, (Part 1 Bankruptcy), Richard De Boo Ltd., Toronto, 1956, p.4.

been discussed and not the nature of the procedure itself. It is not intended to discuss the nature of the procedure in very great detail at this stage because it is, in many respects, a "current" procedure which will be subjected to much greater scrutiny in the chapters to follow. For the present, a brief description would suffice, with attention being drawn to aspects of the procedure which are no longer applicable. All references to sections will be the sections contained in BA [Can.] R.S.C. 1985, c.B-3 as amended up to 1992.

The procedure under Part III, BA [Can.] permitted a company as an insolvent person to make a proposal to its creditors by lodging a copy of the proposal with a licensed trustee, accompanied by a statement of its financial position at the date of the proposal.[266] This had the effect of staying the enforcement remedies of all unsecured creditors.[267] The claims of secured creditors could not be stayed except for a period of six months after the proposal had been approved by the court. A meeting of the unsecured creditors had to be summoned by the licensed trustee to consider the company's proposal. During the period between the filing of the proposal and the creditors' meeting the trustee was required to make an appraisal of the affairs and property of the company making the proposal for the purpose of being able to estimate the company's financial position and the cause of its financial difficulties or insolvency. The trustee had to report the result of his appraisal at the meeting of the creditors.

At the meeting a majority in number and three fourths in value of the creditors with proven claims, present in person or by proxy, and voting on the resolution could resolve to accept the proposal. Such an acceptance is, nevertheless, subject to the rights of secured creditors. A secured creditor could opt to be bound by the proposal if it gave up its security for the benefit of the unsecured creditors. If the proposal had been accepted the trustee was obliged to make an application to court to approve the proposal. If the court approved the proposal it became binding on all creditors with provable claims against the company and who were affected by the terms of the proposal. If the creditors rejected the proposal the company was automatically declared bankrupt.

A proposal has been described as "a contract between the debtor and his creditors"[268] But it should be noted that it is not an entirely voluntary contract since a specified majority is

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266 s.50.(1) BA [Can.] If the company was bankrupt it had to be lodged with the trustee of the estate.

267 s.69(1) BA [Can.].

268 *Employers' Liability Assurance Ltd v. Ideal Petroleum (1959) Ltd*(1976) 26 C.B.R. (N.S) 84 (S.C.C.), per de Grandpré, J, at p.92. For earlier formulations of the same principle see *Caplan, Re; Lawrence v. Dashiff et al.* (1969) 15 C.B.R. (N.S.) 191.(Que S.C.); *Lipson, Re; (Sterling Dress Company)* (1923), 3 C.B.R. 640 (Ont.S.C.) per Fisher J. at p.643.

able to bind the minority.[269] Thus, it appears from the foregoing that the proposal procedure as enacted in BA [Can.] 1949 was in many ways a refinement on the schemes of arrangement procedure which preceded it. The absence of any need to make an application to court; the ability to trigger a stay and that too without a court application; the provision for some supervision of the company's affairs in the hiatus between the filing of the proposal and the creditors' meeting are a definite improvement over spartan schemes of arrangement procedure. Despite the improvements, the procedure was not as successful as expected, particularly as a means of ensuring a corporate reorganization. This was mainly because it did not provide for a stay on secured creditors until the proposal had been approved.

Official Management under the Australian Corporations Law

Down in the Antipodes, 1961 saw the introduction of a considerably different rescue procedure known as "Official Management" into the Australian Uniform Companies Legislation. Having been repealed by the *Corporate Law Reform Act*, 1992, this procedure is no longer part of the CL [Aust.]. Nevertheless, it must be considered even briefly for the sake of completeness and because it adopted a very different approach to the rescue of insolvent companies, compared with Schemes and Proposals. It appears to have been based on the Judicial Management procedure introduced into South Africa in 1926 but with a greater emphasis on *creditor* management rather than *judicial* management.[270] In place of a statutorily binding arrangement with the insolvent company's creditors, which is the objective of a scheme or proposal, this procedure sought to achieve a complete reversal of the company's financial situation (*i.e.* the repayment of all its debts in full) through what was hoped would be a better and more efficient management of the company's affairs. In a scheme or a proposal the company's creditors could resolve to enter into a composition with the company. By requiring the payment of all debts in full, the final objective of Official Management was, therefore, considerably higher than that of a scheme or a proposal. In the ensuing discussion references will be made to those statutory provisions in force up to the date of its repeal.

The procedure involved the vesting of the company's management in an "Official

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269 *Abacus Cities Ltd., (Trustee of) v. AMIC Mortgage Investment Corp.* (1991) 2 C.B.R. (3d) 196 (Alta.Q.B.). See the dictum of Forsyth J. at p.201.

270 The South African regime seems to have had its roots in English and American procedures and was associated with "the concept of bankruptcy and developed from the practice of appointing receivers in equity." See Patterson, W., Ednie, H., and Ford, H., *Australian Company Law* Vol.3., (3rd ed., Revised,) Butterworths, Australia, at [333/1].

Manager" appointed by the special resolution of the creditors at a meeting summoned and held for that purpose.[271] Although the appointment was made by the creditors, the act of summoning the creditors' meeting could, from the company's point of view have been either voluntary or involuntary. Thus, a majority of the directors of the company could have resolved to summon the meeting of the creditors, or the meeting could have been requisitioned in writing by a judgement creditor whose debt, of at least AU$ 1000/-, had not been paid.[272] The special resolution of the creditors to place the company under an Official Manager was passed if a majority in number and 75% in value of those creditors present and voting in person or by proxy agreed to the resolution.[273] The decision of the majority was statutorily binding on the minority.

Immediately upon the special resolution being passed, the company was deemed to be under official management for the period specified in the resolution, which could have been for a maximum period of three years from the date of the resolution.[274] There were two major consequences of a company being placed under Official Management. Firstly, the directors of company ceased to hold office and the person appointed as Official Manager assumed their powers, duties and functions.[275] Secondly, an automatic moratorium which prohibited the commencement or continuation of any legal proceedings against the company applied for the duration of the Official Management.[276] Such proceedings could be commenced or continued only with the leave of court.

The Official Manager has been described as being more of a "company doctor" than a Receiver.[277] On being appointed, an Official Manager was required to take into his custody and control all the property to which the company was or appeared to be entitled and to conduct the business and management of the company in the manner which would be most economical and beneficial to the interests of both the creditors and the members of the company.[278] To this end, the Official Manager was also given the power to sell or otherwise dispose of the company's

271 s.439 CL [Aust.] (rep s.56 CLRA, 1992).

272 s.436 CL [Aust.] (rep s.56 CLRA, 1992)

273 s.435(2) CL [Aust.] (rep s.56 CLRA, 1992).

274 ss.442(1)(a) and 439(1)(a) CL [Aust.] (rep s.56 CLRA, 1992).

275 s.442(1)(b)-(d) CL [Aust.] (rep s.56 CLRA, 1992).

276 s.444(1) CL [Aust.] (rep s.56 CLRA, 1992).

277 See Patterson W., Ednie, H., and Ford, H., *Australian Company Law*, *supra* at [333/1].

278 s.448(1)(a) & (b) CL [Aust.] (rep s.56 CLRA, 1992).

property in the ordinary course of business.[279] Property could be disposed of otherwise than in the ordinary course of business only if the value of the property did not exceed AU$ 5,000/-.[280] In conducting the company's business, the Official Manager was, however, obliged to comply with any directions given to him by the creditors pursuant to a special resolution. He was also statutorily bound to perform all the statutory duties imposed by law on a company's directors.[281] The Australian legislature also invested in the Official Manager a power hitherto enjoyed only by the Trustee in Bankruptcy and the Liquidator. This was the power to avoid any settlement, conveyance or transfer of property, a charge on property, a payment made or an obligation incurred by the company in the same manner as would a trustee in bankruptcy of an individual.[282]

As mentioned above, the only objective of Official Management was the repayment of creditors in full. If at any stage the Official Manager formed the opinion that this objective could not be attained by the continuation of the Official Management, he was required to summon a meeting of the company's members to determine whether the company should be placed in voluntary liquidation.[283] The Official Manager also had the power to make an application to court for the company to be wound up on the ground that it was unable to pay its debts.[284] But, once the Official Manager determined that it would not be possible to pay the company's debts in full, it appears that he would have no option but to summon the meeting of members.

Official Management was rarely attempted because of the procedure's unrealistic target of repaying every creditor in full within a specified period of time.[285] Nevertheless, the

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279 s.450(1) CL [Aust.] (rep s.56 CLRA, 1992).

280 s.450 (2) CL [Aust.] (rep s.56 CLRA, 1992).

281 s.448(1)(d) CL [Aust.] (rep s.56 CLRA, 1992).

y282 s.449(1) CL [Aust.] (rep s.56 CLRA, 1992).

283 s.448(3) CL [Aust.] (rep s.56 CLRA, 1992).

284 s.462(2)(f) read with s.460(1) CL [Aust.] (rep s.56 CLRA, 1992).

285 See *Harmer Report*, para.47, p.26. Patterson, Ednie, and Ford observed in 1984: "In our original edition [1962] we said it would remain to be seen whether official management would be of any real substantial assistance to the industrial potential of Australia or whether there would be little use of this Part because of other more affective remedies available to creditors. In our Second Edition in 1972 we said that experience since 1962 had shown that many official managements had been unsuccessful. We said however, the blame for that was not the legislative provisions for official management. Some of the earlier failures were the result of invoking the provisions where, for one reason or another, the circumstances were unfitted to be dealt with under official management. Since 1972 official management has remained more or less in the background; and (continued...)

procedure was not without its champions who, in comparing Official Management with Chapter 11 Bankruptcy in the United States and the then proposed Australian Voluntary Administration procedure, have argued that:

> "[I]n a philosophical sense, Official Management is far superior to both the more popular Reorganization procedure used in the United States and the new Administration procedure proposed for Australia"[286]

Although eventually considered unsuccessful and repealed, the enactment of the Official Management procedure marks a significant development in the law of corporate rescues. It statutorily recognised for the first time that "management" of the company had a role to play in a corporate rescue. It also confirmed the necessity for a moratorium during the life of the procedure to protect the company from precipitous actions of the creditors.

"WELCOME WINDS OF CHANGE": BANKRUPTCY AND INSOLVENCY LAW REFORM

For well nigh a hundred and ten years the law governing corporate insolvency, in general, and insolvency rescue procedures, in particular, in England, Australia and Canada resembled stagnant lakes which were ruffled but occasionally by the gentle breeze of an amendment. Despite the amendments made in 1906, the schemes of arrangements procedure in the English Companies Acts were little used. There were, as has been seen, occasions when "Lakes" Canada and Australia were more than ruffled when strong single gusts carried in the Companies Creditors' Arrangements Act and the Proposals with unsecured creditors under the Bankruptcy Act in Canada and Official Management under the Corporations Laws in Australia. These isolated gusts however caused no more than a few waves on the otherwise still lakes and these procedures soon settled like sediment, remaining mostly unnoticed and unused by Canadian and Australian Companies. In the 1970s and 1980s however, a series of proposals for reform gathered like storm clouds over the horizon with strong gale force winds of change ready to churn up the sediment and even wash it ashore.

Messrs. Tassé, Cork, Colter, and Harmer

The first sign of reform clouds beginning to gather was in February 1966 when the Canadian Minister of Justice, who was responsible to Parliament for the administration of the

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285(...continued)
our 1972 comments apply equally to the period since 1972." See *Australian Company Law*, (3rd ed., Revised,) *supra*, [333/1].

286 See McCabe, B., "Official Management v. Reorganization under Chapter 11 of the United States Bankruptcy Code: In Defence of Official Management" (1992) *20 Australian Business Law Review* 320 at 335.

Canadian Bankruptcy laws appointed a committee to "review and report on the bankruptcy and insolvency legislation of Canada". The committee of three, which was chaired by Mr. Roger Tassé, submitted its report in June 1970 to the Minister of Consumer and Corporate Affairs who had taken over the responsibility to Parliament for the *Bankruptcy Act.* The committee's main recommendation was that piece-meal reform by way of amendments to the existing *Bankruptcy Act* 1949 should give way to an entirely new statute.[287] One of the chapters of the report was devoted to the aims and objectives of the proposed new Bankruptcy Act. Among the several aims and objectives identified were the "rehabilitation of the debtor"[288] and the "protection of the credit and economic system".[289] The discussion on the first of these objectives centred around the individual debtor and was not extended by the Committee to companies. Later on it observed:

> "There is [*] a strong public interest in the economic recovery of an enterprise that has failed or is in danger of failing. Such an enterprise, *provided it is economically viable*, should be given all economic opportunities to be reorganized".[290] [italics added]

This was mentioned by the committee, however, as an aspect of protecting the credit and economic system and not of the rehabilitation of the debtor.[291]

Across the Atlantic in England, in January 1977, a committee under the chairmanship of Sir Kenneth Cork (as he later became) was appointed by the President of the Board of Trade, charged with the responsibility of reviewing insolvency law and practice. The terms of reference of the "Cork Committee," as it came to be known, were: "to review the law and practice relating to insolvency, bankruptcy, liquidation and receiverships in England and Wales and to consider what reforms are necessary or desirable; to examine the possibility of forming a comprehensive insolvency system and the extent to which existing procedures might, with advantage, be harmonised and integrated; to suggest possible less formal procedures as alternatives to bankruptcy and company winding up proceedings in appropriate circumstances; and to make recommendations."[292] Like the Tassé Committee, the Cork Committee, also rejected piece-meal amendment to the existing law in favour of a whole new act governing both individuals an companies. The Cork Committee also had its own statement of the objectives of insolvency law,

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287 *Tassé Report* para.0.0.15, p.xiii.

288 *ibid.* para.3.0.10 p.87.

289 *ibid.* para.3.0.12 p.87.

290 *ibid.* para.3.0.13 at p.88

291 *ibid.* para.3.0.12 p.87.

292 Report of the Review Committee on Insolvency Law and Practice; Cmnd 8558 HMSO London 1982: para 404, p.iii.

and in it observed that:

> "The aims of a good modern insolvency law include the provision of means for the preservation of *viable* commercial enterprises capable of making a useful contribution to the economic life of the country."[293] [italics added]

Elsewhere in its report Cork Committee pointed out in connection with rehabilitation that where companies are concerned, society's interest does not run to the "preservation or rehabilitation of a company as such, though it may have a legitimate concern in the preservation of a commercial enterprise."[294]

Back in Canada, sadly the Tassé Committee's recommendations never found their way on to the statute books. Although between 1970 and 1984, six bills based on the *Tassé Report* and containing an entirely new bankruptcy law were presented from time to time in the Canadian Dominion Parliament, the Government of the day never had the will to see them enacted. Thus in March 1985 the Minister of Consumer and Corporate Affairs appointed a special Advisory Committee, under the chairmanship of Mr.Gary Colter, to recommend ways of amending the existing bankruptcy law rather than enacting an entirely new one.[295] Like its predecessor, the Colter Committee too recognized that:

> "Bankruptcy legislation should allow for effective reorganizations and support the maintenance of *viable business enterprises*."[296] [italics added]

In November 1983 the Federal Attorney General of Australia asked the Law Reform Commission of Australia to inquire into the law and practice relating to the insolvency of both individuals and bodies corporate. The Harmer Commission, as the commission came to be known, was concerned that the pre-reform legislative approach to corporate insolvency was conservative in that it did not emphasise or encourage a constructive approach to corporate insolvency law which, for example, focused upon the "*possibility* of saving a business (as distinct from the company itself) and preserving employment prospects.[297] The Harmer Commission saw the salvation of failed or failing companies or even those that were viable not so much as a specific objective of insolvency law but rather as a consequence of achieving a "fair and orderly process of dealing with the financial affairs of insolvent individuals and companies" which, in the

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293 *Cork Report*, para.198

294 *Cork Report*, para.193.

295 See the *Colter Report*, p.18.

296 *Colter Report*, p.20.

297 *Harmer Report*, para.52.

eyes of the Commission was one of the aims of insolvency law.[298] It took the view that a constructive or creative approach to insolvency required "the preservation, where practical and possible, of the property and business of the company in *the brief period* before creditors are in a position to make an informed decision."[299]

There appears to be a significant difference between the rescue objectives identified by Tassé, Cork and Colter Committees on the one hand and the Harmer Commission on the other. In the case of the former, the viability of the commercial enterprise is an essential requirement. Clearly such requirement is logical and necessary if the law is to have commercial sense. The vital question to be answered is whether it is a *threshold* requirement which must be satisfied before the rescue laws have effect. In the Harmer Commission's view, viability of the enterprise was clearly not a question which the law was concerned with. That was a matter for the creditors to decide and the objective of the law was to provide them with an opportunity to do so.

Criticisms of the existing regimes

Recognition of Receivership and Managership as a "rescue" procedure

The practice of the English Court of Chancery to appoint a Receiver to protect a person's equitable interests in property by receiving its income may, it is claimed, be traced as far back as to the middle of the 15th Century.[300] The appointment by the Court of a Receiver *and Manager* with powers to manage that property is a practice of comparatively recent origin.[301] The distinction between the two roles of Receivership and Managership is perhaps best described in the following, oft cited, words of Jessel M.R. in *Re Manchester and Milford Rly Co.*:

> A "receiver" is a term which was well known in the Court of Chancery, as meaning a person who receives rents or other income paying ascertained outgoings, but who does not, if I may say so, manage the property in the sense of buying and selling or anything of that kind. We are most familiar with the distinction in the case of partnership. If a receiver was appointed of partnership assets, the trade stopped immediately. He collected the debts, sold the stock in trade and other assets, and then under the order of the Court the debts of the going concern were liquidated and the balance divided. If it was desired to continue the trade at all it was necessary to appoint a manager or a receiver and

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298 *Harmer Report*, paras 33 and 53.

299 *Harmer Report*, para.53.

300 See O'Donovan J., *Company Receivers and Managers*, The Law Book Company Ltd., 1981, p.2.

301 In *Re Newdigate Colliery Ltd.* [1912] 1 Ch. 468, Cozens Hardy M.R. said, "The jurisdiction of the Court is extremely old, but I believe the practice of appointing a manager is far more modern..." at p.472.

manager as it was generally called. He could buy and sell and carry on the trade."[302] Jessel M.R. was clearly referring to the practice of the Court of appointing Receivers and Managers. However, the business community rapidly developed the practice of the debenture holder appointing a Receiver and Manager under powers contracted for and set out in a floating charge.[303]

The English floating charge, may be described as a charge upon the whole or substantially the whole of the company's present and future property which in the ordinary course of business would change from time to time. It is said to "float" because from the date the charge is executed and until the occurrence of a specified event, the charge does not attach to any of the property to which it is said to apply but hovers over them, enabling the company to trade with that property. Upon the occurrence of the specified event, which is commonly default by the company in the repayment of moneys secured by the charge, the charge is said to crystallise. On crystallisation it attaches to all the property to which the company has title, excluding those subject to other prior encumbrances.

A well drawn floating charge usually empowers the holder to appoint a receiver and manager over the property charged, which would, usually, cover the whole property and undertaking of the company.[304] The charge,[305] as described above, usually gives the receiver and manager extensive powers to carry on the business of the company thereby preserving its goodwill and maintaining its going concern value. In certain instances the receiver and manager has been able to restore an ailing enterprise to profitability and return it to its former owners. In other instances the receiver and manager has been able to sell whole or part of the business of the company as a going concern. All this may be done without the debenture holder incurring

302 (1880) 14 Ch D 645 at 653.

303 "Mortgagees began to insist upon the appointment by the mortgagor of a receiver to receive the income, keep down the interest on incumbrances, and hold the surplus, if any, for the mortgagor, and to stipulate often that the receiver should have extensive powers of management. Presently mortgagees stipulated that they themselves should in place of the mortgagor appoint the receiver to act as the mortgagor's agent." *Gaskell v. Gosling* [1896] 1 Q.B. 669, *per* Rigby L.J. at pp.691-692.

304 The other options include the power to take possession, which is not normally exercised and due to the near penal nature of the liabilities imposed upon a "mortgagee in possession" the Courts of Equity in the latter half of the 19th Century "were very slow to decide that possession had been taken". See *Gaskell v. Gosling* [1896] 1 Q.B. 669 per Rigby L.J. at p.691. In New South Wales, Australia, it appears that if the debenture provides for the appointment of a receiver and manager the debenture holder would not be able to appoint a receiver only of income. *Harold Meggitt Ltd. v. Discount Finance Ltd.* (1938) 56 W.N. (N.S.W.) 23.

305 And by statute in Australia. See s.420 CL [Aust.].

any liability, since, until the commencement of a winding up by the appointment of a liquidator, the Receiver and Manager is invariably deemed by the debenture[306] to be the agent of the company.

At the time of the Cork Committee's deliberations the most successful rescues of the business or the viable parts of the business of a company were those that took place under the direction of a receiver and manager appointed by the holder of a floating charge. Although the Cork Committee was quite critical about the floating charge itself, it nevertheless considered the power to appoint a Receiver and Manager of the whole property and undertaking of the company to be of "outstanding benefit to the general public and society as a whole".[307] The British Government also recognised the fact that "one of the very significant benefits to which the floating charge has given rise has been the opportunity which the appointment of a Receiver under a charge offers for the rescue and rehabilitation of the viable parts of a company in difficulties."[308] Thus when the Government's proposals came to be enacted an English Administrative Receiver was specifically given the power to carry on the business of the company.[309]

It should be noted however, that it has been stressed many times that Receivership is not a collective insolvency process but a means whereby a particular secured creditor may recover what is due to him under the charge. It may, therefore be said that receivership acts as a rescue procedure only where circumstances permit or when the receiver is so inclined.

Review of the Schemes of Arrangements Procedure

The remaining methods of rescue, which applied to all companies, were less efficient.

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306 In England, since 1986, an administrative receiver of a company is statutorily deemed to be the company's agent unless and until the company goes into liquidation. s.44(1)(a) IA 1986 [UK].

307 *Cork Report*, para.495.It should be noted that the Cork Committee did not commission any empirical research in order to establish the number of occasions Receivership had resulted in a "rescue" or the "benefit" derived by the General public and the society as a whole. See Rajak, H., "The Challenges of Commercial Reorganizations in Insolvency: Empirical Evidence from England" in Ziegel, J., (Ed) *Current Developments in International and Comparative Corporate Insolvency Law*, Clarendon Press, Oxford, 1994, p.192 at 195; and Fletcher, Prof. Ian F., "The Genesis of Modern Insolvency Law - An Odyssey of Law Reform., p.365 at 371.

308 *A Revised Framework for Insolvency Law*, D.T.I., Cmnd.9175 1984, para.29. The use of Receivership as a means of achieving a rescue had been judicially recognised by Street J., of the Supreme Court of New South Wales in *Duffy v. Super Centre Development Corporation Ltd.*, [1967] 1 N.S.W.R. 382: "To some extent the privately appointed receiver, particularly in current commercial practice, makes an effort to restore the financial prosperity of the company whose affairs he has been appointed to administer by a debenture holder." At pp.383-384.

309 s.42 read with Sch.1, cl.14., IA 1986 [U.K.].

A company could either hope that its creditors would observe an informal moratorium or enter into a formal scheme of arrangement with its creditors under section 206 of the Companies Act 1948, now section 425 of the Companies Act 1985.

Section 206 of the Companies Act, 1948, came under the scrutiny of the Cork Committee. Having observed that it was ironical that the s.206 procedure was today frequently made use of by solvent instead of insolvent companies, for whom it was originally intended, the Committee identified a number of defects in the present procedure which had brought this state to pass.

The great drawback in the s.206 procedure was that there was no moratorium upon the creditors until the scheme was sanctioned by the court.[310] Determining the classes and summoning all the creditors took time. Consequently, a single creditor could scupper a scheme which had the support of the majority by presenting a petition to liquidate the company. Alternatively, by merely threatening to liquidate the company such a creditor could acquire a nuisance value which he could use to gain preferential treatment from the other creditors. The result was that the procedure was not popular and little used as a means of rescue.

The next defect identified by the Committee as inherent in the s.206 procedure was its "formality and complexity." It criticised the need for the Court to be "heavily involved" in the procedure. This "heavy" involvement of the Court takes place on two occasions. First, on the application, usually *ex parte,* by the company[311] to Court to summon the meetings of the creditors/members. Second, on the application to Court to sanction the scheme, if agreed to by the required majority. The fact that the exact wording of the advertisements summoning the creditors and the sanctioning order have to be settled in Chambers appears to be viewed by the Committee as evidence of heavy Court involvement.

The difficulties that attend the determination of classes and the risk that an approved scheme can be destroyed by a single creditor or member alleging at the sanctioning stage that the classes had not been correctly selected is another drawback identified by the Committee.

Further, although a scheme of arrangement may be desirable and be in the interest of all concerned, often when a company is insolvent its management is no longer interested, has left the company or has lost control and there is finally no one in authority with the requisite desire and ability to push the scheme through. While this view may be true of a hopelessly insolvent company that has become so due to the ineptitude of its management, it does not apply to

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310 *Cork Report*, para.408., p.98.

311 The Supreme Court Practice, 1991, p.1468-1471

companies that are often forced into insolvency due to extraneous factors.

Finally the Committee observed that it was not possible under s.206 to compel a secured creditor to agree to a modification or variation of his rights, a step that might be essential if the scheme is to be effective.

Having thus identified the defects inherent in the s.206 procedure the Committee went on to observe that its general overhaul was not within its terms of reference. It concluded by saying:

> "[T]here is no means of substantially improving the present scheme of arrangement process for insolvent companies. However while the section 206 procedure should remain available for insolvent companies, where it may be necessary in the case of a complicated scheme by a large company, we propose two alternative procedures for arrangements by corporate debtors which we consider will facilitate the effecting of fair and reasonable schemes."[312]

The history of the procedure shows that an overhaul of the s.206 procedure in relation to *insolvent* companies was very clearly within the Committee's terms of reference. Whether the Committee took account of the development of similar procedures in other countries is not clear from the report.

The Harmer Commission in the course of it deliberations examined the provisions pertaining to compromises and arrangements in the Australian Corporations Law. It too dismissed the compromises and arrangements procedure as "cumbersome, slow and costly and particularly unsuited to the average private company which is in financial difficulties."[313] It must be noted however, that a number of sections have been added to the procedure after the publication of the report and that what the Law Reform Commission refers to is the procedure that applied at the date of its deliberations.

The Colter report observed that since the Companies Creditors Arrangements Act was available only to debtors who have outstanding bonds or debentures issued under a trust deed the procedure was restricted to relatively large public companies.[314] At the time of the Colter Committee's deliberations the "instant trust deeds" which have made the CCAA [Can.] available to almost all companies had not gained recognition. Thus the Colter report opined that this procedure was not available to the vast majority of companies.

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312 Report of the Review Committee on Insolvency Law and Practice; Cmnd 8558 HMSO, London 1982: para 422, p.101.

313 The Law Reform Commission, Report No.45, *General Insolvency Inquiry*, Canberra, Australian Government Publishing Service, 1988, Vol.1. para.46.

314 *Colter Report,* p.51

The new "rescue" procedures

The saga of corporate insolvency law reform in England, Canada and Australia, which began by the appointment of the first reform committee in Canada the mid 1960's and ended with the enactment of the Corporate Law Reform Act in 1992 in Australia, resulted in the introduction of new statutory regimes directed specifically towards facilitating the rescue of financially troubled companies or parts of their businesses or a better return to the creditors than would be possible in a winding up. The Administration Order Procedure and Company Voluntary Arrangements in the U.K., Business Proposals in Canada and Company Voluntary Arrangements in Australia joined the ranks of Receivership and Managership under a floating charge, and the little used Statutory Compromises and Arrangements. There follows a brief account of the main features of these new procedures.

English Administration Order Procedure

After having identified the features of a Receivership which facilitated the rescue of an insolvent company the Cork Committee stated that "in a significant number of cases companies have been forced into liquidation, and potentially viable businesses capable of being rescued have been closed down for want of a floating charge under which a receiver and manager could have been appointed." It therefore went on to recommend that in all cases where there was no floating charge an administrator should be appointed with all powers normally conferred upon a receiver and manager appointed under a floating charge including the power to carry on the business of the company and to borrow for that purpose.

There is no statutory statement of the object of the administration order procedure in the Insolvency Act, 1986 (U.K.).[315] An administration order is however, defined as one which directs that during the period for which the order is in force the affairs, business and property of the company shall be managed by a person called an administrator appointed for that purpose by the Court.[316]

A moratorium applies from the moment the petition for an administration order is presented. This moratorium does not affect a holder of a floating charge who is able to scupper the application for the administration order by appointing an administrative receiver. If the administration order is made then the moratorium continues in a stronger vein applying even to

315 The preamble to the statute makes no mention of the remedial purpose of the procedure. The Insolvency Act 1985, of which the 1986 Act is a consolidation is similarly silent.

316 s.8(2) IA 1986 [U.K.].

the floating charge holder. On the order being made the administrator takes into his custody all the company's property and also takes control over the management, business and affairs of the company. He must investigate the affairs of the company and formulate a proposal to achieve the objective stated by the court in its order. The administrator is given great powers to achieve the object of the administration order. For example he is able to sell assets subject to charges and also to set aside certain transactions antecedent to the administration order. The administrator's proposal must be presented to the creditors at a meeting summoned for that purpose. If the creditors approve the proposal then the administrator must act in furtherance of the proposal. If it is rejected the administration comes to an end.

English Company Voluntary Arrangements

The Cork Committee recommended, in addition to the statutory enshrinement of Receivership as an insolvency procedure,[317] the introduction of two new procedures entitled "Administration" and "Company Voluntary Arrangements". The two new procedures were initially proposed as two equally viable alternatives to schemes of arrangement. But it is evident that the committee preferred and anticipated a greater use of Administration, which in turn was expected to be used mainly where there was no floating charge or, where there was, the charge holder did not intend to appoint a Receiver and Manager.[318] Finally, therefore, the committee's proposals for a Company Voluntary Arrangement procedure read almost as an aside to its proposals for receivership and administration. It ventured to predict that:

> ".. a Voluntary Arrangement for a company ... is only likely to be used, first, where for some reason it is not appropriate to appoint an administrator and, secondly where the scheme is a simple one..."[319]

Earlier in the same chapter the committee examined methods of re-organization for individual bankrupts, and made detailed recommendations for reform. In this instance voluntary arrangements were the Cork Committee's only choice. Since the recommendations for individual voluntary arrangements were detailed, the Cork Committee hoped that the legal draughtsman would adapt the individual voluntary arrangement procedure already described for use by companies and merely set out a brief guide-line for adaptation. Regrettably, the Government which, readily associated itself[320] with the recommendations made by the Cork Committee on

317 As opposed to a mere debt recovery procedure.

318 Now called the Administrative Receiver.

319 Cork Report, *ibid*, para 430, p.103.

320 White Paper entitled "A Revised Framework for Insolvency Law", Cmnd.9175., February 1984.

receivership and for a new administration procedure, did not even mention company voluntary arrangements. It is not surprising therefore, that the company voluntary arrangement procedure was also left out of the Lords Insolvency Bill introduced in that House on 11th December 1984, and was included only by way of a Commons amendment in June 1985.[321]

The Commons amendment which added to the Lords Bill what is now Part I of the 1986 Act, was based upon the individual voluntary arrangement provisions contained in the bill. It was not debated upon either at the Commons' Committee stage, or upon its return to that House or thereafter to the Lords. In view of the fact that this was but one of approximately 1200 amendments tabled (a record in the history of British legislation)[322] the lack of discussion is perhaps understandable. Still, it is surprising that, although the procedures for administration and individual voluntary arrangements are modelled very closely upon Cork's recommendations, the brief guideline for adapting the individual voluntary arrangement procedure has not been followed.[323] As will become evident later on in this thesis, the company voluntary arrangement procedure suffers from poor adaptation, with the result that the company voluntary arrangements have, thus far, failed to achieve even the limited expectations of the Cork Committee.[324]

Briefly stated the procedure is as follows. The directors of a company could make a proposal for a CVA to the creditors and the company. The proposal had to provide for the appointment of a nominee to act as trustee or otherwise in respect of the proposal. The right to make a proposal for a CVA was also enjoyed by the administrator and a liquidator. The procedure which followed varied depending on who made the proposal of the CVA and who was the nominee. The administrator and the liquidator had the right to appoint himself the nominee. In the case of a proposal for a CVA made by the directors the nominee was required to be an insolvency practitioner. If the administrator or liquidator appointed himself the nominee, all he had to do was to summon meetings of the company and the creditors to consider the proposed CVA. If it was otherwise, the nominee had to examine the proposed CVA and file a report in

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321 Amendment introduced by Mr.Alex Fletcher, Under-Secretary of State for Trade and Industry on 22 June 1985 before Standing Committee E of the House of Commons. See Parliamentary Papers 1984-85, Vol 43 H.C.Papers No.458, p.36.

322 Parliamentary Debates (Hansard) Sixth series, House of Commons Sess 1984-85, Volume 84, c.676, 28 October 1985.

323 The draughtsman has however consciously denied companies the benefit of the moratorium which is available by interim order of the court in individual voluntary arrangements. See ss.252-255.

324 See the figures in Appendix 1 *ante*.

court stating whether he considered it necessary for the meetings to be summoned. If he did, then the meetings were summoned and a vote taken. If the specified majority of the creditors and members approved the proposed CVA it became binding on the creditors who were entitled to vote at the meeting. It was possible to make a proposal to the company's secured creditors, but, such a creditor was not bound by the majority vote. The most significant drawback in this procedure is the lack of a moratorium.

Proposals in Canada

The new procedure adds a new dimension to existing procedure by bringing secured creditors within its scope. It is possible for a company as an insolvent person without going into bankruptcy, to file a Notice of Intention to make a proposal and thereby obtain the benefit of an automatic moratorium. From the day the Notice of Intention is filed, the company has thirty days within which to prepare and file the proposal. The moratorium which comes into force on the filing of the Notice of Intention applies against secured as well as unsecured creditors and lasts until the proposal is filed. The proposal which is filed may be made in addition to the unsecured creditor to the secured creditors as well. Otherwise the procedure remains very much the same. An insolvent person or a bankrupt remains able to file a proposal without filing a Notice of Intention. But as with the proposal pursuant to a Notice of Intention it may now be made to secured creditors. Meetings of the creditors have to be summoned to consider the proposal. If a majority in number and three fourths in value of the creditors present in person or by proxy agree to accept the proposal the trustee must make an application to court for the purpose of obtaining its approval. Once the proposal is approved by the court it binds every creditor in respect of all unsecured claims and every secured creditor who fell into the class of creditors who voted and approved the proposal.

Australian Voluntary Administration Procedure

The procedure is described in the heading of the Part in which it is contained as an "Administration of a company's affairs with a view to executing a deed of company arrangement." The object of the procedure, described in the very first section of that Part, is:

> "[T]o provide for the business property and affairs of an insolvent company to be administered in such a way that:
> (a) maximises the chances of the company, or as much as possible of its business, continuing in existence or
> (b) if it is not possible for the company or its business to continue in existence - results in a better return for the company's creditors and members than would result from

an immediate winding up of the company."[325]

The achievement of this objective is facilitated by handing over of the control of the business of the company to an administrator (for the ease of contradistinction with the English Administrator in the ensuing discussion, hereafter referred to as the "Australian Voluntary Administrator". The Australian Voluntary Administrator is required within a given time frame to examine the affairs of the company and submit a proposal to the creditors which may, or may not, advise the execution of a Deed of Company Arrangement which is directed at achieving the object specified in the statute. Thus, Australian procedure is not an end in it self. It is but a means to an end.

DIFFERENT VIEWS ON INSOLVENT COMPANY RESCUES

Around the period that the Administration and CVA procedures appeared on the statute books in the UK, the Colter Report was being discussed in Canada and the Harmer Commission was carrying out its "General Insolvency Enquiry" in Australia, in America, Professors Jackson and Baird threw down the gauntlet to the champions of corporate reorganizations[326] questioning "whether corporate reorganizations should exist at all".[327] The antagonists' arguments are based on an economic analysis of bankruptcy law which view a bankruptcy proceeding as "the back end of the "creditors' bargain".[328] According to Professor Baird:

> "A bankruptcy proceeding always involves a sale of assets followed by a division of proceeds among the existing owners.[329] In a Chapter 7 proceeding [liquidation] the sale is real; in a Chapter 11 proceeding [reorganization] the sale is hypothetical.[*] [C]orporate reorganization could be justified only if investors[330] before the fact would (if they could) agree to a hypothetical sale of assets instead of a real one.[*] [A]s a general matter, investors taken as a group would rarely prefer the hypothetical sale to an actual one. An actual sale eliminates the potential distortions from a fictive valuation of a firm. More important, the costs of an actual sale are likely to be less than the cost of the procedures needed to prevent manipulation and game playing by the participants in the hypothetical sale. [*] [F]or this reason the entire law of corporate reorganizations is

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325 s.435A CL [Aust.].

326 Jackson, T., *The Logic and Limits of Bankruptcy*, 1986, ch 9; Baird, Douglas G., "The Uneasy Case For Corporate Reorganization" (1986) 15 *Journal of Legal Studies* 127.

327 Baird, D.G., "The Uneasy Case For Corporate Reorganizations" (1986) 15 *Journal of Legal Studies* 127 at 128.

328 "Creditors' bargain" is a phrase coined by Professor Thomas H. Jackson. See Jackson, T.H. "Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain." (1982) 91 *Yale Law Journal* 875.

329 This term included all those with rights to the assets of a firm be they bondholders, stockholders or workers.

330 Given the same meaning as owners above.

> hard to justify under any set of facts and is virtually impossible where the debtor is a publicly held corporation."[331]

Jackson, Baird and others[332] call for market economics to play a greater role in the quest for bankruptcy reorganization. Jackson sees no reason why Chapter 7 of the U.S. Bankruptcy Code, which provides for the liquidation of bankrupt entities, cannot be used as a vehicle to sell the firm as a going concern.[333] Prof. Bebchuk proposes that the procedure under Chapter 11 of the U.S. Bankruptcy Code be substituted by a scheme under which each shareholder is called upon to pay within four days a prorated share of all the debts owed by the company. Should the shareholder fail to make payment, his interest is cancelled without compensation.[334] Some of the criticisms should be understood in the light of the concept of reorganization as embodied in Chapter 11. According to Professors Bradley and Rosenzweig[335] financial distress in business was viewed by the U.S. Congress (during the course of the 1978 reform) and bankruptcy law scholars as an exogenous event. Having examined pre and post 1978 reorganization figures, including returns to creditors, they conclude that the principle beneficiaries of post 1978 reorganizations have been the managers of the companies. Consequently, in their view, managers choose to place companies in bankruptcy making the decision to place the company in bankruptcy endogenous and not exogenous.[336]

The Cork Committee appear to have had forewarning of some of the arguments against rescue/reorganization laws when it stated:

> "It is sometimes argued that the function of insolvency law is simply the distribution of the proceeds of the insolvent's assets amongst his creditors, giving him where appropriate personal relief from their claims. The policy of our insolvency laws has always been far

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331 Baird, *supra*, at pp.127-128.

332 *e.g.* Bebchuk, Prof. Lucian Arye, "A New Approach to Corporate Reorganizations" (1988) *101 Harvard Law Review*, 775; Bowers, J.W., "Groping and Coping in the Shadow of Murphey's Law: Bankruptcy Theory and the Elementary Economics of Failure" (1990) *88 Michigan Law Review* 2097.

333 Jackson, T.H. *The Logic and Limits of Bankruptcy Law*, p.223.

334 Bebchuk, L.A., *supra*, at 785.

335 Bradley, M., and Rosenzweig, M., "The Untenable Case for Chapter 11" (1992) *101 The Yale Law Journal*, 1043.

336 *supra*, pp.1044-1047. *cf.* LoPucki, L.M., "Strange Visions in a Strange World: A Reply to Professors Bradley and Rosenzweig" (1992) *91 Michigan Law Review*, 79; Warren, E., "The Untenable Case for Repeal of Chapter 11" (1992) *102 Yale Law Journal*, 437. Both these writers challenge Bradley's and Rosenzweig's interpretation of the figures examined by them: at pp.81 and 440 respectively.

more complex..."[337]

The English, Australian and Canadian Courts have responded in a largely favourable manner to the new rescue procedures. Chadwick J., of the Bankruptcy Court of Ontario observed in *Re N.T.W. Management Group Ltd.*[338]:

> "The bankruptcy and insolvency legislation and in particular the proposal sections are to give an insolvent company an opportunity of putting forward a plan. The intent of the legislation is towards rehabilitation and not liquidation".

Despite the purposive interpretations given by the Courts in the three jurisdictions, it has not been a smooth run all the way from the start for the "new kids on the insolvency block". As Professor Milman points out regarding the British regimes, "Even the strongest advocate of corporate rescue would be forced to admit that the high expectations of 1985 have not been met."[339] Before the a decade had elapsed after the enactment of the Insolvency Act, 1986 [U.K.], the wheels of insolvency law reform were turning once more. In October 1993, the Insolvency Service published a Consultative Document seeking views on proposals for the reform of both the administration order and the CVA procedures.[340]

An important feature of the Consultative Document was that it also sought views on a proposal by economists Philipe Aghion, Oliver Hart and John Moore which has similarities with the proposal made by Professor Bebchuk, described above.[341] The Aghion, Hart Moore proposals essentially suggest a debt/equity swap, with shares being allocated to creditors according to their priority rights, followed by a decision by the new equity holders whether the "new" firm be continued or sold off. Comparisons may be drawn with the great railroad reorganizations in the mid-19th century.

As regards the Australian provisions, Lightman, in an article published within 8 months

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337 *Cork Report*, para.235.

338 (1993) 19 C.B.R. (3d) 162 (Ont.Bktcy.),.

339 Milman, Prof., D., "Rescuing Corporate Rescue" 14 *The Co. Lawyer* p.82. This view is shared by Professor Fletcher who points out that "[D]uring a period of steeply soaring company failures in terms of liquidations and receiverships, the year on year trend of attempted rescues via administration remained essentially flat or indeed had at times a downward inclination." - see Fletcher Prof. I.F. "Administration Orders under the Insolvency Act" *(1994) 2 Insolv LR* page 110 at p.115.

340 Insolvency Service, *The Insolvency Act 1986 - Company Voluntary Arrangements and Administration Orders*, (A Consultative Document), October 1993, (Hereinafter: Insolvency Service, *Consultative Document*, October, 1993.)

341 The Aghion, Hart, Moore proposals are summarised in Appendix E to Insolvency Service, *Consultative Document*, October, 1993, at p.44. See also Aghion, P., Hart, O., and Moore, J., "A Proposal for Bankruptcy Reform in the U.K." 1993 *9 Insolvency law and Practice*, 103.

of the provisions on Australian Voluntary Administration coming into force,[342] takes the view that it is unlikely that this procedure will have the support of secured creditors and that therefore that procedure will not be able to achieve one of its stated objectives which is to rehabilitate failing companies. Nevertheless, she concludes that it "has the potential to allow certain companies to achieve a greater realization of their assets".[343]

SCOPE OF THIS THESIS AND THE METHODOLOGY OF THE STUDY

As a result of the legislative acceptance of the various principles and procedures based thereon recommended by Messrs. Tassé, Cork, Colter and Harmer, it is possible today to subject an insolvent company to one or more rescue regimes prior to subjecting it to a terminal insolvency regime.

This study focuses on each of the statutory rescue regimes available in these three jurisdictions for the rescue of insolvent companies. As will be seen, since the procedures, in particular the new, seek common goals there is a great degree of similarity amongst them. This thesis identifies several common aspects of a corporate rescue. Every aspect, it will be seen is common to at least two regimes. It then examines, in detail, the manner in which each aspect is dealt with under each procedure. This detailed analysis throws up important differences which, it is submitted, affect the relative success or failure of the procedures.

Because the law as applicable in three jurisdictions is examined the study is comparative, as indeed that is the title. In comparativists' terminology, the study is a *microcomparision*,[344] since it concerns the examination of the rules employed in each jurisdiction to solve an actual problem. According to Zweigert and Kötz:

> "One can speak of comparative law only if there are specific comparative reflections on the problem to which the work is devoted. Experience shows that this is best done if the author lays out the essentials of the relevant foreign law country by country and then uses this material as a basis for critical comparison, ending with conclusions about the proper policy for the law to adopt, which may involve a re-interpretation of his own system."[345]

342 Part 5.3A CL [Aust.] although enacted on 18 December 1992, came into force on 23 June 1993. Thus, it is unlikely that Ms. Lightman had the opportunity to consider the application of the provisions to very many "live" cases.

343 See Lightman K., "Voluntary Administration: The New Wave or New Waif in Insolvency Law?" (1994) 2 *Insolv LJ*, page 60.

344 See Zweigert K., and Kötz H., *An Introduction To Comparative Law*, (2nd Revised Ed. - Translated by Tony Weir), Clarendon Press, Oxford, 1987, pp.4-5. Where the study compares the spirit and style of different legal systems, techniques of legislation, interpretation etc.,comparison the term used is *macrocomparision*.

345 *An Introduction To Comparative Law*, (2nd Revised Ed. - Translated by Tony Weir), Clarendon (continued...)

This thesis attempts to meet this minimum standard set out by Zweigert and Kötz. However, as the study progressed, it was felt that since it is a comparison between the procedures as much as between jurisdictions and two of the regimes are available in all three jurisdictions, a separate discussion of the law in each country was unwieldy. In addition it was felt that since there are a number of common aspects but difference in detail, much of the impact was lost in a parallel comparison of jurisdictions. For this reason the study veered away from a national study followed by a critical comparison, in favour of comparing the several common aspects of the various regimes under separate headings in chapters. Each chapter ends with a critical comparison of that aspect of the procedure, and it is hoped that a parallel comparison of aspects makes the comparison clearer and more easily verifiable. In many respects it is similar but not identical to the "systems approach" adopted by Lopucki and Triantis in comparing U.S. and Canadian Reorganizations[346] and by DalPont and Griggs in comparing U.S., Canadian and Australian "Business Rescue Laws.[347] The difference lies in that each aspect of a procedure is analyzed separately often in very great depth with a conclusion on the treatment of that aspect in all the procedures.

Structurally the thesis has eight chapters. Chapters Two, Three and Four examine the questions of Who may initiate the procedure? How? and When? One of the more significant features of the new rescue regimes has been the introduction of moratorium provisions which are triggered by the initiation of a procedure. The effect of the moratoria and the challenges that may be made against them are the subject of Chapter Five. The critical issues of the management of the company during the rescue, the special facilitatory powers conferred on the individual charged with implementing the procedure, the investigation the company's affairs and the preparations for the creditors' meeting, if any, are all scrutinised under the heading "Post-Initiation Procedure: To the meetings of creditors" in Chapter Six. The meeting of the creditors where one is held is of crucial importance to the rescue regimes since in all of them barring Receivership the decision as to the future of the company rests with the creditors. This crucial stage which ordinarily brings the procedure to an end is examined in Chapter Seven. The thesis concludes with Chapter Eight. It has already been said that a critical comparison of each aspect of the regime is made

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345(...continued)
Press, Oxford, 1987, p.6.

346 LoPucki and Triantis "A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies" (1994) 35 *Harvard International Law Journal,* 595.

347 See DalPont, G., and Griggs, L., "A Principled Justification for Business Rescue Laws: A Comparative Perspective" (1995) *5 IIR.*

at the end of each chapter. This chapter analyses the results of each chapter in the context of the objectives of the various regimes and principles of corporate rescue identified in this chapter and examines whether each rescue regime addresses every aspect of a rescue in the most efficient manner possible and eventually achieves its desired objectives. It is also determined whether or not each jurisdiction could benefit from the experiences of the others.

The question may be asked why were the regimes in England, Canada and Australia selected? Would it not be more interesting and instructive to compare for instance the rescue regimes from more obviously disparate systems? For example why not a comparison between Common Law and Civil Law countries or the USA, England, and say Scotland, Ireland or even India or indeed any other combination of jurisdictions.[348] Indeed India may have been an interesting choice taking into account its post-independence inward looking protectionist policy and the enactment of the Sick Industries Act of 1985 to promote the rescue of insolvent or near insolvent Indian Companies.

The choice was made not because of the differences between the rescue regimes that are available in those countries. Instead the choice was made because of the similarities, not in the rescue regimes (which admittedly there are) but similarities in the corporate structure, methods of corporate finance and types of security (here security is used in a functional rather than technical sense and includes retention of title, hire-purchase etc.).[349] Thus it was thought that constructive criticism could be made of the various rescue procedures based on the system being used in and the experience of each country without having to take into account contrasting corporate structures and financing methods.

The experience of the United States under Chapter 11, although of great significance in the context rescue laws in general, was considered to be of lesser importance given that unlike in UK, Australia and Canada the floating charge does not exist in the US corporate finance structure.[350] According to Goode and Gower, the decision in the case of *Benedict v Ratner*[351]

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348 A number of short comparative studies have been published, most of which have examined Chapter 11 of the U.S. Bankruptcy Code. Eg: Dal Pont, G., and Griggs, L., "A Principled Justification for Business Rescue Laws" (1995) *IILR*. See also Fletcher Prof. I.F. "Administration Orders under the Insolvency Act" *(1992) 2 Insolv LR* page 110 and LoPucki and Triantis "A Systems Approach to Comparing U.S. and Canadian Reorganization of Financially Distressed Companies" (1994) 35 *Harvard International Law Journal,* 595. Campbell, A., "Company Rescue: The Legal Response to the Potential Rescue of Insolvent Companies" (1994) *1 ICCLR* 16.

349 This is also the meaning given to security by Professor Diamond in his *Review of Security Interests in Property* for the DTI (London, HMSO.)

350 See Ziegel J.S. "The Privately Appointed Receiver and the Enforcement of Security Interests: (continued...)

may well have thwarted the development of the floating charge in the United States.[352] Ziegel points out that after Article 9, UCC[353] was adopted, the position should have changed since under that article every security agreement is treated as effective between the parties and third parties. Nevertheless, although Part V of Article 9 permits peaceable private execution it does not permit a secured creditor to carry on the management of the company as agent or otherwise. Querying why the Americans have not adopted the private receivership procedure and not finding any satisfactory answers, Ziegel speculates that:

> "It may be that secured creditors' lawyers do not believe that debtors would ever consent to a private receivership provisions in the security agreement. Or again, they may take the position that even if debtors did agree to it they could always frustrate its implementation by invoking chapter 11 or by going straight into bankruptcy."[354]

350(...continued)
Anomaly or Superior Solution?" in Ziegel, J.S. (Ed.) *Current Developments in International and Comparative Corporate Insolvency Law*, Clarendon Press, Oxford, 1994, p.451 from pp.466-467 and 470-472.

351 (1925) 268 US 353.

352 See Ziegel J., and Foster W., (eds) *Aspects of Comparative Commercial Law* (1969), p.318.

353 *i.e.* The Uniform Commercial Code

354 Ziegel, *supra,* at p.467.

CHAPTER TWO

WHO MAY INITIATE A RESCUE?

2.1. *INTRODUCTION*
2.2. *WHO MAY PROPOSE A SCHEME OF ARRANGEMENT?*
2.3. *WHO MAY PROPOSE A CVA?*
2.4. *WHO MAY MAKE A CANADIAN PROPOSAL?*
2.5. *WHO CAN APPLY FOR AN ENGLISH ADMINISTRATION ORDER?*
3.6. *WHO MAY APPOINT AN AUSTRALIAN ADMINISTRATOR?*
2.7. *WHO MAY APPOINT A RECEIVER AND MANAGER?*
2.8. *CONCLUSION*
2.8.1. *Voluntary initiation*
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2.8.3. *Hostile Initiation*

INTRODUCTION

If insolvent liquidation of a company is to be avoided or perhaps halted midway, a rescue procedure should be initiated at the very earliest opportunity since, at such a moment, time is invariably of the essence. Thus, a speedy initiation is fundamental to a successful rescue. An appropriate initiation is equally important. Today, most rescue regimes come supported by powerful and extensive moratorium provisions. If the right to initiate is abused, the consequences to the company's creditors would invariably be worse than if liquidation proceedings had been commenced or allowed to continue. The insolvency law reformers Cork, Colter and Harmer were generally of the view that bankruptcy and insolvency law should promote commercial morality and facilitate speedy and efficient initiation of reorganization procedures.[1]

The identity of the person or persons able to initiate corporate rescue proceedings and the nature of his or their relationship with the company has direct bearing on the speed and propriety of the initiation and also on the eventual success or failure of the rescue.

This chapter examines separately in relation to each procedure the identity of the persons who have the power to initiate a rescue and the relationship between the company and such persons. It concludes with a comparative analysis based on the identity of the initiator.

WHO MAY PROPOSE A SCHEME OF ARRANGEMENT?

The relevant statutory provisions in England,[2] Australia[3] and Canada[4] all provide for

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1 *Cork Report*, paras.198 & 219; *Harmer Report*, Ch.1; *Colter Report* p.20.

2 s.425(1) CA 1985 [U.K.].

3 s.411(1) CL [Aust.].

the procedure leading to a scheme of arrangement to be initiated by a number of persons. The common denominators of these sections are the company, the creditors and, where the company is in liquidation, the liquidator. A Canadian Trustee in Bankruptcy, whose functions are identical in many respects to a liquidator, may also make an application to court seeking an order requiring the summoning the requisite meetings.[5] Others are also permitted to initiate the procedure, but those persons are not similarly empowered in all three jurisdictions.

In each of the provisions referred to above, "Company" broadly means any company incorporated in that particular jurisdiction or any company, wherever incorporated, either registered or having assets or doing business in that jurisdiction.[6] In Canada however, it does not include banks, telegraph and railway companies, insurance companies, trust companies organised under or governed by the *Trust Companies Act* or loan companies organised under or governed by the *Loan Companies Act*.[7] The exclusion of all Insurance Companies should be noted taking into account the fact that the provisions in JSCAA 1870, [U.K.] were first used to restructure ailing insurance companies,[8] and today in England its most recent progeny is being promoted as the ideal means of rescuing such insurance companies.[9] The word "company as used in these provisions does not mean the company's members acting together through resolution passed at a general meeting since the members are given a specific right in both England and Australia to make an application. In Canada they are not.

The reason members are so authorised in England and Australia is that these statutory provisions also provide a framework under which equity reorganisations, take overs and mergers are carried out. For constitutional reasons, members of Canadian companies should take steps under the applicable Provincial Laws or, in the case of companies incorporated under the Federal

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4(...continued)

4 ss.4&5 CCAA [Can.].

5 This is because unlike in England, insolvent Canadian companies may make use of the Bankruptcy Act as well as the Winding Up Act.

6 See s.735 CA 1985 [U.K.], s.2. CCAA [Can.], s.9 CL [Aust.],

7 s.2. CCAA [Can.].

8 *Re Albert Life Assurance Co.* (1871) 15 S.J. 923.

9 Except those that are engaged in underwriting long term business. See Wilkinson and Sutherland, "Creditors' Schemes of Arrangement: Their use for troubled Insurance Companies in the London Market" [1993] 2 *Int.ILR* 30. Note also David Steinberg's remarks on "Identifying legal problems and finding practical solutions" made at a Conference o Schemes of Arrangements, London, 19th & 20th September 1994. However, Schemes of Arrangement cannot be proposed by an English Administration since the Administration Order procedure is not available to insurance companies within the meaning of the Insurance Companies Act, 1982 - s.8(4)(a) IA 1986 [U.K.].

Corporations Law, under that law.[10] In Australia, a company's members may not initiate one type of Schemes of Arrangement, that is, a scheme of arrangement between 30 or more wholly owned subsidiaries of a holding company, the holding company, the creditors or a class of creditors of the holding company and its subsidiaries. In such a scheme, the application may be presented only by the holding company, a creditor of the holding company or, if the holding company is being wound up, by its liquidator.[11] It should be noted that in any event schemes proposed by members are generally outside the scope of this thesis.

Finally, an Administrator appointed by Court under an Administration Order, which is peculiar to the United Kingdom, is also able to initiate the procedure, provided the order under which he was appointed specified the sanctioning of a scheme of arrangement by the court as one of the purposes for which the order was made.[12]

From the standpoint of being the target of a Scheme of Arrangement, the word "creditors" in the JSCAA 1870 [U.K.], has been interpreted widely to include all persons having any pecuniary claim against the company.[13] The wide interpretation appears to be favoured in Australia as well.[14] Thus, it would appear that since a scheme may be proposed to any creditor having a claim against the company, in theory, every such creditor would also be able to make an application to court to initiate a Scheme under these provisions. Whether it would be practically possible is another issue. The CCAA [Can.] expressly provides that both secured and unsecured creditors are able to make an application, provided that the scheme of arrangement is proposed between the company and that category of creditor.[15]

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10 In order to make an application under the CCAA [Can.] the company must be bankrupt or insolvent and should plead its insolvency in the application. See *Reference Re Companies' Creditors Arrangements Act; A.G. Canada v. A.G. Quebec*, 16 C.B.R. 1, [1934] S.C.R. 659, [1934] 4 D.L.R. 75. In theory therefore the members cease to have any beneficial interest in the company's assets. However, in a company rescue some arrangement with the members is often necessary. Thus, it is provided that the CCAA [Can.] may be applied together with any Canadian legislation, Federal or Provincial which provides for the sanction of arrangements between a company and its members or a class of them. See s.20 CCAA [Can.].

11 s.411(1A)(a) and (c) CL [Aust.].

12 s.8(3)(c) IA 1986 [U.K.].

13 See *Re Midland Coal, Coke and Iron Co.* [1895] 1 Ch 267 at 277. Ford states that any other interpretation would have been practically useless since JSCAA 1870 [U.K.] applied only where the company was in liquidation. It should be noted however, that the awesome powers of the receiver and manager under a floating charge had yet to be realised since Rigby L.J. was still to utter his famous judgement in *Gaskell v Gosling* [1986] 1 Q.B. 669 (C.A.).

14 See the judgement in *Re Glendale Land Development Co. Ltd.*, (1982) 7 ACLR 171.

15 see ss.4 & 5 CCAA [Can.].

There is generally some commonality of interest amongst the unsecured creditors.[16] Where such commonality subsists they may, in common, agree to the terms of a scheme for the reduction or delay in repayment, of their debt. An agreement of the majority, one sanctioned by the court, binds a dissenting minority. The *raison d'être* is the commonality of interest. In the case of secured creditors, the terms of each security being unique, there is rarely a commonality of interest among secured creditors, and never any between a secured and the unsecured. In the event of default by a debtor, a secured creditor is entitled to look to his security for satisfaction. Thus, it would be unusual for a secured creditor, unless one of several who rank equally, to make an application to initiate a scheme, since a scheme will not normally seek to affect it.[17] There are however, instances where secured creditors have been bound by a scheme.[18]

A receiver in either jurisdiction has no authority to initiate a scheme of arrangement, although it may be noted that in Canada a receiver appointed by a creditor or the court has the authority to make a Proposal under BIA [Can.].

WHO MAY PROPOSE A CVA?

The persons authorised to make a proposal are the directors, the administrator and the liquidator. Creditors have no right to initiate the procedure. Neither does an administrative receiver. While the meaning of "administrator" and "liquidator" may be ascertained readily, the meaning of the word "directors", is not immediately apparent.

The Directors' right to propose a CVA

It is unusual that the word "directors" is used without qualification. Does this mean that the directors of a company, whatever number there may be, should unanimously decide to initiate the procedure? This question has not, so far, come before the English Courts as an issue to be settled in a CVA. There is nevertheless, judicial dicta on the meaning of the word "directors" in the sections which provide for the initiation of a winding up by court and an administration.

In *Re Instrumentation Electrical Services Ltd*[19] two out of three directors, who were also contributories, presented a petition to compulsorily wind up a company on just and equitable grounds. The third director, who opposed the winding up, sought to have the petition struck out

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16 Except between preferential and non-preferential creditors.

17 Fischer, "Schemes of Arrangement Between a Company and its Creditors" in Lowe, S. (ed.) *Insol '85*, Matthew Bender & Company Inc., §2.04 and Ford H.A.J. and Austin R.P. *Ford's Principles of Corporations Law*, Butterworths, Australia, 1992, p.805.

18 *Isles v. Daily Mail Newspaper Ltd* (1912) 14 CLR 193, *Re Chevron (Sydney) Ltd* [1963] VR 249.

19 [1988] BCLC 551. Hereafter referred to as *"Instrumentation"*.

on the ground that the petitioners had no standing to present the petition. Mervyn Davies J was of the view that where a petition for the winding up of a company was presented by the directors under s.124(1) it could be presented only by *all* the directors. He declined to read the phrase "the directors" as meaning "some of the directors" or "a majority of the directors" or even the "board of directors". He further compared the authority conferred upon the directors with the treatment of creditors and contributories in that subsection. In both the latter classes a single constituent of each class is specifically identified as having authority to initiate the procedure, whereas, "directors" are only identified collectively with no reference to "any director". The judge went on to consider whether the phrase at the end of the subsection "or by all or any of those parties, together or separately", had the strength to refer back to the phrase "the directors" to allow it to be read as "some directors". He concluded that it did not, and said:

> "I do not know whether this construction was intended or is convenient. However since this construction appears to me to be inescapable I must adopt it."

This literal construction appears to be grammatically sound and indeed accords with the maxim *inclusio unius est exclusio alterius*. It is submitted however that Mervyn Davies J. erred in declining to read "the directors" as including the "board of directors".

The phrase "board of directors" is neither a legal term nor a term of art.[20] It is simply a phrase commonly used to describe all the directors who at a given moment have been appointed by the shareholders for the purpose of managing the company and carrying out the other functions and duties specified in the Articles of association. Thus, the "board of directors" is numerically indistinguishable from "all the directors". Although it has no bearing on the facts of this particular case and its outcome since there was no resolution of the board of directors, for the purposes of management of the company, the decision of a majority of the directors binds the minority, and is to all intents and purposes the decision of "all the directors" or the "board of directors".

Mervyn Davies J's construction certainly proved to be inconvenient to Millett J in the case of *Re Equiticorp International Ltd.*,[21] This was a case arising under subsection 9(1) of Part II, of IA 1986 [U.K.] where five out of seven directors of a company had resolved at a board meeting to have it placed in administration. One of the directors who had not been present at the

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20 The recognised word for a body of persons officially constituted for the transaction or superintendence of some particular business, indicated by the full title as ... Board of Directors. O.E.D. 2nd Ed Vol II, 1989, Oxford.

21 (1989) 5 BCC 599. Hereafter "*Re Equiticorp*".

meeting had subsequently sworn the affidavit in support of the petition. There was nothing to suggest that the remaining director would either support or oppose the petition. While the petition was still in draft form, Counsel sought the Court's opinion as to whether the Court had jurisdiction to make an administration order on an application made in this manner by the directors, particularly in view of the decision in *Re Instrumentation.*

Millett J rightly distinguished *Re Instrumentation* on the grounds that the petition presented in that case was without any formal resolution of the board of directors. In what appears to be a contradiction, he goes on to observe that in any event it was unnecessary for him to depart from Mr. Justice Mervyn Davies's analysis of the language of section 124(1) in order to grant the petition for administration. He states that he is "perfectly prepared to read the words 'the directors' in s.9 as meaning all the directors", notwithstanding Mr. Justice Mervyn Davies's analysis that "all the directors" did not mean the "board of directors".[22]

Despite Mervyn Davies J.'s express refusal to read the phrase "the directors" as meaning "the board of directors", the fact that there was no resolution of the board, does allow *Instrumentation* to be distinguished in cases where a resolution has been passed. It is submitted that the correct position is that a decision of a majority of the board of directors of a company, since it binds the minority both absent and dissenting, is a decision of the "directors".

Due to the similarities between s.124(1) and s.9(1)., the interpretation of one has a significant impact on the interpretation of the other. The only common feature between those two subsections and s.1.(1) is the use of the words "the directors". The "Company", "creditor(s)" and "contributory(ies)" who are authorised to initiate an administration and a winding up by court have no such authority to initiate a CVA under s.1(1) IA 1986 [U.K.]. Nevertheless, as judgements interpreting the word "directors" they have a bearing on the interpretation of that word in s.9(1) IA 1986 [U.K.].

Thus, a proposal for a CVA should be made by the "directors" either unanimously or

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22 It is not evident in the case reports whether Counsel in the case sought the Court's direction whether all the directors should swear the affidavit in support of the petition, since in this case only one director had made the deposition. In fact, rule 2.12 expressly provides for the affidavit to be made by one of the directors on behalf of the others. Millett J, however took pains to explain that:

> "Once a proper resolution of the board has been passed, ... it becomes the duty of all the directors, including those who took no part in the deliberations of the board and those who voted against the resolution to implement it; and even in the absence of a specific authorization to any and every director to take such steps as are necessary to implement it, which is contained in this particular resolution, that remains the legal position." at p.599.

acting as would the board of management of the company in the manner which the articles provide for the making of decisions for the company. This would *prima facie* indicate that whoever makes the proposal it flows from the directors making it to the creditors and to the company with the directors acting, as they usually do, as agents for the company.

There is some difficulty in following this argument to its logical conclusion. It is provided that an approved CVA takes effect as if made by the company at the creditors meeting convened to consider the proposal.[23] If the directors may resolve at a meeting of the board to propose a voluntary arrangement why should the proposal be made to the creditors *and the company*? Would not a decision of the board in normal circumstances be sufficient to bind the company? As will be seen, where the directors present a petition for administration or winding up they do not have to seek the approval of the members. If the company is insolvent what interest do the members have in the company? The beneficial interest in the assets having passed to the creditors the members' interest, if any, is merely residual. Does the mandatory involvement of the company imply that through a voluntary arrangement the directors may propose a reorganization of the company's share capital?

It is not appropriate to address these questions at this stage since in doing so a number of matters which have still to be considered must first be addressed. However, it may be said in relation to the directors that, in the circumstances, although a majority resolution of the board of directors does not appear to be binding on the company it would certainly be binding between each director.[24]

WHO MAY MAKE A CANADIAN PROPOSAL?

The persons entitled to initiate a Proposal under Part III Division 1 of BIA [Can.] are: an insolvent person, a receiver,[25] a liquidator of an insolvent person's property, a bankrupt or a trustee of the estate of a bankrupt.[26] There is no reference to a "company" or "corporation".

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23 s.5(2) IA 1986 [U.K.].

24 Table A of the Companies (Tables A to F) Regulations, 1985, provides at Art.88 that "questions arising at a meeting shall be decided by a majority of votes. In the case of an equality of votes, the Chairman shall have a second or casting vote". Art 89 provides, "The quorum for the transaction of the business of the directors may be fixed by the directors and unless so fixed at any other number shall be two." It has been held that the quorum may be one, thus providing for the situation where there is only one director of the company. See *Re Fireproof Doors* [1916] 2 Ch. 142.

25 But only where the person is an insolvent person.

26 s.50(1) BIA [Can.].

Reference should be made to s.2 to determine whether a company comes within the definition of a person. S.2 defines a person as including a corporation. A "corporation" includes any company incorporated or authorised to carry on business under Canadian Law,[27] and any incorporated company, wherever incorporated that has an office or carries on business within Canada. The provision is similar to the one in CCAA [Can.], and does not include building societies having a capital stock, or incorporated banks, savings banks, insurance companies, trust companies, loan companies or railway companies.[28] These companies are excluded from the purview of the whole of BIA [Can.].[29] The greater majority of Canadian companies may, as will be seen, make a proposal, or have a proposal made on their behalf, under Part III Division 1 of BIA [Can.].

A proposal may be made by a Canadian company on its own only if it is an "insolvent person" or a "bankrupt". Both terms are defined in section 2.

To qualify as an "insolvent person",[30] a company should not be bankrupt, it should reside or carry on business in Canada and its liabilities to creditors which are provable as claims against it under BIA [Can.] should amount to at least one thousand dollars. Virtually every Canadian company to which the BIA [Can.] applies would satisfy these criteria. However, the company should also have either ceased paying its current obligations in the ordinary course of business as they generally become due,[31] or on the application of the either the cash-flow or balance sheet test, become unable to meet its obligations.[32] The implications of the final requirement on the question of when a proposal may be made is examined in part 3.3.3.

The term "bankrupt" as defined does not presuppose any insolvency or likelihood of insolvency of the debtor company. To qualify as a "bankrupt" the company must have made an assignment or had a receiving order made against it,[33] which means that voluntary or involuntary

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27 That is by or under an Act of Parliament or of any Province,

28 s.2 BIA [Can.].

29 *Re Ditchburn Boats & Aircraft (1936) Ltd.*, 19 C.B.R. 216, appeal quashed 19 C.B.R. 240.

30 s.2 BIA [Can.].

31 This may be established by the failure of the company to meet a demand for payment of a sum due. This is also an Act of Bankruptcy under Part II, s.42(1)(j) BIA [Can.]. See Houlden L.W. & Morawetz C.H., *Bankruptcy Law of Canada* (3rd ed., Revised) Canada, Carswell Publications. D§9 and D§9.1.

32 Sub paras (a) and (c) respectively. For a description of the cash-flow and balance sheet tests of insolvency see Goode, R.M., *Principles of Corporate Insolvency Law*, 2nd Ed, London, Sweet and Maxwell, Centre for Commercial Law Studies, 1990, pp.26-44.

33 s.2, BIA [Can.].

liquidation proceedings should have been commenced against it. The acts of bankruptcy required to be proved by a person petitioning for an involuntary bankruptcy necessarily imply insolvency on the part of the debtor although insolvency it self need not be proved.[34] Further, constitutionally, a solvent voluntary liquidation of a company may not be carried out under the provisions of BIA [Can.].[35]

There is no indication as to whether it is the shareholders or the directors who must decide that the company should make the proposal as an insolvent person or a bankrupt. However, an assignment in bankruptcy may be made by a company if the board of directors pass a resolution authorizing the assignment.[36] The same rule ought to apply in relation to a proposal by an insolvent person, it being, initially at least,[37] less serious than an assignment.

"Trustee" or "licensed trustee" means a person who is licensed or appointed under BIA [Can.]. and in the context of this section would mean the trustee in bankruptcy .

A "receiver" is defined under BIA [Can.] as a person who has been appointed to take, or has taken, possession or control, of *all* or *substantially all* of the inventory, the accounts receivable, or the other property of an insolvent person or a bankrupt that was acquired for or is used in relation to a business carried on by the insolvent person or bankrupt. The appointment should have been made pursuant the powers contained in a security agreement[38] or an order of a court.[39] Thus the term "receiver" under the Canadian statute includes a person with the powers of an administrative receiver under IA 1986 [U.K.] and a receiver and manager under CL [Aust.]. Further, except through the appointment of a receiver under a security agreement, no creditor is able to compel the company to make a proposal.

As will be described in 3.2.3., the procedure which leads to the filing of a Proposal may

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34 What must be proved is that the debtor committed an act of bankruptcy. See *Re Gagnon* [1921] 1 C.B.R. 556. It is unnecessary for a petitioner to prove the debtor's insolvency *Re Vermilion Placers Inc.* [1982] 41 C.B.R. (N.S.) 188. Contrast the need in an English Administration to satisfy the Court that the company is or is likely to become insolvent.

35 See s.49(1) BIA [Can.]. The reasons are constitutional.

36 Houlden L.W. & Morawetz C.H. - *Bankruptcy and Insolvency Law of Canada* (3rd Ed, Loose Leaf) Canada, Carswell Publications. D§9 and D§9.1.

37 If the proposal is not accepted by the company's creditors the company is deemed to have made an assignment in bankruptcy on the day on which the Proposal was filed - s.57 BIA [Can.].

38 i.e. an agreement under which property becomes subject to a security. See s.243(2)(a) BIA [Can.].

39 i.e. Made under any law that provides for or authorizes the appointment of a receiver or a receiver and manager. See s.243 BIA [Can.].

also be initiated by the filing of a Notice of Intention. Only one person, namely, an insolvent person as described above, has the right to file such a Notice of Intention.[40]

WHO CAN APPLY FOR AN ENGLISH ADMINISTRATION ORDER?

In England, only the court having jurisdiction to wind up a company has the power to make an administration order, appoint an administrator, and initiate the procedure contained in Part II of the Insolvency Act 1986, (U.K.). Thus the ultimate discretion is vested in the court. But the courts discretion cannot be exercised in a vacuum, and a facilitatory application to court by way of petition should be made.

The petition may be presented by either the company, the directors or by a creditor or creditors or by all or any of them.[41] The supervisor of a company voluntary arrangement[42] and a Clerk of a Magistrates' Court in the exercise of powers conferred by section 87A of the Magistrates' Court Act 1980, namely the enforcement of fines imposed upon companies,[43] are also authorised to present a petition.

The wording of s.9(1) IA 1986 [U.K.] is, similar to s.124(1), IA 1986 [U.K.] which provides for the application by way of petition for a winding up by the court. The only material difference is that under s.124(1) "a contributory or contributories" are also able to apply for a winding up order. They have no such status under s.9(1).

The company's ability to present a petition under this section indicates that the members may resolve at a general meeting to put the company into administration.[44] Although members have no individual or collective right to petition, qua members,[45] they are, in theory, still be able to do so qua the company. Whilst this may be unlikely in practice, such a right may be used by members in circumstances where the directors refuse to put the company into administration. The exercise of this right, would, due to the several statutory steps that must be followed, prove tortuous and time consuming. For this reason, its practical use, if any, would be limited to the

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40 s.50.4(1) BIA [Can.].

41 s.9(1) IA 1986 [U.K.].

42 s.7(4)(b) IA 1986 [U.K.].

43 Inserted by s.62(2)(a) of the Criminal Justice Act, 1988, and applicable from 5 January 1989 -(S.I. 1988 No.2073(C.78).

44 See Fletcher, Ian F., *The Law of Insolvency,* London, Sweet and Maxwell, 1990, 355; Morse, G., (ed), *Palmer's Company Law,* (25th ed. Revised), London, Sweet and Maxwell, 14017.

45 See Totty, and Jordan, *Insolvency,* (Revised), London, Longman, C5.03, 5/5. [Release 15 (1992)]. Nor would they have a right to be heard at the hearing of the petition. See *City Football Club (1980) Ltd.,* (1991) BCC 133.

smaller companies.[46]

It is submitted that the presentation of a petition for an administration order, so far as it is for the purpose of rescuing a company, would be within the directors' remit conferred by a company's Articles to manage its business. If such is the purpose of a petition, and it is presented pursuant to a resolution of the directors that the company be placed in administration, the resolution would, it is submitted, be *intra vires* the directors and may not be called in question by the members.

However, the purpose of an administration order may extend to a liquidation of a company's assets in circumstances which are more advantageous than a winding up.[47] Until the 1985 reforms, directors had no authority to wind up a company without the prior consent of its shareholders, unless the articles expressly so provide.[48] Under s.124(1) the directors are now authorised to present a petition for winding up.[49] In the absence of any such provision, the directors would have been powerless to initiate an administration for the purpose of allowing the company's creditors a better realisation of the company's assets than would be available to them in a winding up. Consequently, even if the word "directors" had not been used in s.9(1), in the light of s.124(1) it is submitted that the directors would be able to file a petition for an administration order, whether it be for the purpose of rescuing the company or liquidating the

46 A general meeting of the members, commonly referred to as an extraordinary general meeting (see Art.36, Table A, CA 1985, [U.K.]), should be summoned, and notice given of the resolution to be passed. Usually, the articles of association of the company would provide for the directors to convene the meeting [See, ibid.A, art.37]. If the directors have been guilty of mismanagement it is most certain that they would be unwilling to convene the meeting. In this event, the members may, provided they have the backing of one-tenth of the voting paid up capital, requisition the directors to convene an extraordinary general meeting [ibid., s. 386]. The directors must do so within 21 days and the meeting must be held within 28 days. The minimum period of notice for such a meeting is 14 days. See also Farrar, John H., *Farrar's Company Law*, 3rd Edition, London, Butterworths, 1991, p.323; Gower, L.C.B., *Gower's Company Law*, 5th Edition, London, Sweet and Maxwell, 1992, p.503.

47 s.8(3)(d) IA 1986 [U.K.].

48 Until the end of the 1970s a practice had grown in England for directors to present petitions for the winding up of companies without reference to the members, (Parker, G.B. (ed) *Buckley on the Companies Acts,* 14th ed. London, Butterworths, 1981, p.537. *Palmer's Company Law,* 22nd ed., London, Sweet and Maxwell, 1976, p.891) but this was expressly condemned by Brightman J. in *Re Emmadart Ltd.,* ([1979] 1 Ch. 540) as follows:

> "The practice which seems to have grown up, under which a board of directors of an insolvent company presents a petition in the name of the company where this seems to the board to be the sensible course, but without reference to the shareholders, is in my opinion wrong and ought no longer to be pursued, unless the articles confer the requisite authority, which article 80 of Table A does not." *Ibid.* at 547, B-D.

49 The right however, is restricted to petitioning for a winding up of by court.

assets. This view is supported by the manner in which r.2.4(3) IR 1986 [U.K.] is drafted. R.2.4(3) IR 1986 [U.K.] provides that if a petition is presented by the directors, it must state that it is so presented under s.9, "but from and after presentation it is to be treated for all purposes as the petition of the company."[50] The only occasion the directors would not have been able to make an application for an administration order would have been where there is an express provision to the contrary in the company's memorandum or articles. Thus, the sole impact of the inclusion of the word "directors" in section 9(1) would be to nullify any provision in the memorandum or the articles of the company which prohibits the directors from petitioning for an administration order.

If the directors wish to petition for an administration order they must do so as the "the board". As s.9(1) currently stands, individual directors or a minority of directors have no standing to initiate an English Administration.[51] The Cork Committee pointed out that:

> "The right of directors to apply for the appointment of an Administrator is of fundamental importance. Later in this report we make proposals to augment the present provisions relating to fraudulent trading by a new concept of 'wrongful trading'. This will expose the directors to an increased risk of personal liability if they allow their company to continue to trade while insolvent. One of the courses open to them, as we indicate below, will be to apply for the appointment of an Administrator; and it is important that their right to do so would be unfettered. Indeed, we have recommended elsewhere that the legislation should expressly provide that, if the directors at any time consider the company to be insolvent, they should have a duty to take immediate steps for the company to be placed in liquidation, receivership or administration." [52]

Throughout this passage the Cork Committee continues to refer to the "directors" as opposed to a "director". In contrast s.214 IA 1986 [U.K.] provides for directors to be made personally liable for wrongful trading individually rather than collectively as the board. Because directors are individually liable, even if the board of directors of a company resolves against placing that company in Administration, any director who voted for the resolution may be able to establish that he took every step with a view to minimising the potential loss to the company's

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50 Insolvency Rules 1986, r.2.4(3). Compare the view expressed in Totty, and Jordan, *Insolvency Law*, (Loose Leaf) London, Longman:
"r.2.4(3) may be *ultra vires* the Lord Chancellor in that it effectively negates a part of s.9, rather than giving effect to it as the Rules are required to do by s 411 of the Act." at p.5/6 Release 15 (1992).

51 See the discussion at p.106, *supra*. See also *Re Instrumentation Electrical Services Ltd.*, [1988] BCLC 551 at 553 a-c. in which the meaning of the word "directors" in section 124(1) was examined, and *Re Equiticorp International Ltd.*, (1989) 5 BCC 599 where Millett J held that a decision of a majority of the directors bound those absent and dissenting.

52 *Cork Report*, *supra*, para.501.

creditors.

The term creditor, as defined in the Act, includes prospective or contingent creditors. By this, persons with an unliquidated claim for damages in contract and in tort become creditors able to present a petition. Such creditors, it may be noted, had no status under section 206 of the Companies Act, 1948 to be summoned to, and vote at, a meeting of creditors.

WHO MAY APPOINT AN AUSTRALIAN VOLUNTARY ADMINISTRATOR?

The Australian Voluntary Administration procedure is not a court procedure, and is initiated by the appointment of an administrator.[53] The persons able to appoint an administrator under CL [Aust.] are the company,[54] a liquidator[55] and a chargee.[56]

From the standpoint of its authority to initiate a Voluntary Administration[57] the meaning that may be attributed to "company" in s.436A(1) is very restricted. Under the Australian Corporations Act the members have no status to initiate the administration procedure.[58] The Australian Law Reform Commission in its General Insolvency Inquiry considered and rejected the possibility of requiring the appointment of the administrator to be by resolution of the members.[59]

A company may appoint an administrator only following a resolution of the board of

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53 s.435C(1)(a) CL [Aust.].

54 436A CL [Aust.].

55 s.436B CL [Aust.].

56 s.436C CL [Aust.].

57 As opposed to the companies that may be the subject of a Voluntary Administration.

58 Contrast the position in England under an administration order.

59 Australian Law Reform Commission, *Discussion Paper No.32.*, Sydney, August 1987, p.25; *Harmer Report*, p.35 The decision is based on the ground that

> "[C]ompany law has reposed responsibility for the management of companies with directors rather than the members. This is so both at common law and under statute (for example, the decision to initiate a creditors' voluntary winding up or to place a company under official management or to apply for a court liquidation under the existing companies legislation is made by the directors of the company). There is no reason for the voluntary procedure being recommended by the Commission to differ from the general law in this respect."

This reasoning, although valid for the State of New South Wales, (see *Re Inkerman Grazing Pty Ltd.*, [1975] 1 ACLR 102; *Spicer v Mytrent Pty Ltd.*, [1984] 8 ACLR 711) does not apply across the other Australian states (see *Re Standard Bank of Australia Ltd.*, [1898] 24 VLR 29; *Re Birmacley Products Pty Ltd.*, [1943] VLR 29; *Re United Uranium NL*, [1990] VR 121; *Re Grant Resources*, [1991] 1 Qd R 107) or in other Common Law countries (see *Re Galway and Salthill Tramways Co*, [1918] IR 62; *Re Emmadart*, [1979] Ch 540).

directors that it should do so.[60] Matters that the board must consider in arriving at that decision are discussed in 3.3.5. If the company is already being wound up the appointment cannot be made by the company.[61]

If a company is being wound up and its liquidator or provisional liquidator may by writing appoint an administrator of the company.[62] The liquidator or provisional liquidator initiating the administration may, with leave of the Court, appoint himself as the administrator. The Harmer Commission hoped that the provision would enable the conversion from a members' voluntary winding[63] up to administration, and give the opportunity in other windings up to promote, where appropriate, a company deed of arrangement.[64]

A creditor, other than a holder of a charge over the whole or substantially the whole of a company's assets has no right to appoint an administrator.[65] The Harmer Commission was of the view that to give creditors the right to appoint an administrator would detract from the voluntary nature of the procedure.[66] Exception was made in the case of a holder of a charge over the whole or substantially the whole, of a company's property may, on the ground that such an appointment would be made as an alternative to the appointment of a receiver which the holder in any event would be entitled to do. In contrast to the receiver whose primary task is to look after the interests of the holder, the administrator would look after the interests of all creditors.[67] Thus, a person who is entitled to enforce such a charge on the whole or substantially the whole, of a company's property may, if the charge has become and still is enforceable, by writing

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60 s.436A(1)(a) CL [Aust.].

61 s.436A(2) CL [Aust.].

62 s.436B(1) CL [Aust.]. See also s.496(1)(b) CL [Aust.] which applied only in the case of a members voluntary winding up. This appointment was also viewed by the Harmer Committee as one made by the company. See the *Harmer Report, supra*, p.35. It has also been acknowledged that it would often be the case, though not always, that a company being wound up would be insolvent. See Corporate Law Reform Bill 1992, Explanatory Memorandum, p.97, para.470.

63 Where a declaration of solvency must be made. See s.494(1) CL [Aust.].

64 *Harmer Report, supra*, p.35.

65 This is so even though administration is an "insolvency procedure" which may be initiated only in the event or likelihood of an insolvency. Contrast this position with the right of a creditor to initiate a winding up or a scheme of arrangement, bearing in mind that both are court procedures.

66 *Harmer Report, supra*, p.36. A creditor has no right to initiate a company voluntary arrangement under IA 1986 [U.K.] which as its name indicates is entirely voluntary.

67 *Harmer Report, supra*, para.66.

appoint an administrator of the company.[68] The chargee loses this right once the company goes into winding up.[69]

WHO MAY APPOINT A RECEIVER AND MANAGER?[70]

The only person able to appoint a Receiver and Manager (hereafter simply the Receiver) over the whole or substantially the whole of the property of a company, is the holder of an instrument which confers upon him such powers or into which such powers are implied by virtue of any enactment. If, in England, the Receiver appointed is to be an Administrative Receiver, the instrument under which the appointment is made should be a charge, which as created was a floating charge.[71]

Although no such provision is generally made in the debenture, it is well settled now that in making the appointment the debenture holder acts as the agent of the company. In *Gaskell v. Gosling*,[72] Rigby L.J. said:

> "Though it was the mortgagee who in fact appointed the receiver, yet in making the appointment the mortgagee acted, and it was the object of the parties that he should act, as agent for the mortgagor. Lord Cranworth, in *Jefferys v. Dickson* stated the doctrine of Courts of Equity on the subject to the effect following. The mortgagee, as agent of the mortgagor, appointed a person to receive the income, with direction to keep down the interest of the mortgage, and to account for the surplus to the mortgagor as his principal..."[73]

In England and Canada, it is established that, once appointed, the receiver acts as the agent of the company until such time as it is wound up.[74] The position is slightly different in

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68 s.436C(1) CL [Aust.].

69 s.436C(2) CL [Aust.].

70 As previously mentioned this thesis is concerned only with the privately appointed Receiver and Manager over the whole or substantially the whole of the property of a company appointed pursuant to powers contained in an instrument or an enactment which are implied in or take effect as if contained in an instrument. It is not concerned with Receivers of only part of a company's property or Court appointed Receivers. However, comparisons with such receivers will be drawn where appropriate.

71 In IA 1986 [U.K.], although not specifically dealt with, the identity of that person is implied in the definition of "administrative receiver" as being the holder of any debentures of that company secured by a charge which as created was a floating charge, or any person acting on his behalf. See s.29(2)(a) IA 1986 [UK]. There are no provisions in BIA [Can.] or CL [Aust.] which expressly or impliedly touch upon the identity of the person able to appoint a Receiver in those countries.

72 [1896] 1 Q.B. 669.

73 *Ibid.* at p.692.

74 s.44(1)(a) IA 1986 [U.K.]. The position in Canada is the same. See Bennett, F, "*Receiverships*", (continued...)

Australia in that, since the 1992 reforms, the agency continues despite commencement of a winding up.[75] By the debenture holder acting as the company's agent in making the appointment, the parties overcome the anomaly that would otherwise arise, of an agent of the company being appointed under an instrument to which the company is not a party.[76]

However, debentures do not provide for the debenture holder's agency in making the appointment. Instead the appointment of a receiver is often described in terms of, and is widely recognised as a contractual right.[77] The debenture holder clearly has a personal interest in appointing a receiver. Thus, in theory at least, the exercise of this right may conflict with normal duties of an agent. The question that arises is whether the debenture holder is a fiduciary, as agents normally are, and liable for breach of fiduciary duty for putting his interests first in making an appointment which may cause loss to the company, or whether, like in the case of the receiver, it is only a "very special and... limited agency" which is genuinely non-fiduciary.[78]

Although the debenture holder is agent of the company for the purpose of appointing the receiver, it has been held that an appointment cannot be made outside the powers specified in the debenture.[79] Also attempts to impose upon the debenture holder a duty of care to be exercised when appointing a receiver, though not the more onerous duty of a fiduciary, has been robustly rejected by the English Courts.[80]

74(...continued)
The Carswell Company Ltd, Toronto, 1985. p.316.

75 s.420C(3) CL [Aust.].

76 See Goode, R.M. "*Principles of Corporate Insolvency Law*, pp.77 & 93.

77 See *Shamji v. Johnson Matthey Bankers Ltd.* (1986) ; *Re Potters Oils*, [1986] 1 WLR 201; Lightman and Moss, *The Law of Receivers of Companies*, (2nd ed.) Sweet and Maxwell, London, 1994. para:7-05. Contrast the specimen demand set out in Lingard's *Bank Security Documents* (3rd Ed, Butterworths, 1993, p.185) is interesting in this regard:

> "Having regard to your inability to meet your liabilities *and your request to us to appoint a Receiver,* [or specify event of default], we hereby make formal demand for payment forthwith of the sum of ...
> We further give you notice that failing payment of the above sum to us [forthwith], *we reserve the right without further notice to exercise the power to appoint an administrative receiver* over your undertaking property and assets...." (Italics added)

Within this one document, the authority to appoint a "Receiver" is described as being derived from the Borrower's request, however, the authority to appoint an administrative receiver on the other hand appears to be acknowledged as a power exercisable by the debenture holder as of right.

78 See Meagher, Gummow and Leahane, *Equity: Doctrine and Remedies* (2nd ed) p.669. See also Milman, D., "The Receiver as Agent" (1981) 44 *MLR* 658 at 670.

79 *Cryne v. Barclays Bank* [1987] BCLC 548.

80 See *Shamji v. Johnson Matthey Bankers Ltd and others* (1986) 2 BCC 98.

CONCLUSION

Except in the case of a receivership, the identities of the persons authorised to initiate the various regimes are broadly similar.

More companies are excluded from the rescue provisions of the BIA [Can.] and CCAA [Can.] in comparison with the relevant statutes in England and Australia. However, in England, insurance companies may not apply for or be the subject of an administration order.[81] There is no exclusion of any category of company from 5.3A of the Australian Corporations Law. Where creditors are authorised to initiate a procedure, the term "creditor" generally receives a wide interpretation. It includes secured and unsecured creditors although under some regimes a secured creditor's rights are hardly if ever affected. In England it is also expressly defined to include prospective and contingent creditors, but in Australia it is uncertain whether a person having an unascertained claim for damages would be a creditor.

The identities being broadly the same, it is futile to make a classification of the regimes based on the identity of the initiator. However, it is possible to classify the "initiators" on the basis of their relationship with the company and determine whether the initiation is voluntary or hostile or even nondescript.

In the next chapter, when examining the "Method of initiation" the procedures will be classified as those which are a "proposed solution to the company's debt crisis", and those which are "a means to a solution". If the procedure is one which is a "proposed solution" whether it is initiated voluntarily or not has some bearing on the legal nature of the "solution" if it is accepted by the creditors. As regards the regimes which are "a means to a solution" the power to make a hostile initiation is important since, very often, initiation dislodges the existing management.

The following discussion commences with initiations which are manifestly voluntary and proceeds to the hostile after having examined whether some initiations may more properly be described as nondescript rather than voluntary.

Voluntary initiation

In Schemes of Arrangement, English Administration, Australian Voluntary Administration and Canadian Proposals the company's right to initiate each procedure is specific.[82] The

81 It is likely that this exclusion will be removed. For definitions of "company" see ss.705 & 735 CA 1985 [U.K.]; ss.111(4),(a), 216(8), 217(6), 388(4), & 435(11) IA 1986 [U.K.].

82 In Canada it is by virtue of the fact that "person" includes a "corporation". See s.2 BIA [Can.].

company's right would usually be exercised by the board of directors pursuant to a resolution of the board.[83] It is expressly provided as such in the provisions relating to Australian Voluntary Administration.[84] In the provisions relating to CVAs, the word "company" is not used and the company's right of initiation appears to be vested in and exercised by the directors. The directors are also given a specific mention in s.9(1) IA 1986 [U.K.] which applies to English Administrations. But as has been mentioned, the right is not enjoyed by individual directors.

"Company" may also mean the members acting in concert, and scope of the word "company" as found in s.9(1) IA 1986 [U.K.] does allow the members of a company to initiate an English Administration should they so wish to. It is not possible to infer a similar right from the provisions relating to Australian Voluntary Administration. Members are however given specific authority, distinct from the company's, in the English and Australian provisions relating to Schemes of Arrangement.

Where a rescue is initiated by the company or, where they are able, its members, the initiation is voluntary in the purest sense. However an initiation would also be voluntary if it is initiated by an agent of the company on its behalf. The limited right of an English Administrator to initiate a Scheme or a CVA and of a privately appointed Canadian Receiver to initiate a Scheme or a Proposal may be treated as a voluntary initiation since each is in law the deemed agent of the company.[85] A proposal made by a privately appointed receiver in Canada is not a proposal to the insolvent person flowing from the charge holder but one on behalf of the debtor to all creditors including the charge holder.

Liquidators may initiate Schemes of Arrangement, CVAs, Canadian Proposals and Australian Voluntary Administrations. Of these regimes all but the last are procedures which propose a solution. Australian Voluntary Administration is the only procedure which does not propose a solution but mandatorily takes the management and control of the company and its property out of the hands of the directors and places it in the hands of an independent third party. English Administration, which is similar to Australian Voluntary Administration in this respect, is the only procedure which a liquidator is not authorised to initiate outside Receivership. Unlike English administrators and privately appointed receivers, the law does not deem, or recognise provisions which deem, the liquidator to be the agent of the company.

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83 This is implied in the case of a Scheme since the members are given a specific right to initiate the procedure.

84 s.436B(1) CL [Aust.].

85 See Chapter X below for a discussion on the agency of the agency of the Receiver.

On the commencement of a winding up all the directors cease to be able to exercise any of their powers[86] except to the extent that the relevant party in authority[87] sanctions their continuance. But it does not necessarily mean that the liquidator automatically steps into their shoes, although the duties owed by him to the company have been described as similar to those applying to the directors.[88] He is primarily appointed for the purpose of winding up the company's affairs and distributing its assets.[89] In so doing, he acts for the benefit of the creditors who have a beneficial interest in the company's assets although not as their agent. He need be mindful of the members interest only to the extent that they have a residual interest in the company.

Nevertheless, he has been described as the agent of the company,[90] and the description is apt if account is taken of the various functions and powers which are conferred upon the liquidator[91] since some of these powers could not be effectively exercised unless in exercising

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86 ss.91(2) and 103 IA 1986 [U.K.] (relates only to voluntary winding up) and s.471A(1) CL [Aust.] (relates only to a winding up by court). In a members' and a creditors' voluntary winding up, the company ceases to carry on business from the commencement of the winding up. However, the corporate state and corporate powers of the company, notwithstanding anything to the contrary in its articles continue until the company is dissolved - s.87(1) IA 1986 [U.K.], s.93(1) CL [Aust.]. The directors would have the limited power where a provisional liquidator has been appointed to oppose the winding up petition.

87 This is the company in general meeting or the liquidator, in a members' voluntary winding up, [Ss.91(2)], and the liquidation committee or the creditors, in a creditors voluntary winding up. [S.103.] See also s.114(2).

88 See Ford and Austin, *Ford's Principles of Corporations Law*, 6th ed., Butterworths, Australia, 1992, p.830.

89 Sub-sections 91(1) and 100(1). In a winding up by court, the statute amplifies this obligation slightly by stating that the liquidator's appointment is to secure that the assets of the company are got in, realized and distributed to the company's creditors and, if there is a surplus, to the persons entitled to it. S.143(1).

90 In *Re Silver Valley Mines*, [(1882) 21 Ch.D. 381] Cotton L.J. described the position of a liquidator as follows:

> "He is a person appointed by the court to do a certain class of things; he has some of the rights and some of the liabilities of a trustee, but is not in the position of an ordinary trustee. Being an agent employed to do business for a remuneration, he is bound to bring reasonable skill to its performance..." at p.392.

Unhappily, the liquidator's agency is not described by Cotton L.J., in unequivocal terms as being that of the company or the court. It is submitted that the words in the passage quoted could be construed to mean the agent of the company or the court. Indeed, elsewhere in the same judgement Jessel M.R. speaks of "an official liquidator who... is a paid agent of the Court...".- at p.386. See also Rajak H., *Company Liquidations*, CCH Editions Ltd, 1988, at ¶901, where the liquidator is described as an "officer of the court and an agent of the company". See also Fletcher I.F., *Law of Insolvency*, London, Sweet and Maxwell, 1990. p.465.

91 Part.3, Sched.4, IA 1986 [U.K.]. The liquidator has been treated as the agent of the company, (continued...)

them he acts as the agent of the company. It should be noted however, that in some cases the liquidator has been treated like a trustee.[92] In Australia, it has been held that when determining the debts of the company the liquidator acts in a quasi-judicial manner for the benefit of all creditors generally and not for the company.[93] The question to be answered is whether, in initiating a rescue, a liquidator acts on behalf of the company so that the initiation could be considered a voluntary act or whether he acts on his own account.

The Harmer Commission accepted that an initiation of the then proposed Voluntary Administration procedure would be a voluntary act on behalf of the company.[94] In England and Australia the initiation of the procedure leading to a scheme of arrangement may be considered as the exercise[95] of the power granted to make any compromise or arrangement with creditors or persons claiming to be creditor, or having or alleging themselves to have any claim (present or future certain or contingent, ascertained or sounding only in damages) against the company, or whereby the company may be rendered liable.[96] A proposal for a CVA however, encompasses a "composition in satisfaction of its debts" or "a scheme of arrangement of its affairs". The term "scheme of arrangement" could be construed to include both a compromise or arrangement and thus, a CVA may be proposed in the exercise of this same power. The only difficulty with this line of reasoning is that in England the power to make a compromise or arrangement may be exercised only with sanction, whereas the power to make an application appears to be exercisable as of right.

Although the directors of a company have no authority to appoint a Receiver, they may nevertheless invite the debenture holder to do so. In such circumstances, the appointment, for all practical purposes may be considered as voluntary.

Non-voluntary but non-hostile initiation

In Canada the trustee in bankruptcy may initiate a Scheme and a Canadian Proposal. In

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91(...continued)
when instructing solicitors and incurring legal costs see *Re Anglo-Moravian Hungarian Junction Railway Co.* (1875) 1 Ch. D. 130.

92 *Black & Co's case* (1872) 8 Ch App 254 and *Ayerst v C & K (Constructions) Ltd* [1976] AC 167.

93 *Ayrest v C & K (Construction) Ltd* [1976] AC 167.

94 The ultimate wording of the act does not, it is submitted, reflect the Harmer Commission's intentions. Rather it seems to indicate whether in fact the liquidator would initiate the procedure on his own account, on behalf of the company or on behalf of the creditors.

95 With sanction in England.

96 Para. 2 of Sched.4, IA 1986 [U.K.], ss.477(1)(c) and 506(1) CL [Aust.].

a Canadian bankruptcy the powers of the company and its directors and even the shareholders are not affected by the bankruptcy.[97] The making of a proposal however is an act the directors of the company may still do since the bankrupt company's authority to do so is retained under s.50(1) BIA [Can.]. Further, unlike the liquidator, the trustee is not considered to be the agent of the company. Thus, the authority to make a voluntary initiation during bankruptcy remains vested in the company. Neither does the trustee act for the creditors in carrying out his functions as the trustee. To the extent that a proposal does not receive the approval of the company's directors it would, in theory, constitute an initiation against the wishes of the company. However, the upshot is that in making a proposal or in initiating a scheme the trustee does not appear to be acting for either party.

A Canadian Proposal may also be initiated by a court appointed Receiver. On the appointment of a Receiver by the Canadian Court, the directors of the company do not cease to hold office, but their powers to deal with the property which is the subject of the appointment ceases.[98] To a great extent they cease to be able manage the business of the company.[99] It is also well established that a Court appointed receiver is not the agent of the company[100] or the creditor who sought his appointment. He is an officer of the court and has a duty to act impartially.[101] Thus, the initiation of a Canadian Proposal by a Court appointed Receiver is neither a voluntary act of the company nor an act on behalf of the company's creditors. It appears to be an initiation on the Court appointed receiver's own account.

Hostile Initiation

An initiation by the creditors is *prima facie,* hostile and their right to initiate the various regimes varies considerably.

At one end of the scale every type of creditor, whether secured, unsecured, contingent or prospective is able to initiate an English Administration, A similar broad spectrum of creditors may initiate a Scheme, except that creditors with a claim for damages in tort would experience some difficulties in trying to exercise their rights. It would appear that despite the advantage of

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97 *Re Canada Cereal and Flour Mills Co.* (1921) 2 C.B.R. 158, *National Trust Co., v. Ebro Irrigation and Power Co.,* [1954] 3 DLR 326.

98 *Measures Brothers Ltd. v. Measures* [1910] 2 Ch. 248; *Wealstead v. Hadley* (1904) TLR 165.

99 *Moss Steamship Co. Whinney* [1912] AC 254 at 260.

100 *Channel Airways v. Manchester Corp.* [1974] 1 Lloyds Reports 456.

101 *Burt Boulton & Hayward v. Bull* [1895] 1 QB 276 at 279. See also *Trusts and Guarantee Co v. Grand Valley Railway Co.* (1915) 24 DLR 171 at 173 per Hodgins JA.

an express enabling provision in the statute, similar difficulties would be experienced by such creditors who try to initiate an English Administration.

At the other end of the scale are the procedures where a hostile initiation is restricted to a certain class of creditor. In this limited creditor category Receivership stands out as being the only procedure which may be exclusively initiated by a creditor who has a charge over the whole or substantially the whole of the company's property. In England the charge must specifically be a floating charge. A substantial chargee is also the only type of creditor who may initiate an Australian Voluntary Administration.

Both the Cork Committee and the Harmer Commission waxed eloquent about the benefits of receivership: the ability of a receiver to save an ailing business where appropriate and how beneficial it would be if such a regime was available to companies where there was no floating charge. The Administration Order Procedure does allow unsecured creditors to put a company into Administration but the complex, costly and practically impossible stages that a diligent creditor must go through to enforce his statutory rights and the Cork Committee's dream, is a far cry from the smooth, efficient and inexpensive manner in which a receiver is appointed. As mentioned an Australian "substantial chargee" does have such a right but not unsecured creditors.

It is submitted however, that it would be unrealistic to give unsecured creditors as powerful a right as a floating charge holder for the simple reason that the floating charge holder would be in possession of more detailed and accurate financial information about the company than any other creditor. Whilst, in theory it would be beneficial to the unsecured creditors to be able to initiate either a CVA or an Administration as smoothly and efficiently as the holder of a floating charge the threat of the exercise of such a right would hang like Damocles's sword over the company.

Hence, it is submitted that except in the case of a Receivership and an Australian Voluntary Administration and perhaps in a Canadian Scheme initiated by a creditor when the company was in liquidation, the creditors' powers to initiate a hostile rescue where available are unlikely to be used effectively.

In Canada, the Colter Committee did not display the same faith in Receivership as did its English and Australian counterparts. There was no recommendation that unsecured creditors in Canada should, through a separate procedure, enjoy the same benefits available to a secured creditor through a receivership. Still, the ability of a privately appointed receiver to make a proposal indirectly allows a receiver himself to grant the unsecured creditors the benefit of his management and control over the company. It is likely that this power would be exercised by the privately appointed receiver only where there is a surplus of assets remaining after the secured creditor's claim has been satisfied in full. If the assets prove to be inadequate, the making of a Canadian Proposal by a Receiver may conflict with the Receiver's primary duty which is to the debenture holder.

Even so, in theory, as agent of the company, the Receiver would have the right to make a Canadian Proposal at any time he chooses. Apart from removing the Receiver the debenture holder would not be able to interfere because if the Receiver takes instructions from the debenture holder that would be adequate to constitute the Receiver the debenture holder's agent.[102]

To the insolvency practitioner it would matter little whether a procedure is initiated on behalf of the company or not. To him or her all that would matters is whether the person initiating it has the power to do so. But, as will become evident from the succeeding chapters, the procedure to be followed within the context of a single regime varies depending on the identity of the person who puts it in motion.[103] Regimes which seek to make a proposal to the company's creditors at the very outset are naturally easier to initiate if done voluntarily or in a non-hostile manner. For example a Canadian Proposal, which has been described as a contract between the debtor and the creditors,[104] is entirely a voluntary or at least non-hostile. The same is true of a CVA. In contrast, the ability of creditors, secured and unsecured, to take steps to initiate a scheme would seem to indicated that the company may be forced into that procedure involuntarily. As will be seen from the next chapter, such an appearance is deceptive since the manner of initiating a scheme[105], does not lend itself to an efficient hostile initiation.

Rescue regimes which are initiated by placing the management of the company in the hands of an independent insolvency practitioner should, in theory prove the most difficult to initiate in a hostile manner. As will be seen this is indeed the case where the initiation process depends upon considerable co-operation from the company. But where the need for co-operation is dispensed with, initiation becomes easier.

102 Bennett, F., *Receivership*, Carswell Company Ltd, Toronto, 1985.

103 For example the procedure which follows the initiation of a CVA by the directors of a company varies from the that which follows its initiation by the liquidator or administrator.

104 *Employers' Liability Assurance Ltd v. Ideal Petroleum (1959) Ltd* (1976) 26 C.B.R. (N.S) 84 (S.C.C.), per de Grandpré, J, at p.92. For earlier formulations of the same principle see *Caplan, Re; Lawrence v. Dashiff et al.* (1969) 15 C.B.R. (N.S.) 191.(Que S.C.); *Lipson, Re; (Sterling Dress Company)* (1923), 3 C.B.R. 640 (Ont.S.C.) per Fisher J. at p.643.

105 Examined fully in 3.2.1 *ante*.

CHAPTER THREE

HOW MAY A RESCUE BE INITIATED?

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Introduction

At the beginning of the previous chapter it was pointed out that a swift initiation is imperative if the insolvent liquidation of a company is to be averted or even arrested midway. A swift initiation assists in suspending temporarily any uncertainty concerning the company's immediate future and, where a moratorium is triggered on initiation, in protecting the company's property from any precipitous action by its creditors.

Whether an attempted rescue is successful or not it is in the creditors' interests that costs of the rescue as a whole be kept to the very minimum. Unless the company were to return to solvency as a result of the rescue, all costs incurred would be payable out of funds which would ordinarily be available to the creditors. Here the return made to the creditors becomes relevant. As long as the return from the rescue exceeds the return creditors would have received in the event of a liquidation, the creditors may be willing to endure higher transaction costs as the price payable for a greater return. Since it is not possible to predict with certainty whether an attempted rescue will be successful, creditors always run the risk of failure and having to bear unimpeachable initiation and other transaction costs of the failed attempt in addition to liquidation costs. Costs, specifically initiation costs, are also important from the company's point of view, particularly on account of the fact that, when the initiation of a rescue procedure is contemplated, the company is or is likely to become insolvent. If initiation costs are high, the result might be that a company which has business worth saving may yet go to the wall because it does not have enough funds to meet these expenses.

Nothing affects the speed and cost of commencing a rescue procedure more than the method whereby it is commenced. However, important though it may be to pursue a swift and cheap method of commencing a rescue, such a goal should not be achieved at the expense of the creditors's rights which are directly affected by the commencement. Thus, adequate safeguards for the creditors should be built into either the initiation process itself or other aspects of the procedure.

During the course of this chapter it will become apparent that the initiation of any one of the procedures under consideration invariably involves several steps. Each step may be common to several of the procedures, if not all, or it may be unique. Depending on the step which is being considered, the procedures may be classified in different ways. Procedures which fall into one class on the basis of a common step taken in initiation, may fall into a different class if another step is taken into account.

In order to avoid a possible imbalance of treatment which any premature classification might yield, it is proposed to first examine the various steps involved in the initiation of each procedure separately. In conclusion an attempt will be made to classify the regimes based on the most significant characteristic(s) revealed by this examination together with a comparative analysis between logically comparable classes and between regimes within a single classes. An attempt will also be made to determine whether any procedure could successfully adopt the methods used by any other in its class or adapt the methods used in a procedure of a different class for the purpose of either increasing the speed in which the rescue may be commenced, reducing initiation costs or ensuring that the rights of creditors are protected.

INITIATING A SCHEME OF ARRANGEMENT

General aspects

A "scheme of arrangement" is an expression used to describe a "compromise or arrangement" proposed under s.425(1) CA 1985 [U.K.], s.411(1) CL [Aust.] and ss.4 & 5 CCAA

[Can.]. In all three jurisdictions the procedure leading to the sanctioning of a Scheme of Arrangement is generally commenced by the court making an order that meetings of the company's creditors[1] be convened to consider a proposed Scheme of Arrangement.

Several requirements should be satisfied in order to initiate a Scheme of Arrangement. First, a compromise or arrangement must be proposed between a company and its creditors or a class of creditors or its members or a class of members.[2] Thereafter, an application should be made to court seeking an order requiring meetings of the company's creditors to be convened to consider the proposed compromise or arrangement.[3]

The affidavit accompanying the application[4] would have annexed as exhibits, inter alia, a copy of the scheme, a copy of the explanatory statement required under the Act or by Court and all documentation referred to in the Scheme.[5] Thus, the task of preparing the proposal for a compromise or arrangement with creditors should be done prior to the making of the application to the court.

In Canada it has been recognised that it may not always be possible for a company to place the proposed compromise or arrangement before the court when the application is made. In such cases it is likely that the Canadian Court would fix a date on which the scheme should be submitted and meanwhile order a stay until the terms of the scheme are worked out. This flexible approach adopted by some Canadian Courts[6] has been frowned upon by others. In *Banque Laurentienne du Canada v. Groupe Bovac Ltée*[7] the Quebec Court of Appeal held that the proposed scheme should exist before the application is made although it could be modified or varied thereafter. Houlden & Morawetz are critical of this decision on the grounds that it robs the CCAA [Can.] of a great deal of flexibility. They argue that schemes are often complex and

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1 And, if necessary, the members.

2 Under the CCAA [Can.] for constitutional reasons a scheme of arrangement may not be made with the members. In any event, in this thesis we are concerned with schemes proposed between a company and its creditors.

3 s.425 CA [U.K.]; ss. 411 to 412 CL [Aust.]; ss. 4 & 5 CCAA [Can.].

4 The application may be by way of originating summons (R.S.C. Ord.102.r.2.(1) [U.K.], s.10 CCAA [Can.], or petition or notice of motion.(s.10 CCAA [Can.].)

5 See generally *Atkin's Encyclopædia of Court Forms in Civil Actions*, London, Butterworths, 1992, Forms 69 and 79, *Australian Encyclopædia of Forms and Precedents*, Revised, Butterworths, Australia, 1992, Forms 1.45 and 1.50.

6 See *Re Fairview Industries Ltd.* (1991) 11 C.B.R. (3d) 43 (N.S.T.D.), and *Re Northland Properties Ltd.* (1988), 73 C.B.R. (N.S.) 146.

7 (1991), 9 C.B.R. (3d) 248.

time is required for the details to be negotiated with the company's creditors. In *Re Inducon Development*[8] it was held that at the least an outline scheme should be submitted at the time of the application.[9]

Neither of the statutes prescribe any particulars which should be included in a proposed scheme. The courts have from time to time indicated that certain terms should or should not be included. Beyond this, on a practical note, the contents of a scheme are limited only by the sagacity of the draughtsman and the practical need to propose terms which the creditors would be likely to accept.

"Compromises" and "Arrangements"

It is useful to begin this study with the terms "compromise" and "arrangement" because that is what the scheme must propose. Neither term is defined in either of the statutes but the courts have expressed views as to their scope and meaning. It is generally accepted in all three jurisdictions that a proposal to "compromise" would pre-suppose the existence of a dispute between the company and its creditors and set out the terms for settling that dispute.[10]

An "arrangement" on the other hand has been held not to be limited to something similar to a compromise,[11] and the Courts have been inclined to construed the term "arrangement" widely.[12] It has been said to envisage an agreement whereby the a single creditor or a class of creditors would receive payment in full in preference to the to the company's other creditors.[13] In England and Australia it has been construed as not including a composition or compromise with creditors under which the creditors agree to take *less* than the whole amount of their

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8 (1991) 8 C.B.R. (3d) 306 (Ont.Gen.Div.)

9 Since a company must be insolvent in order to propose a scheme under the CCAA [Can.], where a stay is imposed until the scheme is filed the court may appoint an interim receiver to protect the company's property, or require the company to report to court and the creditors until the proposal could be presented. Houlden L.W. & Morawetz C.H. claim that in the larger insolvencies it is now common to appoint a "monitor" to supervise the affairs of the company. See *Bankruptcy and Insolvency Act* (Revised) Carswell Canada, § N .10 .

10 See *Sneath Valley Gold Ltd.* [1893] 1 Ch. 477, a case in which the meaning of the word "compromise" as used in a trust deed was examined. See also *Mercantile Investment and General Trust Co. v. International Co. of Mexico (1891)* [1893] 1 Ch.484, *Mercantile Investment and General Trust Co. v. River Plate Trust Loan and Agency Co.* [1894] 1 Ch.578, *Re N.F.U. Development Trust Ltd.* [1971] 1 W.L.R. 1548.

11 *Re Guardian Assurance Co.* [1917] 1 Ch 431.

12 *Re Savoy Hotels Ltd.* [1981] Ch 351; [1981] 3 All E.R 646. See also *Re International Harvester Co. of Australia Pty Ltd* [1953] VLR 669.

13 *Re E.D. White Ltd* [1929] 29 S.R. (N.S.W.) 389; *Re Robinson and the Trustee Act., supra.*

respective debts in full and final payment.[14] It has also been held that the words "compromise" and "arrangement" do imply an element of accommodation on each side. Thus, a scheme which involved the expropriation of the rights of some members of a company with no compensating advantage did not receive the court's sanction.[15] Houlden and Morawetz take the view that there is little practical significance in the distinction between "compromise" and "arrangement".[16] By whatever name it is referred, the creditors to whom the scheme is proposed will be asked to accept either absolutely or contingently, rights under the scheme in place of their claims against the company.[17]

The company should take care not to propose a scheme of arrangement involving a transaction outside the objects of the company since in England the Courts have no jurisdiction under this section to approve it.[18] Where the scheme is in relation to the company's members, it will not receive the court's sanction unless it has been approved by the company because the section assumes such consent.[19]

If it is intended that the scheme should culminate in the liquidation and distribution of the company's assets, care should be taken to ensure that the established rules on proof of claims and *pari passu* distribution are not altered by the scheme.[20]

Schemes should be proposed to the "Creditors"

The compromise or arrangement should be proposed to the company's creditors or a class thereof. Who is a creditor for the purpose of the compromise and arrangement provisions of England, Canada and Australia? Neither the English nor the Australian Act defines the word creditor. In England in the case of *Re Midland Coal, Coke and Iron Co.,*[21] Lindley LJ observed that the word "creditor" is used in the widest sense and includes every person who has a

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14 *Re Contal Radio Ltd* [1932] 2 Ch. 66; *Re Robinson and the Trustee Act* [1983] 8 ACLR 228.

15 *Re N.F.U. Development Trust Ltd.* [1973] 1 All.E.R. 135

16 Houlden L.W. & Morawetz C.H., *Bankruptcy and Insolvency Law of Canada* (Loose Leaf) Carswell Canada, N§10.

17 Fischer, "Schemes of Arrangement between a Company and its Creditors", in Lowe S., (ed) *Insol '85,* Conference papers of the International Insolvency Conference 1985, Matthew Bender, § 2.03.

18 *Re Oceanic Steam Navigation Co., Ltd.* [1939] 1 Ch 41.

19 *Re Savoy Hotels Ltd.* [1981] Ch 351; [1981] 3 All E.R 646.

20 *British Eagle International Airlines v. Compagnie Nationale Air France.* [1975] 2 All E.R. 390, *National Westminster Bank Ltd v. Halesowen Presswork and Assemblies Ltd.* (1972) AC 785.

21 [1895] 1 Ch 267, C.A.

pecuniary claim against the company whether actual or contingent. This would include debenture holders, other secured and unsecured creditors,[22] and shareholders who are also creditors.[23]

Although it is technically possible to bind all the company's creditors by way of a scheme, as a practical matter, it is not usual. It is generally the unsecured creditors, who do not enjoy a priority status in a liquidation and whose claims arose prior to the scheme being proposed that are bound.[24] Ford points out:

> "A scheme will not normally purport to affect secured creditors. However, the court has the power to sanction a scheme which affects a secured creditor, but the power will be used only sparingly in the face of substantial opposition."[25]

The CCAA defines "secured creditor" and "unsecured creditor" in s.2. The definitions are perhaps necessary because of the separate treatment of each class in sections 4 and 5.

Notwithstanding the wide definition given to the word creditors in *Re Midland Coal etc.*, where the scheme is proposed to the unsecured creditors of the company, the question arises whether it should include persons with an unliquidated claim for damages. There appears to be no case in point in England. But such creditors do now come within the definition of creditor for the purpose of ss.9(1) and 124(1). Prior to 1986 these creditors had no rights in a scheme.

The position in Australia appears vague at best. In the case of *Re Corbett Morris & Associates Pty Ltd.*,[26] McClelland J held that a person having an unliquidated claim for damages in tort was not, a "creditor" of a company which is insolvent.[27] McClelland J himself has expressed the opinion that this view is wrong and should not be followed. In the subsequent case of *Re Glendale Land Development Co Ltd (in liq)*[28] McClelland J held that "creditors" may extend beyond such provable claims and embrace claims over and above those provable in a

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22 *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213 C.A. Holders of bearer debentures would have to produce them at or before the meeting to be able to vote. *Re Wedgwood Coal Co.* [1877] 6 Ch.D. 627.

23 *Re Madras Irrigation, etc., Co* [1881] W.N.172. Shareholders holding bonds of the company are entitled to vote at a meeting of the company's creditors.

24 See Fischer, "Schemes of Arrangement between a Company and its Creditors" *supra* at §2.04.

25 Ford H.A.J. and Austin, R.P. *Ford's Principles of Corporation Law* 6th Ed., [2125] p.806 and see *Re Empire Mining Co.* (1890) 44 Ch D 402; *Re Alabama, New Orleans Texas and Pacific Junction Railway Co.* [1891] 1 Ch 213.

26 [1985] 10 ACLR 40

27 See also *Trocko v. Renlita Products Pty Ltd* [1973] 5 SASR 207 and *Re Weymouth Guarantee and Discount Co Ltd* [1975] 10 SASR 407.

28 [1982] 7 ACLR 171

winding up. In *Re R L Child & Co Pty Ltd*[29] he stated that "this formulation was not intended to limit the scope of the expression but rather to indicate that persons with unliquidated, prospective or contingent claims were not excluded, notwithstanding difficulties in assessment in value in such cases.[30]

However an analysis of the relevant Australian provisions seems to indicate that persons with unliquidated claims for damages in tort have a right to be present at meetings of creditors. First s.411(4) supposes that creditors would have "debts or claims" against the company. Further, since the Court has a right to stay actions under s.411(16) and since an action in tort may quite properly be stayed, a person having such a claim ought to have the right to express his view at the meetings of creditors. Such persons would fall into a class of their own.

In Canada, persons having an unliquidated claim for damages would fall into the category of unsecured creditors. Under the Canadian Bankruptcy Act "creditor" includes a person with an unliquidated claim for damages and S.12(1) and (2) of the CCAA, which must be read together with the Bankruptcy Act, appears to bring such persons within the scope of "unsecured creditors" in the CCAA.[31] As in Australia the claims of such creditors may be stayed by the Canadian Court.

There are a number of other matters of practical importance which must be dealt with within a scheme of arrangement. For example the scheme may provide that it be administered by an administrator or that an monitor be appointed to monitor the company's affairs. Such matters are examined more fully under 4.8(A) below.

Statement explaining the proposed scheme

A statement explaining the effect of the compromise or arrangement and, in particular, stating any material interests of the directors of the company (whether as directors, members or creditors of the company or otherwise) and the effect of the compromise or arrangement on such interests so far as it is different from the effect on like interests of other persons, should be

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29 [1986] 10 ACLR 673.

30 Ibid at p.674. However, such creditors may not prove in the winding up of an insolvent company. See *Ford's Principles of Corporations Law*, *supra*, [2125] p.805.

31 A claim under the CCAA [Can.] is defined as any indebtedness liability or obligation of any kind that if unsecured would be a debt provable in bankruptcy within the meaning of BIA [Can.]. See s.12(1) CCAA [Can.]. The procedure to be used in determining the amount of a claim of any secured or unsecured creditor is also set out. If the claim is unsecured and proceedings are pending under the Winding Up Act or if the Company has made an authorized assignment or if a receiving order has been made against it in the Bankruptcy Act then the claim should be proved according those statutes. See s.12(2) CCAA [Can.].

prepared to accompany every notice summoning the meeting which is sent to a creditor or member.[32] Such a statement must also be included in every notice summoning the meeting given by advertisement, or alternatively the advertisement must notify the place at which creditors or members who are entitled to attend can obtain copies of the statement.[33] Where the compromise or arrangement affects the rights of debenture holders of the company the statement must give a similar explanation as respects the trustees of any deed for securing the issue of the debentures as it is required to give as respects the company's directors.[34] The statement must be made available free of charge to all creditors and members entitled to attend.[35]

In Canada there is no statutory requirement that explanatory statements should accompany the notices convening the meeting.In practice however the court would require such explanatory statements to be served.[36] Referring to the limited information mandatorily made available to creditors, Duncan writing in the year the CCAA was enacted opined that, from the point of creditors, the scheme introduced by this statute marked a definite retrogression in Dominion legislation on insolvent companies. He observed:

> "Whatever may be the experience in other jurisdictions, ample experience in Canada has demonstrated that creditors are not able to protect themselves when a company makes a proposal of compromise under an Act of Parliament unless they have first had an opportunity of examining the books and transactions of the debtor company through their own trustee."[37]

The application to Court

Once a scheme of arrangement and the accompanying documentation has been prepared, an application should be made to court seeking an order summoning meetings of the creditors or members or classes thereof to whom the scheme has been proposed. The application may be made by either the company (often ex parte), any creditor or member, if the company is being wound up, by the liquidator, or if in England an administration order in relation to the company is in force, by the administrator or in Canada by the trustee in bankruptcy.

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32 s.426(2) CA 1985 [U.K.], (first introduced by CA 1948 [U.K.].), s.412(1)(a) CL [Aust.].

33 s.246(3) CA 1985 [U.K.], s.412(1)(b) CL [Aust.].

34 s.426(4) CA 1985 [U.K.], s.412(3) CL [Aust.].

35 s.426(5) CA 1985 [U.K.], s.412(4) CL [Aust.].

36 See Goldman *et al*, "Arrangements under the Companies' Creditors Arrangements Act" (1990) 1 *C.B.R. (3d)* 135, at 156.

37 Duncan & Reilley, *Bankruptcy in Canada (2nd Ed of Duncan on Bankruptcy)*, Toronto, Canadian Legal Authors Ltd., 1933, p 1108.

The proposed scheme and the attached documents are closely examined by the courts in deciding whether or not to summon the meetings. If for any reason it takes the view that it would not approve the scheme in spite of an approval by the creditors and the members then leave would not be granted to summon the meetings.[38]

If classes of creditors or members are to be summoned the responsibility for deciding who are to be summoned to a meeting as constituting a class is the applicant's.[39] A "class" whether it be of creditors or members must be "confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest."[40] This definition of a class by the English Court of Appeal has been accepted in both Canada and Australia[41]. In *Re Links Textiles Corporation Ltd (Receivers and Managers Appointed)*[42] Mark J opined "[S]imilarity of interest is to be assessed in relation to the proposed scheme, if implemented."[43] Whether a creditor or member falls into a particular class or not depends upon the nature of his contractual relationship with the company and generalizations should not be made.[44]

Features peculiar to the initiation of Australian Schemes

Although based on the English provisions, the Australian procedure has been "Australianised" by a number of alterations and additions. The question is whether these alterations and additions have improved the procedure and made it more efficient. Mention will be made only of those provisions which are peculiar to Australia.

S.411(1), under which the first application is made to Court is, [as are ss. 4 & 5 of the CCAA (Can.)], very similar to s.425(1) of CA 1985 (U.K.), except for the fact that it attempts to clarify and explain in some detail the procedure to be followed. Firstly, it specifies that the application to Court is to be by way of summary procedure. Secondly, that the meetings may be

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38 *Re Dorman Long and Co. Pty. Ltd.* [1934] 1 Ch 635 at 655-656. See also *Re Glendale Land Development (No.2)* (1982) 1 ACLC 562 at p.563.

39 *Practice Note* [1934] WN 142. See also *Re Hellenic and General Trust Ltd.*, [1976] 1 WLR 123; *Re Weymouth Guarantee and Finance Discount Co Ltd* (1975) 10 SASR 407, *Re International Harvester* (1983) 7 ACLR 796 the dictum of Lush J at p.801.

40 *Per* Bowen L.J. in *Sovereign Life Assurance Co v. Dodd* [1892] 2 Q.B. (C.A.) 573, at p.583.

41 *Re Bond Corporations Holdings Ltd.* (1991) 9 ACLC 1264; *Re Jax Maritime Pty Ltd., and the Companies Act 1961* [1967] NSWR 145.

42 (1990) ACLC 1089.

43 at p.1093.

44 For further cases see the *Supreme Court Practice* 1991. pp.1468-71

convened in more than one place and even outside the jurisdiction of the Court summoning it.[45] In making such an order the Court is required to take into consideration where the creditors or members, or the creditors or members included in the class concerned reside.[46] Finally, it provides that the Court may approve the explanatory statements which must accompany notices of the meeting under s.412(1). Although in England, explanatory statements are statutorily required there is no requirement for the Court to approve them.

S.411(1A) which follows has no counterpart either in England or Canada and was introduced into the Australian legislation in 1990.[47] It applies to a company having 30 or more subsidiaries which wishes to enter into a compromise or arrangement involving itself, its creditors, each of its subsidiaries and their respective creditors. Under this section the Court is able to consolidate the meetings of the creditors where the number of meetings would otherwise be so great as to constitute a significant impediment to the timely and effective consideration by the creditors of the terms of the scheme. In order to qualify for such a consolidation of meetings the compromise or arrangement must firstly be proposed between 30 or more companies that are wholly owned subsidiaries of the holding company and the creditors or class of creditors of each of those subsidiaries, and between the holding company and the creditors or class of creditors of the holding company. Secondly, the scheme in relation to each subsidiary must include a term that orders will be sought transferring the whole of the undertaking and of the property and liabilities of the subsidiary to the holding company. As in s.411(1), when making the order the Court is empowered to authorise the explanatory statement required to accompany the notices of the meeting.

The consolidation of meetings where there are less than 30 subsidiaries is dealt with in the succeeding subsection which was also introduced in 1990 along with s.411(1A). Under s.411(1B) the Court may, if it is of the view that circumstances exist that justify it so doing, make an order under s.411(1A) even if there are less than 30 subsidiaries.

While s.411(1A) and (1B) may be viewed as refining the compromise and arrangement procedure to enable multi-subsidiary corporations to make efficient use of it, it is merely an extension within the existing framework, and does not make any fundamental alteration to the

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45 Thus meetings may be held even abroad as was done in the case of the Schemes of Arrangement proposed by the Bond Corporation. Meetings were held in London, Geneva and Perth (Western Australia).

46 s.411(3A) CL [Aust.].

47 Amendment Act No.110 of 1990, Sch.3.

procedure as applied in England.

S.411(2) however introduces a further step in the procedure. Under this section the Court is not able to make an order summoning a meeting or meetings under s.411(1A) or (1B) unless 14 days notice of the hearing of the application has been given to the Australian Securities Commission (ASC), and the Court is satisfied that the ASC has had a reasonable opportunity firstly, to examine the terms of the proposed scheme and a draft of the explanatory statement that must accompany the notice of the meeting and secondly to make submissions to the Court in relation to either the scheme or the explanatory statement. The explanatory statement referred to in this section is similar to the statement referred to in ss.426(2) and (3).

The Court is also able to order two or more meetings, be it of the creditors or members or a class of either. In such an event the meetings, for the purpose of ascertaining the required majority are considered as a single meeting, and the votes cast for and against the scheme are aggregated.

Features peculiar to the initiation of Canadian Schemes

The CCAA, makes heavy weather of emphasising the fact that it applies to both secured and unsecured creditors by having two separate sections to set out otherwise identical provisions for each category. No reason for this is adduced in any of the debates of either House of the Dominion Parliament nor in any of the commentaries on the statute. The English provision clearly applies to both categories and reason for so dividing the two sections is made more inexplicable by the treatment of both categories of creditors together in the very next section.

The significant difference between the English and Australian provisions and the CCAA is the fact that the English and Australian provisions encompasses schemes of arrangement with shareholders as well. The reason for their exclusion from the scope of the CCAA is constitutional. That an arrangement with the members of a company is often part and parcel of one with creditors was recognised by the Dominion Parliament which made provision for the CCAA to be applied together with provisions in Dominion or Provincial legislation which authorises or makes provision for the sanction of arrangements between a company and its members or a class of them.[48]

Under the CCAA an application to Court under s.4 or 5 may be made by the trustee in Bankruptcy. This is possible because, unlike in England, insolvent Canadian companies may make use of the Bankruptcy Act as well as the Winding Up Act.

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48 s.20 CCAA [Can.].

INITIATING A CVA

Nature of a proposal for a CVA

The first step in initiating a CVA is the preparation of a proposal directed at the company and its creditors. According to the rules the proposal is also prepared for the intended nominee in order that he may prepare a report upon it.[49]

Ambiguity shrouds the meaning of the word "company" in s.1(1) IA 1986 [U.K.]. "Company" could mean the "members" or the "company as a legal entity" since the word is used in either sense within the context of both the Companies Act, 1985 and the Insolvency Act, 1986. When the part played by the members of the company in sanctioning the voluntary arrangement is considered, it will be seen that the avoidable ambiguities in section 1 mentioned above, also lend themselves towards obscuring the boundaries of a company voluntary arrangement. Namely, whether a company voluntary arrangement culminates in a trilateral agreement between the company, the creditors and the members or merely a bilateral agreement between the company and its creditors?

The word "creditors" in s.1(1) IA 1986 [U.K.] is also not free from debate as to its meaning. Professors Sealy and Milman argue that it does not include a creditor with a contingent or prospective claim or with an unliquidated claim for damages.[50] They rightly point out that there is no definition of creditor for the purpose of Part I of the Act which relates to the CVA procedure. Thus, it is opined that it would be normal to give the word "creditor" its dictionary meaning, *i.e.* "one to whom a debt is owing", and that this would exclude a prospective or contingent creditor and a person whose claim was for unliquidated damages. Whatever may be the merits of giving the word "creditor" its dictionary meaning, the interpretation given to the word "debt" is indeed supported by the passage cited from Prof. Goode's *Principles of Corporate Insolvency Law*.[51] This interpretation of the word "creditor" (hereafter the "restricted interpretation") is said to be reinforced by the fact that r.13.12 and r.12.3 IR 1986 [U.K.] which extend the concepts of debt and provable debt to include the wider categories of claim, are only applicable in the case of a winding up.[52]

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49 r.1.2 IR 1986 [U.K.].

50 See Sealy, L.S., and Milman, David, *Annotated Guide to the Insolvency Legislation* (4th Revised ed.) CCH Editions Ltd, 1994, pp.28 and 641.

51 at p.31 *et seq.*

52 *cf.* The meaning given to the word "debt" in the provisions pertaining to individual insolvency in s.385(1) read with s.382(3) IA 1986 [U.K.].

In favour of the "restricted interpretation", it is further noted that although contingent and prospective creditors are expressly given the same rights as creditors elsewhere in IA 1986 [U.K.][53] the absence of similar provision in Part 1 makes it reasonable to assume that the word creditor does not have a wider meaning in s.1 IA 1986 [U.K.]. It is submitted against this interpretation that such reasoning does not give adequate emphasis to the relationship between the Administration, Winding Up and CVA procedures and the purpose of the new "rescue" regimes.

S.1(3) IA 1986 [U.K.] empowers an administrator and a liquidator, respectively, to initiate a CVA while an Administration Order is in force and the company is being wound up. If the petition for the administration or winding up order was presented by a contingent or prospective creditor, as is permitted under ss.9 and 124 IA 1986 [U.K.], and if, as it is argued, "creditor" in s.1(1) IA 1986 [U.K.] does not include a contingent or prospective creditor, any CVA proposed by the administrator or the liquidator would exclude the very person whose petition placed the company in administration or winding up.

If a CVA is proposed by a liquidator after the claims of all creditors, had been proved, then it may be argued that there are no further contingent and prospective claims against the company since, upon proof, all such claims would have been converted to debts. The position however would be different if the CVA was proposed by the liquidator before creditors' claims had been proved, or by the administrator during the course of an Administration.

An administrator has no power under an Administration Order to modify creditors' rights or to make a distribution to the company's creditors.[54] If such a modification or distribution is to be made it must be done pursuant to a CVA or a Scheme of Arrangement under s.425, CA 1985 [U.K.]. Thus, the purpose of initiating an Administration would be defeated if the creditor who initiated it was shut out from a CVA proposed by the administrator and was able the day after the CVA was finalised to place the company in liquidation. Not being a "creditor" it would not have been entitled to vote at the meeting of the creditors and would not therefore be bound by the CVA under s.5 IA 1986 [U.K.].

The rules governing English Administrations and CVAs provide for the proof of and admission of debts at meetings of the creditors and for the chairman of the meeting to admit or reject a creditor's claim. Unlike r.12.3, IR 1986 [U.K.] which is confined to the proof of debts

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53 *e.g.* in ss.9 and 124, which deal with the standing to present petition for an administration and a winding up order.

54 See Goode, Prof. R.M., *Principles of Corporate Insolvency Law* at p.125 and *Re St. Ives Windings Ltd* (1987) 3 BCC 634.

by creditors for the purpose of receiving a dividend payment in the liquidation, it is clear that rr.1.17, 2.22 and 2.23 IR 1986 [U.K.] apply to the proof of debts and claims for the purpose of the *creditors' entitlement to vote* only. Thus, it is submitted that the absence of rules which correspond to r.12.3, IR 1986 [U.K.] in the CVA procedure does not, on its own, imply that contingent and prospective creditors are excluded from a CVA. Further, although the restrictive interpretation appears, *prima facie*, to be supported by the decision in *Re FMS Financial Management Services Ltd*[55] it should be noted that in that case the creditor with an unliquidated claim for damages was permitted to prove for the purpose of receiving a dividend under the CVA.

R.13.12 IR 1986 [U.K.] on the other hand applies to winding up in general and not only to the proof of debts.[56] The fact that "debt" and, by implication, "creditor" receive an uniform interpretation at all stages in a winding up, and the fact that it is possible to initiate a CVA while a winding up is in progress, would seem to indicate that a uniform interpretation should be given to the word "creditor" as used in both these regimes. (Hereafter the "wider interpretation"). Although an Administration cannot be initiated by a liquidator, the wording in s.9(1) IA 1986 [U.K.] supports such a consistent interpretation. It appears that all that stands in the way of dispensing with the restrictive interpretation in favour of the wider is the absence of words such as those in ss.9(1) and 124(1) IA 1986 [U.K.] and rr.13.12 and 12.3 IR 1986 [U.K.].

Further, it is difficult to reconcile the restrictive interpretation of s.1(1) with rr.1.17 and 2.22. Professors Sealy and Milman acknowledge that r.1.17(3) IR 1986 [U.K.] creates confusion by referring to a "debt of an unliquidated amount" and a "debt whose value is not ascertained". In the annotations to r.2.22 it is pointed out that both these rules "assume" that a claimant for an unliquidated amount or for a sum whose value is not ascertained may be regarded as a "creditor" but concedes that there is more support for this assumption in an administration than in a CVA since contingent and prospective creditors have the right to present a petition for Administration.

The wider interpretation appears to be supported by the decision in *Re Cranley Mansions*[57] where it was held that a creditor with an unliquidated claim was not bound by the CVA because the creditor had not agreed to the Chairman's valuation of the claim under r.1.17(3) for voting purposes. Without going into the merits of this decision, with which at least one latter

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55 (1989) 5 BCC 191

56 *n.b.* The authors opine that r.13.12 IR 1986 [U.K.] would have been better located in Part VII of the Act which contain provisions of general application in winding up.

57 (1994) BCC 576.

decision[58] does not fully concur, if the creditor had agreed, then despite her claim being unliquidated, she would have been bound.

Whilst the rules are certainly lacking in consistency and the wider interpretation of the word creditor has its own pitfalls it is submitted that it is perhaps more in tune with the overall purpose of the rescue provisions in the Act. In *Re a Debtor (No.162 of 1993); Doorbar v. Alltime Securities Ltd*,[59] a creditor was bound by a voluntary arrangement in relation to contingent debts owed by the debtor.[60]

Form of the CVA

Neither of the relevant Parts in the Act and Rules require the proposal for a CVA to be in any particular form. There are however, some matters which must be dealt with by the person making the proposal.

First, the voluntary arrangement that is proposed, should consist of either a "composition" in satisfaction of the company's debts" or a "scheme of arrangement of its affairs".[61] Neither "composition" nor "scheme of arrangement" is defined in IA 1986 [U.K.]. It also appears to be the first occasion in which "composition" has appeared in a statute, or part of a statute, relating to the Insolvency and reorganization of *companies* since the enactment of the Joint Stock Companies Act of 1844, although it has appeared in successive Bankruptcy statutes since 1833, and continues to appear, in a similar context, in the current statutory provisions relating to individual insolvency in the Second Group of Parts of IA 1986 [U.K.].[62] According to Forsyth:

> "The term composition in strictness only applies to cases where the creditors agree to take *less* than the whole amount of their respective debts..."[63]

Since the words "in satisfaction of its debts" is used in connection with "composition" in s.1(1), it is implicit that where the proposed voluntary arrangement is a "composition", the company

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58 See *Re a Debtor (No.162 of 1993); Doorbar v. Alltime Securities Ltd,* (1994) BCC 994 decided too late for inclusion in the Guide.

59 (1994) BCC 994

60 This writer's views on the applicability of the CVA procedure to contingent creditors have been previously published in a review of the *Annotated Guide to the Insolvency Legislation*. See (1995) 4 *International Insolvency Review*, 104 at 105-107.

61 s.1(1) IA 1986 [U.K.].

62 s.253(1) IA 1986 [U.K.]. See the discussion at pp.29-31 *supra*, where the application of the Bankruptcy Acts to insolvent companies until 1862 is examined.

63 Forsyth, William, *A Treatise on the Law relating to Composition with Creditors*, London, Saunders and Benning, 1841, p.1. See also *Re Griffith,* (1886) 3 Morr,111.

concerned is or is likely to become insolvent.

Similarly, although the word "arrangement" has been used in connection with "compromises and arrangements" under the winding up provisions[64] in the companies statutes since 1862, and under the Joint Stock Companies Arrangements Act, from 1870 to 1901.[65] The phrase "scheme of arrangement" is again a new comer to the English corporate insolvency statutes. However it has been, and continues to be, used freely in practice to describe a compromise or arrangement under the Companies Act.[66]

Secondly, the proposal should also provide for a person, called the "Nominee", to act, in relation to the voluntary arrangement, as trustee or otherwise for the purpose of supervising its implementation. The nominee must be a person qualified to act as an insolvency practitioner.[67] The wording of this sub-section is rather unusual. In the context of Part 1 and the rules, the implementation of the arrangement would take place after the proposed voluntary arrangement had been approved by the creditors and the members. The person appointed to supervise the *implementation* at that stage is identified in s.7 as the "supervisor". In contrast, the role of the "nominee" is to implement the procedure until the company's and creditors' meetings are held and the proposed voluntary arrangement is either accepted or rejected.

Thirdly, in addition to complying with the requirements set out in sub sections 1(1) and 1(2) of Part 1 of the Act, a proposal, must also comply with the criteria set out in Rule 1.3 of the Insolvency Rules, 1986.[68]

Contents of a proposal for a CVA

The person making the proposal would begin by giving a short explanation as to why, in his opinion, a voluntary arrangement is desirable. He must also give reasons why creditors may

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64 The liquidators were, as they are today, entitled to enter in to a "compromise or arrangement" with creditors.

65 Since 1901 in the relevant provisions of the Companies Acts, into which the provisions of the Joint Stock Companies Arrangements Act were transferred. See p.75 *supra*, at ftn.242.

66 It should be noted that in Canada it has been held that a scheme of arrangement involves the debtors assets being vested in or controlled by a trustee until the proposal is carried out. *Re Griffith*, *supra*. ftn.63.

67 s.1(2) IA 1986 [U.K.].

68 Rule 1.3 is found in Chapter 2 of the Rules which relates only to proposals by directors. Rule 1.12, however, which is contained in Chapter 4 and deals with proposals by an administrator or a liquidator where another insolvency practitioner is the nominee, provides that the content of the proposal should be as required by Rule 1.3 and that the references to the directors in Rule 1.3 should be read as referring to the administrator or the liquidator. See r.1.12,(1)(2)&(3) and r.1.1(3) IR 1986 [U.K.].

be expected to concur with such an arrangement.[69]

Rule 1.3(2) goes on to identify a number of matters which must be stated or otherwise dealt with in the proposal. Even though there are a number of matters, due to the somewhat haphazard manner in which they are particularised, there is little indication of the scheme or form to which one may expect a proposal to adhere. The matters that should be stated or otherwise dealt with are as follows:

- So far as they are within the immediate knowledge of the person making the proposal:[70]
  - the company's assets with an estimate of their respective values;[71]
  - the extent to which the assets are charged in favour of the creditors;[72]
  - The extent (if any) to which particular assets are to be excluded from the voluntary arrangement;[73]
  - the nature and extent of the company's liabilities;[74]
  - details of transactions which, should the company go into liquidation,[75] are liable to be set aside or otherwise avoided and how it is proposed to indemnify the company in respect of such claims;[76]
  - the manner in which the company's liabilities are proposed to be met, modified, postponed or otherwise dealt with by means of the arrangement;[77]
  - how it is proposed to deal with preferential creditors and creditors who are, or claimed to be, secured.[78]

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69 r.1.3(1) IR 1986 [U.K.].

70 r.1.3(2)(a)(i)and (ii) IR 1986 [U.K.]

71 r.1.3(2)(a)(i) IR 1986 [UK].

72 r.1.3(2)(a)(ii) IR 1986 [UK].

73 r.1.3(2)(a) IR 1986 [U.K.].

74 r.1.3(2)(c) IR 1986 [U.K.].

75 r.1.3(2)(iii) IR 1986 [U.K.] refers only to the possibility of claims being made in the event that the company should go into liquidation and ignores the fact that such claims may also be made when the company is in administration.

76 r.1.3(c)(iii) IR 1986 [U.K.].

77 r.1.3(2)(c) IR 1986 [U.K.].

78 r.1.3(2)(c)(i) IR 1986 [U.K.]. Where the proposal is prepared by the administrator, firstly, the names and addresses of the company's preferential creditors together with the amounts of their respective claims, and secondly, such other matters which the administrator considers appropriate (continued...)

- Particulars of any property, other than assets of the company itself which is proposed to be included in the arrangement, the source of such property and the terms on which it is to be made available for inclusion;[79]
- The manner in which the business of the company is proposed to be conducted during the course of the arrangement;[80]
- Details of any credit facilities which it is intended to arrange for the company and how the debts arising as a result of such facilities are to be paid;[81]
- Whether the directors are to offer guarantees for the purpose of the arrangement and whether (if so) any security is to be given or sought.[82]
- The manner in which the funds held for the purpose of the arrangement are to be banked, invested or otherwise dealt with, pending distribution to creditors.[83]
- The proposed dates of distribution to creditors.[84]
- The manner in which the funds held for the purpose of payment to creditors, and not so paid on the termination of the arrangement are to be dealt with.[85]
- The amount proposed to be paid to the nominee (as such by way of remuneration and expenses.[86]
- The name address and qualification of the person proposed as supervisor of the voluntary arrangement and confirmation that he is, so far as the directors are aware, qualified to act as an insolvency practitioner in relation to the company.[87]
- The functions which are to be undertaken by the supervisor.[88]

78(...continued)
for ensuring that members and creditors are able to reach an informed decision on the proposal should be set out in the proposal. The second requirement applies to the liquidator as well. See r.1.10(1) IR 1986 [UK].

79 r.1.3(2)(n) IR 1986 [U.K.].

80 r.1.3(2)(m) IR 1986 [U.K.].

81 r.1.3(2)(n) IR 1986 [U.K.].

82 r.1.3(2)(j) IR 1986 [U.K.].

83 r.1.3(2)(k) IR 1986 [U.K.].

84 r.1.3(2)(f) IR 1986 [U.K.].

85 r.1.3(2)(l) IR 1986 [U.K.].

86 r.1.3(2)(g) IR 1986 [U.K.].

87 r.1.3(2)(p) IR 1986 [U.K.].

88 r.1.3(2)(o) IR 1986 [U.K.].

- The manner in which it is propose that the supervisor of the arrangement should be remunerated and his expenses defrayed.[89]

Where the proposal is prepared by the directors of the company, they should give the intended nominee written notice thereof. The notice should be delivered to the nominee (or a person appointed by him to take delivery of documents) together with a copy of the proposal. The procedure is initiated when the nominee agrees to act by endorsing a copy of the notice to the effect that notice had been received by him on a specified date.[90] The same would apply where the proposal is prepared by the administrator or the liquidator and another insolvency practitioner was appointed the nominee.[91]

If the proposal is prepared by the administrator or the liquidator of the company and he himself was the nominee, then it appears that the procedure would be initiated when notices of the meetings are sent out to the creditors and the members.

INITIATING A CANADIAN PROPOSAL

Depending on the identity of the person initiating the procedure, a Canadian Proposal may be initiated either by the filing of a Notice of Intention to make a Proposal, or by directly making a Proposal to the company's creditors. Either route leads to the same conclusion, namely the consideration by the company's creditors whether or not to accept the Proposal. It appears however, that the majority of business Proposals filed in Canada are filed pursuant to a Notice of Intention.

Giving Notice of Intention to initiate a Canadian Proposal

By permitting an insolvent person to file a Notice of Intention to make a Proposal to its secured and unsecured creditors BIA [Can.] provides a "means to a rescue" procedure similar to Administration in England and Voluntary Administration in Australia.[92] This procedure is available only to an insolvent person.

If a company is an insolvent person, it may, *before lodging a copy of a proposal with a*

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89 r.1.3(2)(h) IR 1986 [U.K.].

90 r.1.4(1)&(2) IR 1986 [U.K.].

91 r.1.12(1) IR 1986 [U.K.].

92 Prior to the 1992 reforms, debtors usually filed a first draft Proposal and sought an extension of time to work out definitive terms and file a second Proposal to *unsecured creditors*. Such "holding proposals" as they came to be known were usually allowed by the court. See *Fisher Oil & Gas Corp. v. Guaranty Bank and Trust Co.* (1982) 44 C.B.R. (N.S.) 225, 40 O.R. (2d) 548, 142 D.L.R. (3d) 43 (C.A.).

licensed trustee, file a notice of intention, in the prescribed form, with the official receiver in its locality, stating its intention to make a proposal.[93] The notice of intention should also state the name and address of a licensed trustee who has consented, in writing, to act as trustee under the proposal, and the names of the creditors with claims amounting to two hundred and fifty dollars or more and the amounts of their claims as known or shown by the company's books.[94] A copy of the trustee's consent to act should be attached.

The Canadian Insolvency Practitioners Association, in written *Standards of Professional Practice* prepared for their members recommend that a trustee must make an initial assessment and satisfy himself that the company's intention to file a proposal is *bona fide*. He should also establish whether there are any reasons why he cannot or should not act as trustee in respect of the company concerned and whether he will be able to do so with objectivity.[95] The trustee is advised to assess the company's attitude and the likelihood that a Proposal will be filed and that he can acquire a knowledge of the company's business which is adequate for the purpose of understanding the practices and transactions of the industry within which the company filing the Notice of Intention operates.[96] It is also suggested that the trustee should consider any liability he may expose himself to under environmental protection legislation. It should be noted that these are not statutory obligations placed upon the trustee and are a mere guide to the "best practice" in the circumstances. The fact that a trustee has consented to act under a company's Notice of Intention to make Proposal should not be construed as in any way implying that the company will, or is even likely to, be able to file a Proposal which is viable.[97]

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93 s.50.4(1)(a) BIA [Can.]. The need for a debtor to be able to file a notice of intention before filing a proposal was first identified in Report of the Study Committee on Bankruptcy and Insolvency Legislation, Chairman Mr. Roger Tassé, Canada, Ottawa, 1970, p.91. Until the recommendation of the Tassé Committee was implemented in the 1992 amendment the practice had been for the debtor to file a holding proposal asking for time to file a proposal. See *Fisher Oil and Gas Corp., and Peat Marwick Ltd., v. Guarantee Bank and Trust Co.* [1982] C.B.R. (N.S.) 225; *Re Record Barn Ltd,* [1977] 23 C.B.R. (N.S.) 246; Marantz, R. Gordon, "Lets Make a deal: Proposals under the Bankruptcy Act," [1984] *9 Canadian Business Law Journal*, pp.52-54.

94 s.50.4(1)(b)&(c) BIA [Can.].

95 See Canadian Insolvency Practitioners Association *Standards of Professional Practice* No.10., §3.01, quoted in full in Houlden & Morawetz *The Bankruptcy and Insolvency Act* (Revised) Carswell, Canada, E§4.1.

96 Canadian Insolvency Practitioners Association *Standards of Professional Practice* No.10., *supra* at § 3.05 and 3.06.

97 *cf.* the position in England under an administration order and the proposed reform of the CVA procedure under which the nominee will be required to make a statement that there is a reasonable (continued...)

When the Notice of Intention to make a Proposal has been filed with the Official Receiver, the procedure is initiated.[98] A number of steps follow the filing of a notice of intention leading up to the making and filing of a Proposal. These steps are examined fully later on in this thesis. These steps should be distinguished from the steps which follow the making of a Proposal without a Notice of Intention. However, once a Proposal under a Notice of Intention is made the procedure that follows is the same.

Initiating a Canadian Proposal without notice[99]

Subject to the provisions relating to a notice of intention, proceedings for a proposal are commenced by lodging the proposal in the case of an insolvent person with a licensed trustee, and in the case of a bankrupt with the trustee of the estate. The proposal should be in writing, provide the information in Form 35 and be signed by the debtor company. The terms of the proposal should be set out as well as particulars of any securities or sureties proposed.[100] These steps should be followed whoever makes the proposal under s.50(1).

A Proposal is defined as including a proposal for "a composition, for an extension of time or for a scheme of arrangement."[101] A "composition" is an agreement under which the debtor keeps control of his assets having persuaded his creditors to accept less than full payment in satisfaction of their debts.[102] In contrast, it has been held that in a "scheme of arrangement" the debtor's assets are held by a trustee for the benefit of the creditor until the proposed arrangement is carried out.[103] An extension of time would generally allow the debtor further time for the payment of current debts. The debtor may or may not retain control over his assets. Clearly a composition extension of time or a scheme of arrangement would be more likely to succeed where there are no secured creditors since the retention of control over his assets by the

97(...continued)
prospect of a successful CVA. See the DTI's Consultative Document *Company Voluntary Arrangements and Administration Orders*, October 1993, p.27, para.4.2.

98 The primary consequence of initiation is the moratorium which comes into effect automatically. See the discussion on the moratorium in Chapter 5 *infra.*

99 If a Proposal is made following a Notice of Intention its contents are on the same lines.

100 s.50(2) BIA [Can.]. Although the statute identifies the filing of the proposal with the trustee as the point at which the proceedings are commenced it should be noted that the moratorium does not come into force at this point. This occurs only when the trustee files a copy of the proposal with the Official Receiver under s.62(1) BIA [Can.]. See the discussion in Chapter 5 *ante.*

101 s.2 BIA [Can.].

102 *Re Griffith* (1886) 3 Morr. 111. H.C.). See also Forsyth, *supra.* at Ftn.63.

103 See *Re Griffith, ibid.*

debtor or the grant of that control to a trustee are inconsistent with a secured creditor's rights of possession and sale and the right to appoint a receiver.

Whether the company is bankrupt or an insolvent person, the proposal must be made to the creditors generally, either as a mass or separated into classes as provided in the proposal. Where a proposal made generally to the creditors does not provide for more than one class of unsecured claim, for the purpose of voting, the unsecured creditors are deemed to fall into one class.[104] A Proposal may also be made to secured creditors[105] in respect of any class or classes of secured claim.[106] If a proposal is made to one or more secured creditors in respect of secured claims of a particular class, then it should be made to all the secured creditors having secured claims of that class.[107] Secured claims may be included in the same class only if the interests of the creditors holding those claims are sufficiently similar to give them a commonality of interest.[108]

Contents of a Canadian Proposal

There are indeed very few matters that must mandatorily be included in any business Proposal. Some matters are to be included only if certain circumstances prevail at the time the Proposal is made. A characteristic common to most of these matters is that they relate to payment. There is no mandatory requirement for instance to disclose all assets and liabilities and the extent to which the assets are secured.

All Proposals must provide for payment to be made to preferential creditors in priority

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104 54.(2) BIA [Can.]. Regarding voting on a proposal see p.390, 425 *ante*.

105 Until reform in 1992 a proposal had no application to secured creditors. Thus unless the secured creditors agreed to corporate with the debtor and the unsecured creditors and waived any default that the filing of the proposal may have resulted in the chances of success on a proposal were limited. See the *Proposed Bankruptcy Act Amendments - Report of the Advisory Committee on Bankruptcy and Insolvency*, Chairman Gary F. Colter, Canada, Ottawa, 1986, p.50.

106 s.50(1.2) BIA [Can.].

107 s.50(1.3) BIA [Can.].

108 s.50(1.4) BIA [Can.]. A number of prescribed factors should be taken into account in determining whether secured claims are sufficiently similar, namely: the nature of the debts giving rise to the claims; the nature and priority of the security in respect of the claims; the remedies available to the creditors in the absence of the proposal, and the extent to which the creditors would recover their claims by exercising those remedies; the treatment of the claims under the proposal, and the extent to which the claims would be paid under the proposal. Other criteria, consistent with those mentioned should also be considered. The Court has the power, on an application made to it at any time after notice of intention or a proposal is filed, to determine in accordance with the criteria mentioned above, the classes of secured claims appropriate to a proposal, and the class into which any secured claim falls (s.50 (1.5) BIA [Can.]).

to the claims of other unsecured creditors[109] and for the payment of all proper fees and expenses of the trustee.[110] Provision must also be made for the payment to the trustee of all *moneys*[111] payable under the Proposal to be distributed by him, subject to priorities, to the creditors.[112]

Paragraph 1 of Form 35 requires the Proposal to disclose how payment will be made to secured creditors. Although this reads as a mandatory requirement in Form 35 it would seem to apply only where the proposal is made to secured creditors, since a Proposal need not be made to the secured creditors, and where it is not, a secured creditor's rights are not affected by the moratorium provisions.[113]

Unless the debtor procures, or proposes to obtain, the consent to the contrary from the Canadian revenue authorities, the Proposal should provide for payment in full of taxes payable under the Income Tax Act or similar claims under provincial legislation outstanding at the date the Proposal is intended to be filed.[114]

If the Proposal is made after the repudiation of a lease of real property, it should provide for the payment of compensation to the landlord under s.65.2(3).[115] If it is intended that the creditors should receive promissory notes, debentures, shares in the capital stock of the debtor etc., the Proposal must provide for the delivery of these to the trustee for distribution subject to priorities.[116]

A Proposal made conditional on the purchase of shares or securities or on any other payment or contribution by the creditors must provide that the claim of any creditor who elects not to participate in the Proposal will be valued by court and that creditor will be paid cash on approval of the Proposal.[117]

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109 s.60(1) BIA [Can.] and para 2 of Form 35. In a English Company Voluntary Arrangement, the company is able to enter into an arrangement with preferential creditors as well, but with the restriction that such a creditors preferential status or the amount of his claim may not be reduced without that creditors consent. See s.4(4) IA 1986 [UK]. However in Canada priority status is afforded only to a limited class of creditor.See s.136(1) BIA [Can.].

110 s.60(1) BIA [Can.] and para 3 of Form 35.

111 Not, as in Company Voluntary Arrangements the *property* comprised in the arrangement.

112 s.60(2) BIA [Can.].

113 s.69.1(5) BIA [Can.]. This provision is subject to ss.79 and 127 to 135 and sub-s.248(1).

114 s.60(1.1) BIA [Can.]. If the Proposal is made following the filing of a Notice of Intention then the relevant date is the date on which the Notice of Intention was filed.

115 s.60(1.5)(a) BIA [Can.].

116 s.60(3) BIA [Can.].

117 s.65. BIA [Can.].

If the Proposal is made by a company already bankrupt, and any of the matters set out in s.173 are proved against it, the Proposal must provide reasonable security for the payment to all unsecured creditors of not less than 50¢ on the dollar or a percentage approved by court.[118]

Subject to the overriding requirement that the terms of the Proposal must be definite,[119] the contents of a Proposal are otherwise only limited by the ingenuity of the draughtsman and practical considerations of what may and may not be acceptable to the creditors.

Where the company making the proposal is bankrupt, there should also be attached a statement of affairs referred to in section 158 of the Canadian Bankruptcy and Insolvency Act.[120] A proposal made by a bankrupt company must be approved by the Inspectors before any further action is taken upon it.[121]

If the company making the proposal is not bankrupt, a statement showing the financial position of the company at the date of the proposal should also be lodged with the licensed trustee. The statement must be verified by affidavit.[122]

INITIATING AN ENGLISH ADMINISTRATION

Applying for an Administration Order

An administration under IA 1986 [UK] is initiated by the making of an administration order. The person or persons able to seek an administration order should present a petition to the court having jurisdiction to wind up the company.[123] The petition must be supported by an affidavit[124] to which may be attached a report (hereafter the Rule 2.2 report) by an independent person to the effect that the appointment of an administrator of the company is expedient.[125]

The affidavit attached to the petition must:

- state that the deponent believes that the company is or is likely to become insolvent;

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118 s.59(3) BIA [Can.].

119 For instance the Proposal should not provide that the debtor will pay his creditors when he is able to do so. See *Re Cowdrill* (1922) 2 C.B.R. 610, 22 O.W.N. 238 (S.C.)

120 s.50(2)(a) BIA [Can.].

121 Section 50 (3)

122 s.50(2)(b) BIA [Can.]. Should the Proposal be filed subsequent to the filing of a Notice of Intention, the trustee under the Notice of Intention is also obliged to file several documents.- s.50(5). BIA [Can.]. These are discussed in Chapter Six.

123 s.9(1) IA 1986 [U.K.].

124 rr.2.1 and 2.3. IR 1986 [U.K.].

125 r.2.2 IR 1986 [U.K.].

- identify the purpose or purposes specified in s.8(3) which are expected to be achieved by the making of the administration order;
- state the company's financial position, specifying (to the best of the deponent's knowledge and belief) the company's assets and liabilities including contingent and prospective liabilities;
- state details of any security known or believed to be held by the company's creditors of the company and whether any security confers on the holder the right to appoint an administrative receiver (if an administrative receiver has been appointed that fact must be stated);
- details of any winding up petition which may have been presented against the company to the extent that the deponent is aware of any such petition;
- state any other matters which the deponent is aware of and believes will assist the court in deciding whether or not to make the administration order;
- state whether a report under r.2.2 has been prepared and if not why.[126]

It is submitted that the expressions "to the best of the deponent's knowledge and belief", "known or believed" and "so far as within the immediate knowledge" should apply primarily where the petition for the administration order is presented against the wishes of the company. Where the petition has been presented by the company, the directors, a friendly creditor or the supervisor of a voluntary arrangement they should not be used as an excuse for presenting hastily drawn up papers with inaccurate financial information, particularly where no r.2.2 report is attached.

The Rule 2.2 report

The Rule 2.2 report is optional under the Rules.[127] However, at least until January 1994 it appeared to have acquired almost a mandatory status with courts refusing to make an administration order without a report from an insolvency practitioner. The r.2.2 report has been described as "one which very much influences the court, because it is prepared by experienced people detached from the emotions raised by failure...and can make a serious and objective assessment of the chances".[128] Such a report from an insolvency practitioner appears to cost

126 r.2.3 IR 1986 [U.K.].

127 For an outline of a r.2.2 report see Fletcher, Higham and Trower, *Law and Practice of Corporate Administrations*, Butterworths, 1994.

128 See the judgement of Harman J. in *Re Newport County Association Football Club Ltd.* (1987) BCC 635 at 635.

from around £15,000/- to £25,000/-.[129] By definition it is not a cost incurred by the administrator and as such may not be charged as costs of the administration. Consequently it is a high, up-front, cost which must be met by the company, before obtaining an administration order. In most cases it is likely that the company would at this stage be in dire financial straits and could ill afford such an expense. Allegations are thus rife that the high cost of the r.2.2 report is a substantial hinderance to the use by smaller companies of the administration order procedure.[130]

Indeed, the courts have found that at times these reports are unnecessarily elaborate and detailed and the result of unduly protracted and extensive preliminary investigations.[131] Sir Donald Nicholls, V.C., in a Practice Statement which sought to remedy the position, acknowledged the negative impact of high costs on the rescue and rehabilitation of insolvent but potentially viable businesses and said:

> "It is of the greatest importance that the costs of obtaining an administration order should not operate as a disincentive or put the process out of reach of smaller companies."[132]

There is no outright declaration that r.2.2 reports would no longer be required for the purpose of an administration order[133] but the statement seeks to address the problem at three levels. Firstly, in what are described as "normal cases" what the court would require of a r.2.2 report is a "concise assessment of the company's situation and of the prospects of the administration order achieving one or more of the statutory purposes". It concedes however, that the extent of the investigation and amount of material eventually placed before court should be a matter of judgement of the person who prepares the report which in turn will vary from case to case. The report should, nonetheless, contain an explanation of the availability of finance required during the period of the administration.

Secondly, it indicates a willingness on the part of the courts to be flexible in the interest of reducing the costs of initiating the administration procedure. If the court has insufficient

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129 The DTI Consultative Document claims that figures of up to £20,000 are often cited. see para 5.3 p. 29.

130 "[T]he demand for a [r.2.2] report is usually seen as a distinct handicap, imposing expensive and lengthy obligations on the company and the IP and, indeed the court." See the DTI Consultative Document 1993, para 5.2 p.29.

131 *Quaere* whether such reports are the result of an over-zealous approach by the insolvency practitioner charged with making the report or perhaps an even more cynical desire to exact as much as possible out the company by way of fees.

132 [1994] 1 W.L.R 160.

133 This position could very well have been taken since the report is still discretionary.

material on which to base its decision but the proposed administrator is in court it may accept supplementary material by way of oral evidence followed by a written report covering those matters which will be placed on file. Where appropriate the court may even appoint an administrator on the condition that he report back to the court within a short period so that the court can consider whether to continue or discharge the administration order. In certain instances the court may ask the administrator to hold a meeting of the creditors and report back to the court both within a short time.

Finally, it is conceded that there may be some cases in which a r.2.2 is not needed because it will prove to be of little assistance to the court and the practitioners are reminded that a r.2.2 report is not a mandatory requirement.[134] Perhaps, fearing that the Practice Statement could be misconstrued, the final concession is made with the reminder that it has been "the experience of the judges who sit in the Companies Court that, in general, a rule 2.2 report is valuable as a safeguard in assisting the court to see whether the application has a sound base."

The DTI in a Green Paper published in 1993, questioned whether it is really necessary for the purpose of an administration order.[135] In response to the Green Paper, the Justice Committee on Insolvency Law concurs that in small cases the judge could dispense with a r.2.2 report and adjourn the administration petition pending the passing of a creditors voluntary arrangement.[136]

Easy as it is to criticise the r.2.2 report for its cost, it is also important not to lose sight of the purpose of a r.2.2 report in the context of the procedure as it currently stands. Usually prepared by an experienced insolvency practitioner who is emotionally detached from the consequences of the company's failure, its purpose is to assist the court in making a decision whether, in the light of the circumstances in which the company is placed, it is likely that one or more of the purposes specified in s.8(3) will be achieved. Few judges of the Commercial Court, if any, would claim to have the expertise of an insolvency practitioner entrusted with the preparation of such a report. It is therefore not surprising that the r.2.2 report has been described by judges as "valuable as a safeguard"[137] and "one which very much influences the court"[138].

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134 There is as yet no evidence as to how this practice statement is being implemented.

135 DTI Consultative Document 1993, para.10 & 6.1 pp.6 & 33.

136 It is not clear at this point whether this a voluntary arrangement entered into after the DTI's proposed reforms have been implemented.

137 *Practice Statement* [1994] 1 W.L.R 160.

138 See the judgement of Harman J in *Re Newport County Association Football Club Ltd.* (1987) BCC
(continued...)

Take it away, or reduce the care and consideration that goes into its making, and the burden placed upon the court would automatically increase.

While dispensing with the r.2.2 report may, from the company's perspective, have the beneficial effect of reducing the cost of initiating an administration, it may also have the adverse effect, in some cases, of increasing the immediate costs of at least one class of creditor by prompting litigation which challenges the administration. This would also inevitably drive up the transaction costs of the administration and result in a reduction of the dividend recoverable by all unsecured creditors and floating charge holders. It is submitted that a comparative estimate should be made of the possible cost to creditors of challenging an administration or a moratorium initiated by the court without the benefit of a r.2.2 report.

In its Green Paper the DTI also sought views on whether it would be appropriate to amend the "likely to achieve" test. Without a r.2.2 report the "likely to achieve" test becomes more difficult to apply. The report is a necessary foundation for the application of the test. If the "likely to achieve" test is removed along with the r.2.2 report then the role of the court in making an administration order may be reduced to a mere rubber stamping exercise. It is submitted that, if both the r.2.2 report and the "likely to achieve" tests are dispensed with, there is no significant advantage to either the company or the creditors in retaining the courts' involvement in the initiation process.

The court procedure to obtain an administration order

Notice of the petition for an administration order, together with a copy of the petition, affidavit in support and documents exhibited to the affidavit must be served on any person who has or is entitled to appoint an administrative receiver of the company.[139] A copy of the petition, affidavit in support and documents exhibited to the affidavit should also be served on the person proposed as administrator, if an administrative receiver has already been appointed, on him, if a petition to wind up the company is pending, on the petitioner and any provisional liquidator that may have been appointed.[140] If the application is made by a creditor, the petition must be served on the company.[141]

In addition to the petitioner and the company, all the persons on whom the petition should

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138(...continued)
635 at 635.

139 s.9(2)(a) IA 1986 [U.K.] and r.2.6(1)&(2)(a) IR 1986 [U.K.].

140 r.2.6(2) IR 1986 [U.K.].

141 r.2.6(3) IR 1986 [U.K.].

have been served are entitled to appear and be represented at the hearing of the petition.[142] Any other person who has an interest which justifies his appearance may appear with the leave of court. Such persons are likely to be a director (except where the petition is presented by the directors), a holder of a fixed charge or any unsecured creditor (other than if the petition was presented by such a person) and a member. Where the company is plainly insolvent, members will not normally be given leave *qua* members.

At the hearing, if the requirements set out in s.8(1) are satisfied,[143] the court may make an order appointing an administrator directing that, during the period for which the order is in force, the affairs business and property of the company shall be managed by the administrator.[144] It is important to bear in mind that whilst the filing of the petition and affidavit, the preparation of the r.2.2 report, notice to the floating charge holder etc., are all steps in the initiation process, the Administration Order Procedure is in fact initiated by the court making the administration order and appointing the administrator. The person appointed as an administrator should be a registered insolvency practitioner. There are no proposals in the DTI Green Paper for allowing any other person to act as an administrator.

INITIATING AN AUSTRALIAN VOLUNTARY ADMINISTRATION

Appointing a Voluntary Administrator

The initiation of an Australian Voluntary Administration is indeed simple. Unlike Administration in England, it is not a court procedure and is initiated simply by the appointment of an administrator in writing.[145] If the appointment is made by the company it should be by a writing under its common seal pursuant to a resolution of the directors.[146] Should the appointment be made by a "substantial chargee"[147] or by a liquidator or provisional liquidator,[148] it need only be by writing. Conspicuous by its absence is any obligation to

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142 r.2.9(1) IR 1986 [U.K.].

143 i.e. the court is satisfied that the company is or is likely to become unable to pay its debts and considers that the making of an administration order would be likely to achieve one or more of the purposes set out in s.8(3).

144 s.8(1) & (2) IA 1986 [UK]. For the form of order see Appendix 7 in Fletcher Higham and Trower, *The Law and Practice of Corporate Administrations, supra.*

145 s.435C.(1)(a) CL [Aust.].

146 s.436A (1) CL [Aust.].

147 s.436C(1) CL [Aust.].

148 s.436B(1) CL [Aust.]. See also s.496(1)(b) CL [Aust.] which applied only in the case of a (continued...)

furnish the voluntary administrator with information on the company's financial health along with the appointment in writing. As will become evident, it is the duty of the administrator to obtain this information as soon as possible after his appointment.

However, several requirements should have been met prior to appointing the administrator.

If the appointment is made by the directors, then the board of directors should have resolved that the company is insolvent or likely to become so and that the company be placed in voluntary administration.[149] In the case of an appointment by a liquidator, the liquidator should have formed the view that he or she thinks that the company is insolvent. Where a "substantial chargee" makes an appointment, there is no requirement that the company should be or be likely to become insolvent. Instead, what is required is that the "substantial charge" should have become and remain enforceable.[150]

In all cases the person to be appointed voluntary administrator should in turn have consented in writing to the appointment,[151] and at the time of the appointment should not have withdrawn his consent to act. The administrator's consent should have been obtained prior to making the appointment.[152]

The person who is appointed as administrator should be a registered liquidator.[153] Indeed, where the appointment is made during the course of a winding up, the liquidator or a provisional liquidator appointed in that winding up may, with the leave of court, appoint himself the voluntary administrator.[154]

148(...continued)
members voluntary winding up.. This appointment was also viewed by the Harmer Committee as one made by the company. See the *Harmer Report* supra, p.35 It has also been acknowledged that it would often be the case, though not always, that a company being wound up would be insolvent. See Corporate Law Reform Bill 1992, Explanatory Memorandum, p.97, para.470.

149 s.436A CL [Aust.].

150 The issue of insolvency and the enforceability of the charge are examined more fully hereafter in part 3.3.5 under the title "When a Voluntary Administration may be initiated".

151 s.448A CL [Aust.].

152 cf. The position in a Receivership where the appointment is of effect only when it is accepted by the Receiver. See s.33(1)(a) IA 1986 [U.K.] which requires the acceptance before the end of the business day next following the day on which the appointment was made. See also *Cripps (Pharmaceuticals) Ltd. v. Wickenden* [1973] 1 WLR 944.

153 Registered under Part 9.2 CL [Aust.]. The Australian registered liquidator is the equivalent of the English Insolvency Practitioner.

154 s.436B(2) CL [Aust.].

INITIATING A RECEIVERSHIP

Appointing a Receiver and Manager

A Receivership is initiated by the debenture holder appointing a Receiver in the manner and pursuant to the powers set out in the debenture. Generally the appointment is in writing. If the appointment is made in England, IA 1986 [U.K.] implies that it should be in writing by requiring that the Receiver be sent an "instrument of appointment".[155]

No financial information about the company need be given to the Receiver at the time he is appointed. It is the Receiver's duty to obtain this information as quickly as possible after he is appointed.

The person appointed as an administrative receiver in England, and as a receiver in Australia should be, respectively, an insolvency practitioner or a registered liquidator. There is no such requirement if the receiver in England is not an administrative receiver.

CONCLUSION

Having, examined the method of commencing each procedure in detail, it is now possible to attempt to classify them for the purpose of further discussion. The preceding study demonstrates that the initiation of a procedure sometimes involves several steps being taken, some of which are peculiar to a particular regime. As it was pointed out at the beginning of this chapter, the procedures may be classified in a number of ways on the basis of common characteristics or common steps which must be taken in the process of initiation. Following such a classification, it is possible to carry out a comparative analysis between procedures within a single class and between logically comparable classes. An attempt could then be made to determine whether the absence or presence of any particular features relevant to initiation of a single procedure or a class makes or ought to make a procedure or a class of procedures more efficient, cost effective and ensure the protection of creditors' rights; and further whether any procedure could successfully adopt the methods used by any other in its class[156] or adapt the methods used in a procedure in a different class.

Procedures which involve the making of a proposal for a rescue on initiation

Schemes of Arrangement, CVAs and Canadian Proposals (without a Notice of Intention) are all commenced by drawing up a "proposal", by what ever name called, to be presented for

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155 s.33(1) IA 1986 [U.K.].

156 Depending on the particular classification under consideration.

consideration by the company's creditors and sometimes the members as well. (Hereafter, for convenience, the word "proposal" includes a proposed Scheme of Arrangement, a CVA and a Canadian Proposal). A "proposal" so drawn up would seek to present a "solution" to the company's debt repayment crisis and the problems which in the first instance brought about the company's insolvency. It would also contain, or be shortly followed by, detailed financial information about the company concerned. It would then be left to the creditors, and if appropriate the members, to examine the "proposal" and the information supplied and to decide whether or not accept the proposed "solution". If the "proposal" is accepted by an adequate proportion of the creditors, and if applicable the members, the company proceeds down the path prepared by the "proposal" which will culminate at best in a full recovery, at worst in a liquidation, but in the latter instance, hopefully with a better return to the creditors than would be possible in a winding up.

The initiation of each of these procedures may have other consequences which are not necessarily common to the others. Further, the manner in which the meetings are convened and conducted and the company is managed up to and after the meetings also vary and striking differences may be seen. These systemic differences are examined in greater detail in the following chapters. Simply on the basis of the *modi operandi* of initiation, Schemes of Arrangement, CVAs and Canadian Proposals (without a Notice of Intention) may be classified together as procedures which make a "proposal for a rescue on initiation".

It would be reasonable to expect a "proposal" and its accompanying documentation, if any, (hereafter collectively referred to as "the documents" or "the documentation") to present an accurate picture of the company's financial position and to explain in some detail how the debt crisis affecting a company is to be resolved. There is a significant variance in the approach take by each regime in actually specifying the information that should be contained in the documents.

None of the applicable statutes governing Schemes specify any matters which must be dealt with in the proposed compromise or arrangement. The provisions governing Canadian Proposals specify only a few matters that should be stated. Only in the rules affecting CVAs[157] is it enumerated in any detail what matters should be stated or otherwise dealt with in the composition or scheme of arrangement proposed in a CVA.

Hence, except in the case of a CVA, it is clear that there are no "standard" clauses which may be found in every "proposal". There are, nevertheless, a number of common areas which

157 IR 1986 [U.K.].

should be addressed in the documentation and, as an examination of standard insolvency precedents reveals, are indeed so addressed. Subject to the *caveat* that the following classification is for the purpose of convenience of discussion only, the areas which would generally be set out in the documents presented in a Scheme of Arrangement, CVA,[158] or Canadian Proposal may be broadly classified under the following headings: (a) the company's liabilities and assets; (b) proposals for the repayment of creditors; and (c) other provisions which include financing arrangements, management of the company and its assets, and administrative and miscellaneous details.

Heading (a) covers the disclosure of known and verifiable information on the state of the company's finances which would enable each creditor to evaluate his prospects of recovery under the applicable regime. Heading (b), which is self explanatory, is the core of any "proposal". Headings (c) deals, inter alia, with the manner in which goals set out in a "proposal" are to be realised.

(a) Liabilities and Assets

A logical starting point in the assessment of any "proposal" to restructure a company's debt is a statement of the nature and extent the company's assets and liabilities. In a CVA the proposed composition or scheme of arrangement itself would disclose this information together with an estimate of the respective values of the assets and the extent to which they have been charged.[159] In a Canadian Proposal such information would not be contained in the proposal but in the Financial Statements which must mandatorily accompany it.[160] In a Scheme, this information would be set out in detail in an annexure to the statement of affairs accompanying the proposed scheme or be annexed to the scheme itself.[161]

None of the regimes expressly require the person making the proposal to disclose the

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158 r.1.3(3) IR 1986 [U.K.].

159 r.1.3.(2)(a) IR 1986 [U.K.]. For an example see *Atkin's Court Forms*, Vol.10 Form 4, (CVA by directors) cl.1, and Form 6, (CVA by joint administrators), cl.4 (Under heading "STATUTORY AND OTHER MATERIAL INFORMATION").

160 s.50(2)(b) BIA [Can.]. The mandatory nature of this provision was identified in *Jackson (Trustee of) v. Lowry* (1987), 65 C.B.R. (N.S.) 261; 42 D.L.R. (4th) 481. Until 1992 the Financial Statement was specifically required by Rule 83 B&IR [Can.] to be in the form of Form.74, B&IR [Can.]. However in 1992, Rule 83 B&IR [Can.] was repealed - see S.O.R. 92-579. Houlden & Morawetz presume that a statement based on Form 74 would suffice under s.50(2)(b) see - *Bankruptcy and Insolvency Act* (Loose Leaf) Carswell Canada, E§4.

161 In an Australian scheme it would be contained in the report based on Form 507 annexed to the statement of affairs under Sched.8, Part 2, 2(a) C.reg. [Aust.].

exact nature and amount of the company's assets or liabilities.[162] As a practical matter, the disclosure would also inevitably have a bearing on the number of creditors on whom notices of the meeting of creditors is served and may consequently impinge upon the smooth and successful implementation of a the procedure.[163]

The valuation of the assets is the cornerstone of the attempted rescue. In a liquidation although the assets are required to be valued in the various statements of affairs furnished by the directors of the company to the liquidator or trustee in bankruptcy this valuation has no real impact on the ultimate value realized in respect of those assets by the liquidator or trustee in bankruptcy. Only the realized value is paid to the creditors in the order of priorities.[164] In contrast the acceptance or rejection of a proposed plan of rescue hinges on the value given to the assets which is fictional.

The method of valuation adopted would to some extent depend upon the final outcome sought by the procedure's initiator and the financial status of the company at the moment of initiation. If the proposal is directed at ensuring the survival of the company, or its business it is likely that the valuation will be made on the basis that the company is a "going concern". Valuations of this nature may be expected in proposals voluntarily made by the directors prior to the commencement of any liquidation proceedings, or where a Canadian Receiver or even a liquidator, in all three countries, perceives the possibility of selling the company or its business as a going concern. A "going concern" valuation would usually include assets such as good will" which will be worth nothing in the event of a liquidation. A "break up" or near "break up" valuation may be expected in limited circumstances where a proposal is made within a liquidation in order to reach a specific compromise with the creditors.

If it is a "going concern" valuation, each creditor should take care to ascertain the break up valuation and compare to what extent the company would be able, out of its own assets, to

162 In a CVA these matters should be disclosed only so far as they are within the immediate knowledge of the person making the proposal. See - r.1.3(2)(a)(i)and (ii) IR 1986 [U.K.]. The word "Liabilities" is not defined in either Part 1 of IA 1986 [U.K.] or IR 1986 [U.K.]. Thus, it may be widely interpreted in the light of its meaning in s.123(2) IA 1986 [U.K.] to include every kind of obligation to which the company is exposed, actual and potential.

163 In a CVA if the proposal is made by the directors the extent of the liabilities disclosed should reflect the number of creditors disclosed in the certified statement provided to the nominee under r.1.5 IR 1986 [U.K.]. However, if the administrator or the liquidator makes the proposal the statement of the companies affairs does not have to conform to r.1.5 IR 1986 [U.K.].

164 See Bebchuk, L.C., " A New Approach To Corporate Reorganizations" [1988] 101 *Harvard Law Review* 775.

meet its liabilities in general and his in particular in the event of a forced liquidation.[165] It is often the case in England, Australia and Canada that unsecured creditors of companies, including those with large asset portfolios, receive little in the event of an insolvent liquidation since generally the majority of, if not all, the assets are secured. In CReg. [Aust.], although no direct reference is made to either "going concern" or "break up" values, the author of the explanatory statement is required to set out the dividend which scheme creditors may anticipate if the company were to be liquidated within 6 months of the application to court being made to initiate the procedure and, if a composition of the company's debts is proposed, the dividend that the creditors may expect under the terms of the composition.[166] It appears that in a scheme under CCAA [Can.] the Canadian court would also require an information circular to be sent to the all parties affected by the scheme containing, inter alia, an appraisal of the liquidation value of the company's assets and an indication of what each class of creditor would receive in an immediate liquidation.[167] There is no similar requirement in the provisions pertaining to CVAs,[168] English Schemes, and Canadian Proposals. In a CVA the creditors would be able to rely upon the nominee in a CVA, who is an insolvency practitioner, to determine whether the valuation in the proposal is realistic in the course of giving his comments on the proposal.[169] Nevertheless, it is submitted that such a provision could usefully be incorporated into Part 1 of IR 1986 [U.K.].

The valuation of assets is also important from the standpoint of the secured creditor, even though the "proposal" may not be expressly directed at that category of creditor, since generally, secured creditors are not affected by English and Australian Schemes, CVAs and Canadian Proposals. They may look to their security for satisfaction to the exclusion of other creditors. Where the liquidation value of a charged asset is less than the charged value, the secured creditors would be forced to claim their unpaid balance as unsecured creditors. Creditors whose security

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165 This is often the only source. There are instances where some shareholders, or parent companies have made their own reserves available. For example the payment made to the depositors of the collapsed BCCI by the Ruler of Abhu-Dhabi.

166 Sched 8, Part 2, 2.(4) CR [Aust.]. *Australian Corporations Law: Principle and Practice* Vol 2, (Revised), Butterworths, Australia, para:[5.1.0055]. See also BCH Scheme, Sched.2, Para.1.

167 See Goldman, Baird and Weinczok "Arrangements under the Companies' Creditors Arrangements Act" 1 C.B.R. (3d) 135, at 157.

168 However, see the specimen form in *Atkin's Court Forms*, Vol.10, Form 4, (CVA by directors) Cl.1 and Form 6, (CVA by joint administrators), Cl.3 (Under the heading "STATUTORY AND OTHER MATERIAL INFORMATION")

169 r.1.7(2) IR 1986 [U.K.].

is inadequate to cover their debt are likely to disagree with the proposer's valuation of the assets charged to them since, as will be duly seen the valuation given will affect/ determine the number of votes each such creditor will be entitled to for the purpose of voting on the proposal should there be a shortfall in their security.[170] The higher the valuation the lower the unsecured balance and, consequently, the fewer the votes that the creditor will be entitled to and smaller his influence on the voting on the proposal. Such problems, if they do occur, would be more likely where the proposal is made by the company. In any event, this rule marks a departure from the practice in other insolvency procedures where secured creditors are allowed to value their own security for the purpose of calculating their vote.

Thus, if the "proposal" aims to preserve the company or part of its business as a going concern, it would be helpful to the creditors if the person making the proposal would in the documents set out the difference between "going concern" and "break up" values.

Prior transactions which may need to be adjusted

In a liquidation it may be possible to swell the assets of the company by setting aside certain types of prior transactions. Only in a CVA is it mandatory that disclosure should be made of transactions which, should the company go into liquidation,[171] are liable to be set aside or otherwise avoided. While this requirement should not present any problems where the person making the proposal is the administrator or the liquidator, it is submitted that where directors have benefitted from such transactions, they are unlikely to make a truthful statement since it would not be in their interest to do so.[172] Unlike the Statement of Affairs under Rule 1.5 the directors are not required to certify that the details of the matters in the proposal are correct to the best of their knowledge and belief. A certificate to that effect may be obtained by the nominee by calling for "particulars" under Rule 1.5(2)(g) for the purpose of making his report to the court on the proposal.

In addition to giving details of such transactions the person making the proposal is

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170 As will be seen, the Rules, as they presently stand, do not provide for a valuation of the security by the secured creditor himself, as is the case in other insolvency procedures. See r.2.24 (administration); r.3.11(6) (administrative receivership); r.4.95(1) (winding up); r.6.-- (bankruptcy). The only provision which is identical to r.1.19(3)(c) is r.5.19(3)(b) (check) which applies to individual voluntary arrangements.

171 r.1.3(2)(iii) IR 1986 [U.K.] refers only to the possibility of claims being made in the event that the company should go into liquidation and ignores the fact that such claims may also be made when the company is in administration.

172 However contrast the wording in *Atkin's Court Forms*, Vol.10, Form 6, (CVA by joint administrators) where reliance is placed upon the statement by the directors.

required to give further details of how it is proposed to indemnify the company in respect of such claims. If the company is in administration or in liquidation, indemnification could take the form of the transactions being set aside or avoided by an application to court under the relevant statutory provisions. If not, unless the beneficiaries of such transactions relinquish their benefit, which may prove practically impossible to obtain without a court order, the required indemnity would have to be given by the directors.

In contrast, BIA [Can.], which does not require any disclosure to be made of such transactions, goes a step in the opposite direction to IA 1986 [U.K.] and permits a proposal to provide that the provisions in the Act which relate to fraudulent transfers of property[173] shall not apply.[174]

Identification of creditors

In an Australian Scheme only the creditors or a class of creditors to whom the scheme would apply, known as "scheme creditors"[175] and the debts owed to them should be identified in the statement of affairs[176] which should accompany the notices summoning the meetings.[177] Further, any scheme creditor who is connected with the company, known as an "internal creditor",[178] and any scheme creditor whose debts are guaranteed, known as a "guaranteed creditor" should also be identified.[179]

In a CVA too, this information is not required to be disclosed at the moment the procedure is initiated. But, it should be contained in the statement of affairs which follows within 7 days of the proposal being delivered to the nominee. There is no statutory requirement in the provisions applicable to Canadian Proposals that the creditors to whom the proposal is being made be identified. In stark contrast is the requirement in a Notice of Intention to make a Canadian Proposal where the names of the company's creditors with claims amounting to C$250/- or more and the amounts of their claims should be specified.

173 ss.91-101 BIA [Can.].

174 s.101.1(1) BIA [Can.].

175 See Sched.8, Part 1,1 CR [Aust.].

176 Shed.8, Part 2, 1(c) CR [Aust.].

177 ss.411(1) and (1A) CL [Aust.].

178 i.e. "(a) a creditor who is a member of the company; or (b) a relative or spouse of a member; or a relative of the spouse of a member;" - See Sched.8, Part 1,1 CR [Aust.].

179 Shed.8, Part 2, 1(d) and (e) CR [Aust.].

(b) Proposals for the repayment of creditors

It has been pointed out that if a company is insolvent or, in some cases, even where it is only likely to become so, the mere identification and treatment of the cause of its insolvency will not make the company solvent again.[180] This is, therefore, the core of the proposal which tells the creditors of the manner in which the company's liabilities are proposed to be met, modified, postponed or otherwise dealt with under the proposal[181] and establishes whether the proposal is a composition, compromise, arrangement, scheme of arrangement or for an extension of time.

As already pointed out there are no "standard" clauses for a "proposal" or its accompanying documentation. Such matters would almost invariably vary from company to company, being determined by the particular circumstances in which each company is placed; including the availability of funding and its goodwill,[182] the attitude of creditors towards the company[183] and the experience, ability and ingenuity of the author of the proposal.

Payment to the creditors

Payment to creditors in a CVA and in an Australian Scheme is usually out of a defined parcel of assets. In a CVA they are referred to as "included in the arrangement" and in an Australian Scheme as the "scheme fund".[184] Generally, the "scheme fund" and the "assets included in the arrangement" will be constituted by the assets of the company and the "proposal" would not have to go into very great detail about them. In contrast, where any property, other than the assets of the company itself is included in a "proposal" the source of such property and the terms on which it is to be made available for inclusion should be set out in some detail.[185] In the case of a CVA, the extent to which any particular assets are to be excluded from the

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180 However, if the likelihood of insolvency is detected at an early stage remedying the cause may indeed prevent the company actually becoming insolvent.

181 r.1.3(2)(c) IR 1986 [U.K.]. For example, see cl.2-4 in Form 68, (Schemes) Vol:9 *Atkin's Court Forms*; cl.1 & 2 in Form 4, (CVA by directors) and cl.3-5 in Form 6, (CVA by joint-administrators) Vol:10, *Atkin's Court Forms*; Art.IV, Precedent No.75A, Houlden & Morawetz *Bankruptcy and Insolvency Act* (Loose Leaf).

182 i.e. if the company is hoping to continue to trade during and after the proposal is put into effect.

183 eg: Does the company play an important part in the businesses of its creditors.

184 See *AEFP*, Vol.5, Pr 1.25, Cls.5 & 7. See also Fischer, "Schemes of Arrangement Between a Company and its Creditors", in Lowe (Ed.) *Insol '85*, Matthew Bender, §2.05[2].

185 r.1.3(2)(n) IR 1986 [U.K.]; See *AEFP*, Vol.5, Pr 1.25, Cls.5 & 7. See also Fischer, *supra* §2.05[2].

voluntary arrangement must also be stated.[186]

Control of funds to be paid to the creditors.

Australian Schemes, CVAs and Canadian Proposals adopt a similar approach regarding the control of the funds to be paid to creditors. In an Australian Scheme, assets included in the scheme fund may be placed under the control of a regulated practitioner called a scheme manager/administrator. In a CVA, the assets included in the arrangement are handed over to the "Supervisor" of the arrangement[187] while in a Canadian Proposal the "moneys payable under the proposal" should be paid to the trustee for distribution.[188] The difference between CVAs and Canadian Proposals on one hand and Australian Schemes on the other is that in the former the passing of control is mandatory while in the latter it is discretionary, although in practice it invariably takes place.

Finally the creditors will need to be informed of the proposed duration of the Scheme, CVA or Canadian Proposal,[189] and the proposed dates of distribution to creditors.[190] In a CVA it must further be disclosed how funds which have been held for payment to creditors, but which have not been paid when the arrangement is terminated, will be dealt with.[191]

(c) Other provisions.

Legislative control over the contents of a "proposal" is indeed limited. It is non-existent in the provisions governing schemes, but a limited control has surfaced in the provisions governing CVAs and Canadian Proposals.

Preferential Creditors

Although no reference is made to the rights of preferential creditors in the various statutory provisions pertaining to schemes in the three jurisdictions, it would not be possible to deprive such a creditor of his preferential status without his consent. These preferential creditors

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186 r.1.3(2)(a)(iii) IR 1986 [U.K.].

187 A CVA should disclose the manner in which the funds held for the purpose of the arrangement are to be banked, invested or otherwise dealt with, pending distribution to creditors. See r.1.3(2)(k) IR 1986 [U.K.]

188 s.60(2) BIA [Can.] and Cl.4 Form 35.

189 r.1.3(2)(e) IR 1986 [U.K.].

190 r.1.3(2)(f) IR 1986 [U.K.].

191 r.1.3(2)(l) IR 1986 [U.K.].

rank *pari passu* amongst themselves.[192] On issues such a consent to a moratorium or even deferred payment outside a liquidation, bankruptcy in Canada or an English Administration, a majority of the preferential creditors would be able to bind the minority. It is usual however, to find provisions in schemes which provide for the payment of preferential creditors in full.[193]

A CVA is required to state how it is proposed to deal with preferential creditors.[194] The provisions of BIA [Can.] applicable to Canadian Proposals go even further and require the payment of all preferred claims in full.[195] It also requires the payment of all claims by the Crown under s.224(1.2) of the Canadian Income Tax Act and any similar claims under provincial legislation.[196]

Secured Creditors

Unless previously secured assets are included in the proposal, secured creditors would not ordinarily be affected by a proposal. Nevertheless in a CVA and a Canadian Proposal it must be stated how creditors who are, or claimed to be, secured will be dealt with.[197]

Creditors connected with the company.

In a CVA disclosure must be made of how such creditors will be treated under the proposal.[198]

Financing the voluntary arrangement

The goods and services[199] most businesses require for their daily operations are obtained on short term credit which, usually, is repayable on demand. After a company declares to its creditors through a proposal that it is insolvent, the providers of such goods and services are unlikely to continue to offer credit terms. It is also unlikely that, at this stage, the company will

192 See Goode, Professor R.M. *Principles of Corporate Insolvency Law*, 72 & 73.

193 See *Atkin's Court Forms*, Vol.9, Form 68, Cl.3; *AEFP*, Vol.5, Pr.1.25, Cl.7.(1)(a). See also BCH Scheme, Sched 1, Cl.1.2.

194 r.1.3(2)(c)(i) (for CVAs) IR 1986 [U.K.]; See also:cl.3.(1) Form 68 (Schemes), Vol 9, *Atkin's Court Forms*, cl.7.(1)(a), Form 1.25 (Schemes) *AEFP*;

195 s.60(1) BIA [Can.].

196 s.60(1.1) BIA [Can.].

197 A mandatory requirement in a CVA. See r.1.3(2)(c)(i) IR 1986 [U.K.]. For sample provisions see cl.2(c)(i) Form 4, and cl.4 in Form 6 Vol:10 *Atkin's Court Forms*. See also Form.35 B&IR [Can.].

198 r.1.3(2)(c)(ii) IR 1986 [U.K.].

199 This would include, bank overdraft facilities, power, heating, rent, wages etc.

have adequate cash reserves to pay up front for its goods and services for the duration of the arrangement.[200] No rehabilitation of a company is possible without working capital and the most pressing problem facing a company seeking to rehabilitate is to obtain such financing. It is usually the company's bank which provides it by granting an extension on the existing facilities. However, such an extension is usually not forthcoming without security and guarantees of repayment in priority to existing creditors.

In addition to requiring short term financing, if the company is involved in a project which is incomplete, it may require further long term financing to ensure its completion.[201] New providers of credit, would usually require security having priority to existing securities while old lenders will require guarantees or additional security. The guarantees may be forthcoming from the directors of the company or other persons. Details of all credit facilities obtained by the company must be given in a CVA together with information on how the company will meet the debts arising out of those facilities and whether the directors will be guaranteeing repayment or whether any other security will be given.[202] Although there is no requirement in the other procedures such information would ordinarily be provided in the Australian Scheme documentation.[203]

Management of the company during the arrangement

Traditionally, creditors, particularly banks, have always been suspicious of the persons in control of insolvent companies in the period preceding an insolvency, and have preferred to displace them by the appointment of a receiver while attempting to rehabilitate the company. Neither of the statutory provisions in the procedures under consideration require a change in the persons responsible for the management of the company during the arrangement, and clearly the existing management may remain in control. A CVA is required to set out the manner in which the business of the company is proposed to be conducted during the course of the

200 There has however, been at least one case where the company seeking an Administration Order has been "cash rich" and been able to provide its own working capital finance. Interview with Mr.Nick Segal, Partner, Allen and Overy, Solicitors on 23 February 1994. It is submitted that such instances must be the exception. The insolvent state of such a company could hardly be the cause of bad "management", since it requires considerable foresight and a very early acknowledgement by the directors of the company's financial predicament, if it is to left with large cash reserves.

201 An example of a company which required such financing is Olympia and York.

202 r.1.3(2)(j) IR 1986 [U.K.].

203 See *AEFP*, Vol.5, Pr 1.25, Cls.5 & 6.

arrangement.[204] Once a CVA is approved the property comprised in the arrangement must be handed over to the Supervisor. A CVA must therefore, identify the person proposed as supervisor of the voluntary arrangement and confirm his qualification (to the directors' knowledge) to act as an insolvency practitioner in relation to the company.[205] The Australians approach this matter in a different manner. CL [Aust.] provides for the Court to appoint an administrator to administer a scheme which has been approved[206] and it is now the practice that such an administrator will be appointed.[207]

Administrative and miscellaneous details

Finally a CVA is required to address the question of remunerating the nominee and the supervisor and meeting their expenses. As far as the nominee is concerned, the CVA must disclose the amount proposed to be paid to the nominee on account of both remuneration and expenses.[208] Regarding the supervisor, it is not necessary to disclose the exact amount to be paid and it would be sufficient if only the manner in which the supervisor's remuneration and expenses are to be met is disclosed.[209] The Australian precedents on Schemes do not go into any detail concerning the remuneration of the administrator appointed under a scheme and simply provide that the administrator will be paid hourly[210] on account of work performed and time spent by him, his partners or his staff.[211]

Although mandatory statutory provisions requiring the disclosure of information in Schemes and Canadian Proposals are non-existent or limited in comparison to CVAs, generally the information found in proposal documents prepared for the purpose of initiating those procedures would cover the same areas and address the same issues found in a CVA. The question that arises therefore is whether mandatory provisions are desirable? There is a strong case for such provisions in a CVA since it stands alone among the proposal procedures in

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204 r.1.3(2)(m) IR 1986 [U.K.]. N.B. This is subject the change that may take place upon a hand over of property subject to a CVA to Supervisor. See Rule 1.23 IR 1986 [U.K.].

205 r.1.3(2)(p) IR 1986 [U.K.].

206 s.411(7) CL [Aust.].

207 See *AEFP*, Vol.5, Pr 1.25, Cls.3.

208 r.1.3(2)(g) IR 1986 [U.K.].

209 r.1.3(2)(h) IR 1986 [U.K.].

210 Which rate should not exceed the maximum rate set out by the Insolvency Practitioners Association of Australia.

211 See *AEFP*, Vol.5, Pr 1.25, Cls.4.

providing for an arrangement to become binding without the intervention of a court.[212] In contrast, Schemes and Canadian Proposals take effect only upon the approved proposal receiving the sanction of the court. The court has the discretion to refuse to sanction the approved proposal or in some cases to insert provisions into the Scheme or Proposal. It is submitted that, should mandatory statutory provisions requiring the disclosure of information be initiated into provisions governing Schemes and Canadian Proposals they would not place too great a burden on the initiators of those procedures nor limit their flexibility and would indeed be a benefit to the creditors.

Procedures which provide an opportunity for a rescue on initiation

In contrast to the procedures which make a "proposal for a rescue on initiation", in an English Administration, Australian Voluntary Administration, Receivership and a Notice of Intention to make a Canadian Proposal, no such "proposal" is presented at the point of initiation. Rather, these regimes attempt in different ways to create a climate, usually protected by a moratorium, within which a solution to a company's debt problems may be formulated and even implemented. The identity of the person(s) charged with the task of formulating this solution varies as does the role played by the creditors and striking differences between the procedures may be seen. For the purpose of this chapter, English Administration, Australian Voluntary Administration, Receivership and a Notice of Intention to make a Canadian Proposal, may be loosely described as affording an "opportunity for a rescue on initiation" rather than making a "proposal for a rescue on initiation".

It should be noted that the classification of these procedures in this manner is not dependent upon the similarity of steps taken at the outset, for they are quite varied, but rather on the fact that they do not make any "proposal for a rescue on initiation". Australian Voluntary Administration and Receivership are initiated simply by the appointment of a person in writing; an English Administration by an application to Court and the making of a Court order; and a Canadian Proposal with Notice by the filing of the notice with the Official Receiver. But, although the *modi operandi* of initiation are disparate, the objective sought to be achieved is uniform.

If the information required to initiate these procedures is taken into account, it is clear that in an Australian Voluntary Administration and a Receivership no information whatsoever is furnished to the appointee at the moment of initiation. A limited amount of information is

212 See s.5(2) IA 1986 [U.K.].

furnished to the Trustee upon the filing of a Notice of Intention to make a Canadian Proposal. In comparison, the information that must be prepared and furnished to the Court in order to initiate an English Administration is extensive and this undoubtedly makes it more costly to commence.

Procedures initiated by the procurement of a court order

The procedures may further be classified according to whether or not an initiation is dependent upon the obtainment of a court order. Examined in this manner, Schemes of Arrangement in all three jurisdictions and English Administration stand apart from all the other procedures on the grounds that a court order is required for the purpose of their initiation. Whilst this may create the impression that in these procedures the court acts as the initiator, and that such a classification would have been more appropriate in the preceding chapter, it should be noted that the appropriate court does not have the power to initiate either of these procedures on its own volition. Without an application being made to it by a person empowered to do so, no order may be made. Fundamental although the court's role may be, it is still only an aspect of the initiation which does not directly affect the character of the procedure which follows.[213]

Procedures involving the appointment of a independent person

There are two broad categories. Namely, the procedures where an independent person is appointed at the outset and the procedures where no independent person is appointed. The former class may be further broken down into two sub-classes; procedures where the person appointed takes over the business affairs and property of the company for the duration of the procedure and those where the person appointed acts as a monitor and an administrative officer. In the first of the two sub-classes may be found Receivership, English Administration, Australian Voluntary Administration and Canadian Proposals under a Notice of Intention, which in turn have already been classified as procedures which provide an opportunity for a rescue on initiation. In the second, sub-class are CVAs, and Canadian Proposals without a Notice of Intention. Whilst these have also been classified as procedures initiated by the making of a "Proposal" it should be noted that in the case of the other procedure that falls into this category, namely, Schemes of Arrangement, there is no mandatory requirement that a monitor must be appointed. Although the appointment of an independent person as a step in initiation makes these procedures stand apart

213 Schemes of Arrangement also fall into the class of procedures which are commenced with the making of a proposal and English Administration into that class of procedure which creates an environment within which a rescue may be worked out.

from English and Canadian Schemes, it should be noted that the appointment does not itself appreciably affect the speed of, or the cost incurred in, initiation.

Speed, Cost and Creditor Protection

The procedures which are the easiest and quickest to initiate are Australian Voluntary Administration, Receivership and the Notice of Intention to make a Canadian Proposal. It may be noted that they are all procedures which do not propose a solution at the outset but instead create a climate in which such a proposal may be formulated. They are also procedures in which an independent person is appointed, but, as pointed out before, this does not affect the speed of initiation. At the other end of the spectrum are English Administration and the procedures where a "Proposal" has to be made. The "Proposal" procedures are placed as such since the preparation of the relevant documents would invariably consume time and could not be initiated in a hurry, perhaps to prevent the commencement of liquidation proceedings. Although the initiation of an English Administration would not be so time consuming, it is not as simple as initiating an Australian Voluntary Administration, a Receivership and Notice of Intention to make a Canadian Proposal.

From the cost angle, the ranking remains the same. It should be noted that the low initiation cost associated with an Australian Voluntary Administration, a Receivership and Notice of Intention to make a Canadian Proposal may not be retained throughout the procedure. Savings made on initiation may be lost on post initiation expenses. This is because the procedure in these cases becomes more complex after initiation. In contrast, the post initiation cost of "Proposal" procedures should theoretically be less since the expensive task of preparing the "Proposal" has already been accomplished and all that remains is for the meetings to be summoned and held. For this reason it is important that the non-"Proposal" procedures provide for rapid termination in the event that a rescue is found to be inappropriate for the company. Post initiation costs are however outside the scope of this chapter and any comparison of pre and post initiation costs should be postponed for a later chapter.

Turning to the issue of the protection of creditors' rights and interests, this objective is best achieved at the stage of initiation in the procedures which are commenced through the procurement of a court order. The procurement of a court order is designed to prevent the abuse of the procedure and thus provide protection for the creditors. By requiring the court to evaluate the application and the documents on which it is based it is hoped that an inappropriate initiation will be avoided. There is, nevertheless, a price to be paid for such protection. Applications to court are costly and time consuming. Court charges and lawyers' fees have to be met in addition to the charges of specialist financial and legal advisors who would have prepared, where relevant, the proposed scheme of arrangement and the rule 2.2 report to be placed before the court.

The absence of a court order for the purpose of initiation does not imply that the other procedures are bereft of measures which protect the creditors. A good example of such a measure is the appointment of an independent person to take over or monitor the affairs of a company. The appointment of an independent person does not prevent an inappropriate initiation. It merely provides post initiation protection for the creditors. But, unlike the court driven procedures, the appointment of an independent person to take over or monitor the affairs of a company does not directly affect the cost or speed in which the procedure may be initiated. Nevertheless it may have the effect of increasing the post initiation costs.

Finally, it appears that the procedure that would benefit most from the methods used in the other procedures is English Administration. The belt and braces approach in English Administration sets it apart from the other procedures since in addition to protecting the creditors from an inappropriate initiation by the means of the court order it also seeks to protect creditors after initiation by appointing an independent person to take over the business property and affairs of the company. Desirable though such protection may be some compromise should be made since the party eventually paying for this protection is the creditor. It is submitted the role of the court in the initiation process should be dispensed with, and the administrator should be appointed by the initiator in the same manner as an Australian Voluntary Administrator is appointed. Such a step will also automatically dispense with that r.2.2 report. Creditors ought to be willing to take the risk of an inappropriate initiation being made if the initiation costs are minimal and the procedure may yet be terminated if found to be inappropriate. The initiation of a scheme has no other effect on the company. If the scheme of arrangement is proposed by the company its directors continue in office and are not displaced by an independent insolvency practitioner and the management and control of the company's business property and affairs remains with them. Similarly, if the scheme is proposed by an authorised person other than the company, such as a liquidator there is no change in the control over the company's business property and affairs.

CHAPTER FOUR

WHEN A RESCUE PROCEDURE MAY BE INITIATED

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INTRODUCTION

The persons empowered to initiate the various rescue procedures[1] do not have *carte blanche* authority to exercise their powers at any time they wish. In some instances, certain conditions must be shown to prevail, or be likely to, before a rescue procedure is set in motion. In others, particular conditions must be shown to be absent. The result is that, at times, the initiation of a rescue procedure is prohibited altogether.

The broad purpose of requiring a company to establish the existence or absence of any such conditions prior to initiating a rescue procedure is to prevent the abuse of the procedure and thereby to protect the interests of the creditors of a company. From the creditors' point of view, abuse of a rescue procedure may result in, inter alia, the assets of the company being placed at risk and a reduction in the ultimate dividend received by a company's creditors. However,

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1 Identified and examined in detail in Chapter Two, *supra.*

although in the majority of circumstances, the victims of any abuse of process would be primarily the creditors, some conditions also exist to protect non-creditor interests, such as shareholders.

It has been pointed out that in Schemes of Arrangement and English Administration, the relevant courts are also invested with powers connected with the initiation process.[2] In these procedures the courts themselves do not act as "initiators" since they cannot on their own motion cause an application to be made so that they may exercise their powers. However, as will be seen, once an application has been made, the courts do not always have an unbridled freedom, and in some cases are able to make the relevant order only in certain limited circumstances. Such restrictions on the powers of the courts exist primarily for the protection of interests of parties who would be affected by the initiation of the rescue and should be taken into account in considering the issues of when the initiation of a rescue procedure may be appropriate.

In this chapter, the conditions, if any, which have to be shown to exist or which must be shown to be absent before each rescue procedure is commenced will be examined in detail, concluding with a comparative discussion aimed at determining whether the protection afforded thereby is both real and cost-effective.

When a Scheme of Arrangement may be initiated

Matters affecting the application to court in England, Canada and Australia

There is no requirement in either the English or Australian statutory provisions[3] that a company should be insolvent or on the threshold of insolvency before an application may be made to court for the purpose of initiating a scheme of arrangement. The absence of such a requirement is more due to the fact that the same provisions may be made use of for the purpose of restructuring equity holdings by way of a scheme of arrangement with the companies members rather than a deliberate omission of the word "insolvent" by the legislature.

The position under the CCAA [Can.] differs since there is an express requirement that the company proposing a compromise or arrangement should be a "debtor company".[4] For the purpose of the CCAA [Can.], a "debtor company" is defined as a company which is bankrupt or insolvent.[5] The words "bankrupt" and "insolvent" in turn are not defined in the CCAA [Can.]. It is, however, likely that Canadian Courts will look to the definitions in the other statutes

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2 See Chapter Three at pp.134 and 153 *supra*.

3 S.425(1) CA 1985 [U.K.], and s.411(1) CL [Aust.].

4 ss.4 & 5 CCAA [Can.].

5 s.2(a) CCAA [Can.].

governing matters of insolvency and bankruptcy, namely BIA [Can.][6] and the Canadian Winding up Act.[7] The definition of "debtor company" in CCAA [Can.] makes further reference to these other Federal statutes which govern corporate insolvency.[8] Thus, a company that has committed an act of bankruptcy within the meaning of the *Bankruptcy Act*[9] or has been deemed insolvent within the *Winding Up Act* whether or not proceedings under either statute have been commenced against the company, is a "debtor company" for the purpose of the CCAA [Can.]. Echoing the definitions in these statutes, the definition in the CCAA [Can.] goes on to state that a company that has made an authorised assignment or against which a receiving order has been made under the Bankruptcy Act [Can][10] or is in the course of being wound up under the *Winding Up Act* [Can.] is also a "debtor company"[11]

It has been pointed out that the CCAA [Can.] is a Federal statute within the domain of bankruptcy and insolvency and is *intra vires* the powers vested in the Dominion Parliament of Canada under s.91(21) of the *British North America Act.*[12] Consequently, it would be unconstitutional for the CCAA [Can.] to enable a company to propose a compromise or arrangement otherwise than as an insolvent or a bankrupt since legislation relating to property and civil rights is within the exclusive jurisdiction of the Provinces. As described by Duff C.J.C:

> "the Act,[the CCAA (Can.)]... creates powers to be exercised in case, and only in case of insolvency"[13]

Therefore the mandatory requirement that a company seeking to use the CCAA [Can.] should be bankrupt or insolvent was inserted into that statute for constitutional reasons and not for the purpose of protecting the rights of shareholders and creditors.

The need for the company to be a bankrupt or insolvent is one of the key differences between the CCAA [Can.] on the one hand and both the CA 1985 [U.K.] and the CL [Aust.] on the other. Under the CCAA [Can.] the compromise or arrangement may be proposed only to the

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6 BIA [Can.] defines a bankrupt as "a person who has made an assignment or against whom a receiving order has been made or the legal status of that person".

7 R.S.C. 1985, c. W-11

8 s.2(b) CCAA [Can.].

9 Now the *Bankruptcy and Insolvency Act,* (BIA [Can.]).

10 N.B. the BIA [Can.] refers to an "assignment" and not an "authorised assignment".

11 s.2(c) & (d) CCAA [Can.].

12 See *A.G. of Canada v. A.G. for Quebec and A.G. for Ontario* 16 C.B.R. 1.

13 *A.G. of Canada v. A.G. for Quebec and A.G. for Ontario, ibid,* p.2.

company's creditors although the court has the power to summon a meeting of the shareholders as well.[14] If a proposal is to made to the shareholders of the company then a parallel application would have to be made to the court under the applicable Corporations Law.[15]

Although the "debtor company" requirement in the CCAA [Can.] is a direct result of constitutional imperatives, it has, from the creditor's point of view, a welcome effect in that it restricts the use of that statute to circumstances where the company is in fact insolvent or threatened with insolvency. The "debtor company" requirement, therefore, acts like the first barrier against the CCAA [Can.] procedure being used outside insolvency as an means to obtain the protection of the stay on proceedings that may be imposed by court on initiation. For example, if there was no requirement of insolvency and a company was able, *ex parte*, to persuade a Canadian court to grant a stay, the procedure could be used as a means of staying litigation or execution of a judgement, leaving it to the creditor or the person affected to bear the expense of having the stay lifted.

Despite the absence of a similar express requirement of insolvency in England and Australia, if a company is in a situation where it has to enter into a compromise or arrangement with its creditors then, in most cases,[16] it should be facing or anticipating financial difficulties. However, the lack of such a requirement in the CA 1985 [U.K.] does not prejudice creditors in England since no stay of proceedings may be imposed by the court upon initiation or thereafter unless the company is in a winding up or a petition for winding up has been presented.[17] Except in these circumstances, each creditor and any other person that may be affected by the initiation of the procedure retains the right to initiate any proceedings against the company and if necessary effectively bring to an end a wrongly initiated Scheme of Arrangement.[18] In Australia, however, as will be discussed in greater detail,[19] the court has the power, on an application being made

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14 s.4 CCAA [Can]. The shareholders have no voting rights at such a meeting summoned under the CCAA [Can.] but a meeting of a company's creditors under the CCAA [Can.] may be combined with a meeting of its shareholders summoned under the appropriate corporations law. See Houlden L.W. & Morawetz C.H. *Bankruptcy and Insolvency Act* (Revised) Carswell, Canada, N§24. Such a meeting was held in *Olympia and York Developments Ltd., v Royal Trust Co.* 102 D.L.R. (4th) 149 (Ont.Gen.Div.)

15 Which may be federal or provincial.

16 Except, for example, where there is a novation of contracts in a takeover.

17 See *Booth v. Walkden Spinning and Manufacturing Co., Ltd.,* [1909] 2 KB 368,*Bowkett v. Fuller's United Electric Works Ltd.,* [1923] 1 KB 166 and *Re Richards and Co.,* (1879) 11 Ch.D. 676.

18 However, this power may also be abused. See the discussion at 5.2.1. *ante.*

19 See Chapter Five under the Australian approach to maintaining the status quo during a Scheme of (continued...)

to it by the company, a creditor or a member of the company, to order a restraint of further proceedings against the company.[20] Once a stay is in place, even if the procedure is being misused, creditors and share-holders would be unable to take proceedings against the company and bring the procedure to an end. They would have to try and stop the scheme being approved at the meetings or, if it is approved at that stage despite their opposition, then they would have to wait until the scheme is brought before the court for the purpose of obtaining its sanction. Thus in the event of an attempted misuse of the procedure in Australia, the creditors, members and third parties are reliant on the ASC's ability to examine the proposed Scheme of Arrangement and to make representations to the court before the order is made and on the fact that the discretion whether or not to make the relevant order finally rests with the court.[21]

Special restrictions affecting the application to court under the CCAA [Can.]

The procedure under the CCAA [Can.] is not available to all debtor companies. By an amendment introduced in 1952 an attempt was made to curtail the scope of the CCAA [Can.] by the introduction of what is now s.3. This section provides that compromises and arrangements may be entered into only if the debtor company has outstanding an issue of secured or unsecured bonds issued under a trust deed and the creditors to whom the compromise or arrangement is proposed includes those bond holders.

It has been mentioned[22] that at the time the CCAA [Can.] was enacted there were no provisions on the Canadian Federal or Provincial statute books which allowed a company to propose a compromise or arrangement to its creditors outside winding up or bankruptcy proceedings.[23] The CCAA 1933 [Can.] appeared to fulfil this lacuna. However, the Bankruptcy Act [Can.], enacted thereafter in 1949, also made provision for a debtor to make a Proposal to its creditors prior to going into bankruptcy. However, compared with the CCAA [Can.], the new

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19(...continued)
Arrangement at 5.2.3.

20 s.411(16) CL [Aust.].

21 The court's discretion is examined more fully below under the heading *"Matters affecting the court's decision to make the order."*

22 See the discussion in Chapter One under the heading "The Canadian Companies Creditors Arrangements Act" at 1.6. *supra.*

23 A compromise or arrangement could be proposed under the *Winding Up Act* [Can.] or a proposal made under the *Bankruptcy Act* [Can.] but in order to do so the company would first have to be placed in liquidation or a receiving order or an assignment would have had to be made. This was not always so since under s.13 of the *Bankruptcy Act 1919* [Can.] a proposal for composition or arrangement could be made prior to an assignment or receiving order.

provisions of the BA [Can.] permitted such a debtor to make a Proposal to its unsecured creditors only.

By 1952, concerns had been expressed that the CCAA [Can.] was being abused by companies which made *ex parte* applications to court after they had been threatened with court action or execution of a judgement. The applications were hastily drafted and the compromises or arrangements proposed were often wholly unacceptable to creditors. Further, it was observed that since there was no supervision of the management of the company during the period between the making of the order and the conduct of the meetings there was a risk of the company's assets being dissipated.[24] Thus it was opined that "ordinary companies without bondholders and few secured creditors" should be made to make use of the provisions in the new Bankruptcy Act, 1949, which provided for supervision of management by a trustee, by denying such companies the right to use the CCAA [Can.].[25] Canadian Legislature clearly shared these views since the use of CCAA [Can.] was restricted in such a way that it would only:

> "[L]eave companies that have complex financial structures, and a large number of investor creditors, able to use the Companies' Creditors Arrangements Act for the purpose of reorganization."[26]

Thus, the small to medium sized companies, and even some large companies which relied on bank overdraft facilities, secured loans and credit terms offered by those with whom they dealt on a regular basis, were excluded from the CCAA [Can.]. Perhaps due to this amendment,[27] the CCAA [Can.] was not widely used thereafter. However, the provisions in the BA [Can.] were soon found to be inadequate for the purpose of a corporate debt reorganization since secured creditors could not be made a party to a Proposal approved thereunder and were consequently unaffected by the moratorium. It was widely acknowledged that the law in this regard was

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24 See Goodman, H.M. "Practice note on the Companies' Creditors Arrangement Act, 1933", *32 C.B.R. 227.* See also Biddel, J.L., "Proposals under the Bankruptcy Act and the Companies' Creditors Arrangements Act" in *Special Lectures of the Law Society of Upper Canada: 1956,* (Part 1 Bankruptcy), Richard De Boo Ltd., Toronto, 1956, p.79.

25 Goodman, *ibid,* p.228.

26 The Hon. Mr. Garson, Minister of Justice, introducing the Bill. House of Commons Debates, 1952-53, pp.1268-1269.

27 There is no evidence that the Act was widely used at the time the amendment was passed. See Edwards, "Reorganizations under the Companies' Creditors Arrangements Act" (1947) 25 *Canadian Bar Review* 585 where it is said "[I]t [the CCAA] has received little attention in either Canadian legal literature or the decisions of the courts." Goodman, (32 C.B.R. 227) on the other hand begins his Practice Note stating that "The above Act [the CCAA] has of late been used frequently by insolvent debtor companies for the purpose of making compromises, arrangements and reorganizations."

defective and, although many attempts at reform were made, the Proposal provisions in the BA [Can.] remained unaltered until 1992.

When the current recession began to bite in the late 1980s and Canadian companies found themselves having to service secured loans taken during the lending boom of the mid 1980s, they began to seek ways of circumventing the restriction imposed by s.3 CCAA [Can.], for the purpose of getting the benefit of the moratorium against both secured and unsecured creditors available under the CCAA [Can.] while they attempted to reschedule their debts.

Therefore, since around 1988, by the issue of what have come to be called "instant trust deeds", usually for a nominal amount and issued only a few days or even hours before the application to court under ss.4 and 5 CCAA [Can.], companies have sought to come within the scope of that Act.[28] A series of first instance decisions have upheld such "instant trust deeds" as valid on the ground that, notwithstanding the comments in Hansard, the Act does not require the debentures to be issued for any specified amount or time period.[29] The view has also been expressed that trust deeds should not be challenged in proceedings under the CCAA [Can.] since there is no provision which allows the court to examine the validity of a trust deed.[30] If the validity of a trust deed must be examined, separate proceedings should be brought for that purpose.[31] "Instant trust deeds" have received the approval of Doherty J.A. in his dissenting judgement (in part) in *Nova Metal Products Inc. v. Comiskey*.[32] in the following terms:

> "In my view it is inappropriate to refer to these transactions as "shams." They are neither false nor counterfeit, but rather exactly what they appear to be, transactions to meet jurisdictional requirements under the Act so as to permit an application for reorganization under the Act. Such transactions are apparently well known at the Bar."[33]

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28 See generally in this regard Goldman, Baird and Weinczok "Arrangements under the Companies' Creditors Arrangements Act" (1990) 1 *C.B.R. (3d)* 135, pp.142-154; Crozier, "Good faith and the Companies' Creditors Arrangement Act" [1989] *15 Canadian Business Law Journal* 89, pp.90-92; Newbold, "Recent Developments - The Companies' Creditors Arrangements Act" *7 B.F.L.R.* 51, pp.52-53.

29 *Re United Maritime Fishermen Co-op* (1988) 67 C.B.R. (N.S.) 44, varied on reconsideration (1988) 68 C.B.R. (N.S.) 170, 87 N.S.R. (2d) 333, 22 A.P.R. 333 (Q.B.), reversed on other grounds - (1988) 69 C.B.R. (N.S.) 161, 51 D.L.R. (4th) 618, *Re Stephanie's Fashions Ltd.* (1990) 1 C.B.R. (3d) 248 (B.C.S.C.), *Diemaster Tool Inc. v. Skvortsoff*, *Ultracare Management Inc v. Gammon* (1990) 1 O.R.(3d) 321 (H.C.J.).

30 *Nova Metal Products Inc. v. Comiskey*. (1990 1 C.B.R. (3d) 101.

31 *Nova Metal Products Inc. v. Comiskey*. (1990) 1 C.B.R. (3d) 101.

32 *ibid.*

33 *ibid.* at p.123.

But, in *Re Norm's Hauling Limited,*[34] Wimmer J refused an application based on two such "instant trust deeds". 'With some hesitation and with the utmost of respect for the opinions of those who see these so called "instant trust deeds" as a permissible way for a company to get itself within the Act' said Wimmer J, "It is the duty of the court to give effect to legislation, not to emasculate it. The plain language of s.3 offers no other conclusion than that it was enacted to exclude certain companies from the benefits of the Act...In my opinion, s.3 contemplates the existence of securities characterised by genuineness in the sense that they were issued to raise capital or secure existing indebtedness and not, as here, to achieve an oblique purpose."[35]

Nevertheless, until there is an unequivocal pronouncement from a Superior Court the balance appears to be in favour of strict compliance with s.3. It is likely that the courts will continue to allow the procedure to be initiated by the creation of such "instant trust deeds", but care should be taken not to fall foul of strict compliance by the creation of only one bond, since the law requires and the courts have insisted on *"bonds"* instead of a single bond.[36]

The refusal by some of the Canadian Courts to go behind the trust deed and their willingness instead to be satisfied with an applicant's strict compliance with s.3 is evidence of a pragmatic approach to the interpretation of rescue laws. Clearly in the court's view the benefit that the company and its creditors may derive from having an opportunity to make and consider a scheme of arrangement under the CCAA [Can.] outweighs the risks that prompted the introduction of s.3 CCAA [Can.].

The court's discretion to make the order

Once an application seeking an order summoning a meeting of the creditors and, if appropriate the members, to consider a scheme of arrangement, has been made to court, the making of the order is not mandatory[37] and the court has the discretion whether or not to make it.

In Canada a distinction should be drawn between the courts' approach to the interpretation of s.3 CCAA [Can.] and the general discretion which they (the courts) enjoy in deciding whether or not an order should be made requiring the meetings of creditors to be summoned.

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34 (1991) 6 C.B.R. (3d) 16.

35 *ibid.* at pp.18-19.

36 *Nova Metal Products Inc. v. Comiskey* (1990) 1 C.B.R. (3d) 101.

37 This is clearly the position in Canada. See *Re Ursel Investments Ltd* (1990) 2 CBR (3d) 260 reversed on other grounds 10 C.B.R. (3d) (Sask.C.A.).

The refusal by some Canadian Courts to look behind the so called "instant trust deeds" and their willingness to be satisfied with a company's strict compliance with s.3 for the purpose of acquiring the capacity to make an application under the CCAA [Can.] appears to have to some extent blurred the courts' view of the wide discretion conferred by ss.4 and 5 CCAA [Can.] and elsewhere in that Act. Goldman, Baird and Weinczok[38] observe that:

> "Based on *Re United Maritime Fishermen Co-Op.*, supra an overriding principle requiring strict adherence to the provisions of the CCAA has developed."

They focus in particular on the court's approach to the interpretation of s.3 and cite extracts from the judgements in both the Trial and Appellate Division. No doubt, as Hoyt J.A, in the New Brunswick Court of Appeal observed:

> "[I]t is my view that if the particular company falls within the ambit of the act it is entitled to the benefits of that Act...",[39]

but, it is submitted that the "entitlement" to which Hoyt J.A. refers, is an entitlement which is subject to the other provisions of the Act and the general discretion vested in the court to scrutinise the application for fairness. Whilst it is conceded that an unscrupulous company may create an "instant trust deed" in bad faith, it does not necessarily follow that every such deed would inevitably be created with the same motive. Therefore although Crozier laments non-imposition of a "good faith" requirement on a debtor seeking to establish jurisdiction by strictly complying with s.3 CCAA [Can.],[40] it is submitted that permitting instant trust deeds do not deny the authority to determine the bona fides of the applicant by studying the scheme proposed and other documents accompanying the application. Indeed, the fact that the court has the discretion whether or not to make the order sought under ss.4 and 5 CCAA [Can.] has long been recognised.[41] If, for example, the court is of the view that the scheme of arrangement proposed is not in the creditors' best interests it can decline to make the order.[42]

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38 In "Arrangements under the Companies' Creditors Arrangements Act", 1 C.B.R. (3d) 135 at 154-155.

39 *Canadian Co-operative Leasing Services v. United Maritime Fishermen Co-op,* (1988) 51 D.L.R. (4th) 618 at 622.

40 See Crozier, L., "Good Faith and the Companies' Creditors Arrangements Act", [1989] 15 *Canadian Business Law Journal*, 89 at 93.

41 See Edwards, S.E. "Reorganizations Under The Companies' Creditors Arrangements Act", (1947) 25 *C.B.R.* 587 at p.601; *Re Ursel Investments Ltd.* (1990) 2 C.B.R. (3d) 260, reversed on different grounds (1992) 10 C.B.R. (3d) 61 (Sask.C.A.)

42 *Re Avery Construction Co.* (1942) 4 D.L.R. 558. In this case the company which had a paid up capital of only C$50/- sought to use the CCAA [Can.] as a means to wind up the company. This (continued...)

It was pointed out earlier[43] that an Australian Court cannot make an order summoning the meetings unless the applicant had given the Australian Securities Commission (hereinafter ASC) 14 days notice of the hearing of the application[44] and it is satisfied that the ASC had the opportunity to examine the terms of the proposed scheme and a draft of the explanatory statement with which the notice of the meeting must be accompanied and to make submissions to the Court in relation to either the scheme or the explanatory statement. In addition to listening to the submissions made by the ASC, if any, the Court has the further power to require the ASC or any other person, which the court must specify, to furnish the Court with a report as to:

- the terms
  - of the compromise or arrangement or
  - of the scheme for the purpose of or in connection with which the compromise or arrangement has been proposed,
- the conduct of the officers of the body or bodies concerned and
- any matters which in the opinion of the ASC or the other person appointed should be brought to the Court's attention.[45]

It appears that the power to summon a report may be exercised by the Court at any time where an application has been made under Part 5.3 CL [Aust.]. To the extent that the power is used at the time the application and before an order is made, it appears to be unnecessary in view of the ASC's power to make submissions to the Court on the scheme and the draft explanatory statement before the order is made under ss.411(1) or 411(1A) CL [Aust.].

It has been suggested that the existence of s.411(2) CL [Aust.] does not affect an Australian Court's discretion to further examine the proposal and establish whether,

> "[T]he scheme is of such a nature and cast in such terms that, if it achieves the statutory majority at the creditors meeting, the court would be likely to approve it on the hearing of a petition which is unopposed",[46]

If it is not the court will not usually make an order summoning the meeting. In *F.T.Eastment and Sons Pty Ltd. v. Metal Roof Decking Supplies Ltd*[47] the court after having examined the scheme

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42(...continued)
would have taken place without an investigation of the company's affairs and whether there are any contributories.

43 See Chapter Four p.136, *supra*.

44 A shorter period of notice may be accepted by the Court provided that prior permission to that end had been obtained from the Court or the Commission.

45 s.415(2) CL [Aust.].

46 *F.T.Eastment and Sons Pty Ltd. v. Metal Roof Decking Supplies Ltd* (1977) 3 ACLR 69. See the dictum of Lawrence Street J at p.71. Followed in *Re Price Mitchell Pty Ltd* (1984) 9 ACLR 1.

47 *supra*.

refused to summon the meeting on the grounds, inter alia, that several clauses attempted to confer jurisdiction on the court where it had none. The Australian Courts have been reluctant to set down exhaustive statements of what a Court will consider in exercising its discretion at this stage of a scheme.[48] But, some matters that the Australian Courts have taken into account are: questions of public policy and commercial morality;[49] the limitation of liability of the scheme administrator;[50] the interests of the creditors who may be careless of their own interests; whether a creditor who is bound by the scheme can enforce it against the persons bound to implement it;[51] and whether it provides, without good reason, for the modification of interests bound by the scheme.

As in Australia and Canada it is not statutorily incumbent on the English Court to examine the proposed scheme prior to making the order. However in marked contrast to both these jurisdictions, neither has a practice been established whereby schemes are scrutinised by the court before making the order. The stage at which the English Court does examine the scheme is at the point an application is made to sanction a scheme approved by the creditors.[52]

WHEN A PROPOSAL FOR A CVA MAY BE MADE

Conditions of general application

Section 1 defines, broadly, the circumstances in which each authorised to make a proposal of a CVA (hereafter referred to as the "proposer") may do so. The directors have the authority so long as an administration order is not in force, or the company is not being wound up.[53] If an administration order is in force or the company is being wound up, the administrator or the liquidator, respectively, has the right to make a proposal.[54]

In spite of these limitations, the scope of the authority of each proposer as defined by section 1 is indeed very wide. Thus, the authority of each proposer to make a voluntary arrangement must be read in the context of the rest of Part 1 and, particularly in the case of the administrator and the liquidator, in the context of the powers conferred elsewhere in the

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48 *Re Price Mitchell Pty Ltd* (1984) 9 ACLR 1

49 *Re Buildmat (Australia) Ltd.* (1983) 7 ACLR 944 at 947-948.

50 *Re Price Mitchell Pty Ltd. supra.*

51 *Re Glendale Land Development Ltd., (in liq.)* (1982) 7 ACLR 171, *Re Buka Minerals NL* (1983) 8 ACLR 507.

52 See *Re Dorman Long and Co. Pty. Ltd.,* [1934] 1 Ch. 635.

53 s.1(1) IA 1986 [U.K.].

54 s.1(3)(b) IA 1986 [U.K.].

Insolvency Act, 1986.

Initiation of the procedure appears to depend entirely upon the subjective opinion of the proposer that a CVA is required and is appropriate in the circumstances in which the company is placed. Neither the Insolvency Act, 1986, nor the Insolvency Rules, 1986 expressly requires any condition to be fulfilled, or any external, objectively ascertainable standard to be satisfied, before this decision may be taken. Despite the fact that the company voluntary arrangement procedure is contained in Part I of the Insolvency Act, 1986, there is no express requirement within that Part that the company should be insolvent or likely to become so in order to initiate the procedure. Indeed such a condition cannot exist if the proposal is made during the course of a members' voluntary winding up, and the liquidator has no grounds for forming an opinion under s.95. It may or may not exist if the proposal is made by the directors or the liquidator appointed in a creditors' voluntary winding up or a winding up by court in any of the circumstances specified in section 122(1)(a) to (g) except (f). Only if the proposal is made during the course of:

- an administration;[55] or
- a voluntary winding up which converted from a members' to a creditors' voluntary winding up; or
- a winding up by court which was commenced on the grounds that the company is unable to pay its debts;

is it implied that such a condition must exist prior to making a proposal. Actual or prospective insolvency is a pre-requisite for the commencement of each of these procedures.

The only reference to "insolvent" and "insolvency" in connection with the company seeking a company voluntary arrangement is in r.1.6,[56] which empowers the "nominee" under the proposal to require the person making it to furnish further and better particulars as to the circumstances in which, and the reasons why the company is or (as the case may be) is threatened with, insolvency.[57] Does the use of the words "further and better particulars" imply that particulars of the company's insolvency should have been given to the nominee, and that therefore insolvency or its likelihood is a prerequisite for the making of a proposal? It is

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55 Sub-s.8(1) IA 1986 [U.K.]. The Court is required to be satisfied that the company is, or is likely to become, unable to pay its debts, and must consider that the making of the order would be likely to achieve one or more of the purposes set out in 8(3). Although the statute places the burden upon the Court, indirectly, it requires the person who is making the application to Court under s.9(1) to first ascertain objectively whether the Court is likely to take this view. If not the application may prove to be futile.

56 The word "insolvency" is used many times as part of the phrase "insolvency practitioners".

57 r.1.6 IR 1986 [U.K.].

submitted that it does not. In the first instance s.rule 1.6 applies only where the proposal has been made by the directors.[58] It has no application where the proposal has been made by the administrator or the liquidator. If a company is in administration, insolvency or its likelihood is mandatory, it is not always the case if the company is in liquidation. Secondly, the nominee's use of the powers conferred by rule 1.6 is discretionary. It would equally be valid to say that rule 1.6(1)(a) would apply only if the company were insolvent or on the threshold of insolvency. If not the nominee would not have cause to seek further and better particulars. It is therefore submitted that sub-rule 1.6(1)(a) does not have the strength to refer back to the entirety of Part 1 of the Act and the remainder of the rules. In practice, however, it is unlikely that a company would try, or be able, to use a CVA unless it was insolvent.

When a CVA may be initiated by an English Administrator

Under s.1(3), an administrator's authority to make a proposal is broadly described as "where an administration order is in force in relation to the company." When s.1(3) is read with s.8(3) the question arises whether an administrator would be able to make a proposal if the Court has, in making the administration order, failed or declined to specify "the approval of a voluntary arrangement under Part 1" as one of the purposes for whose achievement the order is made. If this is indeed the case, and the administrator considers that a proposal for a voluntary arrangement should be made, the proper procedure for the administrator would be to make an application to the Court under s.18 for the administration order to be varied by the specification of s.8(3)(b) as an additional purpose before making the proposal.[59]

When a CVA may be initiated by the Liquidator

As in the case of the administrator, the liquidator's authority to make a proposal is framed in the widest possible terms. The only requirement under s.1(3)(b) is that the company should be in the process of being wound up, which could be either a members' or a creditors' voluntary winding up or a winding up by Court. Since a winding up by court commences with the presentation of the petition for winding up a provisional liquidator too may, depending upon the scope of the functions required of him by Court[60] and/or subject to any limitation of his powers

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58 r.1.6(1) IR 1986 [U.K.].

59 *Re St.Ives Windings Ltd.*, (1987) 3 BCC 634 where the administrator had successfully achieved a more advantageous realisation than would have been possible in a winding up, but was unable to make a distribution to the creditors.

60 s.135(4) IA 1986 [U.K.].

by court,[61] make a proposal.

WHEN A CANADIAN PROPOSAL MAY AND MAY NOT BE MADE

When a Canadian Proposal may be made

When a proposal may be made under the Canadian Bankruptcy and Insolvency Act, flows from the capacity of the person making the proposal.

A Canadian company may make a proposal outside an insolvent liquidation or bankruptcy only if it is an insolvent person. It has been mentioned that three of the criteria that must be met before a company may be classified as insolvent would be satisfied by virtually all Canadian companies. It is the final criterion, itself divided into three alternative sub-criteria, that actually triggers the state of being an insolvent person. A state which must prevail in order that a proposal may be made.[62]

The first and last alternative sub-criteria are a statutory enunciation of the cash-flow and balance sheet tests respectively. The second alternative sub-criterion is the cessation by the company of the payment of current obligations in the ordinary course of business as they generally become due. Each of them demonstrates an inability or even unwillingness on the part of the company to meet its debt obligations.

Clearly the existence of either of the three alternative sub-criteria would be matters within the knowledge of the company. Particularly the third sub-criterion, concerns a state of affairs of which persons outside the company would be ignorant. The company is required when lodging the proposal with the trustee to also lodge a statement showing its financial position at the date of the proposal, verified by affidavit as being correct to the belief and knowledge of the debtor.[63] Thus the company must be able to establish its own insolvency before it can make a proposal. A company has for example been held to be insolvent if it manages to pay its debts and keep its business going only due to the financial support given by third parties.[64]

When a Canadian Proposal may not be made

The procedure under BIA [Can.]., is not available to building societies having a capital stock, or incorporated banks, savings banks, insurance companies, trust companies, loan companies or railway companies since none of these is a "person" for the purposes of the

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61 s.135(5) IA 1986 [U.K.].

62 *Re Pateman* (1991) 5 C.B.R. (3d) 115.

63 s.50(2)(b) BIA [Can.].

64 See *Janpur Produits de Bureau Inc* (1993) 2 C.B.R. (3d) 46 (Que.S.C.)

Bankruptcy Act.[65]

The other restriction applies only in the case of sole traders and persons carrying on business as partners and has no application to companies. A debtor in respect of whom a consumer proposal has been filed under Division II may not make a proposal under this Division until the administrator under the consumer proposal has been discharged.[66]

WHEN AN ENGLISH ADMINISTRATION ORDER MAY AND MAY NOT BE MADE

The requirements of s.8 IA 1986 [U.K.]

Before an administration order may be made by the court a number of statutory requirements must first be fulfilled.

Firstly, the court must be satisfied that the company is or is likely to become unable to pay its debts (within the meaning given to that expression by section 123 of the Insolvency Act). Section 123 specifies five alternative grounds and a sixth additional ground on the basis of which the company may be deemed to be unable to pay its debts. The first and perhaps the most important ground, from a creditors point of view is that in section 123(1)(a) which provides that where a creditor to whom the company owes a sum in excess of £750/-, has served on the company a statutory demand requiring payment of the debt, and the company has failed to pay or compound for it for three weeks, it is deemed unable to pay its debts. Section 123(1)(b), (c) and (d) each in a like vein require proof that an attempt to enforce a judgement debt in England and Wales, or Scotland or Northern Ireland has proved to have been wholly or partially futile. The fifth alternative ground requires the court to be satisfied that the company is unable to meet the "cash flow test" i.e. pay its debts as they fall due or shortly thereafter. Finally the sixth additional ground incorporates the "balance sheet test" of a company's inability to pay its debts and requires the court to be satisfied that the value of the company's assets is less than the amount of its liabilities taking into account contingent and prospective liabilities. Thus section 8(1)(a) restricts the administration order procedure to companies that are or are on the threshold of being in a state of insolvency.

Secondly, the court must consider that the making of an order under this section would be likely to achieve either

(a) the survival of the company, and the whole or any part of its undertaking as a going concern;
(b) the approval of a voluntary arrangement under Part 1 of the Insolvency Act;

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65 s.2 BIA [Can.].

66 s.50(1.1) BIA [Can.].

(c) the sanctioning under section 425 of the Companies Act 1985 (formerly section 206 of the Companies Act 1948) of a compromise or arrangement between the company and its creditors and/or members; or

(d) a more advantageous realisation of the company's assets than would be effected on a winding up.

There has been a difference of judicial opinion as to the interpretation of the word "likely" in section 8(1)(b). In *Re Consumer & Industrial Press Ltd.*,[67] Peter Gibson J. held that "likely" meant more likely than not (i.e more than a 50% chance). But in *Re Harris Simons Construction Ltd.*,[68] Hoffmann J. held it was sufficient if there was a real prospect of achievement of the purpose or purposes for which the order was sought, even if that prospect were more modest than a 50% chance. The latter interpretation of has been followed by Vinelott J. in *Re Primlaks (U.K.) Ltd.*,[69] and, it is submitted, is more in accordance with the broad remedial purpose of the statute.

The use of the word "satisfied" in section 8(1)(a) and the word "considers" in 8(1)(b) has attracted some comment from legal commentators. It is thought that the degree of proof required in the former is higher.

The tussle between English Administration and Receivership: Where the administration order cannot be made

An administration order may be made in respect of all companies except those that are in liquidation, either voluntarily or compulsorily, and those that are Insurance Companies within the meaning of the Insurance Companies Act 1982. Authorised institutions under the Banking Act, 1987, were until August 23rd 1989 a further specie of company in respect of which an administration order could not be made. But by the Banks (Administration Proceedings) Order 1989, the exclusion was ended. It is also possible that the administration order procedure or a similar procedure may, in time be made available to Insurance Companies as well.

An Administration may not be initiated after any one of the winding up procedures are initiated. This is so even though a liquidation of assets is possible under sub-section 8(3)(d). Once a liquidator has been appointed he has no status under section 9(1) to invoke the administration order procedure.[70] The reason behind excluding the liquidator from sub-section

67 (1988) 4 B.C.C. 68.

68 (1988) 5 B.C.C. 11.

69 (1989) 5 B.C.C. 710.

70 Contrast this position with that which prevails under Part 5.3A of CL [Aust.] and Part III, Division I of BIA [Can.] where liquidators are expressly authorised to invoke the procedure.

9(1) may lie in the fact that the liquidator may himself achieve both the purposes mentioned in sub-section 8(3)(b) and (c).[71] He also has the power to dispose of a company's assets, which achieves part of the purpose specified in subsection 8(3)(d). As the legislature has identified in the same subsection, a more advantageous realisation of assets is possible outside a winding up. Thus, *in the event that the liquidator is of the opinion that whole or part of the business of the company is redeemable,* he will not be able to shake of the "disadvantage" that attaches to a "quick fire" sale of assets in a winding up. A conversion from a winding up to administration should drive up the realisable value of the assets. The liquidator would be able, where the circumstances permit, to ensure the survival of the company and the whole or any part of it as a going concern. Consequently, there is good reason to include the liquidator among the category of persons authorised to apply for an administration order and to enable a change of procedure from winding up to administration.[72]

The other instance in which the court is precluded from making an administration order has, as will be seen, had great bearing on the development of the administration order procedure. It is however, unlike the absolute exclusions mentioned earlier subject to a number of exceptions.

Once a petition for an administration order has been presented to court, notice of its presentation must be given to the person who has appointed, or is entitled to appoint an "Administrative Receiver". The "Administrative Receiver" is the name given by the Insolvency Act 1986 to the person formerly known as a Receiver and Manager under a floating charge.

If there is a floating charge over the assets of the company the charge holder may on receipt of notice, appoint an administrative receiver, if he has not done so already. This stage in the administration order procedure is of crucial importance to a floating charge holder. As far as the court is concerned, once an administrative receiver has been appointed, it has no option, save in certain prescribed circumstances, but to dismiss the petition.

A court may proceed to make an administration order despite the existence of an administrative receiver only where, firstly, the charge holder has consented to the appointment, or secondly, the charge itself would be released or discharged as a transaction at an undervalue or preference, or avoided under the provisions pertaining to the avoidance of floating charges or challenged as a gratuitous alienation or an unfair preference once the administration order is

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71 Liquidators in Australia and Canada have identical powers.

72 The problems of set off will have to be dealt with.

made.[73]

Subject to these exceptions, the petition has to be dismissed. The charge holder too has no other choice. He is unable to refrain from appointing an administrative receiver and simultaneously prevent the appointment of an administrator. If he consents to the appointment of an administrator or fails to appoint an administrative receiver under the charge, he must, until the administrator is discharged by court, hold his peace.

WHEN AN AUSTRALIAN VOLUNTARY ADMINISTRATION MAY AND MAY NOT BE INITIATED

When an Australian Voluntary Administration may be initiated

The resolution which should be passed by the board of directors of a company before an administrator is appointed must satisfy two conditions. It must be to the effect that the directors voting for the resolution are of the opinion that the company is, or is likely in the future to become, insolvent,[74] and that an administrator should be appointed.[75]

There is no indication whether "insolvent" should be read as meaning that the company is unable to pay its debts, or in the light of the wider meaning given to the word insolvency in the section 459C(2).[76] The subjective standard to be applied in determining the existence or likelihood of insolvency does not point towards a consistent interpretation. An inability on the part of a company to pay its debts is, at best, difficult to determine. The answer would vary depending on whether the measure is the cash flow or balance sheet test; whether contingent and prospective liabilities are to be taken into account. Section 459C(2), in relation to a winding up in insolvency creates a rebuttable presumption of insolvency where a receiver or a receiver and manager of property of a company is appointed under a floating charge. While a receiver and manager is most often appointed when a company is unable to meet its debt obligations, he may also be appointed for other reasons specified in the security: a fact conceded by the Harmer Commission in its report.[77] Considering the moratorium on creditor rights imposed by the initiation of an administration it is submitted that an interpretation based on a company's ability

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73 s.9(3) IA 1986 [U.K.].

74 s.436A(1)(a) CL [Aust.].

75 s.436A(1)(b) CL [Aust.].

76 Both IA 1986 [U.K.] and BIA [Can.], in setting out the circumstances in which the may be initiated refer to an inability to pay debts rather than insolvency. When referring to a *state of insolvency*, IA 1986 [U.K.] does not use the word insolvent but refers to an inability to pay debts. See Goode, R.M., *Principles of Corporate Insolvency Law, supra*, p.25.

77 *Harmer Report, supra*, para.139, p.69.

to pay its debts is to be preferred.

No appointment of an administrator can be made by the company if it is already being wound up. In such circumstances, the liquidator or provisional liquidator may by writing appoint an administrator of the company.[78] The liquidator himself may have been appointed either in a voluntary winding up or winding up by court, each of which could be either solvent or insolvent. The former could be either a members[79] or a creditors voluntary winding up.[80] The latter, a winding up in insolvency or upon other grounds.[81] Whatever the circumstance under which the liquidator was appointed, he must, before acting under section 436B(1) be of the opinion that the company is insolvent or is likely to become insolvent in the future. (A most likely situation if the company is being wound up!). The standard that must be met is again subjective.

In these circumstances it is to be expected that since the liquidator will in all cases be an insolvency practitioner and, in some cases, also an officer of the court, the standard will be met with reference to factual data. If at the time the winding up commenced the company is not asset solvent, the length of time the liquidator may hope to trade before the insolvent state begins to bite would be limited compared to the time period that could be contemplated by the directors.

Where the liquidator makes the appointment, since all debts become due upon the commencement of a winding up, the test of insolvency ought to be the balance sheet test. In the case of a members voluntary winding up an additional test of insolvency may be applied. Namely, the inability on the part of the company to pay its debts in full within the period stated in the declaration of solvency made by the directors. If the liquidator is of the opinion at any time that such is the case then he has the option of initiating an administration.[82]

Where a provisional liquidator has been appointed the position may be different, because unlike in the United Kingdom, in Australia a winding up is taken to have begun or commenced with the making of the winding up order and all debts are not yet due.

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78 s.436B(1) CL [Aust.]. See also s.496(1)(b) which applied only in the case of a members voluntary winding up.. This appointment was also viewed by the Harmer Committee as one made by the company. See the *Harmer Report*, *supra* p.35. It has also been acknowledged that it would often be the case, though not always, that a company being wound up would be insolvent. See Corporate Law Reform Bill 1992, Explanatory Memorandum, p.97, para.470.

79 Where a declaration of solvency must be made. See s.494(1) CL [Aust.].

80 See Part 5.5 CL [Aust.].

81 See Parts 5.4 and 5.4A CL [Aust.].

82 s.496(1)(b) CL [Aust.].

Curiously neither the directors nor the liquidator or provisional liquidator is required to make a determination that administration would satisfy either of the objects set out in section 435A. It is suggested that such a determination is implied by the very act of appointing of an administrator. However, if a liquidator in a creditors voluntary winding up or a winding up in insolvency or by court appoints an administrator, there occurs a change to an insolvency procedure with objects which differ at least in part from those of a winding up. Unless the appointment by such a liquidator is limited to situations where it is not possible for the company or its business to continue in existence and is made for the sole purpose of obtaining a better return for the creditors and members than would result from an immediate winding up, there would be a transformation in the immediate objects of both liquidation procedures. The rights of fixed charge holders which are unaffected by a winding up are stayed under an administration. In fact all uncompleted enforcement proceedings are stayed. Thus it is submitted that where a liquidator in a creditors voluntary winding up or a winding up in insolvency or by court appoints an administrator, in view of the fact that the appointment is voluntary and without reference to court, it is in the interests of the creditors that the appointment should be accompanied by a statement that the liquidator is of the opinion that it is likely that either of the objects in section 435A can be achieved.

It may be noted that the liquidator's authority to initiate an administration is similar to his authority to propose a scheme of arrangement[83] between the company and its creditors, which if successful would bring the winding up to an end.

A person who is entitled to enforce a charge on the whole or substantially the whole, of a company's property may appoint an administrator of the company only if the charge has become and still is enforceable and as in the case of an appointment by a company before the company is wound up.

When an Australian Voluntary Administration may not be initiated

In Australia there are few restrictions on the use of administration as a rescue procedure. Where a company is already being wound up the directors have no right to initiate the procedure.[84] The same applies to a chargee entitled to enforce a charge on the whole or substantially the whole of a company's property.[85] Where a provisional liquidator has been

83 s.411(1) CL [Aust.].

84 s.436A(2) CL [Aust.].

85 s.436C(2) CL [Aust.].

appointed, an administration may still be initiated because in Australia a winding up commences with the making of a winding up order and not from the date the petition for winding up is presented. For example in *Aloridge Pty Ltd (Prov.Liq.Apptd.) v. Christianos*[86] a provisional liquidator had been appointed in respect of Aloridge Pty Ltd on the application of Christianos the 1st Respondent. Disputes had arisen between the 1st Respondent and the provisional liquidator, inter alia, on the grounds that the provisional liquidator had sought to set aside a transaction, of which the beneficiary was the 1st Respondent. The 1st Respondent was also a "substantial chargee" of the company and sought to appoint an administrator under s.436C CL [Aust.]. The charge on which the 1st Respondent relied was also in dispute in proceedings between the company and the 1st Respondent. The company then made an application under s.447A CL [Aust.] seeking an order that the voluntary administration be brought to an end. The court made the order ending the voluntary administration on the grounds that the administrator had been appointed, in the first instance, for an improper purpose, namely to displace the provisional liquidator and wrest control of the company from him and hoping that the administrator would be more compliant than the provisional liquidator.

It is further expressly provided that an administrator cannot be appointed under ss.436A, 436B or 436C if the company is already under administration.[87]

When a Receiver may and may not be appointed

When a Receiver may be appointed

The appointment must be made strictly in accordance with the terms of the debenture.[88] Usually, if the right to appoint a Receiver has accrued to the floating charge holder the charge is considered to have crystallised. However it must be noted that the appointment of a receiver itself is also considered a crystallising event. Today, most debentures give the holder wide rights to appoint a receiver and manager as and when he chooses. However unless a contractual right exists under the debenture or it may be implied from the terms, a debenture holder does not have the right to appoint a receiver and manager in the absence of breach or default by the borrower and merely because his security is in jeopardy.[89] In *Cryne v. Barclays Bank*[90] the debenture

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86 13 ASCR 99 (Fed C of A)

87 s.436D CL [Aust.].

88 See O'Dovovan, J., *Company Receivers and Managers*, p.21; Picarda, H., *The Law Relating To Receivers, Managers and Administrators*, 2nd Ed., Butterworths, London, 1990, p.63

89 *Cryne v. Barclays Bank* [1987] BCLC 548. Contrast the position with the right to make an (continued...)

holder sought to argue in appeal that it had an inherent right to appoint a receiver once its security was in jeopardy without any need to imply any term in the facility letter. Kerr L.J. rejected the debenture holder's argument holding that such a right should be expressly stated in the contract or properly implied. The debenture holder was liable in damages for making a wrongful appointment.

Once the right to appoint a receiver has accrued, the debenture holder may decide to exercise it at any time he wishes. He does not owe the borrower a duty of care in deciding whether to appoint a receiver. In *Shamji v. Johnson Matthey Bankers Ltd and others*[91], the plaintiffs argued that the debenture holder owed the mortgagors and guarantors a duty of care to consider all relevant matters before appointing receivers.[92] Citing dicta of Lord Denning in *Standard Chartered Bank Ltd. v. Walker*[93] and Lord Moulton in *McHugh v. Union Bank of Canada*[94] Hoffmann J acknowledged that a mortgagee or receiver exercising a power to sell the mortgaged property owes a duty to the mortgagor or guarantor to take reasonable care to obtain fair value. He pointed out however, that in the event of a conflict between the interests of the mortgagor and the mortgagee, any duty of care which the mortgagee owes to the mortgagor is subordinated to his right to act in the protection of his own interests. In so holding, Hoffmann J., relied heavily on the dictum of Salmon L.J. in *Cuckmere Brick Co Ltd. v. Mutual Finance Ltd.*[95] to the effect that:

> "If the mortgagee's interests as he sees them, conflict with those of the mortgagor, the mortgagee can give preference to his own interests..."[96]

Thus although the appointment of a receiver appeared to Hoffmann J to involve an "inherent conflict of interest" since the power to do so in that case was granted in unqualified terms, the decision by the mortgagee to exercise that power cannot be challenged except perhaps upon the

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89(...continued)
application to court for the appointment of a receiver. *Re London Pressed Hinge Co Ltd.*, [1905] 1 Ch 576.

90 [1987] BCLC 548.

91 (1986) 2 BCC 98.

92 However, in this case the right to appoint a receiver had already accrued to the debenture holder and only temporarily suspended by agreement between the parties.

93 [1982] 1 WLR 1410.

94 [1913] AC 299 at 311.

95 [1971] Ch 949

96 *ibid.* at 965.

grounds of bad faith. A similar view was expressed by Hoffmann J., in *Re Potters Oils (No.2.)*[97] after again citing the dictum of Salmon L.J., in *Cuckmere.* above.

Several points should be noted in connection with the facts of these cases. In *Shamji v. Johnson Matthey Bankers* the contractual right to appoint a receiver had already accrued and the bankers had withheld appointing a receiver. In *Re Potters Oils (No.2.)* the company was already in liquidation when the receiver was appointed. The Receiver would not have been the agent of the company and the bank would have ceased to be the agent of the company in making the appointment.

Insolvency or the likelihood of insolvency is not a factor which the debenture holder has to take into account. The company may be perfectly solvent but any default even one which may be classified as technical which gives rise to the right to appoint a receiver would entitle the debenture holder to validly make the appointment.

A demand generally precedes the appointment of a receiver.[98] In England, if the money is payable on demand, "all the creditor has to do is to give the debtor time to get from some convenient place".[99] In Canada a number of cases established that the debtor should in addition be given a reasonable time to make payment.[100] The courts drew a distinction between the enforceability of a security on default and when the creditor could move to enforce the security.[101] What was meant by a reasonable time depended very much on the particular circumstances in which each debtor was placed with regard to being able to find a solution to his financial difficulties, the terms of the debenture and the relationship between the parties.

Such considerations have however been rendered academic by the insertion in 1992 of a statutory requirement that a secured creditor must give 10 days notice of his intention to enforce a security on all or substantially all of the inventory, accounts receivable or other property of the

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97 [1986] BCLC 98.

98 However, O'Donovan argues that a demand should not be a pre-requisite. See *Company Receivers and Managers,* The law Book Company, 1981, p.32

99 per Goff J (as he then was) in *R.A. Cripps and Son Ltd., v. Wickenden; Cripps (Pharmacuticals) Ltd., v. Wickenden,* [1973] 2 All.E.R. 606 at 616.

100 *West City Motors Ltd., v. Delta Acceptance Corp.,* [1963] O.R. 683 (H.C.), *Roland Elwyn Lister Ltd., v. Dunlop Canada Ltd.,* (1982) 41 C.B.R. (N.S.) 272 (S.C.C.). See also *Lowes Chrysler Dodge Ltd., v. Bank of Montreal et al.,* (1979) 31 C.B.R. (N.S.) 71 (Ont.S.C.) and *Canadian Imperial Bank of Commerce v. George White & Sons Co.,* (1980), 36 C.B.R. (N.S.) 309 (Ont.S.C.).

101 See *Roland Elwyn Lister Ltd., v. Dunlop Canada Ltd.,* (1982) 41 C.B.R. (N.S.) 272 (S.C.C.). (1979) 27 O.R. (2d) 168 (C.A.)

company that was acquired for or is used in relation to a business carried on by the company.[102] Indeed the Colter Committee, who recommended that a secured creditor should give the company 15 and not 10 days notice[103] saw receivership (but not necessarily receivership and managership) as acting as an obstacle to a corporate reorganization. It observed:

> "Since there is no effective restraint on the enforcement of security, the secured creditor and its receiver are the parties who determine the method and timing of liquidation of the property of an insolvent debtor. It is obvious that an immediate cessation and liquidation of the business of the debtor precludes a reorganization of its affairs. The debtor is not given an opportunity to establish that it could carry on its business and recover a larger amount for all parties involved."[104]

Later on in its report, however, the Colter Committee pointed out that "the Receiver also provides a means for the reorganization of the debtors affairs."[105] This apparently contradictory statement is only explicable if the Colter Committee is treated as referring to reorganization as a means of ensuring a recovery for the unsecured creditors in the first instance, and as a means of keeping the viable parts of the business intact in the latter.

When a receiver may not be appointed

In England, once an administration order has been made and during the period for which an administration order is in force an administrative receiver may not be appointed.[106] Indeed if an administration order is made despite the appointment of an administrative receiver, the administrative receiver is required to vacate office.[107] An order would be made in such circumstances only if the debenture holder has consented to the making of the order or the floating charge itself would be either liable to be released or discharged as a transaction at an undervalue or preference, avoided or challenged as a gratuitous alienation or an unfair preference under the Act.[108]

CONCLUSION

Except in Receiverships, CVAs, and Schemes of Arrangement in England and Australia, insolvency or its likelihood is an express pre-requisite to initiation. It will be seen from the

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102 s.244(1) and 243(2)(c) BIA [Can.].

103 *Colter Report,* p.42, Option C.

104 *ibid.* p.37.

105 *ibid.* p.50.

106 s.11(3)(b) IA 1986 [UK].

107 s.11(1)(b) IA 1986 [UK].

108 s.9(3) IA 1986 [UK].

discussion in the next chapter that in these procedures, where insolvency is not a pre-requisite, an automatic statutory moratorium does not apply.[109] The court may stay proceedings against the company in an Australian scheme of arrangement, but an application must first be made to the court. In English Administration, Australian Voluntary Administration and Canadian Proposals, with or without a Notice of Intention, a moratorium applies upon the procedures being initiated. In the case of a scheme of arrangement under the CCAA [Can.] a stay is not automatic and must be sought in the application to initiate the procedure.

Is it therefore, possible to establish a link between the moratorium and the requirement of insolvency? No statement to that effect has been made by either of the reform committee's reports. However in principle it is submitted that a moratorium ought be available only if the company is insolvent. When a company is in insolvent liquidation the collective interest of unsecured creditors replace their individual interests but secured creditors retain the right to pursue their individual interests. If the rights of both secured and unsecured creditor are to be restrained, it is submitted that the benefit of the restraint should be available only where the company will be, or is likely to be, forced into liquidation and its assets dismembered if the stay is not imposed.

Is it necessary to go a step further and determine whether the procedure is likely to be a success or not before the procedure is initiated and the benefit of the moratorium is granted? Such a determination is expressly required in initiating an English Administration. A determination akin to this is, to some extent, made in initiating a scheme of arrangement in Australian and Canada. However a court in either of these jurisdictions does not attempt to pre-empt the creditors' and members' decisions on the scheme, but, prior to making its first order, merely examines the proposed scheme for the purpose of determining whether it is lawful. The court then has a second opportunity to decide whether to approve the Scheme of Arrangement when it is brought before the court for the purpose of obtaining its sanction. But, having examined its validity prior to ordering the meetings, it may be precluded from rejecting it except on the grounds that the proper procedure has not been followed.

The initiation of a rescue only in circumstances where there is a "real prospect" of success, even if it is less than 50%, goes some distance towards pacifying an insolvent company's

109 A *de facto* moratorium applies in the case of a Receivership, however this is due to the fact that all the property of the company is held for the benefit of the debenture holder. No other unsecured creditor has an interest in that property except to the extent that there is a surplus remaining after the debenture holder's claims are satisfied. However the claims of other secured creditors, retention of title holders, and creditors under a conditional sale or hire-purchase are not stayed.

creditors that the maximum benefit will be derived from its limited resources at the least expense.[110] But to what extent are the creditors being deluded by such an evaluation? Assuming that the evaluation of the prospects of the success of a rescue is accurate, should it be obtained at all costs? The fact that court makes the necessary evaluation in an English Administration means that the cost of an application to court is attached to the attainment of the ideal. Could this cost be avoided by dispensing with the application to court and conferring the obligation of making the valuation on an independent insolvency practitioner? Clearly the answer is no, since the Court assumes no liability in making the evaluation of the prospects of success. If the responsibility of determining the prospects of an English Administration was passed on to an insolvency practitioner the thorny issue of the liability that may attach to the insolvency practitioner in making the evaluation would have to be addressed. Evaluation without liability may be abused and may just as well be dispensed with altogether. Evaluation with liability would not result in a dramatic reduction in cost to the company, and indirectly the creditors, since the insolvency practitioner would inevitably pass on the cost of his personal liability insurance on to the company.

The other feature peculiar to English Administration is the ability of the holder of a floating charge over all or substantially all of the company's assets to block the initiation of the procedure by the appointment of an administrative receiver. Part of the rationale[111] for granting the floating charge holder such a power is the fact that administrative receivership itself is a procedure which has the potential achieve the same result as an English Administration. Thus the blocking of an English Administration by the floating charge holder does not necessarily terminate the attempt to rescue the company. However, as will be seen in greater detail later, the immediate objectives of the English Administrator and the Administrative Receiver differ. The English Administrator acts in the interests of the general body of creditors and the company, whilst the Administrative Receiver acts primarily for the floating charge holder although he must keep the interests of the company and the other unsecured creditors firmly in view.

In stark contrast is the position of a floating charge holder in Canada who must give a minimum ten days notice to the company prior to enforcing the charge. Thus, in Canada the

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110 If there is no real prospect of the purpose of initiation being achieved then the maximum benefit will be derived from liquidation since the cost of the rescue, except the cost incurred for the purpose of determining the prospect of success, could be avoided entirely.

111 The other reason is the impact on corporate borrowing if a "classic" form of security lost its potency in this manner.

interests of the floating charge holder are secondary to the public interest and the interests of the creditors as a whole. In England it is the reverse.

The main beneficiaries of the provisions which restrict access to the procedures are the creditors. However, restrictive provisions which were appropriate in the economic climate and credit system which prevailed when they were introduced may cease to be appropriate if either the economic climate or credit system changes. So long as the risks which follow initiation of a rescue procedure out weigh the benefit that may be derived therefrom by the creditors there is no problem. However, where the benefit begins to out weigh the risk which is run, the restrictive provisions begin to act as a hinderance rather than a protection. This is clearly demonstrated by the positive approach adopted by the Canadian Courts in interpreting s.3 CCAA [Can.]. Although "strict compliance" does not appear to accord with the intentions the legislature had at the time s.3 was introduced, it does enable the modern Canadian Companies to enter into compromises or arrangements with their creditors when the only other alternative available at the time was bankruptcy.

CHAPTER FIVE

PRESERVING THE STATUS QUO DURING THE RESCUE

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5.8. *CONCLUSION*

INTRODUCTION

Which ever procedure is used, the mere fact of initiation is a clear signal to the company's creditors that the debtor company is insolvent or likely to become so in the near future.[1] As was pointed out in Chapter 1, ordinarily, in the absence of any formal statutory insolvency procedure, the release of such sensitive financial information into the public domain would result in each creditor immediately taking steps to recover its debt from the company. This flurry of creditor activity which is rewarded by the race going to the swiftest would be terminated if bankruptcy or winding up proceedings were initiated on notice of the company's insolvency. In such proceedings each creditor's right to recover its debt by individual action is replaced by a right to prove for a dividend in the winding up. It has been seen that the failings of the terminal insolvency proceedings were such that they hardly, if ever, resulted in any dividend being paid to the unsecured creditors. Further, even if the liquidator discovered that all or part of a company was salvable such proceedings were not easily reversible. Therefore, a business which may have recovered from insolvency could nevertheless be lost once liquidation proceedings commenced.

Rescue procedures are designed to remedy the failings of the terminal insolvency procedures and to achieve at best the survival of all or part of the company or its business or, failing that, a better realisation of its assets than would be possible in a bankruptcy or winding up. There is however a cost to initiating and running a rescue procedure. Such costs would be well worth bearing if the objectives of the rescue were achieved. However it is usually impossible to predict with any certainty whether an attempted rescue will be successful since a positive outcome depends on a multitude of factors. Where an attempted rescue fails the costs of the failed rescue attempt would have to be added to the costs of bankruptcy or winding up which must inevitably follow. Such costs would be borne by the preferential and unsecured creditors in the form of a reduction in the dividend, if any, that is paid out.[2] Thus the initiation of a rescue may also be considered a warning that unless the attempted rescue[3] is successful the unsecured creditors will be forced to be content with the receipt of a smaller dividend than they

1 In an English Administration, Canadian Proposal, Australian Voluntary Administration and a Scheme of Arrangement under the CCAA [Can.] insolvency or its likelihood is a prerequisite.

2 Where the assets of the company are insufficient to pay any dividend in some procedures it may be the holder of the floating charge who will have to bear the costs. Eg. see s.19(4) IA 1986 [U.K.] and ss.443D and 443E CL [Aust.].

3 Here "rescue" includes "a better realization of the company's assets" although the business itself may not necessarily survive.

may have otherwise received had the company gone directly into a winding up.

The initiation of a rescue procedure does not by itself terminate a creditor's right of action against the company and replace it with a right to prove for a dividend. Indeed such a right remains vested in the creditors during the course of the procedure and is only temporarily stayed by any moratorium.[4] It is trite but true that, in the absence of any other business ties, creditors themselves are not driven by any altruistic motives in agreeing to preserve a debtor but only by a desire that they may be eventually repaid.[5] Therefore, owing to the uncertainty which almost invariably shrouds any attempted corporate rescue, it is easy to understand a creditor's desire to recover as much of it debt from the company notwithstanding the attempted rescue. Indeed as will be seen in the course of this chapter, there is plenty of evidence that such action has been attempted at times successfully.

Balanced against each creditor's interest in recovering whatever it can from the company, is the company's interest, which in most cases would include the directors' interest,[6] and society's[7] to see the rescue through to a successful completion. One of the factors which affects the success of a rescue is the extent to which the property and business of the company may be kept together as an integral unit until the procedure is completed. If during the course of the procedure the company is dismembered by the sale or seizure of its property, or any property on which its business relies, there may be no purpose in continuing with the procedure. Whilst the company's interest in maintaining the status quo is clearly discernible, collectively, the creditors also have an interest in ensuring that a single creditor does not obtain an advantage over others that are staying their hand and running the risk of the rescue failing in the expectation that it will either result in either saving the company's business, or at least in providing a better return to the creditors than would be possible in a winding up.

Thus with the exception in the case of CVAs, all modern procedures provide for a moratorium to take effect upon the initiation for the purpose of preserving the company's property and the status quo between creditors until the rescue procedure has run its course. Could it therefore be said that the moratorium also ensures that the principle of *pari passu* distribution

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4 See *Barclays Mercantile Business Finance & Anor v. Sibec Development*, [1992] 1 WLR 1253; (1993) BCC 148. However such a termination may be proposed and negotiated for in the procedures which seek to present a solution to the company's debt repayment problems. See for example Cl.8, Pr.1.25 *A.E.F.P.*.

5 See Aristotle, *Nicomachean Ethics*, bk.IX, ch.7.

6 Where they may be accused of wrongful or fraudulent trading.

7 See the discussion in Chapter One on society's interest in preserving businesses.

amongst unsecured creditors, which will come into effect in the event of a winding up, is protected and no creditor is allowed to achieve an advantage over the others? However, as will be seen, some moratorium provisions go further than preserving the status quo amongst the unsecured creditors to whom *pari passu* distribution principally applies. Such moratorium provisions ensure that the rights and remedies of secured creditors who have traditionally stood outside a winding up and the application of the *pari passu* doctrine are stayed.

This chapter examines in detail the nature and scope of the moratoria available under the various rescue procedures and concludes with an analysis of the type of moratorium which protects the interests of the company and the creditors as a whole and also safeguards the interest of each individual creditor.

DIFFERENT APPROACHES TO MAINTAINING THE STATUS QUO DURING A SCHEME OF ARRANGEMENT

The initiation of the procedure leading to a scheme of arrangement does not have an automatic effect on the legal status of the company or on its contractual and other legal relationships. There is no moratorium which has immediate effect on the making of the court order summoning the meetings. Therefore, practically, the initiation may result in creditors who are apprehensive of the outcome of the meetings taking steps to safeguard their interests. However, although there is no automatic moratorium which has effect on initiation, in Australia and Canada it has been recognised that the period between the making of the order and the conduct of the meeting is a period during which the company's assets and the conduct of its business are vulnerable to disruptive creditor action and that it is appropriate if some creditors should not be able to obtain satisfaction of their claims before the scheme has been considered by the creditors to whom it is proposed. Thus both the CL [Aust.] and the CCAA [Can.] give the court the power to stay proceedings against the company while a scheme is still pending.

The English approach

In comparison with the CL [Aust.] and CCAA [Can.] the CA 1985 [U.K.] makes no provisions for an application to be made to court for a stay of proceedings against the company while the procedure leading to a scheme is pending.

It was shown in Chapter 2 that in the years between 1870 and 1908, if a company in England wished to propose a scheme of arrangement under the JSCAA 1870 [U.K.] it was necessary at the very least to pass a resolution for a voluntary winding up. However, as the Loreburn Committee observed it seemed anomalous and was inconvenient, that a winding up should be commenced as a preliminary condition to an arrangement between the company and its creditors.[8] Thus, on the committee's recommendation, in 1908, the provisions of the JSCAA 1870 [U.K.] were extended to apply to all companies including those that were not being wound up.

As Palmer pointed out, "to wind up even temporarily is in some cases perilously inconvenient."[9] It would appear however that if the winding up was by court, one of the benefits was and still is, is that from the moment the petition for winding up is presented the court has the power to stay any proceedings or restrain further proceedings against the company.[10] In contrast, if the company is not in the process of being wound up by court or no petition for winding up is pending, the court has no jurisdiction, after ordering the meetings, but prior to sanctioning the scheme, to stay the execution of a judgement which had been obtained before the order.[11]

When the Cork Committee examined the schemes of arrangement procedure it remarked that it was ironical that this procedure is today frequently made use of by solvent instead of insolvent companies. Among the several defects which were identified as being the cause for the lack of use of this procedure by insolvent companies was the absence of a moratorium. The schemes procedure was, in the opinion of the Cork Committee, "long and involved," a minimum of eight weeks being required for a scheme to proceed from proposal to sanction. During this period creditors could individually exercise all available rights and remedies against the company and jeopardize the scheme. However, despite the decision in *Booth v. Walkden Spinning and Manufacturing Co. Ltd.*, the Cork Committee's found that the English Courts appear to have sometimes imposed an informal moratorium until one was formally agreed by the majority of creditors. Such stays were not based on any general power vested in the Court but depended mostly upon evidence of an informal moratorium which appeared to have the support of a majority of the creditors. The Courts however have been aware of the dangers inherent in relying on such informal moratoria. The Committee observed that

> "The insolvent company's inability - particularly if it is a trading company - to hold the position (that is to prevent winding up or the random seizure of assets by individual

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8 Cd.3052 Parliamentary Papers 1906 Vol XCVII

9 Palmer, Sir Francis B., *The Companies Act, 1907, and the Limited Partnerships Act, 1907* (2nd Ed), London, Stevens, 1908, p.44 cited in full at p.74 *supra.*

10 See *Bowkett v. Fuller's United Electric Works Ltd.*, [1923] 1 KB 160 where action was stayed under the Companies Act. See also *Re Richards & Co,* (1879) 11 ChD 676. The current statutory provision is s.126 IA 1986

11 *Booth v. Walkden Spinning and Manufacturing Co. Ltd.*, [1902] 2 KB 368 DC

creditors) during the period necessary for the devising and processing of a scheme, makes it difficult for even the most uncomplicated scheme of arrangement to be launched."[12]

Thus, although Loreburn Committee's primary objective in extending the provisions of the JSCAA 1870 [U.K.] to companies that were not in a winding was to enable a company, without going into liquidation, to effect an arrangement with its creditors and not to facilitate reorganizations of equity holdings by solvent companies, the absence of, inter alia, a moratorium has stood in the way of this primary objective being realised.

Since the schemes of arrangement procedure extended to both solvent and insolvent companies, the Cork Committee was of the view that a "general overhaul" of the prevailing schemes of arrangement procedure, was not within its terms of reference.[13] Having considered whether the procedure could be improved for insolvent companies, it concluded that, although desirable, there was no means of substantially doing so. Clearly in the Cork Committee's opinion the introduction of a moratorium would not have made a significant difference to the procedure. Nevertheless, it is important to note that it felt that schemes of arrangement should remain available for larger companies engaged in a complex restructuring although without a moratorium. Today the stay operates if the scheme is proposed during the course of an administration.

The Canadian approach

In Canada it has long been recognised that a moratorium plays a vital role in the success of a scheme of arrangement.[14] Section 11, CCAA [Can.], which gives the court the power to impose a stay on "proceedings" has been part of that statute since its enactment in 1933.[15] The Canadian courts have identified the purpose of the moratorium provisions in the CCAA [Can.] as the maintenance of the *status quo* as regards a company so that proceedings may be taken under that statute.[16]

Under s.11 CCAA [Can.] the court has the jurisdiction to make an order staying all

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12 Ibid. para.408., p.98.

13 A scheme of arrangement may be entered into by solvent as well as insolvent companies. In the context of solvent companies it is the primary means of effecting a cram down in a reorganization of equity.

14 See the observations of Gibbs J.A. in *Chef Ready Foods Ltd., v. Hongkong Bank of Canada* [1991] 2 W.W.R. 136 at p. 140.

15 S.11 CCAA [Can.] R.S., C-25, was formerly s.10 of 23-24 Geo.V., Chap.36.

16 *Re Northland Properties Ltd.*,(1988) 73 C.B.R. (N.S.) 146. See also *Sairex GmbH v. Prudential Steel Ltd.*,(1991) 8 C.B.R. (3d) 62 (Ont.Gen.Div.), *Chef Ready Foods Ltd., v. Hongkong Bank of Canada, supra,* at p.140.

proceedings that have been or might be taken in respect of the company under both BIA [Can.] and the Winding Up Act [Can.] or either of these statutes. The court may further restrain any further *proceedings* in any action, suit or proceeding against the company on such terms at it sees fit, and order that no suit, action or other proceeding be proceeded with or commenced against the company other than with the leave of, and subject to such terms as may be imposed by the court.[17]

Unlike under ss.4 and 5 CCAA [Can.][18] where the persons authorised to make an application to the court for the purpose of initiating a Scheme of Arrangement are named, the identity of the person able to make an application for a stay is not so limited. Under s.11 CCAA [Can.] "any person interested in the matter" may make an application to court seeking a stay of proceedings.

As far as the timing of the application is concerned, it is possible that an application under s.11 CCAA [Can.] could be made "whenever an application has been made under this Act" (i.e. the CCAA [Can.]). Thus, there is no necessity for the court to have made an order that a meeting of the company's creditors be summoned. It is important, nevertheless, to determine the time limits within which the application for the stay may be made since it goes to the root of both the court's jurisdiction to make the order and the duration of the stay. Since the court has the power to impose the stay with or without notice to any other person,[19] such a stay would be most effective if it were obtained along with the order summoning the meetings of creditors. An examination of the reported cases on the subject confirms that in the majority of cases the application for the stay is made with the application under ss.4 or 5 CCAA [Can.] by the same person. However, it should be noted that the Canadian Courts have not limited the making of orders under s.11 CCAA [Can.] to the period in-between the order summoning the meetings and the rejection or sanction of the proposal. *Prima facie*, if the word "whenever" in s.11 CCAA [Can.] is interpreted broadly, the courts jurisdiction to make an order under s.11 may be invoked at any time after an application under the act has been made. Similarly, the power vested in the court under s.11(c) CCAA [Can.] appears to be wide enough for an application for the stay to

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17 s.11 CCAA [Can.]. On the subject of the moratorium under the CCAA [Can.] see generally Goldman, Baird and Weinczok "Arrangements under the Companies' Creditors Arrangements Act" 1 *C.B.R. (3d)* 135, from 169-180 and Edwards S.E., "Reorganization under the Companies Creditors' Arrangements Act" (1947) 25 *Can.Bar.Rev.* 567.

18 See the discussion under Chapter Two *supra*.

19 s.11 CCAA [Can.].

be made after the scheme has been approved. Thus, it has been held that in exceptional circumstances the court can make an order under s.11 CCAA [Can.] even after the Scheme of Arrangement has been sanctioned.[20] Where the moratorium continues after the scheme has been sanctioned, creditors not bound by the scheme would be affected by it.[21]

Compared with the more modern procedures where the moratorium descends automatically on the initiation of the procedure, in a scheme of arrangement under the CCAA [Can.] the moratorium is dependent upon an order of court being made. The duration of the order is a matter for the court's discretion. Ordinarily it would last until either the proposed scheme is rejected by the creditors at the meeting or until an approved proposal is sanctioned by the Court. However, if as pointed out above, an order is made after the scheme has been sanctioned[22] the court should clearly specify when it must come to an end. It should be noted that the CCAA [Can.] provides that the power to impose a moratorium under s.11 may be exercised notwithstanding anything to the contrary in the BIA [Can.] or the Winding Up Act [Can.].

The thrust of the moratoria is against "proceedings". "Proceedings" are, or may be, the subject of a stay in every other procedure which provides for a moratorium, and it is relevant to examine the meaning attributed to the word under s.11 CCAA [Can.] by the Canadian Courts.

The earliest reported interpretation of "proceeding" under the CCAA [Can.] is by Kelly J in *Gray v. Wentworth Canning Co. Ltd.*[23] He opined that:

> "An examination of said sec. 10 indicates to me that the Court has discretionary power in a number of respects. It may stay all proceedings under the *Bankruptcy Act* and the *Winding Up Act* or either of them. It may also restrain proceedings in any pending action against the company and, as well may prohibit the commencement of any future suits, actions or other proceedings against the company. The words "other proceeding" must, in my opinion, be of a kind similar to a suit or action. In short they must be the means of instituting a cause in the Court."[24]

It is submitted that Kelly J's interpretation accords comfortably with a plain reading of s.11 CCAA [Can.]. The stay in question was limited only to proceedings in future actions and suits.[25]

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20 *Algoma Steel Corp. v. Royal Bank of Canada*, (1992) 11 C.B.R. (3d) 11.

21 *Multidev Immobilia Inc. v. Société Anonyme Just Invest* (1988) 70 C.B.R. (N.S.) 91.

22 *Algoma Steel Corp. v. Royal Bank of Canada, supra.*

23 (1950) 31 C.B.R. 182

24 *ibid.* at 185.

25 *Gray v. Wentworth Canning Co., Ltd., supra,* at p.185.

The next occasion the meaning of "proceeding" as found in s.11 CCAA [Can.] came to be construed was thirty four years later in *Meridian Developments Inc. v. Toronto Dominion Bank.*[26] Having heard extensive submissions on the meaning of the word "proceeding", including citations from English and Canadian cases and Judicial Dictionaries which indicated that proceedings should be confined to those which necessarily involved a court or court official, Wachowich J preferred to treat them as merely persuasive. He sought to distinguish *Gray v. Wentworth Canning Co. Ltd.*,[27] on the grounds that in that case Kelly J's interpretation of "proceeding" was limited to the wording of the order which was in issue. It is submitted that clearly this was not the case. Instead, Wachowich J decided to base his interpretation of the word on the "wide scope of action which Parliament intended for this section of the Act. It should be noted that Wachowich J gives no hint throughout his judgement of the source out of which he determined Parliament's intention.

Nevertheless, whatever may be the merits of Wachowich J's reasoning, the decision in *Meridian Developments Inc. v. Toronto Dominion Bank.*[28] has proved to be a watershed as far as the scope of the stay under s.11 CCAA [Can.] is concerned. Taking their cue from this decision judges have taken the view that "proceedings" in s.11 CCAA [Can.] is not restricted to proceedings involving the court or its officers. Thus, in *Re Philip's Manufacturing Ltd.*,[29] the court's order under s.11 CCAA [Can.] provided, inter alia, that subject to certain limitations, a bank, as a secured creditor, was not entitled to realize its security, or to set off deposits of the debtor against debts due to the bank and that the bank should continue to lend money to the debtor pursuant to an operating line of credit. The bank sought an order vacating the stay imposed against it under s.11 CCAA [Can.]. It must be noted that the bank never challenged the validity of the order, but merely sought to have it vacated on the ground that as the sole secured creditor[30] it would never approve the scheme proposed by the company.[31] Stays have also been

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26 (1984) 52 C.B.R. (N.S.) 109.

27 (1950) 31 C.B.R. 182

28 (1984) 52 C.B.R. (N.S.) 109.

29 (1992) C.B.R. (3d) pp. 17 and 25.

30 That is other than statutory secured creditors. See (1991) 3 C.B.R. (3d) 17 at p.20.

31 Scarth J. vacated the stay under s.11 CCAA [Can.] on these grounds, notwithstanding the fact that he did not find the company to be "hopelessly insolvent". There was also evidence that the bank had knowingly contravened the order by declining the company its line of credit. See (1991) 9 C.B.R. (3d) 17 at pp.23-24. However, the decision vacating the stay order was reversed on appeal on the ground that it was not sufficient for the bank to establish that it would not accept the

imposed on the alteration of supply agreements[32]

However it appears that post *Meridian* judges have relied more upon Wachowich J's pronouncement of the "wide scope" of the legislation which "allows a judge to make orders which will effectively maintain the status quo for a period" rather than on the wider meaning given by him to the word "proceeding".

In *Chef Ready Foods Ltd., v. Hongkong Bank of Canada*[33] the court had ordered under s.11 CCAA [Can.] that:

> "the right of any person, firm or corporation to realize upon or otherwise deal with any property, right or security held by that person, firm or corporation on the undertaking property and assets of the Petitioners be and the same is postponed..."[34]

The bank sought to challenge the stay. However, as Gibbs J.A. pointed out it did not attempt to question whether "a step, not involving any court or litigation process, taken to realize upon the accounts receivable is a "suit, action or other proceeding...against the company..."[35] Rather it sought to argue that its security in respect of the company's accounts receivable, commonly referred to as a "s.178 security" under the Bank Act [Can.], was outside the scope of the CCAA [Can.].[36] Endorsing the liberal construction of the provisions in CCAA [Can.] made in a series of prior cases[37] the British Columbia Court of Appeal held that security in the CCAA [Can.] includes a s.178 security. It however left the question of whether "a step, not involving any court or litigation process, taken to realize upon the accounts receivable is a "suit, action or other proceeding...against the company" tantalisingly open.

Since the stay is not automatic, great care must be taken in drafting the Court order since the scope of the stay is solely dependent on the wording in the order. For example, in *Re Arthur*

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debtor company's proposals for re-organization. It had not addressed the company's prospects for obtaining alternative financing. See (1991) 9 C.B.R. (3d) 25.

32 See *Quintette Coal Ltd v. Nippon Steel Corp.* (1990) 80 C.B.R. (N.S.) 98 at p.100.

33 [1991] 2 W.W.R. 136

34 *ibid.,* at p.139.

35 *ibid.,* at p.139.

36 R.S.C. 1985, c. B-1.

37 Namely: *Meridian Dev. Inc. v. T.D. Bank*; *Meridian Dev. Inc. v. Nue-West Ltd.,* [1984] 5 W.W.R. 215; *Northland Properties Ltd v. Excelsior Life Ins. Co. of Can.,* [1989] 3 W.W.R. 363, 73 C.B.R. (N.S.)195; *Re Feifer and Frame Mfg. Corp.,* (1947) 28 C.B.R. 124; *Wynden Can. Inc. v. Gaz Métropolitain Inc.* (1982) 44 C.B.R. (N.S.)285 and *Norcen Energy Resources Ltd., v. Oakwood Petroleums Ltd.,* [1989] 2 W.W.R. 566.

Flint Co.[38] the court, in confirming a scheme approved by the creditors, ordered that for a period of two years no suit action or other proceeding for the recovery the "said debts" could be proceeded with or commenced. It was held that this stay did not restrain the presentation of a petition in bankruptcy by the creditors since bankruptcy proceedings are not proceedings for the collection of a debt.[39] It was further held that if bankruptcy proceedings were to be stayed an order should be made covering that exact point.

The persons most affected by a stay would be the company's creditors. However the court's powers under s.11 CCAA [Can.] are not restricted to staying "proceedings" by creditors only. The only statutory requirement that the order must adhere to is that the proceedings stayed must be either in "respect of the company" or "against the company". Therefore it appears that proceedings which have been or may be commenced even by a third party who is not a creditor may be stayed.[40] Creditors who are not bound by the scheme may also by subjected to the moratorium which continues after the scheme has been sanctioned by the Court.[41]

The Australian approach

Australia stands in between Canada and England in addressing the issue of the moratorium in a scheme of arrangement outside insolvent liquidation proceedings. The CL [Aust.] makes provision for the court to impose a moratorium during the procedure, however, the moratorium so imposed is not as powerful or extensive as the stay which may be imposed by a Canadian court under the CCAA [Can.] but is necessarily wider than the non existent moratorium in England.

Under s.411(16) CL [Aust.], two pre-conditions must be satisfied before the courts jurisdiction in this regard may be invoked. First, it must be shown that no order has been made or resolution passed for the winding up of the company. If the company is being wound up, the moratorium comes into force automatically, with no necessity for a court order.[42] More on this later. Secondly, it should be established that "a compromise or arrangement has been proposed" between the company and its creditors or a class of such creditors. The requirement that a compromise or arrangement "has been proposed" is satisfied only if the scheme is "known

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38 [1944] 3 D.L.R. 13

39 *ibid.* at p.18.

40 The constitutional validity of s.11 CCAA [Can.] has been upheld notwithstanding the fact that non-creditor interests might be affected. See *Norcen Energy Resources Ltd. v. Oakwood Petroleums Ltd.* (1988) 72 C.B.R. (N.S.) 1.

41 *Multidev Immobilia Inc. v. Société Anonyme Just Invest* (1988) 70 C.B.R. (N.S.) 91.

42 s.471B CL [Aust.].

publicly, or at least to one or more of the creditors likely to be affected".[43] In *Re Clements Langford Pty Ltd.*,[44] Little J., of the Supreme Court of Victoria, observed that the compromise or arrangement should also set forth in "concrete terms a scheme for the settlement, otherwise than by winding up, of the company's indebtedness to its creditors." However in *Re G.A.E. Pty Ltd.*,[45] Sholl J., in the same court expressed the view that it was not necessary that the scheme should be in a completed form which is capable of being immediately sent to the creditors but at least the general principle of the scheme should have been defined and matters should have reached a stage which would justify the making of the order. It will not be sufficient if knowledge of the scheme is limited to the company or its agents.[46] Further, the limitation of the scheme to one proposed between the company and its creditors prevents a moratorium being sought where the scheme is solely between the company and its members.

It is important to note that on the basis of this requirement, there is no necessity for the application to be made after the order summoning the meetings has been made. It may be argued that the wording is wide enough to make an application under s.411(16) before the main application under s.411(1) CL [Aust.], particularly since the opinion has been expressed that there is no necessity that the scheme should be in completed form.[47] However, there is no record of an application being made under s.411(16) in this manner.

The question arises whether it would be possible to make an application under this section after the scheme had been sanctioned by the court, or whether, where the application has been made before the scheme is sanctioned, the moratorium could continue in force after that event had taken place. There is no reported decision on this matter, but the answer to the first question would be likely to be answered in the negative in view of the fact that the court's jurisdiction to make an order arises only where the company is not being wound up and "a compromise or arrangement has been proposed". Section 411 CL [Aust.] distinguishes between a compromise or arrangement which has been "proposed"[48] and one which has been "agreed" and "approved"[49]. It is therefore, submitted that once the latter events have taken place the

43 *Re G.A.E. Pty Ltd* [1962] V.R. 252.

44 [1961] V.R. 453.

45 *supra*

46 *Re G.A.E. Pty Ltd supra.*

47 See *Re G.A.E. Pty Ltd., supra.*

48 s.411(1) CL [Aust.].

49 s.411(4) CL [Aust.].

compromise or arrangement goes beyond the stage of being merely "proposed" and the court's jurisdiction to make an order under s.411(16) is automatically terminated. Regarding the second question, it appears that if any stay is to apply during the course of an approved scheme of arrangement it would do so only if agreed to by the creditors. The scope and duration of such a scheme should be clearly set out in the proposed scheme.[50]

If the two pre-conditions referred to above are satisfied the company, any member or any creditor may, in a summary way, make an application to court under s.411(16) CL [Aust.]. Although summary proceedings may be, and usually are, commenced ex parte it is indeed surprising that it was held in *Re Reid Murray Acceptance Ltd.*,[51] that an order imposing a stay could not be made unless it was made *inter partes*. However, the court's reasoning is more defensible if read in the light of the other limitations and requirements of the statutory provisions under which it made the order.[52]

On an application being made to it under s.411(16) CL [Aust.] the court may restrain "further proceedings in any action or other civil proceeding" against the company, except by the court's leave and subject to the terms imposed by it.[53] In *Re Reid Murray Acceptance Ltd.*,[54] the court held that since the restraint may be imposed only against "further proceedings in any action or other civil proceeding" it is necessary that the proceedings should have already commenced at the time the application is made.[55] It was further held in this case that the word proceeding also included extra-judicial proceedings such as those that might be taken in the enforcement of a security interest. But at the time this case was heard, the enabling provision authorised the court to impose a stay of further proceedings in "any action or proceeding".[56] However, this provision was amended by the addition of the word "civil" between the words "action or" and the word "proceedings". The qualification of "proceedings" in this manner may

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50 Pr.1.25, Cl.8, *A.E.F.P.*

51 [1964] V.R. 82.

52 The order was made under s.181(9), 1961, (Vic.) This statute was based on the Uniform Companies Act. S.411(16) is the most recent incarnation of this provision.

53 The scope of the court's authority in this case is almost identical to the scope of the Canadian court's authority under s.11(b) CCAA [Can.], the only difference being that the Canadian court is not specifically given the authority to give leave for proceedings against the company to continue.

54 [1964] V.R. 82.

55 *Re Reid Murray Acceptance Ltd., supra.*

56 See s.181(9), 1961, (Vic.).

restrict its application to curial proceedings. There does not appear to be any reported decision on this point and therefore it is instructive to compare s.411(16) CL [Aust.] with ss.440D (1) and 471B CL [Aust.] which impose an automatic stay on "proceeding in a court".

Although the scope of the stay which the court may order is limited to "further proceedings in any action or civil proceeding", the court's discretion in deciding whether or not to make such an order is un-restricted. Indeed in *Re Clements Langford Pty Ltd.*,[57] the court opined that it is undesirable that the court should restrict that discretion by for example setting out *prima facie* rules. But in exercising its discretion it appears that the court would be likely to take into account the interests of the creditors; whether the scheme would be more beneficial than a liquidation; if there is any indication of it, the creditors views on the scheme; and the disadvantages to any particular creditor who will be affected by the scheme.[58]

As mentioned above, if the scheme is being proposed by a liquidator in a winding up in insolvency or by court, or by a provisional liquidator, the company would enjoy the benefit of a stay which came into effect automatically with the commencement of the winding up or the appointment of the provisional liquidator.[59] There is also a significant difference between the scope of this stay and the stay which applies under s.411(16) CL [Aust.]. If the company is being wound up or is under the control of a provisional liquidator, there is a stay on the *commencement* of any proceedings in a court in addition to the stay on the *continuation* any proceeding which has already been begun and the enforcement of process. Probably for greater certainty, but there is no *caveat* to this effect, secured creditors are expressly excluded from the ambit of s.471B CL [Aust.].[60] This appears to beg the question whether they come within the scope of "civil" proceedings in s.411(16) CL [Aust.]. It is submitted that they would not.

MAINTAINING THE STATUS QUO DURING A CVA

Vulnerability of a company during a directors' CVA

At present there is no moratorium which comes into effect upon a CVA being proposed by the directors of a company.[61]

57 [1961] V.R. 453.

58 See *Bond Corporations Holdings Ltd. v. State of Western Australia* [1991] ACLC 1479, 5 ACSR 304.

59 s.471B CL [Aust.].

60 s.471C CL [Aust.].

61 Under s.1(1) IA 1986 [U.K.]

It may be noted that the statutory provisions governing individual voluntary arrangements provide for the debtor seeking to enter into a CVA with his creditors to make an application to court seeking an interim order which would bring a moratorium into effect. The moratorium imposed by the court's order would restrain the presentation of a bankruptcy petition and proceedings thereon and the commencement and continuation of any other proceeding, execution or legal process without the leave of court.

In the section of its report which deals with CVAs, the Cork Committee took the view that "the procedure for individual debtors described in Part 1 of this Chapter could readily be adapted for companies."[62] Unfortunately, as has been mentioned elsewhere in this thesis, the Cork Committee's recommendations on the CVA were neither incorporated into the Government's "*Revised Framework for Insolvency Law*" nor included in the 1st and 2nd readings on the Bills. They were hastily introduced at the committee stage in the Commons and approved by the Lords. Thus, there was no debate on the moratorium provisions which were absent in the CVA but were always available in an Individual Voluntary Arrangement (IVA).

Despite its introduction, the CVA procedure was hardly used by the smaller companies who were the Cork Committee's target users. This lack of user may be blamed primarily on the lack of a moratorium.[63] In contrast, the individual voluntary arrangement procedure was very popular and widely used.

Maintaining the status quo in a CVA proposed by an administrator or a liquidator

If the CVA is proposed by an administrator the scheme has the benefit of the moratorium which came into effect with the initiation of the English Administration.[64]

If the CVA is proposed by a liquidator the imposition of a stay on proceedings against the company depends on whether the winding up is voluntary or by court. If it is voluntary there is no statutory provision which either, imposes a stay automatically, or gives the court the power to do so. In contrast if it is a winding up by court, on the application of the company, a creditor or a contributory, the court has the power to restrain any action or proceeding which is pending

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62 *Cork Report* para.429.

63 See "Barriers to the use of Company Voluntary Arrangements", in the Insolvency Service, *The Insolvency Act 1986 - Company Voluntary Arrangements and Administration Orders, (A Consultative Document,)* London, October, 1993. p.11.

64 The moratorium which comes into effect with the making of an administration order is discussed fully at 6.5 under the heading "The Moratorium in an English Administration".

against the company.[65]

The Insolvency Service's proposals for a moratorium during a directors' CVA

Seven years after the IA 1986 [U.K.] became law and following a report of a Working Party set up in 1992, in October 1993 the Insolvency Service published a Consultative Document on *"Company Voluntary Arrangements and Administration Orders"*. (hereafter the *"Consultative Document"*). One of the main barriers to the use of the CVA procedure identified by the Insolvency Service in the *Consultative Document* was the lack of a moratorium on creditors' rights during the life of the procedure.[66] It was observed that, without a moratorium, it was difficult to restrain individual creditors from taking action against the company during the early stages of a CVA; a time during which the company would be engaged in negotiations with its major creditors.[67] The authors of the *Consultative Document* were however mindful of the risks to the creditors which are inherent in a moratorium, such as that it is of little use where there is no realistic prospect of saving the company and where the announcement of a moratorium would itself trigger a loss to the company.[68] Nevertheless, having weighed the options, the *Consultative Document* concluded that a moratorium should be introduced into the existing CVA to operate in given circumstances and in a given manner.

Under the proposals the current procedure in a CVA would continue to exist and the proposed moratorium would be additional. This means that the directors would continue to be able to propose a CVA without a moratorium but, it is submitted that if this is indeed the case, it is very doubtful whether the procedure without a moratorium would be made use of at all.

Triggering the proposed moratorium and its duration

The proposed moratorium is to be triggered by notice of a prospective CVA together with evidence that the proposed nominee has consented to act in that capacity being filed in Court. Along with his consent to act the nominee would have to indicate that there is a reasonable prospect of a successful CVA. The directors would also have to make a statement that the company has not had the benefit of a moratorium within one year preceding the filing and that

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65 s.126 IA 1986 [U.K.].

66 Insolvency Service, *Consultative Document*, October 1993, para.2.2

67 See Insolvency Service, *Consultative Document*, para.2.3. However some insolvency practitioners appear to have argued that a skilled negotiator could persuade creditors to observe a voluntary moratorium.

68 *ibid.* para.2.4. The example cited in the latter case being businesses in the travel industry.

to the best of their knowledge there are no circumstances which would give a liquidator cause to make an application to court to set aside or avoid a transaction on the grounds that it is at an under value, a preference, an extortionate credit transaction or a floating charge on the grounds that it was given for past value.[69] The moratorium so initiated would have to be advertised and would last for an initial period of 28 days, with the possibility of extension of up to a maximum of 6 months with the approval of court. The *Consultative Document* opines however, that a company which required such an extension up to the maximum period ought to be in Administration rather than proposing a CVA.[70] The proposals up to this point are largely modelled on the procedure currently available to a Canadian company which files a Notice of Intention to make a Proposal under Part III of BIA [Can.].[71]

Extending the duration of the proposed moratorium

It is suggested in the *Consultative Document* that any extension of the moratorium would require the approval of the company's creditors which must be obtained at a meeting convened within the initial 28 day moratorium.[72] If 75% of the creditors present in person or by proxy and voting at the meeting agreed to the extension, it would be so extended automatically unless a direction to the contrary is made by the court. The maximum extension that could be obtained in this manner is for three months.[73] While the court's approval would not be required for extensions of up to three months where the creditors have given theirs, court approval would be mandatory if the extension which is sought took the moratorium period up to the maximum six months. These proposals regarding the manner in which extensions are obtained appear to have been influenced to some extent by the new Australian Voluntary Administration procedure.

Scope of the proposed moratorium

At first the *Consultative Document* does not elaborate on the scope of the moratorium. Indeed it queries whether it should apply to secured creditors. It observes that an "automatic moratorium that bound secured creditors would be a new departure in this country". Unless "secured creditors" here refers only to floating charge holders this statement appears to ignore the automatic effect of ss.10(1)(b) and 11(3)(c) IA 1986 [U.K.] on other secured creditors in the

69 Insolvency Service, *Consultative Document* 1993, paras.2.14, and 4.2 at pp.14 and 27.

70 Insolvency Service, *Consultative Document* 1993, paras.2.15 and 4.3 at pp.14 and 27.

71 See 6.3 below.

72 Insolvency Service, *Consultative Document*, 1993, para.2.16, p.14.

73 Insolvency Service, *Consultative Document*, 1993, para.4.7, p.28.

Administration Order Procedure. This therefore seems to indicate that secured creditors do not come within the proposals pertaining to the moratorium discussed above. However the DTI bows to the body of opinion which suggested that "unless secured creditors were bound by a moratorium any new CVA procedure might have little practical effect" and concedes that the moratorium would bind all creditors including secured creditors.

"Hire purchase agreements" as defined in s.10(4) IA 1986 [U.K.] do not appear to come within the meaning of "secured creditor" in the *Consultative Document*. Reference is only made to secured creditors who have a right to appoint a receiver or an administrative receiver. Views have however been sought on whether it would be appropriate to suspend the right to terminate contracts which have not been breached.[74] It is submitted that due consideration will also have to be given to imposing a similar restraint on the rights of parties under "hire purchase agreements" as is done under ss.10(1)(b) and 11(3)(c) IA 1986 [U.K.].

During the period within which the moratorium operates, the management of the company would remain in the hands of the directors, the company would be subject to what the *Consultative Document* refers to as "relatively low levels of monitoring". It nevertheless, declines to indicate what it means by "relatively low levels" and instead seeks the views of interested persons.

Challenging the proposed moratorium

Given that the directors remain in control and only "low levels of monitoring" is so far intended, it is essential that the creditors should be able to challenge the moratorium even before the first meeting of the creditors is held within the 28 days. As in all other procedures which provide for a moratorium, the creditors in a CVA under the proposed optional procedure would be able to take action with the leave of court. The court's jurisdiction to grant such leave arises with the filing of the notice of intention to propose a CVA.

MAINTAINING THE STATUS QUO DURING THE PROCEDURE LEADING TO A CANADIAN PROPOSAL

Extending the scope of the stay under BA [Can]

Prior to the 1992 reforms, under the old provisions of BA [Can.] where a proposal was made by a debtor, a secured creditor was not, unless it chose to be, bound by a resolution of a company's unsecured creditors to accept a proposal.[75] Neither was a secured creditor affected

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74 Insolvency Service, *Consultative Document,* 1993, para.3.7, p.25.

75 S.54(1) BA [Can] provided that : "Subject to the rights of secured creditors, the creditors may by special resolution resolve to accept the proposal as made or as altered or modified at the meeting

by the stay on the recovery of all claims provable in Bankruptcy which came into effect on the filing of a proposal made by an insolvent person.[76] The only occasion where the exercise of a secured creditor's rights could be effectively stayed was after the proposal had been *approved* by the Court.[77] Given that most lending in Canada is secured,[78] until the end of 1992, a reorganization of an insolvent corporation's affairs through the medium of a proposal was not effective and unattractive to unsecured creditors or corporate entities. The *Colter Report* remarked in 1986 that:

> "The reorganization and rehabilitation of an insolvent business require that its essential assets and organization be kept intact and usually that it be kept functioning. That cannot be done if the creditors are at liberty to try and enforce their rights to be paid out of the assets of the business. Hence the need for generally preventing creditors from doing so while the prospects of reorganizing and rehabilitating the business or selling it as a going

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or any adjournment thereof."

76 The wording in section s.69(1) BA [Can] which imposed the stay was wide enough to include secured creditors within its scope. However, under s.69(2) BA [Can] a secured creditor was given the right:

> "to realize or otherwise deal with his security in the same manner as he would have been entitled to realize or deal with it if this section had not been passed, unless the court otherwise orders..."

77 s.69(2) BA [Can] provided "...but in so ordering the court shall not postpone the right of a secured creditor to realize or otherwise deal with his security, except as follows:

> (a) in the case of a security for a debt that is due at the date of the bankruptcy or of the *approval* of the proposal or that becomes due not later than six months thereafter, that right shall not be postponed for more than six months *from that date.*
>
> (b) in the case of a security for a debt that does not become due until more than six months after the date of the bankruptcy or of the *approval* of the proposal or that becomes due not later than six months thereafter, that right shall not be postponed for more than six months *from that date...*"

See also Marantz, "Lets make a deal: Proposals under the Bankruptcy Act" Vol 9 *Canadian Business Law Journal* pp.47 & 51; Canada, Library of Parliament, Research Branch, Current Issues Review: The Bankruptcy Act Proposed Revisions 1988 (Helen Morrison) p.9.

78 In 1970 the *Tassé Report* remarked: "When the first Canadian *Bankruptcy Act* was enacted, most creditors were unsecured an the amount owed to secured creditors was often only a small part of the total debt. This may be one of the reasons why the bankruptcy and insolvency legislation interferes so little with the rights of secured creditors and that they, to all intents and purposes liquidate their security free from the strict control and supervision imposed by the *Bankruptcy Act* and the *Winding Up Act*. Over the years, new methods of financing have increased the secured debts of almost all commercial debtors. Much financing is now done through security given under section 88 of the *Bank Act* and through new methods of factoring whereby loans are given by the factor to a vendor on the security of a continuing lien on his inventory and accounts receivable." See p. 56 - 57; See also: Papillon, B.M., *Recent Proposals to reform the Bankruptcy Act: An Assessment*, (Paper prepared for the Economic Council of Canada) Ottawa, 1990, pp.44 & 45; *Colter Report supra*, p.53; *Bank of Montreal v. Hall* 65 DLR (4th) 361 at pp.370-374.

> concern, in whole or in part, are determined..."[79]
> "...Unless secured creditors to whom the essential assets have been pledged are either kept in good standing or agree to co-orporate, a proposal cannot be used to effect a reorganization."[80]

It appears that the secured creditors who lobbied strenuously to retain their privileged position under the Canadian Law of Bankruptcy were largely successful in preventing the reforms recommended by the *Tassé Report*, which progressed as far as Bill stage on many occasions during a ten year period, from being enacted.[81] The shortcomings of the proposal procedure in BA [Can] lead to an increased use of the schemes procedure in the CCAA [Can.] as the preferred means of corporate reorganization in the 1980s.[82]

In 1986 the *Colter Report* recommended the amelioration of the reorganization procedure in the *Bankruptcy Act* by enabling corporations to file a "Notice of Stay" on all proceedings, including those of secured creditors, thereby, giving a corporation the opportunity to determine whether a reorganization of its financial affairs was possible. If a proposal was filed the stay was to be extended for 21 days until its approval by the creditors or alternatively, in the event approval not being obtained, the deemed bankruptcy of the debtor.[83] When the amendments were eventually made to BA [Can], although the Canadian Federal Parliament did not provide for a "Notice of Stay" as recommended by the Colter Committee, it clearly took the Committee's recommendations into account since they were embodied in the proposals made in 1988 by the Legislative Review Branch of the Policy Co-ordination Bureau of the Department of Consumer

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79 *Colter Report, supra,* p.49

80 Colter Report, *supra,* p.50 It further said "As the filing of proposal under the Bankruptcy Act does not stay proceedings by secured creditors , they have the power to nullify any attempt at a reorganization." at p.54

81 See Cumming R.C.C. "Canadian Bankruptcy Law: A Secured Creditor's Heaven" [1994] 24 *Canadian Business Law Journal* p.17

82 See the discussion in Chapter 4 *supra*. See also Hayes, Ellen L., "Executory contracts and Proposals under the Bankruptcy and Insolvency Act (Canada): A Comparative analysis with the Companies' Creditors Arrangements Act (Canada)" in Ziegel, J., (Ed) *Current Developments in International and Comparative Corporate Insolvency Law*, Clarendon Press, Oxford, 1994, p.267-268.

83 Tassé Report, *supra,* also recommended that "For a certain period of time after a notice of intention is filed, all proceedings against the debtor should be stayed." (see p.91) However in the same part of the report, later on, it is stated "Under the general plan for an arrangement ... which, we expect, should continue, in practice, to apply mostly, if not only, to commercial debtors, the secured creditor would keep his right, under his contract" thereby restricting the arrangement procedure to those with unsecured creditors. (see p.97) See also Proceedings of the Standing Senate Committee on Banking, Trade and Commerce on Bill S-11, 13-4-1978, 35;29.

and Corporate Affairs on which the bill was based. In 1992 the existing provisions in BA [Can] were replaced with wider provisions applicable to both secured and unsecured creditors.[84] Thus, today under the BIA [Can.] a moratorium may come into force in four circumstances: on the filing of a Notice of Intention to make a Proposal with the Official Receiver;[85] on the filing of the Proposal with the Official Receiver;[86] on the filing of a Consumer Proposal under Division II of Part III of BIA [Can.][87] and; on the bankruptcy of a debtor.[88] Provisions were also introduced to further prevent the automatic or deliberate termination of certain contracts a company had entered into and to prevent the re-acquisition of property in the possession of the company by their owners.

This thesis is primarily concerned with the moratoria following the filing of a notice of intention and the filing of a proposal. It is not concerned with Consumer Proposals and consequently, nothing further will be said about the statutory provisions which provide for the moratorium therein. It is concerned with the moratorium which follows the bankruptcy of a company only to the extent that such moratorium continues or is altered by the making of a proposal by the trustee in bankruptcy or the bankrupt company.

Duration of the moratorium overall

The moratorium comes into force automatically on the filing of a notice of intention or a proposal with the Official Receiver.[89] There is no need for a Court order. A distinction may be drawn between the stay which follows the filing of a Notice of Intention and that which follows the filing of a proposal. Under s.69(1) BIA [Can.] the moratorium takes effect immediately the insolvent person files the Notice of Intention to make a proposal with the Official Receiver, the point at which the statute considers the procedure to have been initiated. In contrast, if no Notice of Intention is filed, the moratorium takes effect only when the trustee files the Proposal with the Official Receiver and not when the Proposal is filed with the trustee, the latter being the point at

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84 S.69 BA [Can] is replaced by four sections, ss.69, 69.1, 69.2 and 69.3 BIA [Can.]. The provisions contained in the former s.69(1) BA [Can] continue with some amendments in the new ss.69(1)(a) and 69.1(1)(a) BIA [Can.]. The old s.69(2) BA [Can] has been removed altogether, thus bringing secured creditors within the scope of the stay.

85 s.69 BIA [Can.].

86 s.69.1 BIA [Can.].

87 s.69.2 BIA [Can.].

88 s.69.3 BIA [Can.].

89 ss. 69(1) and 69.1(1) BIA [Can.]

which the statute considers the procedure to have commenced.[90] If a notice of intention has been filed, the moratorium lasts until the filing of a proposal by the trustee under subsection 62(1) or failing that, the company's bankruptcy.[91] Once a proposal is filed the moratorium which comes into force exists until the proposal has been fully performed. Thus moratorium which takes effect following the filing of a Notice of Intention continues without a hiatus when the proposal is filed. The duration of the stay on the automatic or deliberate termination of certain contracts is not limited by statute. It may be noted that the overall length of the Canadian moratorium exceeds comparable provisions in England and Australia under which the moratorium exists only until the relevant administration comes to an end.

Nevertheless, a company is not completely immune from any attack by a creditor by reason of the moratorium. Speaking of the purpose of the stay provisions in the bankruptcy and insolvency legislation Farley J observed in *Re Cumberland Trading Inc.,*:[92]

> "It is true that under BIA an insolvent person gets an automatic stay by merely filing a Notice of Intention to File a Proposal - as opposed to the necessity under CCAA of convincing the court of the appropriateness of granting a stay (and the nature of the stay). However, BIA does not guarantee the insolvent person a stay without review for any set period of time. To keep the playing field level and dry so that it remains in play, a creditor or creditors can apply to the court to cut short the otherwise automatic (or extended) stay."

When and how a creditor may seek to cut short the moratorium is considered fully under the heading "Challenges to the moratorium." But first it is necessary to consider its nature and scope.

Nature and scope of the stay under ss.69(1) and 69.1(1) BIA [Can.]

Sections 69(1) and 69.1(1), which provide for a moratorium to apply following the filing of a Notice of Intention or the making of a Proposal, are mostly identical and therefore it is convenient to examine such parts of those sections together.

The stay under ss.69(1)(a) and 69.1(1)(a) BIA [Can.].

Both s.69(1)(a) and s.69.1(1)(a) BIA [Can.] provide that,

> "no creditor has any remedy against the insolvent person or the insolvent person's property, or may commence or continue any action, execution or other proceedings, for

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90 s.69.1(1) BIA [Can.]

91 s.69(1) BIA [Can.].

92 (1994) 23 C.B.R. (3d) 225.

the recovery of a claim provable in bankruptcy.[93]

The persons affected by these sub-sections are creditors. In the old s.69(1) BA [Can] the word creditor was followed by the words "with a claim provable in bankruptcy".[94] The deletion of these words in the section's reincarnation as ss.69(1)(a) and 69.1(1)(a) BIA [Can.] however, does not appear to affect the meaning of the word "creditor" since in s.2 BIA [Can.] by definition it means a "person having a claim, preferred, secured or unsecured, provable as a claim" under the BIA [Can.].

Another difference between the old s.69(1) BA [Can] and s.69(1) BIA [Can.] is the use of punctuation. In the former provision the word proceedings was not followed by a comma whereas in the current provision it is. Thus whilst in the former provision the meaning of the word remedy was restricted only to the extent that it should belong to a creditor with a claim provable in bankruptcy, in the current provision it should be one which may be *utilised* for the *purpose* of recovering a claim provable in bankruptcy.

If the words in ss.69(1)(a) and 69.1(1)(a) BIA [Can.] are given their grammatical and ordinary meaning[95] the stay imposed by the sub-sections appears to have a double edged effect. Under the first limb, ending with the words "the insolvent person's property," it is "any remedy" which is available for the purpose of the "recovery of a claim provable in bankruptcy" which is affected. The stay is not imposed by rendering a remedy non exercisable but by treating it as *non-existent* for a prescribed period. Under the second limb, while the *right* to commence or continue any action, execution or other proceeding continues, the *act* of doing so for the "recovery of a claim provable in bankruptcy" is prohibited.

Is not an action, execution or other proceeding a type of remedy which is available to a creditor for the purpose recovering a claim provable in bankruptcy? If so, since it has been extinguished (albeit temporarily) under the first limb is not the second limb thereby rendered

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93 s.69(1)(a) BIA [Can.].

94 The phrase "Claim provable in bankruptcy" is defined in s.2 of the Act as including any lability provable in proceedings under the Act by a preferred secured or unsecured creditor. Further s.121(1) provides that all debts and liabilities to which the bankrupt is subject before his discharge by reason of any obligation incurred before the date of bankruptcy shall be deemed to be claims provable in bankruptcy.

95 See *Maunsell v. Olins* (1975) AC 373, *Victoria (City) v. Bishop of Vancouver Island* [1921] 2 AC 384 on the application of the "grammatical and ordinary meaning". See further on this subject Bennion, F., *Statutory Interpretation*, (2nd Ed.) Butterworths, London, 1992; Bell, J., and Engle, G., *Cross: Statutory Interpretation*, (2nd Ed.) Butterworths, London, 1987, p.47; Dreidger, E.A. *Construction of Statutes*, (2nd Ed.), Butterworths, Toronto, 1983, p.8.

superfluous?

It may generally be presumed that a Legislature would not have intended a futile or pointless result: *lex nil frustra facit* (the law does nothing in vain).[96] It may also be presumed that when the legislature enacts a particular phrase in a statute:

> "it is saying something which has not been said immediately before. The rule that a meaning should, if possible, be given to every word in the statute implies that, unless there is good reason to the contrary, the words add something which would not be there if the words are left out".[97]

Therefore, if the apparent anomaly between the two limbs in s.69(1)(a) and s.69.1(1)(a) is to be resolved and the second limb treated as having a valid purpose, then the species of "remedy" which comes within the second limb must escape nullification by the first. But it is necessary to establish whether ability to commence or continue any action execution or other proceeding is indeed a "creditor's remedy" or whether it has a special meaning of its own.

"Creditor's Remedy"

A "creditor's remedy" is not defined in the dictionaries, but clearly it is a species of remedy available only to persons falling into the category of a creditor. Consequently its meaning will have to be derived from the meaning given to its genus "remedy".

Dictionaries, general or legal, are not considered as authoritative on the meaning of a particular word. However, where the scope of meaning of a word is not readily obvious from its context or there is doubt as to the scope, they are a useful tool to be used in determining the widest possible scope that may ordinarily be given to a word. Whether that scope is in any way limited must be determined from the context of the section, the part of the statute in which the section is and if necessary the whole statute. This is particularly the case where the word used is in the nature of a genus of which there are many species and sub-species.

The *Oxford English Dictionary* (*OED*) defines "remedy", inter alia, as "a means of counteracting or removing an outward evil of any kind; reparation, redress, relief" and as "Legal redress". *Webster's International Dictionary* defines it to include "The legal means to recover a right or to prevent or obtain redress for a wrong; the relief (as damages, restitution, specific performance and injunction) that may be given for a wrong by a court". The *Concise Oxford Dictionary* expands slightly on the *OED* definition of "Legal redress" with "redress: legal or other reparation".

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96 See Bennion F., *Statutory Interpretation*, (2nd Ed.) p.702.

97 Per Viscount Simon in *Hill v. William Hill (Park Lane Ltd.)* [1949] AC 350 at pp 546-547.

Whilst it is tempting to use these definitions as the best guides to the "ordinary" meaning of remedy one cannot ignore other constructions in legal sources. Legal dictionaries are no more authoritative than their more general cousins. But they too are, at least, persuasive, and particularly so where the definition is based on an interpretation given by a court the report of which is cited.

Ubi jus ibi remedium: where there is a right there is a remedy; is an often cited maxim of great antiquity[98] which has prompted English judges to distinguish between rights and remedies. This distinction between right and remedy is drawn in both *Jowitt's Dictionary of English Law* (2nd Edition) and *Osborne's Concise Law Dictionary* (8th Edition) where remedy is described as:

> "[A] means by which the violation of a *right* is prevented, redressed, or compensated. Remedies are of four kinds (1) by act of the party injured, the principal of which are defence, recaption, distress, entry, abatement and seizure; (2) by operation of law as in the case of retainer and remitter; (3) by agreement between the parties, e.g. by accord and satisfaction, and arbitration; and (4) by judicial process, e.g. action or suit.[99] (Italics added)

It is submitted that the distinction between a right and a remedy is often blurred. Is a remedy limited to the "*means*" of obtaining a particular state of affairs? In this event it is merely procedural. Alternatively does it also encompass the object of the procedure?[100] Is not the ability to initiate the means of obtaining the desired state of affairs also a right which belongs to the aggrieved party? The blurring between right and remedy is most obvious in matters of contract, where the remedy, if it may be so called, is non judicial. For example, is termination of a contract or the appointment of a receiver by a secured creditor the exercise of a right or a remedy or both?

In the United States, rights are not distinguished from remedies. Remedy is defined in Black's Law Dictionary as:

> "The *rights* given to a party by law or by contract which that party may exercise upon a default by the other contracting party, or upon the commission of a wrong (a tort) by the other party" (italics added)

In the General Provisions to the Uniform Commercial Code it is provided that:

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98 *Ashby v. White* [1703] 2 Ld.Raym. 955.

99 See *Jowitt's English Law Dictionary* (2nd Ed) p.1540; *Osborne's Concise Law Dictionary*, p.285.

100 Dobbs states "The law of judicial remedies concerns itself with the *nature and scope* of the relief to be given to the plaintiff once he has followed appropriate procedure in court and has established a substantive right. The law of remedies is thus sharply distinguished from the law of substance and procedure." *Handbook on the Law of Remedies*, St.Paul, Minn., West Publishing Co. p.1

> "'Remedy' means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal.[101] 'Rights' includes remedies.[102]

The Official Comment to the definitions in the Uniform Commercial Code indicates that

> "the purpose is to make it clear that both remedy and rights (as defined) *include those remedial rights of "self help" which are among the most important bodies of rights* under this Act, remedial rights being those to which an aggrieved party can resort on his own motion." (Italics added) [103]

It is submitted that in the present context the American definitions are to be preferred, considering the vast array of "self-help", "remedial rights" introduced by the draughtsmen of modern contracts and also the fact that Canadian Law is greatly influenced by its giant neighbour's. Thus, it may be said that although all rights are not remedial, a private remedy is obtained by the exercise of a "remedial" right. The grant of an equitable remedy is discretionary, but an application to court for the exercise of that discretion is the exercise of the wider right of access to justice.

The wide definition of a creditor's remedy would encompass within its scope both secured and unsecured creditors' remedies. However, both s.69(1)(a) and s.69.1(1)(a) BIA [Can.] specifically refer to a creditor's remedy against the insolvent person or the insolvent person's property "for the recovery of a claim provable in bankruptcy". "Creditor" is defined in s.2 BIA [Can.] as a person having a claim which is preferred, secured or unsecured, and which is provable as a claim under BIA [Can.]. However, under s.127(1) and (2), a secured creditor who has realized its security may only prove for the balance due after deducting the net amount realized. The whole sum may be proved for only if the secured creditor surrenders his security to the trustee in bankruptcy for the general benefit of the creditors. It follows therefore, that the realisation of a security by a secured creditor may be distinguished from the "recovery of a claim provable in bankruptcy" and would fall outside the ambit of a creditor's remedy. This construction is further supported by the fact that a secured creditor's realization of its security would be stayed by the Whilst this would appear to be the correct position on a proper reading of the statute, as will be seen, the Canadian Courts have taken the view that the realization of a security is caught up by the stay on creditor's remedies.

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101 This definition as also found in *Black's Law Dictionary* was adopted by the Supreme Court of Canada in *Vachon v, Canadian Employment and Immigration Commission.* [1986] 23 D.L.R. (4th) 641, as was the definition in *Jowitt's Dictionary of English Law.*

102 Uniform Commercial Code § 1-201 (34) and (36)

103 *Uniform Laws Annotated*, Vol 1, (Uniform Commercial Code), St.Paul, Minn, West Publishing Co., 1989, p.73

It appears from the foregoing discussion that the scope of the word remedy is indeed very wide. It would include public as well as private and judicial as well as lawful self-help remedies. Judicial remedies, as a sub-species of remedy available to creditors[104] clearly include within their scope the act of commencing or continuing any action, execution or other proceeding.

"Action, execution or other proceeding"

Whilst "action, execution or other proceeding" as used in ss.69(1)(a) and 69.1(1)(a) BIA [Can.] appear at first blush to come within the scope of a "creditor's remedy" the question that arises is whether the phrase "other proceedings" may be interpreted widely to bring within its scope proceedings that fall outside the scope of a "creditor's remedy"?

It is customary for courts in both England and Canada, when faced with a phrase such as "other proceedings" which follows other words to apply the linguistic cannons of construction "noscitur a sociis" (recognition by associated words) and "*ejusdem generis*" (of the same genus). But the results of the application of these two cannons of construction depend to a great extent upon the meaning that may be attributed to the words "action" and "execution".

The construction of "action", "execution" and thereby "proceedings" is further complicated by the fact that all three words have a number of common meanings. In its widest sense "action" as defined in the *OED* means, inter alia, "the process or condition of acting or doing" and "a thing done, a deed". *Webster's International Dictionary* defines it as including "the process of doing: the exertion of energy" and "a thing done". In the *Concise Oxford Dictionary* it is also defined to include "the fact or process of doing or acting" and "something done; a deed or act". However, these same dictionaries also define "action" as a judicial process. The following definition in the *OED* is representative:

> "the taking of legal steps to establish a claim or obtain a judicial remedy;[105] legal process; the right to take such process... a legal process or suit."

The word "execution" also has a number of meanings, the widest of which is concerned with "the action of executing; the state or fact of being executed."[106] It also means however, as defined

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104 "There are several ways of classifying judicial remedies. Some remedies act on the person (in personam) and some on property (in rem). Some are discretionary and others are available as of right. Remedies amy have legal, equitable or statutory origins. They may order the defendant to pay money, to transfer property or to do other positive acts or to refrain from acting, and they may punish the defendant through fines or imprisonment. Kercher, B., & Noone, M., *Remedies*, Sydney, Law Book Company, 1990, p.3. See further Dobbs Dan B., *Remedies*, St.Paul, Minn., West Publishing Co., 1973.

105 *n.b.* the use of the word "remedy".

106 *OED, Webster's* defines it as "the act or process of executing" and the *Concise Oxford Dictionary*

in the *OED*:

> "the enforcement by a sheriff, or other officer, of the judgement of a court; 'the obtaining of actual possession of anything acquired by judgement of law' (Coke *On Litt.* (1628) 154a); chiefly, *the seizure of the goods or person of a debtor in default of payment*" [italics added];

and as defined in *Webster's*;

> "the process of carrying into effect the judgement or decree of a court; especially the enforcement of such judgement or decree by arrest of the person or *seizure of the property of the debtor*" [italics added].

Turning to the word "proceeding", it appears that, here too, there are a number of meanings the widest of which is the "carrying on of an action or a series of actions; or a particular action or course of action."[107] It also has the narrower and more special meaning described in the *OED* as "the institution or carrying on of an action at law; a legal action or process; any act done by authority of a court of law *any step taken in a cause by either party*". The plural of the word, which is used in BIA [Can.], is defined as "*the course of procedure in a judicial action or in a suit in litigation*; legal action; a particular action at law or case in litigation."[108] [italics added]

The application of the linguistic cannon of construction *noscitur a sociis* limits the commencement or continuation of an "action", "execution", or "other proceedings" for the purpose of recovering a claim provable in bankruptcy.[109] The question to be next answered is whether the words should be interpreted widely or narrowly as described above. It would appear that the wider constructions are synonymous or near-synonymous and the draughtsman would be guilty of tautology if they were to apply. It would also be difficult to apply the maxim *ejusdem generis* to determine the scope of "other proceedings" since there would be no clearly identifiable *genus*. On the other hand if the words "action" and "execution" were to be given the narrower specialist meanings described above "action" and "execution" would be *species* or stages of

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as "the act or instance of carrying out or performing something".

107 *OED*. *Webster's* defines it as including "the action of proceeding; a particular way of doing or accomplishing something; a particular step or series of steps adopted for doing or accomplishing something". The *Concise Oxford Dictionary* defines it, inter alia, as "an action or piece of conduct".

108 The *Concise Oxford Dictionary* defines the plural of "proceeding" as an action at law; a lawsuit."

109 See *Attorney General v. Prince Ernest Augustus of Hanover* [1957] AC 436 where Viscount Simonds said "words, particularly general words, cannot be read in isolation: their colour and their content are derived from their context"; at p.461. See also *Re Bidie*, [1948] 2 All E.R. 995 where Lord Greene said at p.998 that "Words in a statute must not be taken *in vacuo.*" For the application of this cannon in Canada see Dreidger, *supra*, at pp.109-111.

judicial proceedings to be taken by a creditor for the purpose of recovering a claim otherwise provable in bankruptcy. Thus, "other proceeding" would include "*any* act done by authority of a court of law" and "*any* step taken in a cause by either party"

This view is endorsed by the decision in *Re Norris*[110] where the question arose whether an assessment under the *Income Tax Act* contravened s.49 BA [Can] (one of the precursors to s.69(1) BIA [Can.]). The court observed that whilst some part an assessment process may come within the wording of s.49, the assessment complained of was of an administrative nature and not a process to enforce a claim. "It was therefore, not within the meaning of any action execution or other proceeding for the recovery of a claim provable in bankruptcy."[111]

Reconciling "creditor's remedy" with "action execution or other proceedings"

It has been demonstrated that the ordinary meaning of "remedy" would include all judicial proceedings that come within the scope of any "action, execution or other proceeding" If all creditors' remedies available for the purpose of the recovery of a claim provable in bankruptcy are rendered non-existent under the first limb of ss.69(1)(a) and 69.1(1)(a) BIA [Can.] the stay of the exercise of a right which has already been rendered non-existent is superfluous. It has been pointed out that it may be presumed that the Canadian Legislature would not have intended this futile or pointless result. If the apparent anomaly between the two limbs in ss.69(1)(a) and 69.1(1)(a) BIA [Can.] is to be resolved and the second limb considered to have a valid purpose then the species of "remedy" which comes within the second limb must escape nullification by the first. This can only mean that the word "remedy" in each subsection is used in a narrower sense than the one given to it in the preceding paragraph.

If this reasoning is followed remedies which come within the definition of any "action, execution or other proceeding" ought not to come within the scope of the word "remedy" to be nullified by the operation of the first limb of ss.69(1)(a) and 69.1(1)(a) BIA [Can.]. What is stayed under the second limb is only access to judicial proceedings for purpose of recovering a claim provable in bankruptcy. Access to the judicial proceedings for any other purpose ought not to be stayed.

The distinction is admittedly fine. Prior to the 1992 reforms the distinction was wider since "remedy" was not limited to one which would be utilised for the "recovery of a claim provable in bankruptcy" and would have included remedies which did not necessarily result in

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110 (1988) 67 C.B.R. (N.S.) 246

111 *ibid.* at p. 252.

a recovery for the creditor. However even then the courts did not clearly distinguish between "remedy" and "proceedings". In *Vachon v, Canadian Employment and Immigration Commission*,[112] a case arising under s.49(1) BA [Can],[113] the Supreme Court of Canada defined "remedy" broadly and went on to state that the courts have also given a broad interpretation to the stay of proceedings imposed by the section, implying therefore that there was a distinction between "proceedings" and "remedy". However the quotation from the judgement of Tweedie J in *Re Standard Pharmacy Ltd.*,[114] on which the Supreme Court relied to establish the wide interpretation of "proceeding" does not itself adequately distinguish between remedy and proceeding. Tweedie J stated:

> "This section applies to both judicial and non judicial proceedings and distress being a remedy within the meaning of that section, the section is, in my opinion, an absolute bar to any proceedings judicial or otherwise..."[115]

In *Quintette Coal Ltd., v. Nippon Steel Corp.*[116] a case concerning the interpretation of s.11 CCAA [Can.], Gibbs J.A., after quoting from the judgement of Beetz J in *Vachon v. Canada Employment and Immigration Comm.*,[117] said:

> "It must be recognized that s.49 of the Bankruptcy Act is worded differently and includes the word "remedy". However it should also be noted that the paragraph quoted above appears at the end of a section of the judgement entitled "General Nature of Stay of Proceedings Imposed by s.49(1) of the *Bankruptcy Act*" in which no fine distinction is drawn between "remedy" and "proceeding". The emphasis is on the intention of Parliament and the objectives of the statute.

It should be noted however, even though the distinction between the first and second limbs may be described as fine the Canadian Courts have not given any reasons why they have departed from the grammatical and ordinary meaning of the words in these sub-sections since by their interpretation some words have, in effect, been rendered superfluous. It may also be queried whether decisions which interpreted the pre-92-reform provisions have as much weight today since at the time under BA [Can] there was no provision which allowed the stay of secured creditor's rights or restrained the termination of the company's contracts.

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112 23 D.L.R. (4th) 641.

113 R.S.C. 1970, c. B-3.

114 [1926] 2 D.L.R. 300.

115 *ibid.*, at pp.305-6.

116 (1990) 2 C.B.R. (3d) 299 at 312.

117 [1985] 2 S.C.R. 417.

In *Meridian Dev. Inc. v. Nu-West Ltd.,*[118] and *Re Northland Properties Ltd.,*[119] both cases arising under s.11 CCAA [Can.], it was held that the term proceedings should not be restricted to those necessarily involving a court or court official.

The scope of the stay under ss.69(1)(a) and 69.1(1)(a) BIA [Can.]

It is not proposed to identify all the remedies and the proceedings that are affected by these subsections. Primarily the remedy stayed must be exercisable by a creditor, lie against the insolvent person or the insolvent person's property and be exercisable for the recovery of a claim provable in bankruptcy. Likewise only creditors' actions executions or other proceedings for the purpose of recovering a claim provable in bankruptcy are affected by the moratorium. In *Dufferin-Custom Concrete v. Carling/Maplehurst Developments Inc.*[120] the lien claimants in a construction project had served notice of motion requesting the appointment of a trustee under the *Construction Lien Act, (Ontario).* The owner and developer of the project (debtor) filed a notice of intention to make a proposal under BIA [Can.] and a trustee was named. The debtor argued that the lien claimants' motion was stayed by s.69(1) BIA [Can.]. The lien claimants argued that they were not affected by s.69(1) BIA [Can] since they were not creditors within the meaning of the BIA [Can.]. The court however found that the lien claimants' were creditors under BIA [Can.] and that their action was stayed.[121]

This decision appears to give the word creditor the meaning contained in s.2 BIA [Can.]. In fact, as pointed out earlier, the definition in s.2 indicates that a "secured creditor" is a creditor with a claim provable in bankruptcy. However, if s.2 is read with s.127 BIA [Can.] it would seem that a secured creditor is able to prove in a bankruptcy only to the extent that there is a balance remaining after the security has ben realized or that the secured creditor has opted to give up its security for the benefit of the general body of creditors.

In *Textiles Tri-Star Ltée c. Dominion Novelty Inc.*[122] the debtor filed notice of intention to make a proposal and a creditor brought an action for the recovery of unpaid goods delivered within 30 days of the filing of the notice of intention. The creditor argued that it did not require

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118 (1984) 52 C.B.R. (N.S.) 109.

119 (1986) 69 C.B.R. (N.S.) 266.

120 (1994) 22 C.B.R. (3d) 67

121 However, all the parties had agreed that an interim receiver should be appointed under s.47.1 BIA [Can.] to preserve the property and the court appointed the trustee under the proposal to be the interim receiver.

122 (1994) 22 C.B.R. (3d) 213 (C.S.Qué)

the court's authorization to bring the action and that it was subject only to s.81.1(1) BIA [Can.]. Since under ss.38(2) and 81.1(1) BIA [Can.] applied only to goods delivered after 30 Nov 1992, the creditor further argued that s.81.1(1) BIA [Can.] did not apply. It was held that under s.69(1)(a) BIA [Can.] creditors had no remedy against an insolvent person or the insolvent person's property from the time the notice of intention was filed. Since s.81(1) BIA [Can.] did not apply in this case and the creditor had failed to make an application to court under s.69.4 BIA [Can.] for a declaration that s.69(1) BIA [Can.] did not apply, the creditor was subject to the stay.

Contractual and legal self-help remedies arising out of the debtor-creditor relationship between the parties and which authorise the creditor to recover its debt without initiating formal legal proceedings are affected. If the creditor is a bank this ought to include the right to demand repayment,[123] and the right of combination and set-off.[124] Banks may choose to view these as rights and not remedies. But, the exercise of any of these rights in the circumstances of the filing of a notice of intention or a proposal could only be viewed as being for the purpose of remedying the exercising bank's position against the corporation. Notwithstanding the decision in *Dufferin-Custom Concrete v. Carling/Maplehurst Developments Inc.*,[125] referred to above, it is submitted that the right of lien, the right to enforce a security and the right to appoint a receiver[126] stand outside the scope of a "remedy against the insolvent person's property for the recovery of a claim provable in bankruptcy." It may be noted that in the event of a bankruptcy a secured creditor's time honoured right to realising or otherwise dealing with his security during the bankruptcy is not affected.[127]

Forfeiture comes within the realm of self-help remedies.[128] In *Re Westline Ranch*

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123 A bank's right to terminate its agreement with its customer would not be stayed. Contracts may be drafted to terminate automatically on the happening of a given event, such as the filing of a notice of intention or a proposal. However, termination of a contract while it may be a step, is not itself a method of recovering a claim provable in bankruptcy. The fact that s.65.1 BIA [Can.] expressly prevents such an automatic termination would also indicate that such clauses do not come within the ambit of the definition of "remedy".

124 In Canada Insolvency Set Off may be made only if a contractual right exists. See Wood *English and International Set Off*, London, 1989.

125 (1994) 22 C.B.R. (3d) 67.

126 See Salter, R., "Remedies for Banks: An Outline of English Law" and Pennington, R., "Receiverships and Extrajudicial Remedies" in Cranston R., (Ed.) *Banks and Remedies*, London, Lloyds of London Press Ltd, 1992.

127 See s.69.3(2) BIA [Can.].

128 *Ezekiel v. Orakpo* [1977] Q.B. 260.

Ltd.,[129] it was held that the forfeiture of property for the non-payment of taxes under s.38 of the British Columbia Taxation (Rural Area) Act was a "remedy" affect by the old s.69.(1) BA [Can]. However, the same would not appear to apply to distress for rent in arrear which is a common law right of a landlord, now modified by statute[130] since it is not a remedy against the "insolvent person's property" as the ownership in the property does not pass to the tenant. For the same reason, depriving a corporation of the right to use goods under hire or lease by their seizure would not amount to the exercise of a remedy.

A question arises whether arbitration is a contractual remedy caught under the first limb or whether the proceedings which escape its scope should be given a wider interpretation so as to include arbitrations?[131] Every arbitration may not be a creditor's remedy. In some instances it is a procedure available to a party to a contract where there is an arbitration clause, for the settlement of disputes arising out of the contract which do not always give rise to a claim provable in bankruptcy.

If, as has been pointed out, proceedings in equity and at law are outside the scope of the first limb of ss.69(1)(a) and 69.1(1)(a) BIA [Can.], only a limited class of such proceedings would be affected under the second limb, and those too, only in a limited manner. Thus suits in equity, eg: injunctions and specific performance, would appear not to be affected even though brought by a creditor unless they are for the recovery of a claim provable in bankruptcy. The maxims of equity, particularly the requirement that the person who comes into equity must come with clean hands and that which provides that availability of equitable remedies are discretionary would be the only safeguards that a corporation filing a notice of intention or proposal has against such suits.

In theory, proceedings under a petition in bankruptcy should not be automatically stayed.[132] Marantz argues that a bankruptcy petition is not a proceeding for the recovery of a claim provable in bankruptcy but is a proceeding for the benefit of all creditors.[133] This view appears to be correct for winding up and bankruptcy proceedings are not remedies in the hands of an individual creditor for the recovery of moneys due to him but a processes of accounting

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129 [1987] 65 C.B.R. (N.S.) 16 which affirmed 60 C.B.R. (N.S.) 200.

130 See Meehan Dr.E., and Vaartnou P., *Creditor's Remedies in Alberta*, Calgary, Carswell, 1987, p.403

131 In England arbitrations have been held to be proceedings of a quasi-judicial nature.

132 *Re Provincial Refining Co. Ltd.*, (1977), 27 C.B.R. (N.S.) 192.

133 Marantz, G., *supra*, p.45.

assets and liabilities and distributing the surplus first between *all* creditors, subject to priorities, and then shareholders.[134]

Similarly, the tracing of proceeds of an unauthorised disposition of property subject to a simple retention of title[135] clause under a contract of sale will not be stayed as the proceeds are held in trust by the corporation and are not required to be proved as a claim in bankruptcy. It would appear that the same applies to goods subject to an ROT which have not been sold.[136]

In *Dinovitzer v. Weiss*[137] it was held that the old s.69(1) BA [Can] had no effect on an action in which the debtor was the plaintiff. The reasoning in this case should also apply under the new ss.69(1)(a) and 69.1(1)(a) BIA [Can.]. The question arises whether a counter claim, if any, on the part of the defendant to the action is stayed. For the purpose of the principal action although the plaintiff may be the creditor and the defendant the debtor, their roles may be reversed for the purpose of the counterclaim which may also possess all the ingredients of a proceeding for the recovery of a claim provable in bankruptcy. In such circumstances the counter claim is *ipso facto* stayed. The proper course of action for the defendant in such a case would be to make an application to court under s.69.4 BIA [Can.] for a declaration that either ss.69(1)(a) or 69.1(1)(a), BIA [Can.] as the case may be, no longer operates in respect of him on the grounds that he, the defendant, is likely to be materially prejudiced by the continued operation of those sections.[138]

Winroc Supplies Ltd., v. Willows Golf Corp.[139] was a case where lienholders of a corporation had obtained judgements from court, one of which was an order for sale. The issue of the order for sale was adjourned from time to time. After the last adjournment, two other creditors' of the corporation filed a petition for a receiving order but, before the petition for the receiving order was determined, the corporation filed a notice of intention to file a proposal under BIA [Can.]. The court made a receiving order against the corporation and then came to determine the effect of the receiving order and the notice of intention on the lienholders' order

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134 See also Goode, R.M., *Principles of Corporate Insolvency Law,* London, Sweet & Maxwell, 1990, p.12.

135 On Retention of Title, see generally Goode, R.M., *Proprietary Rights and Insolvency in Sales Transactions,* London, Sweet & Maxwell, 1989, Chapter 5.

136 See the definition of property in s.67 BIA [Can.]. See also the judgement in the case of *Vachon v. Canada Employment & Immigration Comm.* (1985) 57 C.B.R. (N.S.) 113

137 (1957) 37 C.B.R. 160

138 s.69.4 (a) BIA [Can.].

139 (1993) 20 C.B.R. (3d) 200, 112 Sask. R. 54 (Q.B.)

for sale. The lienholders argued that the filing of the notice of intention did not affect their right to realize their security by proceeding with the order for sale. The corporation and the creditors argued that the lienholders action was a "continuation of proceedings by creditors" and thus fell within s.69(1) BIA [Can.] and was stayed by the filing of the notice of intention. Since the lienholders' order for sale was granted before BA [Can] was amended the court held that they were not subject to the new stay provisions of BIA [Can.]. Nevertheless the court found that under the old BA [Can] it had the jurisdiction to postpone the right of a secured creditor for a period up to six months.[140] Therefore it postponed the lienholders enforcement for 6 months to give effect to the intentions of the new BIA [Can.].

The stay under ss.69(1)(b) and 69.1(1)(b) BIA [Can.].

Delivery of pledged assets to a lender is now largely limited to the case where assets are paper securities. Borrowers normally retain the use of almost all other types of property, movable and immovable, that are charged. In the case of the floating charge the borrower retains the right not only to use the property charged but also to dispose of it. This right to dispose of assets is central to the floating charge.

In all three jurisdictions under consideration secured lenders have the right to enforce their security without recourse to court proceedings according to the terms of the security agreement. For example, documents creating a security, whether fixed or floating, provide that on the occurrence, singly or concurrently, of one or more specified events, the debtor ceases to have the right to use or deal with the assets secured. Such provisions are essential to make the secured creditor's remedies under the security agreement effective.

While ss.69(1)(a) and 69.1(1)(a) BIA [Can.] have the effect of depriving a creditor of its remedies against a corporation which is an insolvent person for the purpose of recovering a claim provable in bankruptcy, neither section goes so far as to negative any other contractual provision. Thus although a secured creditor may temporarily lose his remedy, the corporation may nevertheless at the same time lose the right to deal with its assets, seriously hampering a rescue of its business.

Consequently in ss.69(1)(b) and 69.1(1)(b) BIA [Can.] it is provided that if, in a security

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140 N.B. It had this right only after the proposal had been approved which in this case was still to take place. In any event, the application of the stay was triggered with the commencement of the proposal procedure and it is submitted that the fact that the order was granted before the amendments were made is irrelevant. If this reasoning were to apply, then any security agreement which came into effect prior to the reforms would not be affected by the stay.

agreement between the corporation and a secured creditor it is provided in substance that on either the corporation's insolvency, or the default by the corporation of an obligation under the security agreement, or the filing by the corporation of a notice of intention under section 50.4, or of a proposal under subsection 62(1) that the corporation ceases to have such rights to use or deal with assets secured under the agreement as it would otherwise have, such provision has no force or effect. The stay lasts under s.69(1)(b) BIA [Can.] until the filing of a proposal under subsection 62(1) BIA [Can.] and under s.69.1(1)(b) BIA [Can.] until the proposal has been fully performed or, alternatively, under either sub-section, until the corporation becomes bankrupt.

The stay under ss.69(1)(c) and 69.1(1)(c) BIA [Can.]

If at the time of filing the Notice of Intention or Proposal the company is a tax debtor under s.224(1.2) of the *Income Tax Act* or under any provincial legislation which is substantially similar to that subsection, the Crown is precluded from exercising its rights under that sub-section in the *Income Tax Act* or under the provincial legislation.[141]

Exceptions where the stay under ss.69(1) and 69.1(1) BIA [Can.] will not apply.

There are no exceptions to the application of the provisions in ss.69(1)(a) and 69.1(1)(a) to unsecured creditors. Thus, such creditors must seek to have the stay lifted under s.69.4 BIA [Can.].

Where secured creditors are concerned however the stays imposed under ss.69(1) and 69.1(1) BIA [Can.] are not all pervading and there are instances where they do not apply.

First, if a secured creditor took possession of secured assets of the insolvent person for the purpose of realization before the notice of intention or the proposal was filed, the provisions in ss.69(1)(b) and 69.1(1)(b) BIA [Can.] do not apply to prevent that secured creditor from dealing with those assets.[142] Secondly, if more than ten days prior to the Notice of Intention or proposal being filed, a secured creditor had given notice of intention under s.244(1) BIA [Can.] to enforce its security against the company it is not precluded from enforcing that security.[143] It has been argued above that, notwithstanding the fact that definition of creditor includes a "secured creditor", the realisation of security by a secured creditor is not a recovery of a claim provable in bankruptcy. But if the wide interpretation given by the Canadian Courts to the stay provisions prevails, the continued realisation of any security and the commencement

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141 ss.69(1)(c) and 69.1(1)(c) BIA [Can.].

142 ss.69(2)(a) and 69.1(2)(a) BIA [Can.].

143 ss.69(2)(b) and 69.1(2)(b) BIA [Can.].

of the realisation of a security under s.244(1) BIA [Can.] would be caught by ss.69(1)(a) and 69.1(1)(a) BIA [Can.]. In any event for the purpose of realisation the secured creditor would have to deprive the company of the right to use the secured property which would be caught by ss.69(1)(b) and 69.1(1)(b) BIA [Can.]. Sections 69(2) and 69.1(2) BIA [Can.] serve to remove any doubt whether the commencement or the continuation of the realisation of security is outside the ambit of the stay..[144]

If the secured creditors holding a particular class of secured claim and to whom the proposal has been made vote for the refusal of a proposal, any secured creditor who holds a secured claim of that class may thereafter realize or otherwise deal with its security.[145] This is not a true exception but a right which arises as a result of the termination of the stay as regards particular creditor. The stay also does not affect secured creditors to whom the proposal had not been made. Such secured creditors may realise or otherwise deal with their security while the stay affects other secured creditors to whom the proposal has been made.[146]

If, after the filing of the notice of intention or the proposal, the company defaults on the payment of any amount that could be subject to a demand under subsection 224(1.2) of the *Income Tax Act* or under any substantially similar provision of provincial legislation which becomes due to the Crown, the stay provided by ss.69(1)(c) and 69.1(1)(c) cease to apply, or terminate, in respect of the Crown. It also terminates if any other creditor is or becomes entitled to realise a security on any property that could be claimed by the Crown exercising its rights under subsection 224(1.2) of the *Income Tax Act* or under any substantially similar provision in provincial legislation.[147]

Termination of certain contracts prohibited

Once a notice of intention or a proposal has been filed in respect of an insolvent company,no person can terminate or amend any agreement with the insolvent company, or claim an accelerated payment under any agreement with that company, on the grounds that the company

144 By the same token it may be argued therefore that these exclusions would not have been necessary if the realisation of a security interest was not stayed under ss.69(1)(a) and 69.1(1)(a) BIA [Can.] and that their insertion indicates that the stay would affect such activity. If so the commencement of the realisation of any security other than pursuant to notice under s.244(1) would be stayed.

145 s.69.1(6) BIA [Can.].

146 s.69.1(5) BIA [Can.].

147 ss.69(3) and 69.1(3) BIA [Can.].

is insolvent or that it has filed a notice of intention or a proposal.[148]

This restriction does not apply in respect of an eligible financial contract, or to prevent a member of the Canadian Payments Association established by the *Canadian Payments Association Act* from ceasing to act as a clearing agent or group clearer for the company in accordance with that Act and the by-laws and rules of that Association.[149] The contracts included by the phrase "eligible financial" contract are set out in 65.1(8) BIA [Can.].[150]

Where an eligible financial contract which was entered into before the company filed a notice of intention or proposal is terminated on or after the filing obligations between the company and the other parties to the eligible financial contract, may be set off in accordance with its provisions, and if net termination values determined in accordance with the eligible financial contract are owed by the company to another party to the eligible financial contract, that other party is deemed, for the purposes of the moratorium provisions in paragraphs 69(1)(a) and 69.1(1)(a) discussed above, to be a creditor of the company with a claim provable in bankruptcy in respect of those net termination values.[151] "Net termination value" is defined as the net amount obtained after setting off the mutual obligations between the parties to an eligible financial contract in accordance with its provisions.[152]

If the agreement is a lease or a licensing agreement, and the insolvent company has not paid rent or royalties, as the case may be, or other payments of a similar nature, in respect of a period preceding the filing of the notice of intention or the proposal a similar stay on termination operates.[153]

Where a company has filed a notice of intention or a proposal, public utilities cannot

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148 s.65.1(1) BIA [Can.].

149 s.65.1(7) BIA [Can.].

150 They include (a) a currency or interest rate swap agreement, (b) a basis swap agreement, (c) a spot, future, forward or other foreign exchange agreement, (d)a cap, collar or floor transaction, (e) a commodity swap, (f) a forward rate agreement, (g) a repurchase or reverse purchase agreement, (h) a spot, future, forward or other commodity contract, (i) an agreement to buy, sell, borrow or lend securities, to clear or settle securities transactions or to act as a depository for securities, (j) any derivative, combination or option in respect of, or agreement similar to, an agreement or contract referred to in paragraphs (a) to (i), (k) any master agreement in respect of any agreement or contract referred to in paragraphs (a) to (j), (l) a guarantee of the liabilities under an agreement or contract referred to in paragraphs (a) to (k), or (m) any agreement of a kind prescribed.

151 s.65.1(9) BIA [Can.].

152 s.65.1(8) BIA [Can.].

153 s.65.1(2) BIA [Can.].

discontinue service to that company by reason only that the company is insolvent or that it has filed a notice of intention or a proposal. Neither can the public utility discontinue services for the sole reason that the insolvent person has not paid for services rendered, or material provided, before the filing of the notice of intention, if one was filed, or the proposal, if no notice of intention was filed.[154]

These stays do not bar a person from requiring payments to be made in cash for goods, services, use of leased or licensed property or other valuable consideration provided after the filing of the notice of intention or the proposal. The fact that an automatic termination clause or acceleration clause has no effect does not mean that the other part to the contract is obliged to continue to advance money or offer credit.[155] It is not possible to override the effect of either of these sections by express agreement.[156]

The court has the power, on an application by a party to an agreement or a public utility, if the applicant satisfies the court that the operation of those subsections would be likely to cause it significant financial hardship, declare that the stay imposed under the relevant subsections do not apply, or apply only to the extent declared by the court.[157]

In *Re Abattoir Coquelicot Inc.*,[158] the trustee of a company which had filed a notice of intention to make a proposal gave its electricity company a letter guaranteeing payment for all services provided after the filing of the notice of intention. Under its by-law the electricity company was entitled to demanded a deposit or a guarantee for a specific amount and it did so. The trustee applied for an order restraining the electricity company from discontinuing the electricity service and a declaration that the guarantee given was sufficient. The court held that BIA [Can.] had priority over the provincial by-law and the application was granted.

Scope of the moratorium where the company is bankrupt

As in Australia, where the commencement of a winding up in insolvency or by court triggers an automatic stay on proceedings in Canada too, a company's bankruptcy automatically triggers a moratorium. The wording of the provisions which imposes the stay in a bankruptcy, follows to some extent the wording in ss.69(1) and 69.1(1) BIA [Can.]. It provides that no

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154 s.65.1(3) BIA [Can.].

155 s.65.1(4) BIA [Can.].

156 s.65.1(5) BIA [Can.].

157 s.65.1(6) BIA [Can.].

158 (1994) 23 C.B.R. (3d) 267 (C.S.Qué).

creditor has any remedy against the debtor company or its property, or is able to commence or continue any action, execution or other proceedings, for the recovery of a claim provable in bankruptcy, until the trustee has been discharged.[159] Unlike in ss.69(1) and 69.1(1) BIA [Can.] a secured creditor is not restrained from realizing or otherwise dealing with its security in the same manner as it would have been entitled to realize or deal with it. The court however has the power to make an order staying secured creditors' rights.[160] This is in marked contrast to the position which prevails in England and Australia where secured creditors' rights are treated as sacrosanct. If the court does make such an order it must not postpone the right of the secured creditor to realize or otherwise deal with its security, except in the manner prescribed by statute.[161]

Thus, if a proposal is made by a bankrupt company or its trustee in bankruptcy a stay against unsecured creditors would already be in place. The filing of a proposal would automatically bring about a stay on the secured creditors as well, provided that the secured creditors would not be able to avail themselves of the exceptions in s.69.1(2) BIA [Can.].

Challenging the stays

Whilst the stays described above are in force they may be challenged under s.69.4 BIA [Can.] and s.50.4(11) BIA [Can.]. Additionally, if the stay applied as a result of s.65.1 BIA [Can.] then the party affected would be obliged to take steps under s.56.1(6) BIA [Can.]. Section 69.4 applies only if the stay which is challenged stemmed from either ss.69, 69.1, or 69.3 BIA [Can.]. In proceedings under s.50.4(11) may be taken only if it is prior to a proposal being filed pursuant to a Notice of Intention.

Challenging the stays under s.69.4 BIA [Can.]

Under s.69.4 BIA [Can.] a creditor who is affected by a stay which takes effect by the operation of either ss.69, 69.1, or 69.3 BIA [Can.] may make an application to court for a declaration that those sections no longer operate in respect of that particular creditor. Where an application is made under s. 69.4 BIA [Can.] the court is required to apply a two fold test and determine whether:

(1) the creditor likely to be materially prejudiced by the continued operation of ss.69, and

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159 s.69.3(1) BIA [Can.].

160 s.69.3(1) BIA [Can.] The rights of secured creditors in this regard are however subject to ss. 79 and 127 to 135 and s.248(1) BIA [Can.].

161 See s.69.3(2) BIA [Can.].

69.3, and

(2) it is "equitable on other grounds" to make the declaration requested.

The court has the discretion to qualify any declaration that it may make under this provision.

"Material prejudice" in s.69.4(a) BIA [Can.] has been described as "an objective prejudice as opposed to an subjective one - i.e it refers to the degree of prejudice suffered vis-à-vis the indebtedness and the attendant security and not to the extent that such prejudice may affect the creditor *qua* person, organization or entity."[162] The creditor should quantify the extent of the prejudice so that the Court can have an idea of the magnitude of materiality. For example, if the security is over a company's accounts receivable, it must be shown that the security over the accounts receivable would be eroded without replenishment by the debtor turning it in to cash to pay operating expenses during the period up to the vote on the proposal. The creditor must make a comparison between the maximum recoverable at the date of the application and the deterioration from that point if the stay is not lifted.

Where it is the creditor's own failure to perfect its legal rights by bringing timely proceedings which results in it being prejudiced by the operation of s.69 BIA [Can.], such prejudice in not "material prejudice" anticipated by parliament. In *Leslie MacIntyre Maritime Associates Inc. v. Zutphen Brothers Construction Ltd.*[163] an unsecured creditor commenced an action in rem one day after an insolvent corporation had filed its notice of intention to file a proposal. The action in *rem* was against three barges actually or beneficially owned by the corporation. If the actions in rem were allowed to continued the creditor concerned would have been placed in a position akin to a secured creditor of the corporation. Section 69 which was triggered by the filing of the notice of intention, had the effect of freezing the unsecured creditor's action. The unsecured creditor sought relief under s.69.4 BIA [Can.] arguing that its action was of a special and unique character and that it should be exempt from the effect of s.69 BIA [Can.]. The court held that the prejudice to the creditor resulted from its own failure and that the facts did not establish that there were "any other grounds" on which the declaration sought should be granted.

Challenging the stays under s.50.4(11) BIA [Can.]

Unlike s.69.4 BIA [Can.], the purpose of s.50.4(11) BIA [Can.] is not to release a single creditor from the application of the moratorium but to abort the procedure under a Notice of

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162 per Farley J in *Re Cumberland Trading Inc.*, (1994) 23 C.B.R. (3d) 225..

163 (1993) 19 C.B.R. (3d) 94. (N.S.S.C)

Intention prior to a proposal being filed. Thus it is not restricted to giving relief to single creditors but all the creditors who are or would be affected by the Proposal. It is clear therefore that it may be used for purposes other than the termination of a stay. Since s.50.4(11) BIA [Can.] may only be utilised prior to the filing of a proposal, it follows that it cannot be used to challenge a stay which takes effect under ss.69.1 or 69.3 BIA [Can.].

The period within which the proposal may be filed may be terminated if either the trustee, interim receiver or a creditor is able to satisfy the court that:

(a) the insolvent person has not acted or is not acting in good faith and with due diligence;

(b) the insolvent person will not be "likely able" to make a viable proposal before the expiration of the period allowed for the filing of the proposal;

(c) the insolvent person will not be "likely able" to make a proposal before the expiration of the period allowed for the filing of the proposal that will be accepted by the creditors; or

(d) the creditors as a whole would be materially prejudiced were the application under this subsection rejected.

Since the provisions are disjunctive it will be adequate if only one of the conditions is established. The benefit of s.50.4(11) is that the applicant has a number of options to choose from and does not have to restrain itself to establishing materially prejudicial conduct. Unfortunately, the courts are yet to develop a uniform method of dealing with applications under s.50.4(11).

In *Re N.T.W. Management Group Ltd.*,[164] a bank sought an order under s.50.4(11) BIA [Can.] terminating the notice of intention. The grounds adduced by the bank were that the companies were not acting in good faith or with due diligence; that it was not likely that the companies would be able to make a viable proposal before the expiration of the period specified by the BIA [Can.]; that it was not likely that the companies would be able to make a proposal before the expiration of the said period which would be accepted by the creditors.

The bank which had served a notice of intention to enforce its security under s.244(1) BIA [Can.] and applied for a receiving order. The day after the bank's notice of intention was served the three insolvent companies filed a notice of intention to make a proposal. Before filing the notice of intention it appears that the companies opened a bank account with a second bank, thus diverting funds otherwise covered by the bank's general security agreement. Whether the new account was opened before or after the Bank served its notice of intention is not clear. In any event the bank moved for the appointment of an interim receiver under s.47.1 BIA [Can.]

164 (1993) 19 C.B.R. (3d) 162 (Ont.Bktcy.)

and the Court appointed the trustee named in the notice of intention to perform that role.

The court found that although the opening of the new bank account and diverting the funds from the bank was certainly an indication of the companies' bad faith, this was done before the filing of the notice of intention to make a proposal. Since the filing of the notice of intention the companies appeared to be acting in good faith. On the facts the officers and principals of the three insolvent corporations were co-operating with the trustee. The court held that there was no evidence that the officers and principals of the insolvent person were not acting in good faith or that *the notice of intention was a sham or filed as a delaying tactic*. There was also no evidence that the proposal would not be filed within the time limit specified under BIA [Can.]. The onus was on the bank "to prove on a balance of probabilities that the insolvent companies will likely not be able to make a viable proposal before the expiration period".

The bank argued that it would not support any proposal put forward by the three companies except a complete discharge of their claims, and therefore the court should terminate the notice of intention. They relied on the judgement of Farley J in *Re Triangle Drugs Inc.* where the procedure was terminated after the proposal had been filed. Chadwick J. distinguished *Re Triangle* on the grounds that in that case the proposal was before court and dismissed the bank's application. In Chadwick J's view the objective of Part III of BIA [Can.] was to give an insolvent person an opportunity to put forward a proposal to its creditors notwithstanding the fact that the objective of s.50.4(11) BIA [Can.] is to terminate the application prior to the expiration of the 30 day period and *prior to the making of the proposal*. This was in fact pointed out by Farley J in *Re Cumberland Trading Inc.*[165]

In *Re Cumberland Trading Inc.*,[166] a secured creditor, Skyview International Finance Corporation (Skyview) demanded repayment in full of the operating finance loan granted to the

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165 (1994) 23 C.B.R. (3d) 225 at pp.230-231. Having agreed with the logic of Mr Justice Chadwick's analysis at p.168 of *N.T.W.*, Farley J said: 'However this analysis does not seem to address the test involved. With respect I do not see this logical aspect as coming into play in s.50.4(11)(c)..." Having cited s.50.4(11)(c) he went on: "It seems to me that clause (c) above deals specifically with the situation where there has been no proposal tabled. It provides that there is no absolute requirement that the creditors have to wait to see what the proposal is before they can indicate they will vote it down. I do not see anything in [C]BIA which would affect a creditor (or group of creditors) with a veto position from reaching the conclusion that nothing the insolvent debtor does will persuade the creditor to vote in favour of whatever proposal may be forth coming. I think that this view is strengthened when one considers that the court need only be satisfied that "the insolvent person will not *likely* be able to make a proposal before the expiration of the period in question, that will be accepted by the creditors..." (emphasis added) This implies that there need not be a certainty of a turndown."

166 (1994) 23 C.B.R. (3d) 225.

debtor Cumberland Trading Inc., (Cumberland) and gave notice under s.244(a) BIA [Can.] of its intention to enforce its security. Two days before the ten day statutory deadline for repayment elapsed Cumberland filed a notice of intention to make a proposal thus bringing about a statutory freeze on Skyview's right of enforcement. Skyview held 95% in value of Cumberland's admitted secured claims and 67% of all claims. At the time the motion was heard, it was not clear whether the creditors would be divided into classes for the purposes of voting on the proposal.[167] Skyview brought motions seeking a declaration that the stay provisions of ss.69 and 69.1 BIA [Can.] no longer operated to prevent it from enforcing its security and a declaration under s.50.4(11) BIA [Can.] that the 30 day period to file a proposal had terminated and for an order allowing a substitution of a trustee. Skyview took the position that its faith and confidence in the management of Cumberland had been irreparably damaged and as such Skyview would not be prepared to vote on any proposal which Cumberland would make. Cumberland relied on the decision of Chadwick J in *Re N.T.W. Management Group Ltd.* which held the it was impossible to make a final determination under s.50.4(11)(c) unless the debtor filed its proposal.

Declining to follow *Re N.T.W*, Farley J observed that s.50.4(11)(c) BIA [Can.] does in fact deal specifically with the situation where there has been no proposal tabled. There is no absolute requirement that the creditors should wait to see what the proposal is before indicating that they will vote it down. No provision in BIA [Can.] affects a creditor (or group of creditors) with a veto position from reaching the conclusion that nothing the insolvent debtor does will persuade the creditor to vote in favour of whatever proposal may be forth coming. The court need only be satisfied that "the insolvent person will not *likely* be able to make a proposal before the expiration of the period in question, that will be accepted by the creditors..." (emphasis added) This implies that there need not be a certainty of a turndown." He was therefore of the view that Skyview's position was adequate proof that Cumberland "will not likely able to make a proposal that will be accepted by the creditors of Cumberland.

Section 50.4(11) BIA [Can.] applies only between the filing of a Notice of Intention and

167 Farley J observed:

"No matter what, Skyview's claim is so large that Skyview cannot be swamped in any class in which it could be put. Clearly Skyview would have a veto on any vote as to a proposal, at least so far as the secured class, assuming that secured creditors are treated as a separate class. This leaves me the interesting aspect that under the BIA regime one could have a proposal turned down by the secured creditor class but approved by the unsecured creditor class and effective vis-à-vis this latter class but with the secured class being able to enforce their security. One may question the practicality [of] a proposal affecting only unsecured creditors becoming effective in similar circumstances to this situation." at p.227.

the filing of the Proposal. BIA [Can.] makes no provision for the termination of the procedure after a proposal has been filed but before it is voted on at the meeting of the creditors. In such circumstances it has been held that one or more creditors, sufficient in number to veto the proposal at the meeting, may persuade the court that the proposal should not await a formal vote but be treated as rejected and that the insolvent person should be adjudged bankrupt.[168] In the event the bankruptcy would date back to the date of filing the notice of intention to make a proposal.

In *Re Triangle Drugs Inc.*,[169] Farley J took the view that for this purpose the court has the power to adopt the principles applicable under the Companies Creditors Arrangements Act described by the Ontario Court of Appeal in *Nova Metal Products Inc., v. Comiskey (Trustee of)*[170] for the purpose of terminating the procedure. Farley J was "convinced upon a review of the BIA today that the philosophy of the CCCAA on this point should be imported into the BIA". Since s.62(2) BIA provides that nothing in the BIA [Can.] shall be deemed to affect the operation of the CCAA [Can.] and the court may order that a proposal made by a corporation pursuant to s.50 BIA [Can.] be taken up and continued under the CCAA [Can.]. The court has the *jurisdiction to transfer a proposal from the BIA [Can.] to an application under the CCAA [Can.].*

The question that arises is whether the court's power to make an order that a proposal made by a corporation under s.50 BIA [Can.] be taken up and continued under the CCAA [Can.] necessarily implies that the philosophy of the CCAA [Can.] should also be imported into the BIA [Can.]. At least one judge of the Ontario General Division in Bankruptcy has opined "The procedure set out in the *Companies' Creditors Arrangement Act* are far different than the procedure in the new *Bankruptcy and Insolvency Act.* Under the CCAA application for the stay must be made to the court. The onus is on the applicant to show that there is some likelihood of success. Under the *Bankruptcy and Insolvency Act* the stay is granted automatically once the notice of intention or proposal is filed."[171]

168 *Re Triangle Drugs Inc.*, (1993) 16 C.B.R. (3d) 1; 12 O.R. (3d) 219 (Bktcy.)

169 (1993) 16 C.B.R. (3d) 1

170 (1990) 1 C.B.R. (3d) 101. See also *Bargain Harold's Discount Ltd. v Paribas Bank of Canada* 10 C.B.R. (3d) 23. (Ont Gen. Div), *Re Perkins Holdings,* 6 C.B.R. (3d) 299 (Ont.Gen.Div.), *Ultracare Management Inc. v. Gammon* 1 O.R. (3d) 321 (Gen Div). *Nova Metal Products (supra)* has however been distinguished by the British Columbia Court of Appeal in *Re Philips Manufacturing Ltd.*, 9 C.B.R. (3d) 25 and not followed by the Saskatchewan Queen's Bench in *Re Norm's Hauling Ltd.*, 6 C.B.R. (3d) 16.

171 per Chadwick J. in *Re N.T.W. Management Group Ltd.*, (1993) 19 C.B.R. (3d) 162 at 167.

THE MORATORIUM IN AN ENGLISH ADMINISTRATION

Perhaps the most important feature of the English Administration procedure from the standpoint of keeping the business of the company going is the statutory moratorium. The Cork Committee in the course of recommending the new Administration Order Procedure dealt with the subject of the moratorium only in the briefest of terms.[172] It was the British Government which gave body to the Cork Committee's proposals on the moratorium.[173] The Government in its White Paper was of the view that, owing to the moratorium provisions, the English Administration procedure would, in appropriate circumstances, provide a more effective method of achieving a rehabilitation or reorganization of a company than a receivership.[174] The Cork Committee had recommended that even in the case of receiverships there should be a stay on the rights of certain secured creditors.[175] But the Government rejected this proposal observing that only a court appointed official, obliged to act in the interests of all creditors and shareholders, should enjoy this protection.[176] The Government's denial of the benefit of a moratorium even to an Administrative Receiver, who under IA 1986 [U.K.] was required to be a licensed insolvency practitioner,[177] demonstrates that any interference with the rights of creditors' is viewed most seriously and should be carried out only under the supervision of an officer of the Court.[178]

Duration of the two stage moratorium in an English Administration

The moratorium in an English Administration may be described as applying in two stages. The first stage comes into force on the filing of the petition for the administration order and lasts until the order is made or the petition is dismissed.[179] For convenience, this stage of the moratorium will be referred to hereafter as the "pre-order moratorium". It comes into force automatically, and unlike in schemes of arrangement in Canada and Australia no special court order is required to trigger it. If an administration order is made, the pre-order moratorium

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172 *Cork Report*, paras.516 and 517.

173 *A Revised Framework for Insolvency Law*, Cmnd.9175, London, HMSO, 1984, para 32.

174 *ibid.* para.33.

175 *Cork Report*, para 516.

176 *Revised Framework Of Insolvency Law, supra*, para 34.

177 s.388(1)(a) IA 1986 [U.K.].

178 Contrast this with the position under the Australian Statute where the Administrator is not a Court official. Also compare the position of a Supervisor in a CVA.

179 s.10(1) IA 1986 [U.K.].

terminates automatically but one which is wider in scope immediately applies. Again, for convenience, this stage of the moratorium will be referred to hereafter as the "post-order moratorium". The post-order moratorium is a corollary of the administration order and no specific order imposing the moratorium is required. Since the post-order moratorium is wider it encompasses everything covered by the pre-order stay. The transition from one stage to the other, although demarcated by the Order, is smooth and without any hiatus.[180] The post-order moratorium lasts for the duration of the administration order[181] which is from the moment the order is made until the order is discharged.[182]

It may be noted that this two stage moratorium was not envisaged at the time the Cork Committee's and the British Government's proposals on the moratorium were being made. The Government in its White Paper only identified a moratorium which would bite on the appointment of the administrator.[183]

The stay against winding up the company

One aspect of the moratorium is directed towards preserving the company as a legal entity and preventing the cessation of its business and the drastic loss in going concern value which is triggered by the commencement of a winding up. Thus, no resolution can be passed nor can an order made for the winding up of the company. However at the pre-order stage this does not affect the right a person may have to present a petition to wind up the company.[184] The preservation of this right is important, since a winding up by court commences from the date the petition is presented. Thus, although at this stage both a members' and a creditors' voluntary winding up[185] is completely stayed, only the court's power to make a winding up order is restrained.[186] The presentation of a petition for winding up and its subsequent advertisement could nevertheless damage the prospects of a petition for administration succeeding and therefore

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180 This may be compared to the moratorium which applies under Notice of Intention to make a Proposal in Canada and its transition where a Proposal is made.

181 s.11(3) IA 1986 [U.K.].

182 s.18(2) IA 1986 [U.K.].

183 See *A Revised Framework for Insolvency Law*, Cmnd.9175, London, HMSO, 1984, para 32.

184 See s.124(1) IA 1986 [U.K.].

185 There can be prospect of a members' voluntary winding up in the circumstances since an English Administration pre-supposes insolvency or the likelihood of insolvency and a members' voluntary winding up requires a declaration of solvency to be made by the directors.

186 ss.10(1)(a) and 10(2)(a) IA 1986 [U.K.].

the court may restrain the advertisement of the winding up petition.[187]

Once the administration order has been made, any petition which has been presented to wind up the company is required to be dismissed.[188] At this point the right to present a petition for winding up, comes to an end since it would constitute a commencement of proceedings against the company.[189] The *Cork Committee* was of the view that while a creditor should not be denied the right to make an insolvency application after an administrator had been appointed, the court should when making the administration order also direct that no insolvency application should be made without the leave of court.[190] Although the court is not required to make such a direction under IA 1986 [U.K.] any person, who has standing, and is desirous of presenting a winding up petition may seek leave to do so from the administrator or the court.[191]

Enforcement of security over the company's property restrained

Whereas the stay of both voluntary and compulsory winding up is adequate to ensure a company's continued existence as a legal entity immediately prior to and during the administration, its business and going concern value will not be adequately preserved unless the expropriation of its property, however lawful or equitable, is not prevented. Therefore the next aspect of the moratorium, which applies during both the pre and post-order stages and is enumerated in what may be described as the first limbs of ss.10(1)(b) and 11(3)(c) IA 1986 [U.K.], is directed at preventing secured creditors from taking any steps to enforce any security over the company's property without the consent of the administrator or the leave of court.[192]

The incorporation of this provision in IA 1985 [U.K.] and into the consolidation of that statute the year after may be considered a milestone in the history of English insolvency law. Traditionally, English Law has jealously guarded the position of the creditor with security over a company's property. During the 141 year history of company law up to the year 1985, no provision had been enacted which prevented a secured creditor of a company from exercising its rights when the company was insolvent. The *raison d'être* for according a protected and privileged status to secured creditors in a liquidation is succinctly put by Professor Roy Goode:

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187 *Re A Company (No.001992 of 1988)* [1989] BCLC 9, (1988) 4 BCC 451 (sub nom *Re Manlon Trading Ltd*)

188 s.11(1)(a) IA 1986 [U.K.].

189 s.11(3)(d) IA 1986 [U.K.].

190 *Cork Report*, para.517.

191 s.11(3)(d) IA 1986 [U.K.].

192 See 6.5.5 below on "Challenging the moratorium in an English Administration."

> "In policy terms, the secured creditor is accorded priority because he bargained for it; other creditors who chose to lend unsecured cannot complain of their subordinate position."[193]

This milestone was reached in 1985 as a result of the Government adopting the Cork Committee's recommendation that a "twelve month prohibition on certain secured creditors realising their security except by agreement or with the leave of the Court, following the appointment of a receiver and manager under a floating charge" should also apply in the case of an administration.[194] Significantly, and as noted previously above, the Government rejected this recommendation so far as it applied to administrative receivership but accepted it for the purpose of administration.[195]

The key words in the provisions which impose the stay during both stages of the moratorium are "security" and "company's property". In relation to England and Wales, security is defined in IA 1986 [U.K.] as any mortgage, charge, lien or other security.[196] The same provision defines a secured creditor of a company as a creditor who holds in respect of his debt a security over property of the company.[197] It should be noted however, that although business men, together with their lawyers, have devised agreements whereby creditors are given security[198] in the broad sense of the word, not all such creditors or agreements come within the definition of "secured creditor" or "security" above.

The first criterion to be satisfied is that the security must lie "over the company's property". This phrase is open to two constructions. One narrow, the other wide. The narrow construction would limit it to property over which the company has legal title. The wider interpretation includes all beneficial interests held by the company. Discussing the nature of

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193 Goode., Professor R.M., *Principles of Corporate Insolvency Law, supra,* p.75.

194 *Cork Report*, para.516.

195 *A Revised Framework for Insolvency Law* DTI Cmnd., 9175 1984, para.34.

196 s.248(b)(i) IA 1986 [U.K.]. In relation to Scotland means any security (whether heritable or movable), any floating charge and any right of lien or preference and any right of retention (other than a right of compensation or set off).- s.248(b)(i) IA 1986 [U.K.].

197 s.248(a). IA 1986 [U.K.].

198 The term security has a double reference, first to security in fact, the kind of "security" provided by a credit investigation of the person to whom credit is extended, by regular business usages and so on; second, and most important for our purposes, the "security" taken by the person extending credit, in the form of collateral to protect him against the contingency of something going wrong with the transaction, principally the borrower's insolvency." See Gilmore G., Alexrod A., "Chattel Security" 57 *Yale Law Journal* 517 at 517 ft.n. 1. citing the Report of the Committee on a Uniform Chattel Mortgage Act of the United States.

assets held by the company for the purpose of distribution in a winding up, Professor Goode writes:

> "The assets of a company in liquidation, like those of a solvent company, are not confined to physical things or to things which are fully owned by the company. *Any beneficial interest held by the company, whether in tangible or intangible property and whether full or limited, indefeasible or defeasible, held absolutely or held by way of security constitutes an asset.* Thus the company's assets may include freehold or leasehold property, goods owned by the company, possession of goods under a lease or hire-purchase agreement, negotiable instruments held by the company, intellectual property rights, contract rights and security interests in tangible or intangible property owned by another. But the company must hold the beneficial interest. Assets beneficially owned by others to which the company has a bare legal title are not available to its creditors."[199] (italics added)

Based on Professor Goode's definition the beneficial interest a company has in any property or goods held by it under a hire-purchase, conditional sale or chattel leasing agreement would constitute property of the company.[200]

The wider construction of "property" has been adopted by the Court of Appeal in *Re Paramount Airways (Bristol Airport plc & Anor v. Powdrill & Ors)*[201]. Two airports, as creditors of a company which was a charter airline operator were statutorily entitled to a lien over property of the company for un-paid airport charges. The airports sought leave to enforce their lien over aircraft leased by the operator from a third party. Browne-Wilkinson LJ formed the view that the lessee had an equitable interest in a leased aircraft which was specifically enforceable in equity against its owner, the third party. That interest came within the definition of property in s.436 IA 1986 [U.K.] because that definition included "every description of interest, whether present or future vested or contingent arising out of incidental to property". Since "lien" was a "security" within the meaning of s.248 IA 1986 [U.K.] the creditors in that case were was entitled seek leave under s.11(3)(c) to enforce their "security".

Doubts have been expressed as to whether this decision of the Court of Appeal will find favour with the House of Lords.[202] Clearly the question that needs to be answered is whether it is appropriate within the context of ss.10(1)(b) and 11(3)(c) IA 1986 [U.K.], to give the word property the full meaning contemplated by s.436 IA 1986 [U.K.]. Attention may be drawn to the fact that s.436 begins with the customary *caveat* "except in so far as the context otherwise

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199 Goode., Professor R.M., *Principles of Corporate Insolvency Law, supra,* p.45.

200 N.B. the creditor in each of these transactions retains legal title to the property.

201 [1990] Ch. 744, (1990) BCC 130.

202 See Totty, P., and Jordan, M., *Insolvency,* (Revised) Longman, C5.06.

requires". Therefore, unless it can be shown that the context within which the word "property" is placed in ss.10(1)(b) and 11(3)(c) demand that it be given a narrower interpretation than that given in s.436 it must be concluded that the creditors in *Re Paramount* had a security which came within the scope of s.11(3)(c) IA 1986 [U.K.].

Whether or not the wider construction of property applies depends, in turn, upon the meaning that may be attributed to the word "security" since that is the most important word in the company of which "property" is found in ss.10(1)(b) and 11(3)(c). In *Re Paramount* the airports were entitled to a statutory lien, and "lien" lies comfortably within the definition of "security" in s.246 IA 1986 [U.K.]. But can the same be said of other rights over "every description of interest, whether present or future vested or contingent arising out of incidental to property" which the company may have? Could such rights be called a "security"? For example if the wider definition of "property" is employed, a company's interest in property held by it under a hire-purchase or conditional sale agreement would undoubtedly be sufficient to make that property the "company's property" for the purpose of ss.10(1)(b) and 11(3)(c) notwithstanding the fact legal title has not passed to the company. In this event would the hirer's or seller's right under the relevant agreement to recover the property and thereby withdraw the beneficial interest in it from the debtor be equivalent to a security over property of the company for the purpose of ss.10(1)(b) and 11(3)(c) of the Act.

The words mortgage, charge and lien which precede the words "other security" are all legal terms with specific legal meaning. Consequently, according to established principles of statutory interpretation, the phrase "other security" ought to be construed *ejusdem generis* with the words "mortgage, charge, lien". In establishing the *genus* of these words, one common feature is that they are each one of the four types of consensual security known to English Law. The fourth being the pledge. If consensual security was the *genus* then "other security" would be restricted to the pledge. This interpretation, although theoretically sound would not be appropriate in the circumstances since it would exclude other types of security known to law such as the statutory lien.[203]

The other common feature in the words "mortgage, charge and lien is that in each of them gives rise in law to a security interest. That is the creditor has a right in the property of the debtor to secure performance by the debtor or a third party. Each of them satisfy all the requirements of a security interest. A security interest:

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203 Recognised by the Court of Appeal as a "security" within the terms of s.11(3)(c) in *Re Paramount supra.*

"(1) must arise from a transaction intended as a security;
(2) is a right in *rem*;
(3) is created by grant or declaration of trust, not by reservation;
(4) if fixed or specific implies a restriction on the debtor's dominion over the asset;
(5) cannot be taken by the creditor over his own obligation to the debtor"[204]

Agreements which do not give rise to a security interest in law are termed quasi-security devises.[205] If an agreement giving rise to a security interest was the *genus* then "other security" in s.248 IA 1986 [U.K.] would be restricted to such agreements. Thus in the case of creditors under hire-purchase, conditional sale and chattel leasing agreements referred to above do not come within the scope of ss.10(1)(b) and 11(3)(c) because neither of these agreements satisfy the third criteria of a security interest. Each is created by reservation and not by grant or declaration of trust.[206]

Further, it would appear that Parliament did not intend that a creditor's rights under a hire-purchase, conditional sale or chattel leasing agreement should be restricted under the first limb of ss.10(1)(b) and 11(3)(c) since such agreements are in any event specifically restrained by the second limb of those two sections.

Prima facie it appears that the conclusion reached in *Re Paramount* gives rise to contradictory results in that case as regards the airports and the lessor of the aircraft. As far as the airports are concerned, their right to exercise a statutory lien accrues because the company has a beneficial interest in the leased property which makes the leased aircraft the property of the company. Thus, their rights are stayed under the first part of ss.10(1)(b) and 11(3)(c). As far as the lessor of the airport is concerned its rights are affected not under the first but under the second limb of ss.10(1)(b) and 11(3)(c). Under the second limb the aircraft would not constitute the "company's property" but "goods in the company's possession" the proprietary rights for which are with the lessor. The company would only have a beneficial interest in using the property by paying the lease rental or, if the lease is a finance lease, of eventually acquiring title

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204 See Goode, Professor R.M., *Legal Problems of Credit and Security* 2nd Ed, London, Sweet and Maxwell, Centre for Commercial Law Studies, 1988, p.1.

205 See generally Goode, R.M. *ibid, supra.*

206 Oditah takes an opposite view to Goode and argues that the four criteria set out by Goode are not necessarily pre-requisites for the creation of a security interest particularly the requirement identified by Goode that the security interest it should be created by grant and not by reservation. One of the determining factors identified by Oditah is the existence of the equity of redemption. See *Legal Aspects Of Receivables Financing*, London, Sweet and Maxwell, 1991, p.7. It is submitted however that in a hire-purchase, conditional sale or chattel leasing the debtor has no equity of redemption for the simple reason that no property or right was ever given away to be redeemed.

after paying off the loan in the form of rental payments.[207]

A broad view of the statutory provisions was also taken in *Exchange Travel Agency Ltd v. Triton Property Trust Ltd.*[208] Harman J took the view that a landlords right or re-entry for the non-payment of rent was a "security" and therefore stayed by the operation of s.11(3)(c) IA 1986 [U.K.]. Whilst there is judicial dicta to the effect that the forfeiture clause in a tenancy agreement is given as security, the word security is not used in the same sense as in s.10(1)(b) and s.11(3)(c) IA 1986 [U.K.].[209]

Floating charge holders exempt from the pre-order moratorium.

One category of secured creditor unaffected by the stay on the enforcement of security during the pre-order moratorium. During this stage of the moratorium there is no restriction against the holder of a floating charge appointing an administrative receiver.[210] Indeed as has been seen above[211] the appointment of an administrative receiver makes it incumbent upon the court to dismiss the petition for administration unless the floating charge under which the administrative receiver was appointed may be impeached.[212] But if the court decides to make an administration order in spite of an administrative receiver being appointed, the administrative receiver must vacate office.[213]

IA 1986 [U.K.] further specifically provides that once the administration order has been made an administrative receiver cannot be appointed.[214] It appears that if not for the exception provided in s.10(2)(b) IA 1986 [U.K.], a floating charge holder's right to appoint an administrative receiver would be stayed under s.10(1)(b) which in turn restrains the enforcement of any security over the company's property. Therefore it ought, in principle, to be adequate if it had merely been provided that any administrative receiver who had been appointed should vacate office, without going on to specify in s.11(3)(b) that no administrative receiver may be appointed while the administration order is in force. Such an action would come within the scope

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207 See Turing, D., "Creditors' Remedies in Insolvency" [1994] *2 JIBL* 46. See also *Transag Haulage Ltd., v. Leyland DAF Finance plc and Anor.* (1994) BCC 356.

208 (1991) BCC 341.

209 See Turing, D., "Creditors' Remedies in Insolvency" *supra.*

210 ss.10(3)(b) and 10(3)(c) IA 1986 [U.K.].

211 See the discussion in Chapter Four *supra.*

212 s.10(2)(b) and s.9(3) IA 1986 [U.K.].

213 s.11(1)(b) IA 1986 [U.K.].

214 s.11(3)(b) IA 1986 [U.K.].

of s.11(3)(c) which is identical in terms to s.10(1)(b).

Repossession of goods in the company's possession restrained

The second limbs of ss.10(1)(b) and 11(3)(c) IA 1986 [U.K.] go on to restrain any steps being taken to repossess goods in the company's possession under any "hire purchase agreement" without the administrator's previous consent or the leave of court. "Hire purchase agreement" in the context of a moratorium includes conditional sale agreements, chattel leasing agreements and retention of title agreements.[215] These restraints are designed to prevent the company loosing the use of property it uses in the daily running of its business.

The key words in this part of the section are "goods in the company's possession". So long as the goods are physically in the company's possession there is little difficulty. The position becomes more complex where for example the company has sub-leased goods leased by it. Would such property still be construed as being in its "possession"? In *Re Atlantic Computer Systems plc*[216] the English Court of Appeal emphatically answered this question in the affirmative. The company Atlantic Computers had sub-leased a large number of computers for which it had obtained lease financing from two lenders. The lenders wished to recover the computers from the end-users and argued that the computers were not in the company's possession since they had been delivered to and were on the premises of the sub-lessees. The court held that although the computers were with the end users they were still in the company's possession. Nevertheless leave was granted to the head-lessors to recover the computers.

Seeking leave from the court to recover one's own property is a costly exercise. Thus, in *David Meek Plant Ltd., v. David Meek Access Ltd.,* an attempt appears to have been made to make the goods cease to be goods in the company's possession "under a hire purchase agreement" by means of an automatic termination clause which terminated the "hire-purchase agreement" when the company went into administration. The court held that, except where notice for recovery had been served on the company, despite the termination of the "hire-purchase" agreement the property remained "goods in the company's possession under a hire purchase agreement". Thus the hirer's action to recover the property was stayed by s.11(3)(c) IA 1986 [U.K.] and leave was necessary.

Commencement and continuation of "proceedings, execution and other legal process" restrained

Finally, it is provided that except with the leave of court and subject to such terms as may

215 ss.10(1)(b) and 10(4) IA 1986 [U.K.].

216 [1992] 1 All ER 476 C.A.

be imposed by it, no other proceeding, execution or other legal process may be commenced or continued and no distress may be levied against the company or its property.[217]

Although ss.10(1)(c) and 11(3)(d) IA 1986 [U.K.] are *prima facie* framed in wide terms and appear applicable to *any* other proceedings against the company s.11(3)(c) IA 1986 [U.K.] has received a restrictive interpretation. In a Scottish case, *Air Ecosse Ltd, v. Civil Aviation Authority*,[218] three Lords of the Court of Session, Inner House unanimously agreed with the decision of the Lord Ordinary that the word "proceeding" should be construed strictly and limited to proceedings taken by a person in the capacity of a creditor. Lord McDonald reasoned that:

> "section 11(3) of the Act of 1986 is confined to the activities of creditors of the company subject to the administration order and that it does not extend beyond that to courses of action which may be open to persons who are not creditors, e.g. competitors under a different statute. It seems to me that sec. 11(3)(a)-(c) disclose a *genus*, viz. creditors of a company subject to an administration order, whose rights as creditors are to be restricted , and the use of the word 'other' in sec.11(3)(d) is simply to bring within that *genus* those *species* of creditor who complete the *genus* but who have been omitted in the earlier paragraphs. In this connection I have found assistance from the clear exposition of the *ejusdem generis* rule contained in the speech of Lord Diplock in Quazi v. Quazi [1980] A.C. 744, at 807 et seq." (Underlining added.)

A close scrutiny of s.11(3) shows that the application of the *ejusdem generis* doctrine may not be as appropriate as may appear at first blush. Dreidger states that unless there is a common category into which all the preceding specific words fall there is no room for the application of the *ejusdem generis* doctrine.[219] Thus, if it can be shown that persons other than a species of creditor are affected by s. 11(3) then the *ejusdem generis* doctrine ceases to apply.

Subsection 11(3)(a) prevents the winding up of a company either voluntarily or by court. The interpretation given in this case was that because the making of an administration order presupposes insolvency on the part of the company a members voluntary winding up is in effect impossible because of the inability on the part of the directors to make a declaration of solvency. Thus the only remaining method of voluntary winding up is the creditor's voluntary winding up which is stayed. The other "person" who is affected by s. 11(3)(a) is a court faced with a winding up petition and it is the power of the court which is stayed. Even if one were to look

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217 s.10(1)(c) IA 1986 [U.K.].

218 (1987) 3 BCC 492.

219 Dreidger E.A, *Construction of Statutes*, (2nd Ed.), Toronto, Butterworths, 1983, p.112. Dreidger's formulation of the *ejusdem generis* doctrine is also cited by Cross in *Statutory Interpretation,* (2nd Ed.), London, Butterworths, 1987, p.132. See also Bennion F., *Statutory Interpretation* Butterworths, London, 1992.

behind the winding up order and at the persons able to present a petition for one, creditors are not the only category of persons who are able to do so. The company, the directors, a contributory or contributories and the Secretary of State may in addition to creditors present a petition for the winding up of the company.[220] This helps to reinforce the argument that although winding up may be resorted to by creditors, it is strictly not a means of debt recovery. It is a process of accounting and distribution between creditors and shareholders alike.

The stay imposed under s. 11(3)(b) is as pointed out by the Inner House restricted to one class of creditor, namely the floating charge holder. S. 11(3)(c) also affects present and contingent creditors. However, it may be argued that the rights affected by the second limb of s. 11(3)(c) are rights accruing to that party *qua* owner and not *qua* creditor/contingent creditor.

A fortiori, it may be argued that the persons affected by s. 11(3)(a)-(c) IA 1986 [U.K.] are not species of a single *genus* and thus a fundamental requirement of the *ejusdem generis* doctrine is not fulfilled. The use of the word 'other' in sec.11(3)(d) IA 1986 [U.K.] does not simply to bring within that *genus* those *species* of creditor who complete the *genus* but who have been omitted in the earlier paragraphs but another category of person or persons which may or may not be limited to creditors. It is submitted, therefore, that the words "other proceedings" in s. 11(3)(d) IA 1986 [U.K.] should be construed without resorting to the *ejusdem generis* rule.

Their Lordships were also reluctant to consider the proceedings in question to be stayed because of an apparent conflict between CAA's public duties, and the private interests of the company under administration. It was conceded that the proceedings by the CAA could not be stayed on these grounds unless a narrow construction was given to s. 11(3)(d).[221] The moratorium imposed under s.11(3)(d) IA 1986 [U.K.] is part of a statutory scheme enacted to promote the rescue and rehabilitation of companies which in the eyes of the Cork Committee was in the Public interest. But no reasonable person could expect or require gains in the nature of those achieved from the rehabilitation of a company to take precedence over public safety. This reason alone should be sufficient to allow the continuance of the proceedings before the CAA if legitimately commenced.[222]

The proceedings in this instance however, were commenced not by the CAA itself but

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220 ss.124(1) and 124(4) IA 1986 [U.K.].

221 *ibid,* at Per Lord McDonald at p.495.

222 Lord Mc Donald opined that having once granted a licence, they [CAA] would not be able to revoke it unless there had been some material change in the circumstances under which it was first given. p.494

British Airways who sought to have the company's licence revoked and a licence granted to itself for that route. Thus the proceedings were brought not in the interest of the public but in British Airways' own self interest. It was conceded that it was unlikely that the service could be run by more than one operator. It is submitted that while it is important that the rights of Public Authorities in certain circumstances should not be stayed, a competitor of a company in administration should not be able to take advantage of its [the company's] weakness to obtain a commercial advantage for itself. For these reasons the judgement in *Air Ecosse* should not be considered in limiting the construction of "other proceeding" in s. 11(3)(d). At least one judge of the High Court in England, namely, Mr Justice Harman in *Re Paramount Airways*[223] has expressed reservations about the reasoning of the Scottish Inner House in *Air Ecosse Ltd, v. Civil Aviation Authority.*[224]

Totty and Jordan[225] query whether a prosecution by the Crown or a non Crown authority which may result in the imposition of a fine is a proceeding affected under s. 11(3)(c). If the reasoning in *Air Ecosse v. CAA* is followed it is unlikely that it would be so long as the prosecution is not commenced in the capacity of a creditor. Even if, as suggested above, the reasoning in *Air Ecosse* were not followed, proceedings of a punitive nature[226] by the Crown or Public Authorities should not be stayed. In determining the scope of "other proceedings" it is the *nature* of the proceedings which must be considered and not the nature/capacity of the *person* bringing the proceedings.

In addition to holding that a Landlord's right of re-entry is a "security" within the terms of ss.10(2)(b) and 11(3)(c) IA 1986 [U.K.], Harman J., in *Exchange Travel Agency Ltd v. Triton Property Trust Ltd.*[227] took the view that it also constituted the commencement of "other legal process" which was stayed under ss.10(2)(c) and 11(3)(d) IA 1986 [U.K.]. In *Re Olympia and York Canary Warf Ltd.,*[228] Millett J., declined to follow this decision of Harman J., taking the view that "legal process" required the "assistance of court".

223 (1990) BCC 130 at 137 and 138

224 *supra.*

225 Totty and Jordan *Insolvency Law, supra,* c.5.06.

226 Other than for punitive damages.

227 (1991) BCC 341.

228 (1993) BCC 154.

The effect of administration on the company's contracts

The making of an administration order does not affect contracts entered into by the company unless the contracts themselves expressly provide for some consequence to follow.[229] In *Re David Meek Plant Ltd; Re David Meek Access Ltd*[230] Judge Weeks Q.C held that an automatic termination clause in a hire-purchase agreement which was triggered by the drafting or presentation of a petition for an administration order did not relieve the hirers of the requirement to obtain leave to repossess the goods except where attempts to repossess the goods had been made before the petition was presented. One of the issues was whether the goods sought to be recovered continued to be "goods in the possession of the company under a hire-purchase agreement" notwithstanding the termination of the contracts.

Challenging the moratorium in an English Administration

Not every aspect of the moratorium in an English Administration may be contested. There are no exceptions in IA 1986 [U.K.] under which, during the period the moratorium applies, a resolution to wind up the company may be passed or the court may make a winding up order. Thus the restriction under ss.10(1)(a) and 11(3)(a) is absolute. However, as pointed out above, during the pre-order moratorium there is no restriction on a persons right to present a petition to wind up the company.[231] No prior leave of court need be obtained for this purpose.[232] Where such a petition for winding up is presented, the petitioner is clearly disputing the propriety of the making of an administration order. As Sealy and Milman[233] point out, the court should be able to combine the hearing on the two applications provided it first gives leave for the winding up proceedings to continue under s.10(1)(c) IA 1986 [U.K.].[234]

In the period between the presentation of the petition for administration and the making

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229 See Goode, R.M. *Principles of Corporate Insolvency Law*, p.129; *Astor Chemicals Ltd v. Synthetic Technology Ltd*, (1990) BCC 97, [1990] BCLC 1 and *Re P&C and R&T (Stockport) Ltd*, [1991] BCC 98 at 104(D-E).

230 [1994] 1 BCLC 818.

231 This right is expressly protected under s.10(2)(a) IA 1986 [U.K.].

232 After the administration order has been made, the presentation of a petition would be restrained under s.11(3)(d) as a "proceeding... or other legal process" against the company.

233 Sealy, L.S. and Milman D. *Annotated Guide to the Insolvency Legislation*, 4th Ed, 1994, CCH Editions, p.51.

234 Although the right to present a petition is expressly excluded from the stay under s.10(2)(a) IA 1986 [U.K.] the right to hear the petition would be caught by the stay against the continuation of "proceedings" against the company.

of an order, the holder of a floating charge over the company's property, if any, has the right to appoint an administrative receiver and bring the pre-order moratorium, as it affects other creditors, to an end. The appointment of an administrative receiver however is not strictly a challenge to the pre-order moratorium since the rights of the floating charge holder are not affected by the stay. Thus the appointment of an administrative receiver at this stage should be viewed as an exercise by the charge holder of its equitable rights under the charge. Once the order has been made, however, the stay on the floating charge holder's right to appoint an administrative receiver becomes absolute.[235] There is no provision under which the charge holder may seek the permission of the administrator or the leave of court to exercise this particular right. All other rights which come within the scope of "enforcement" rights which do not involve the appointment of an administrative receiver would only be stayed under s.11(3)(c) IA 1986 [U.K.]. In *Re Meesan Investments Ltd.*,[236] however, the debenture holder had the right to appoint an administrative receiver before the making of the administration order but did not do so because he was happy with the proposals presented at the time of the petition. Around ten months after the administration order had been made the administrator had achieved the purposes set out in the administration order and the secured property had not been sold. The debenture holder found the debt owing to him increasing and the value of the security decreasing and sought leave to enforce the security. The administrator argued that there was good reason for the delay and that leave to enforce the security should be given to the debenture holder only if there was criticism for the manner in which the administration had been handled. The court found that it could grant leave to enforce a security even where there had been no criticism of the administrator's conduct of the administration and held that the decision would be based upon balancing the interests of the unsecured and secured creditor.

As regards all other species of stay restrained under ss.10 and 11 IA 1986 [U.K.], the consent of the administrator or the leave of the court must be obtained before exercising any statutory or contractual rights and not thereafter. In *Re Atlantic Computer Systems Plc*,[237] the Court of Appeal made a number of important general observations in relation to the granting of leave to creditors to exercise proprietary and security rights against the property of the company in administration.

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235 s.11(3)(b) IA 1986 [U.K.].

236 (1988) 4 BCC 788

237 (1990) B.C.C. 859.

Having compared the stay which applies in the event of a winding up by court it was concluded that in such cases the instances in which the court granted leave for the affected party to proceed had hardened into a set practice. Where the company is in possession of property owned by another leave is granted as of right. Nicholls LJ observed:

> "Whether those whose land or goods are being used by the company during this interim period should be given leave to enforce their proprietary rights forthwith or should be paid ahead of everyone else must depend on all the circumstances, which will vary widely from one case to the next. We do not think that Parliament intended, for example, that if a company's factory or offices are leasehold, and the administrator continues to carry on the business on those premises, the court as a matter of course would always give leave to re-enter, or to distrain in respect of rent accruing from the date of the administration order, or make a direction for payment of the rent in full as an expense of the administration. Likewise in respect of vehicles or machinery which are in the company's possession under hire-purchase agreements and which are being used by a company in the course of carrying on its business. Parliament must have intended, for instance, that, in appropriate circumstances, and for a strictly limited period, such a lessor or owner of goods might not be given leave if giving leave would cause disruption and loss out of all proportion to the loss which the lessor or the owner of goods would suffer if leave were refused. Indeed, Parliament must have intended that when exercising its discretion the court should have due regard to the property rights of those concerned. But Parliament must also have intended that the court should have regard to all the other circumstances, such as the consequences which the grant or refusal of leave would have, the financial position of the company, the period for which the administration order is expected to remain in force, the end result sought to be achieved, and the prospects of that result being achieved."[238]

The administrator along with the court has the power to give leave under s.11(3)(c) and (d). The Court took the view that the application to enforce any security or exercise any contractual right should be made to the administrators in the first instance and established a number of guidelines, twelve in all, based on which the administrator could decide to give his consent.[239] The administrator should not utilise his power to give or withhold consent as a "bargaining counter in a negotiation in which the administrator has regard only to the interests of the unsecured creditors."[240] For example the administration procedure should not be used to prejudice those who were secured creditors, when the administration order was made in lieu of a winding up order. Also leave would be granted if the secured creditor would suffer a substantial loss, greater than that which would be suffered by the others by the granting of leave. The benefit of such

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238 *Re Atlantic Computer Systems plc* [1992] 1 All ER 476 C.A. at p.489 per Nicholls LJ.

239 It is not proposed to set out all twelve guide lines and reference should be made to the case report itself or *Palmer's Company Law* (Revised), Sweet & Maxwell, or Totty and Jordan, *Insolvency*, (Revised), Longmans.

240 *Re Atlantic Computer Systems plc* [1992] 1 All ER 476 C.A. at p.490 per Nicholls LJ.

guidelines is that they are directed at reducing the number of applications that have to be made to the court thus avoiding the costs of such application.

THE MORATORIUM IN AN AUSTRALIAN VOLUNTARY ADMINISTRATION

Following the modern corporate rescue tracks laid down in Chapter 11 of the U.S. Bankruptcy Code, in turn followed in the English Administration Order procedure under IA 1986 [U.K.] and the recommendations for reform in Canada in 1971 and 1986, the Harmer Commission in Australia recommended that a moratorium should apply during the proposed Voluntary Administration procedure.

It was envisaged that the moratorium period would affect all secured and unsecured creditors and all persons having an interest, whether as owner or lessor, in property in the possession or use of the company. The Harmer Commission was however particularly concerned about the advisability of interfering with the rights of secured creditors and creditors with an interest in property used, leased, or occupied by the company. In the course of its inquiry the Harmer Commission observed:

> "In theoretical terms there is a 'presumption' in favour of not interfering with security or other similar rights at all. As a matter of economics it would be undesirable to impede the flow of credit by devaluing the security or other rights which a creditor may require as a condition to giving credit. As a matter of property law, the legal and equitable proprietary rights of the creditor should not be lightly interfered with."[241]

However, it was recognised that a brief initial moratorium promoted an orderly dealing with a company's affairs. An orderly dealing with the company's affairs was beneficial whether the company was to be wound up or rehabilitated. In a winding up it enabled a more beneficial realisation of assets. In a rehabilitation it enabled the dealing with particular assets necessary for a reorganization of the company's affairs. Finally, it was argued that the brief initial moratorium recognised that the debtor continues to have an interest in assets which are subject to the rights of others.[242] These factors appeared to militate sufficiently against the arguments which oppose the moratorium. But the Harmer Commission took pains to emphasise that none of the restraints would destroy a security or convert a secured creditor into an unsecured creditor.[243]

The restrictions recommended by the Harmer Commission to be imposed *ipso facto* during the moratorium were identified by the Commission as falling into three broad categories.

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241 ALRC Discussion Paper No.32., para.72.

242 ALRC Discussion Paper No.32, para.72.

243 *Harmer Report, supra,* para.102.

First, unsecured creditors were to be restrained from bringing or proceeding with a claim against the company or with respect to property of the company. Second, secured creditors were to be restrained from taking steps to enforce their security. Third, owners or lessors of property in the possession or use of the company or occupied by the company were to be restrained from taking possession of or recovering it. A fourth additional, but optional, restriction was that the administrator would be able to apply to the court for an order restraining a receiver or other person already in the process of enforcing a charge over property of the company.[244]

These recommendations were implemented in spirit if not to the letter by the Australian Federal Parliament. The discussion which follows examines the restraints that are imposed for the duration of the administration on windings up, court proceedings, enforcement process, enforcement of charges, the recovery of property owned by a third party in the possession of the company,[245] the restraints which affect property in the possession of a court officer obtained by enforcement of process[246] and the enforcement of a guarantee of the company's liability.[247] The restraints are not absolute and certain categories of person, property or conduct are exempt. It also examines to what extent the moratorium continues under a Deed of Company Arrangement.

Duration of the Moratorium

With the exception of s.440A CL [Aust.] each section which imposes a stay on creditors in one form or the other in Division 6 of Part 5.3A begins with the words "During the administration of the company".[248] In s.440A CL [Aust.] the words which take their place are "under administration". These words establish, by reference to s.435C CL [Aust.] the point at which the moratorium commences and ends. Unlike in the United Kingdom where the moratorium descends in stages,[249] in Australia it commences and lasts throughout the period of the administration with equal force. The moratorium begins, as does the voluntary administration, with the appointment of an administrator (the "Australian Administrator") under

244 It has been mentioned elsewhere that the recommendations of the Harmer Commission were backed up by draft legislation.

245 ss.440A, 440B, 440C, 440D and 440F CL [Aust.]. These restrictions are broadly similar to those imposed under the administration order procedures in the United Kingdom Insolvency Act, 1986.

246 s.440G CL [Aust.].

247 s.440J CL [Aust.].

248 See ss. 440B, 440C, 440D(1), 440F, 440G(2) and 440J(1) CL [Aust.].

249 See the discussion at 5.5. *supra*.

ss.436A, 436B or 436C CL [Aust.]. Similarly, it ceases with the administration coming to an end because of the occurrence of one of the ten events described in ss.435C(2) and 435C(3) CL [Aust.].[250]

Nine of these ten events described imply that administration is not an appropriate procedure in the circumstances of the company concerned or that there has been a serious breakdown in implementing the procedure. The single exception, which indicates that the procedure has been successful, is where the administration comes to an end with the execution of a Deed of Company Arrangement.[251] Administration under the Australian Corporations Law, as in the United Kingdom, is not an end in itself but only a means to an end. The mere execution of a Deed of Company Arrangement does not imply that a company is solvent and that the desired end of putting the company into administration has been realised. A successful company rescue or salvage by recourse to administration under the Australian Corporations Law requires success not only in the administration but also at the second stage of implementing the Deed of Company Arrangement, commencing with its execution. In almost all cases, a continuation, in some form, of the protective moratorium imposed during the administration would be essential. The nature and duration of any such moratorium period should be agreed to by the creditors and must be set out in the Deed of Company Arrangement.[252]

The statute offers some further protection by imposing some mandatory restraints, although limited in scope, until the Deed of Company Arrangement terminates.[253] However, these restraints apply only to those persons bound by the deed of company arrangement and only in respect of claims arising on or before a date which must be specified in the deed.[254] The restraints prevent any person bound by the deed from making an application to wind up the company or from proceeding with an application for winding up which was made before the deed became binding.[255] The statute leaves no room for the winding up application to be made or proceeded with pursuant to the leave of court. A person bound by the deed is also unable to begin or proceed with a proceeding against the company or in relation to any of its property or

250 *Harmer Report, supra,* para.94

251 s.435C(2)(a) CL [Aust.].

252 s.444A(4)(c) CL [Aust.].

253 See ss.444D and 444E CL [Aust.].

254 s.444D(1) CL [Aust.].

255 s.444E(2) CL [Aust.].

to begin or proceed with any enforcement process in relation to property of the company.[256] However unlike in the case of a winding up the person affected by the stay may seek the leave of court to begin or proceed with the proceedings or enforcement. If the court grants leave it may impose terms in accordance with which the applicant for leave must act. It should be noted that there is no restriction of "proceedings" to those in a court as in the moratorium which applies during the procedure.[257] The deed of company arrangement restricts the exercise of the rights of secured creditors and owners and lessors of property only to the extent that such persons voted in favour of the resolution because of which the company executed the deed or the court otherwise orders.[258] Nevertheless, the court is given an overriding right to restrain and restrict any secured creditor, owner or lessor of property from realising or dealing with security or taking possession of or recovering property used by or in the possession of the company.[259] The courts power to make orders of this nature is however limited to very specific circumstances.

Restrictions on winding up

Neither in its report nor in the accompanying draft legislation does the Harmer Commission specifically refer to a stay being imposed on windings up. The only specific reference to winding up is in relation to the exemption that is to apply to "an application for the winding up of the company", implying that the restraint, if any, is imposed by the provisions that precede it. The only restraint capable of affecting a winding up is the one placed on legal proceedings against the company.[260] The Harmer Commission appears to have rightly considered any restraint on voluntary windings up to be superfluous.[261] The Australian Federal Parliament, however, imposed a restraint on all forms of winding up.

The restraint on windings up and the exemptions, however, take account of the

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256 s.444E(3)(a)&(b) CL [Aust.].

257 s.440D(1) CL [Aust.].

258 s.444D(2)and(3) CL [Aust.].

259 s.444F CL [Aust.].

260 It will be seen that the proceedings stayed are those which are against the company or in relation to any of its property. In contrast, in Canada the proceedings are those which a creditor must commence or continue for the recovery of a claim provable in bankruptcy. It was pointed out that bankruptcy and winding up proceedings are not strictly recovery proceedings, although the threat of winding up a company may be ultimate threat in the hands of a creditor.

261 For the purpose of initiating a members' voluntary administration a company must insolvent or likely to become so and therefore the directors would be unable to make a declaration of solvency. The creditors however would in any event able to put the company into a winding up at the meeting of creditors summoned by the administrator, should they wish to do so.

Commission's concern regarding the risk of administration being used as a devise to defeat or delay creditors.[262] Being a restraint on a species of insolvency procedure, the stay on windings up during the moratorium period should be viewed in the light of the Harmer Commission's recommendation that the Australian insolvency procedures should be integrated and facilitate an easy conversion from one insolvency procedure to another with the minimum of expense.[263]

Voluntary winding up

All species of winding up are not, however, treated equally. The restraint imposed on the commencement of a voluntary winding up in the ordinary manner provided for in Part 5.5 of the Australian Corporations Law is absolute. Sub-s. 440A(1) CL [Aust.] provides that a company under administration cannot be wound up voluntarily, except as provided by s.446A CL [Aust.].[264] Section 446A CL [Aust.] applies on the occurrence of either of the three events described in sub-s.446A(1) CL [Aust.]. These events are: first, if, at a meeting convened by the administrator under s.439A CL [Aust.] the creditors of the company *under administration* resolve under s.439C(c) CL [Aust.] that the company be wound up; second, if the *company under administration* contravenes s.444B CL [Aust.], which provides for the execution of the Deed of Company Arrangement; third, if, at a meeting of creditors convened under s.445F CL [Aust.] to consider a proposed termination of *a deed of company arrangement*, the company's creditors pass a resolution to terminate the deed of company arrangement and resolve that the company be wound up.[265]

When read together, there appears a conflict between the last of events described in s.446A(1)(c) CL [Aust.] and the duration of the restraint imposed under s.440A(1) CL [Aust.]. The events in s.446A(1)(c) CL [Aust.] may take place only after a deed of company arrangement is executed.[266] The event of executing the deed of company arrangement brings to an end the

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262 *Harmer Report, supra,* para.103.

263 The Australian Law Reform Commission, *General Insolvency Inquiry,* Issues Paper No.6, p.17; Discussion Paper No.32, para.41; *Harmer Report, supra,* para.51

264 s.440A(1) CL [Aust.].

265 Under s.445E(b) CL [Aust.] notice of the proposed resolution to wind up the company must be given when summoning the meeting to terminate the deed of company arrangement.

266 The distinction is further evident from sub-s.446A(4) CL [Aust.] which provides that on the occurrence of either of the events set out in s.446A(1) CL [Aust.] the administrator is deemed to be nominated as the liquidator. However if it is paragraphs (a) and (b) of this subsection which apply then the person nominated is the administrator of the company. If it is paragraph (c) which applies then the person nominated is the administrator of the deed of company arrangement.

restraint imposed under s.440A(1) CL [Aust.]. Thus, the impact of s.446A on s.440A(1) must be construed without reference to s.446A(1)(c) CL [Aust.]. A construction which views s.446A(1)(c) CL [Aust.] as affecting s.440A(1) CL [Aust.] implies that the duration of the restraint imposed by that sub-section is greater than that which is indicated by a plain reading of that sub-section. Such a construction is further inconsistent with the duration of the restraints imposed by the other sections within Division 6.

The "exception" under ss.446A(1)(a), 446A(1)(b) CL [Aust.] enables a voluntary winding up to commence despite the stay imposed under sub-s.440A(1) CL [Aust.]. However, it is not a true exception. It does not enable any person entitled to commence a voluntary winding up to initiate one outside the framework of an administration. It merely enables a conversion from administration to voluntary winding up within the framework of the administration and fulfils the Harmer Commission's aspirations that the insolvency procedures should be integrated.

Winding up by Court

A specific, but limited exemption, containing within it a check against its abuse, applies to windings up by court. The Court is required to adjourn the hearing of an application for an order to wind up a company if the company is under administration and the court is satisfied that it is in the interests of the company's creditors for the company to continue under administration rather than be wound up.[267] The court is also unable to appoint a provisional liquidator of a company if that company is under administration. Once more the Court must satisfy itself that it is in the interests of the company's creditors for the company to continue under administration rather than have a provisional liquidator appointed.[268] The Harmer Commission recommended that the court should be given some guidelines, and be required to determine the relative merits of ordering a winding up or letting the company continue under administration.[269]

Thus, there is no prohibition in s.440A CL [Aust.] against the presentation of a petition for winding up. The prohibition exists only against the hearing of the application. Nevertheless, the presentation of a petition would appear to constitute a "proceeding in court against the company" which is stayed by s.440D. The proper procedure for a creditor seeking to present a

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267 s.440A(2) CL [Aust.]. In the United Kingdom (See ss.10(2)(a), 11(1)(a) and 11(3)(a) IA 1986 [U.K.]) and Canada a party able to present a winding up or bankruptcy petition is similarly not precluded from so presenting it. However in the United Kingdom, the court has no discretion and is unable to make to make a winding up order (s.11(3)(a) IA 1986 [U.K.]).

268 s.440A(3) IA 1986 [U.K.].

269 *Harmer Report, supra,* para.104.

petition for winding up would be to obtain the voluntary administrator's written consent or the leave of court before proceeding to do so.

In *Re Huntford Pty Ltd.,* 12 ACSR 247 a voluntary administrator had been appointed by a creditor (presumably under s.436C as a charge holder the report does not indicate under which provision). The company challenged the appointment of the voluntary administrator. As a precautionary measure, the creditor who had appointed the voluntary administrator sought to have a provisional liquidator appointed. The court did not hear any argument as to the validity of the appointment of the voluntary administrator but instead heard the creditor's argument for leave under s.440D(1)(b) on the grounds that it raised a question of public interest. Having heard evidence on the state of the company's finances the court held that it was very likely that a winding up order would be made and granted the creditor leave to apply for a winding up order and the appointment of a provisional liquidator. Clearly, it was satisfied that it was in the interests of the company's creditors for the company to be wound up rather than let the voluntary administration continue.

Once a deed of company arrangement has been executed, the right of a person to make an application for a winding up order, which survived the restraints brought into being by the commencement of administration, ceases statutorily if he is bound by the deed. Neither can a person bound by the deed proceed with an application made during the administration, before the deed became binding on him.[270]

The question that arises is whether a petition for the winding up of a company which has been presented but not heard remains valid after there is a breach of the terms of the deed of company arrangement? Under s.459R(1) CL [Aust.] an application for a winding up is automatically dismissed if it is not determined within six months of the application. If a voluntary administrator is appointed either before or after the application was presented, however, by the operation of s.451D CL [Aust.], the six month time period referred to in s.459R is extended by a period of time equal to the period during which the company is in voluntary administration.[271]

Effect of moratorium where there is a conversion from Winding Up to Voluntary Administration

An interesting question arises as to whether the initiation of a Voluntary Administration by a liquidator results in an immediate halt of all proceedings in the winding up. When the Harmer Commission in its General Insolvency Inquiry recommended that a liquidator of a

270 s.444E(2)(a)&(b) CL [Aust.].

271 See *Milankov Nominee's Pty Ltd., v. Roycol Ltd.,* 14 ACSR 296.

company should be able to initiate the voluntary administration procedure, it was hoped that this would enable the conversion from a members' voluntary winding up to administration, and give the opportunity in other windings up to promote, where appropriate, a deed of company arrangement.[272] Section 436B(1) CL [Aust.] enables a liquidator or a provisional liquidator of a company to appoint an administrator of the company if he or she thinks that the company is insolvent, or is likely to become insolvent at some future time.[273] The Commission also observed, that the legislation dealing with any form of winding up should make it clear that a conversion from winding up to administration may be made for the purpose of enabling an arrangement to be made by the company with its creditors.[274] By viewing the initiation of the administration procedure as a conversion from winding up, the Commission clearly intended that the winding up proceedings should be stayed in order that a rescue could take place. There is no express provision to this effect in CL [Aust.] 1992.

In either type of winding up the company ceases to carry on its business except so far as is in the opinion of the liquidator required for the beneficial disposal or winding up of that business.[275] This would usually take place where the liquidator expects to be able to sell the business as a going concern at a higher price. But this right must be exercised in the light of his other obligations. For example, he is obliged, in a winding up in insolvency or by court, as soon as practicable after the order, to cause the company's property to be collected and applied in discharging the company's liabilities.[276] Although he is able to carry on the business of the company, he is precluded from doing so indefinitely and for any purpose other than the one specified in the statute.

Should the liquidator appoint himself as the administrator he immediately acquires wider powers of management supported by a powerful moratorium. The effectiveness of the moratorium would depend on the extent to which secured creditors, retention of title, hire-purchase, conditional sale and chattel leasing creditors have exercised their rights against property owned or held by the company. Similar powers will be acquired by any other insolvency

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272 Harmer Report, *supra,* p.35.

273 See the discussion in 6.3.1.

274 Harmer Report, *supra,* p.35.

275 See ss.493(1) and 477(1)(a) CL [Aust.].

276 s.478(1)(a) CL [Aust.]. In either type of voluntary winding up the liquidator is appointed for the purpose of winding up the affairs and distributing the property of the company. See ss.495(1) and 499(1) CL [Aust.].

practitioner who the liquidator may appoint as administrator.

What then are the consequences of the appointment of an administrator under s.436B(1) CL [Aust.]? What effect does it have upon the winding up? Is the winding up terminated or is it merely temporarily stayed, lying dormant until the administration is ended? Or do both procedures continue in tandem, the one augmenting the other?

Although the statute does not expressly deal with the effect of a voluntary administration on a winding up where it has been commenced by a liquidator, it would seem that ss.440A(1) and 440D(1) CL [Aust.] are wide enough to impose a stay on winding up proceedings which are pending. Whether the stay has the effect of holding the winding up proceedings in abeyance, like an application for winding up, or in fact terminates them altogether is less certain. Section 440A(1) CL [Aust.] may be construed to mean that a voluntary winding up is prohibited altogether. Section 446A, CL [Aust.] provides that if the creditors decide to terminate a deed of company arrangement the company is taken to have passed a special resolution under s.491 CL [Aust.] that the company be wound up voluntarily indicating that the winding up commences afresh. If the winding up had not been terminated altogether this section would have little meaning. The stay of a winding up by court however, depends upon the stay of the continuation of court proceedings under s.440D(1). Under this provision it appears that the liquidator would in theory be able to avail himself of the exception in ss.440D(1)(a) and (b) which permit proceedings to be continued with the voluntary administrator's written consent or the leave of court.

Enforcement of charges restrained

A person cannot enforce a charge on property of the company.[277] No distinction is made between any type of charge in imposing the restraint and floating or substantial charges come within the scope of a "charge". Thus under the Australian Corporations Law the restraint applies with equal force to all types of charge and only those expressly exempt categories fall outside the restraint. The reasons for the exemptions vary between the extent of the property charged, the nature of the property charged and the time at which the enforcement commenced.

Any doubt that may arise whether notice of default under a charge constitutes or is part of the enforcement process is statutorily removed. The restraint on the exercise of a charge does not in any way affect the giving of notice thereunder.[278]

277 s.440B CL [Aust.].

278 s.441E CL [Aust.].

Special exemption for a "substantial chargee"

Special statutory exemptions apply where the whole or substantially the whole of the property of the company is subject to a charge or the property charged under two or more charges in favour of one person together constitute the whole or substantially the whole of the property of the company. The exemptions enable the enforcement of such charges even after the commencement of the administration. If before or during the period commencing with the date on which an administrator must give written notice of his appointment to the chargee and ending at the tenth business day after that day, (the decision period), the charge or charges are enforced then the restraint imposed under s.440B CL [Aust.] does not apply.[279] If it is a single charge it does not matter whether or not the charge was enforced in the same way in relation to all the property charged. Where there are two or more charges, if the charges are enforced by either the appointment of a receiver under powers contained in an instrument relating to the charge or by obtaining an order or appointing a person to enter into and assume control of the property,[280] it does not matter whether or not the charges or any of them were enforced in the same way in relation to all the charged property.

The rationale for allowing a "substantial chargee" is clearly stated in the explanatory memorandum to the amending act. It is recognised that the enforcement in this manner by the appointment of a receiver over all the company's property will "achieve the same kind of orderly administration of the company's affairs that will be made possible by the appointment of an administrator".[281] Although the Cork Committee and the Harmer Commission were very enthusiastic about the benefits of Receivership it is now widely accepted that unsecured creditors derive no benefit from that procedure.

As will be seen the rationale for granting the other exemptions is either the nature of the property secured, or the special nature of the person affected.

Continuation of enforcement commenced prior to administration exempt

The words "cannot enforce a charge" in s.440B CL [Aust.] are wide enough to stay a continuation of an enforcement process commenced prior to the administration. Any doubt whether it is removed by the specific exemption from restraint where certain specified acts have been performed for the purpose of enforcement. However, if a chargee, receiver or other person

279 s.441A(3) CL [Aust.].

280 Whether as agent of the chargee or the company.

281 *Explanatory Memorandum to the Corporations Act 1992* at para.536.

has performed one or more specified acts for the purpose of enforcing a charge prior to the commencement of administration then the restrictions do not apply to such a person enforcing the charge. The chargee, receiver or other person should have either entered into possession, or assumed control of property of the company, or entered into an agreement to sell such property, or made arrangements for such property to be offered for sale by public auction, or has publicly invited tenders for the purchase of such property, or exercised any other power in relation to such property.

All but the last category of action require the performance of a definite action in relation to the charged property. Thus applying the rule that such words should be construed *ejusdem generis* it is submitted that in the absence of any positive action in relation to the property the restraint would apply. In the case of a public sale mere advertisement of an invitation to treat is sufficient. A private sale however, must have been completed. Private negotiations for the sale of the property charged, even those that are on the threshold of an agreement, in the absence of possession will not constitute the exercise of a power in relation to the property. Where the property charged has high commercial value, the best way to exploit that value would often be through a negotiated private sale. In such circumstances it would be in the interest of the charge holder to demonstrate the exercise his right in respect of that property by either the appointment of a receiver under powers contained in an instrument relating to the charge, by obtaining an order or appointing a person to enter into and assume control of the property,[282] prior to negotiating its sale.

The mere doing of an act specified in s.441B(1) CL [Aust.] does not mean that thereafter, the chargee is completely free of the restraints imposed during the moratorium period. The Court may on an application by the administrator restrain the chargee receiver or other person from performing specified functions or from exercising specified powers. Before such an order is made the Court must be satisfied that course of action proposed by the administrator adequately protects the chargee's interests.[283]

Enforcement of charges on perishable property entirely exempt

The value of a charge on perishable goods deteriorates with the goods. If any restraint were to apply to the enforcement of charges in respect of such property, the company would be able to let the security extinguish itself by allowing the property to perish. Thus, if the property

282 Whether as agent of the chargee or the company.

283 s.441D CL [Aust.].

subject to a charge is perishable, enforcement of such charges is entirely exempt.[284]

Protection of property used or occupied by the company

It will be seen from the ensuing discussion that CL [Aust.] imposes a restraint against the commencement or continuation of proceedings against the company's property. As has been mentioned in the discussions under Canada and England a company may use or occupy a considerable amount of property of which it is not the owner. If the owners of that property were able to recover it from the company during the voluntary administration, the whole purpose of that procedure may be jeopardised. Thus during the voluntary administration the owner or lessor of property that is used or occupied by, or is in the possession of the company is restrained from taking possession of the property or otherwise recovering it.[285] This provision would, it appears, be adequate to protect the company against action from owners under a hire-purchase agreement, retention of title holders, and land-lords of rented property. It would also protect company which is a tenant of mortgaged property, where the mortgagee had given notice to the company to pay all rents to it direct.[286]

Restricting civil proceedings against the company

A moratorium prevails against the commencement or continuation of proceedings against the company or its property except with the voluntary administrator's consent in writing or the leave of court.[287] In the latter instance, the court's leave may be subject to terms that the court may choose to impose. The only proceedings which do not come within the restraining provisions are criminal proceedings and what the statute describes as "prescribed proceeding".[288] "Prescribed proceedings" are those which must be allowed to proceed on the grounds of public policy.[289] With regard to an application to court for leave, Young J., in *Foxcraft v. Ink Group*[290], while staying proceedings in an industrial court, observed that it would rarely be granted.

"It may be that where the company is insured against the liability the subject of the

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284 s.441C(2) CL [Aust.].

285 s.440C CL [Aust.].

286 *Tymray Pty. Ltd (admin apptd.) v. Mercantile Mutual Life Insurance Co.* 13 ACSR 111.

287 s.440D(1) CL [Aust.].

288 s.440D(2) CL [Aust.].

289 *Explanatory Memorandum to the Corporate Reform Bill* para.522.

290 15 ACSR 203

proceedings, the administrator will ordinarily consent or the court will give conditional leave, but outside this field it is hard to see situations where it would be proper to grant leave though doubtless there are such situations."[291]

Although the term "no proceeding" appears to be very wide, attention must be drawn to the fact that the restraint applies only to proceedings in "court". Further the proceeding must be brought against the company or in relation to its property. If the proceeding is against any other party, such as even the voluntary administrator the restriction does not apply.[292]

During the administration of a company the enforcement of charges, recovery by an owner or lessor of property used by company and proceedings against the company cannot be pursued except with the administrator's written consent or the leave of the Court.[293] If the voluntary administrator refuses to give his approval or consent he is not liable to an action or other proceeding for damages for doing so.[294]

Suspension of enforcement process and the restraint on the seizure and distribution of property by a Court Officer.

It will be recalled that under ss.10(1)(c) and 11(3)(d) IA 1986 [U.K.] the commencement or continuation of any execution or legal process without the consent of the administrator or leave of the court is restrained. However, IA 1986 [U.K.] does not elaborate on how a court officer who is in the process of executing a judgement should act once the English Administration has begun. Having established that during a voluntary administration no enforcement process in relation to property of the company can be begun or proceeded with, except with the leave of the Court and in accordance with such terms (if any) as the Court imposes,[295] the CL [Aust.] goes on to prescribe how property under a process of execution is to be dealt with once an officer of a court (called the "the court officer"), being a sheriff or the registrar or other appropriate officer of the court receives written notice of the fact that a company is under administration.[296]

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291 *ibid.* at p.205.

292 For example leave would not be necessary to obtain information from the voluntary administrator under s.447B(2) CL [Aust.]. See *J&B Records v. Brashes Pty Ltd. (vol.admin apptd.)* 13 ACSR 680.

293 An interesting question arises whether an administrator may, where the administration has commenced pursuant to an appointment made by a liquidator, permit the liquidator to remain in office to the extent of making use of the liquidator's powers to set aside preferences and other antecedent transactions. The issue does not seem to have arisen in practice yet.

294 s.440E CL [Aust.].

295 s.440F CL [Aust.].

296 s.440G.(1) CL [Aust.].

Once notice has been received by the court officer that a voluntary administration has commenced, the court officer cannot take action to sell property of the company under a process of execution. However if the company's property has been sold in the process of execution the person who bought the property in good faith acquires good title to the property as against the company and the administrator. If property of the company has been sold under a process of execution the court officer cannot pay the proceeds of the sale of the company's property to any person other than the voluntary administrator. Likewise, if the company's money has been seized at any time under a process of execution or money has been paid, at any time, to avoid seizure or sale of the company's property under a process of execution such money must also be paid only to the administrator. The court officer is also precluded from taking action in relation to the attachment of a debt due to the company or from paying to a person other than the administrator, money received from attaching the debt.[297] Nevertheless, if the court is satisfied that it is appropriate to do so, it may allow the court officer to take any action or to make any payment which is otherwise precluded under this provision.[298]

If any property of the company under a process of execution, which has not been converted into money is in the court officer's possession that property should also be delivered to the administrator.[299] Finally, as a general catch-all provision the court officer must pay to the administrator all proceeds or money of a kind[300] which is in the court officers' possession or have been paid into court and have not since the administration was notified been paid out. It is significant that the time at which the execution or attachment commenced or took place is irrelevant. If at the time the court officer is advised of the commencement of a voluntary administration, property or money obtained by execution or attachment is in the court officer's or the court's possession that property or money should be paid out to the voluntary administrator.

The court officer is not however to be deprived of his costs of execution or attachment. Therefore the statute provides that the costs of the execution or attachment are a first charge on property delivered or proceeds or money paid and in order to give effect to a charge on proceeds of money, the court may retain, on behalf of the person entitled to the charge, so much of the

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297 s.440G(2) CL [Aust.].

298 s.440G(7) CL [Aust.].

299 s.440G(3) CL [Aust.].

300 This means money referred to in paragraph (2)(b) or (d) CL [Aust.].

proceeds or money as the court officer thinks necessary.

Restraint on triggering the liability of certain guarantors of the company.

A category of restraint not mirrored in either IA 1986 [U.K.] or BIA [Can.] applies to any guarantee of a company's liability made by a director, who is a natural person, or by a spouse, de facto spouse or relative of such a director. For the purpose of this provision a guarantee is defined as including a relevant agreement[301] because of which a person other than the company has incurred, or may incur, whether jointly with the company or otherwise, a liability in respect of the liability of the company. Liability in turn is defined to mean a debt, liability or other obligation.

Such a guarantee cannot be enforced during the voluntary administration. Nor is it possible to commence any proceeding against any such guarantor except with the leave of the Court and in accordance with the such terms, if any, which the Court may choose to impose. It is further provided that the stay on proceedings to enforce guarantees should not be construed as limiting the scope of the general stay on the enforcement of guarantees.[302]

Whilst a creditor is prevented from enforcing a guarantee of a liability of a company, or beginning a proceeding against a guarantor for that purpose the court retains the power under s.1323 CL [Aust.], to make a range of orders to ensure that a the guarantor can meet his or her liabilities.

Only guarantees made by directors who are natural persons and their spouses or relatives are protected under this provision. Guarantees given by natural persons who are not directors and corporate entities such as banks are not. Further, the protection lasts only for the duration of the voluntary administration. In *Gan v. Saunders and another*[303] a company defaulted on payments which had been guaranteed by a third party. The creditor commenced proceedings for the recovery of payments from the guarantors. While proceedings against the company were pending, the company went into voluntary administration. The creditors resolved that a deed of company arrangement be executed and it was. The creditor continued to pursue its claim against the guarantors notwithstanding the creditors' resolution. The guarantors relied on a clause in the deed of company arrangement which precluded the creditors bound by it from prosecuting any legal proceedings in relation to any debt incurred by the company, arguing that it covered

301 As defined in s.9 CL [Aust.].

302 s.440J(1) CL [Aust.].

303 15 ACSR 298.

proceedings against the guarantors. The court rejected this argument stating that very clear language would be required to justify the interpretation of such a provision as staying proceedings against third parties. The guarantors also argued that by the deed the company's debt to the creditor was extinguished and that therefore the creditors could no longer pursue their claim against the guarantors. In rejecting this argument the court relied on the decision of the Court of Appeal of New South Wales in *Hill v. Anderson Meat Industries*[304] which held with regard to a Scheme of Arrangement that the extinguishment of the debt occurred by operation of law and therefore did not result in the discharge of the surety. The upshot is that whilst a director who is a natural person, or a spouse, de facto spouse or relative of such a director who has guaranteed any liability of the company in voluntary administration would be protected for the duration of the administration if the guarantors wish to have the same protection for the duration of the deed of company arrangement it must be spelt out clearly in unequivocal terms.

Does the initiation of a Receivership trigger a de facto moratorium?

There are no statutory provisions in either England, Canada or Australia which provide for a moratorium to operate upon the initiation of a Receivership. However as the *Colter Committee observed*:

> "Receivership also provides a means for the reorganization of the debtor's affairs because it commonly occurs as a result of the enforcement of security that extends to all or substantially all of the debtor's property. Upon default the holder of the security can cause a receiver to be appointed to take possession of and deal with the assets subject to the security. *Thus proceedings against such assets by subordinated secured creditors, preferred creditors and unsecured creditors are stayed.*" [305]

This stay which the *Colter Committee* refers to is a result of the debenture holder's equitable interest in the property subject to the charge supplanting the company's interests its property. Thus the "stay" affects only persons whose interest is sub-ordinate to charge holder's interest and as such may be described as a quasi-stay or moratorium. The rights that such sub-ordinate interests may have are not extinguished. They survive the appointment of a Receiver and remain exercisable against any residue which remains after the debenture holder's interest has been sated. Among the interests which the company retains is its equitable right of redemption and its interest in the residue of the property and its goodwill which may remain after the debenture holder has realized its security.

The stay in a Receivership described by the Colter Committee does not prevent

304 [1992] 2 NSWLR 704.

305 *Colter Report* p.50.

proceedings being commenced by a third party against the company for the recovery of its property which is in the company's possession. As Nicholls LJ pointed out in *Re Atlantic Computer Systems plc*:

> "The appointment of an administrative receiver does not trigger a statutory prohibition on the lessor or owner of goods such as that found in s 130 in the case of a winding-up order. If the rent or hire is not paid by the administrative receiver the lessor or owner of the goods is at liberty, as much after the appointment of the administrative receiver as before, to exercise the rights and remedies available to him under his lease or hire-purchase agreement. Faced with the prospect of proceedings, an administrative receiver may choose to pay the rent or hire charges in order to retain the land or goods. But if he decides not to do so, the lessor or owner of goods has his remedies."[306]

Likewise the initiation of a Receivership also does not impose any restraints on the commencement of a winding up. Thus, although a Receiver has taken over the management and control of the company's property, the company, through its directors and members is able to initiate either a voluntary or a compulsory winding up. As soon as a winding up is initiated by the passage of a resolution or the making of a winding up order, the deemed agency of the Receiver comes to an end in England and Canada. In Australia, however, the Receiver continues to be the agent of the company after the winding up has commenced.

In England, the appointment of an administrative receiver in respect of a company, limits the ability the court has to make an administration order in respect of that company. Once the court is satisfied that an administrative receiver has been appointed it must dismiss the petition for administration.[307] Thus, it may be said that the appointment of an administrative receiver imposes a moratorium against the making of an administration order. The purpose of this moratorium however is not to maintain the status quo and to preserve the corporate corpus for the benefit of the creditors as a whole but to prevent a competing procedure of like character from being initiated.

However as with most other "moratorium" provisions there are circumstances where the moratorium does not apply and where the court may nevertheless proceed to make an administration order. These circumstances have been mentioned in Chapter Four.

It is not appropriate to describe the first of these circumstances as a "challenge" to the moratorium since it requires the consent of the floating charge holder.[308] The second circumstance may be described as a "challenge" because a party to the petition for administration

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306 *Re Atlantic Computer Systems plc* [1992] 1 All ER 476 C.A., per Nicholls LJ at p.486.

307 s.9(3) IA 1986 [U.K.]

308 s.9(3)(a) IA 1986 [U.K.].

proceedings, which in most cases is likely to be the petitioner, would have to satisfy the court that the very charge under which the administrative receiver has been appointed would be liable to be released, discharged, avoided or challenged if the administration order is made.[309]

Sealy and Milman[310] take the view that the validity of the floating charge can be settled during the course of the application for the administration order. But, as they themselves concede, a number of difficulties lie in the way of a final disposition of such questions at this stage. Among the main difficulties would be the fact that only an administrator or a liquidator has the standing to make an application to have a floating charge set aside under the sections mentioned above,[311] and that no administration order would have been made for the purpose of determining whether the floating charge was created within the various categories of relevant time.

The wording in s.9(3)(b) IA 1986 [U.K.] does lend itself to the construction that the court does not have to make the orders contemplated in (i)-(iii) but that it must merely conclude that the floating charge could be successfully challenged if the administration order was made. However, unless the court's order is taken as a definite irreversible statement of its opinion and how it will decide the matter when the application is made, such an interpretation may be criticised on the grounds that it is only speculative. If it is not speculative it may be *res judicata* between the parties. Further, if it is indeed to be construed as an expression of the court's will which cannot and will not be changed, the administrator would find himself obliged to perform the task of challenging the charge and bear the cost of doing so without having had the opportunity to obtain an indemnity for that purpose.

In theory, if there is certainty that the charge will be set aside if an application is made under the relevant provision, there ought to be no shortage of creditors who are willing to indemnify the administrator for his costs. However, on a practical note, this willingness ought to depend more on the current value of assets subject to the charge and whether on their release the administrator will be able to meet the costs of preserving the company's going concern value out of these assets. If, as was the case in *Re Croftbell*,[312] there are no assets which are subject to the charge the administrator may have no assets on which he can build the rescue.

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309 s.9(3)(b)(i)-(iii) IA 1986 [U.K.].

310 *Annotated Guide to the Insolvency Act*, (4th ed.), CCH Editions, 1994, p.49.

311 See *Re MC Bacon (No.2)* [1990] BCLC 607 at 611.

312 (1990) BCC 781

CONCLUSION

Except in a CVA, a Receivership and a Scheme of Arrangement under s.425 CA 1985 [U.K.], all the other procedures under consideration provide for some form of moratorium which has the effect of maintaining the status quo between the company and some or all of its creditors and preventing the overall dismembering of the corporate corpus. In view of the recent recommendations for reform it appears that it will be only a matter of time before the English CVA procedure joins the ranks of the other procedures which provide for a moratorium.

The discussion and analysis in this chapter has revealed that law reformers in England, Canada and Australia and, if not always, their legislatures, all share the view that it is necessary to maintain the status quo and preserve the corporate corpus during the rescue and, for that purpose, a moratorium should apply. However, as has been seen throughout the preceding discussion, there is a significant difference in the form in which these views have manifested themselves on the various statute books. It is mainly due to a purposive approach adopted by the courts in interpreting these provisions, particularly in Canada, that the differences between the practical application of these provisions are not greater. Differences exist in the manner in which the moratoria begin to apply, their duration, scope, nature and how they may be challenged. These may now be considered.

Commencement, scope and duration of the moratoria

The procedures fall into two distinct categories based on the manner in which the moratoria come into force. They may come into effect either automatically or pursuant to an order of court.

Only in Schemes of Arrangement under the CCAA [Can.] and CL [Aust.] is the commencement of the moratorium dependent on an order of court.[313] As a corollary, the court also has the power to determine the duration of the moratorium it imposes. The right to make an application for a court order imposing a stay arises when the company can satisfy the court that a scheme of arrangement has been proposed. There is no necessity for the order summoning the meetings to have been previously made. Ordinarily, it may be expected that the application for the moratorium would be made simultaneously with the application for the order summoning the meetings. In Australia, the moratorium imposed by the court would usually last until the scheme had been rejected by the creditors or sanction by the court after the creditors' approval

313 It has been pointed out that in an English Administration although the post-order moratorium is dependent to the making of the administration order there is no need for the court to make a specific order imposing it. See p.245 *supra*.

at the meeting. Under the CCAA [Can.] however an application may be made even after the court has sanctioned the scheme, thus extending the duration and scope of the moratorium. At first blush this may seem to be a draconian power which the Canadian courts have arrogated to themselves. The justification, if any, is thin. However, the decisions of the Canadian courts in *Multidev Immobilia Inc. v. Société Anonyme Just Invest*[314] and *Algoma Steel Corp. v. Royal Bank of Canada*[315] appear to have been vindicated by the recent reforms to the Proposal procedure under BIA [Can.].

In Canadian Proposals, English Administration and Australian Voluntary Administration the moratorium commences automatically with the initiation of the procedure. It is submitted that automatic commencement and determination of duration is preferable to long drawn process of obtaining a court order. Since an application has to be made to court, inevitably there is a cost, however small, attached to obtaining and, where necessary, extending the moratorium.

The moratorium which comes into force on the initiation of an English Administration and an Australian Voluntary Administration lasts for the duration of the procedure which is respectively a period of 3 months and 28 days. These periods may be extended by the court. As regards the continuation of the moratorium thereafter the approach in both these procedures is to leave such matters to the agreement of the creditors. In an English Administration the creditors cannot agree to an extension of the moratorium which applies during that procedure when it comes to an end. Such agreement would have to be obtained by the company in the context of any CVA or Scheme which may be proposed by the administrator. The Australian Voluntary Administration procedure does however go a stage further by providing for a limited mandatory stay on persons bound by the deed of company arrangement and giving the court, where necessary, the power to impose a stay on secured creditors, owners and lessors. Thus as regards the duration of the moratorium the Australian Voluntary Administration procedure stands between the Canadian Proposals and English Administration. In a Canadian Proposal the moratorium lasts, in the same form as it came into force, beyond the period required to obtain creditor approval for the proposal until the proposal is fully performed or is terminated. In effect, the stay becomes a mandatory term of the proposal but its scope is wide enough to restrain post-proposal creditors as well as those to who are bound by its terms. In stark contrast in a CVA or a Scheme of Arrangement under s.425 CA 1985 [U.K.] the application of any moratorium either

314 (1988) 70 C.B.R. (N.S.) 91.

315 (1992) 11 C.B.R. (3d) 11.

during or after the procedure must be negotiated with the creditors. The quasi-moratorium which applies in a Receivership commences and ends with that procedure.

The Canadians and to some extent the Australians appear to recognise the fact that, in the period immediately following a successful rescue it would be very unlikely that the company would be granted any significant credit terms except by the persons already bound by the deed. It is however important to bear in mind the benefit of the moratorium under BIA [Can.] and CL [Aust.] would be available only in respect of the company which initiated and made the proposal. Thus the extended moratorium would be of benefit only if the corporate entity which went into the rescue is to survive. If the corporate entity is to be sacrificed for the business which is hived off and sold or incorporated as a company with assets but no liabilities with the proceeds of the sale being used as to pay off the debts then the extended moratorium will not be necessary. If the proposed rescue package is directed at allowing the company to trade out of its difficulties, perhaps in conjunction with a hive-down of a readily saleable asset, the extended moratorium would certainly benefit the company.

Nature of the moratoria

The restraints imposed in the procedures which provide for a moratorium may be identified as falling into several categories depending on the activity which is restrained. These activities are: winding up; actions, execution and other proceedings; enforcement of security; and the recovery of property in the possession of the company owned by others. There are however some stays which are special and available only in the context of a particular procedure.

Winding up

Except in Australian Schemes of Arrangement and Canadian Proposals there are specific restrictions which prevent the commencement or continuation of bankruptcy or winding up of the company. In the procedures where there is no such provision, it is not very clear whether this is an indication that the liquidation process stands outside the moratorium provisions which are directed at or include a restraint of some kind on actions, suits, executions or other proceedings. Winding up is usually the antithesis of a rescue. Its initiation during the course of a rescue would indicate either that the rescue has failed or that winding up is the better option in the circumstances in which the company is placed. Thus the two cannot co-exist.[316] For this

316 In an English Administration once the administration order has been made the any petition for winding up which may have been presented must be dismissed. It should also be borne in mind that sometimes the right to present a petition for winding up is not restrained.

reason, where enabling provision provides for the stay of "other proceedings", unless the context indicates the contrary,[317] it may be construed as restraining a winding up proceedings as a species of "proceeding". It should be noted however that under s.11 of the CCAA [Can.] (Schemes), ss.10(1)(a) and 11(3)(a) IA 1986 [U.K.] (English Administration) and s.440A CL [Aust.] (Australian Voluntary Administration) there is a specific stay which restrains bankruptcy and winding up.

A distinction should however be drawn between the conversion from a rescue to a winding up. This would occur if the rescue cannot be continued successfully. In such circumstances the rescue procedure would automatically terminate or be terminated before the winding up or bankruptcy proceedings commenced.

"Proceedings"

The stay which restrains the commencement or continuation of any proceeding in any action execution or other proceedings is perhaps the earliest form in which the moratorium manifested itself. The oldest of the statutory provisions which provides for such a stay against "proceedings" may be found in the CCAA [Can.]. *Prima facie*, section 11 of that statute limits the stay to actions and proceedings in court. However, as has been seen when the need for a wider moratorium began to be acutely felt during the current recession the Canadian Courts opted for a "purposive approach" and a liberal interpretation, extending it to include set off, and the enforcement of security. A similar wide interpretation has been given the stay on any "action execution or other proceeding" as found in ss.69(1)(a) and 69.1(1)(a) BIA [Can.] without any serious justification except that a broad interpretation accords with the purpose of the legislation. As has been pointed out this reasoning is difficult to accept in view of limitation of the proceedings for the purpose of recovering as "a claim provable in bankruptcy" and that there are other sub-sections in those very sections which are designed to cover the activity covered by the wider interpretation. In stark contrast, ss.10(1)(c) and 11(3)(d) IA 1986 [U.K.], which affect English Administrations, are drafted widely enough to encompass a wide range of proceedings provided they are "against the company or its property". However the Inner House of the Scottish Court of Session in *Air Ecosse Ltd, v. Civil Aviation Authority*,[318] held that proceedings are limited to those which may be taken by a creditor. The result is therefore curious. Where

317 For example in the stay provisions affecting Canadian Proposals the "other proceedings" which are stayed are those which may be taken by a "creditor" for the purpose of a "recovery of a claim provable in bankruptcy."

318 (1987) 3 BCC 492.

the provisions do not *prima facie* lend themselves toward a liberal interpretation the Canadian Courts go to great lengths to give them a wide purposive interpretation. Across the Atlantic, where the provision undoubtedly lends itself to a wide construction, a narrow interpretation is given. There is little room for ambiguity in Australian Schemes and Voluntary Administration. "Proceedings" in that jurisdiction are statutorily limited to "civil proceedings.

Actions of secured creditors

It is perhaps safe to say that the draughtsmen of the CCAA [Can.] never intended that the moratorium in s.11 should encompass secured creditors. If they did, it is inexplicable why they chose to stay the exercise of a secured creditor's rights by restraining suits actions and "other proceedings". It is submitted that it is only due to the boldness and creativity of the Canadian judges that s.11 CCAA [Can.] is today construed as encompassing self help actions such as the enforcement of security and set off. The stance taken by the Canadian Courts is again vindicated by the fact that, all the new rescue procedures, except CVAs provide for the stay on the enforcement of security. There is however a marked difference in the approach adopted by the three jurisdictions.

The Canadian provision achieves the stay against a secured creditor not by restraining the creditor's actions but by nullifying the effect of any provision in a security agreement which provides that the debtor cannot be deprived of property which it has secured for the duration of the procedure. Although it is strictly not an aspect of the moratorium it should be mentioned that in Canada a secured creditor who is the holder of a charge over all or substantially all of the company's inventory, accounts receivable or other property must give 10 days notice to the company before enforcing its security. This notice period is of relevance in comparing the status of such a chargee in Canada with the status of comparable charge holders in England and Australia.

In contrast, in English Administration and Australian Voluntary Administration the restriction is directed at the secured creditor and any action which it may take which would constitute an enforcement. The floating charge holder in England and the "substantial chargee" in Australia have been singled out by the respective statutes for some special treatment which must be mentioned in this comparative conclusion. The floating charge holder is exempt from the first stage of the moratorium in an English Administration. He must be notified of the petition for administration and may appoint an administrative receiver thus preventing the making of the administration order and the appointment of the administrator. The significant difference between the English floating charge holder and the "substantial chargee" in Canada is that the latter has no control over whether the Proposal procedure should be commenced or not If the company files a Notice of Intention or makes a Proposal the "substantial chargee's" hand is stayed. Under the CL [Aust.] the voluntary administrator must give notice of his appointment to the "substantial chargee" and that chargee has the power within 10 business days to enforce the charge. The difference between the Australian and the English procedures is that, should the Australian "substantial chargee" take such a step, it does not *ipso facto* bring the rescue procedure to a grinding halt. However, there is no added benefit that maybe derived by running both procedures in tandem, such as the power that the English Administrator has to claw back the company's assets disposed of in the period immediately preceding voluntary administration.

Action by owners of property in the company's possession

The specific stay of such action is once more a characteristic of the English Administration and Australian Voluntary Administration. However, although not expressly identified as such, actions of this nature would have come within the scope of a stay imposed under either s.11 CCAA [Can.] or s.411(16) CL [Aust.] in Schemes of Arrangement in Canada and Australia since they would come within the ambit of "actions" or "other proceedings" against "the company". In England under IA 1986 [U.K.] "possession" includes cases where the goods are physically held by another pursuant to an agreement with the company.

Challenging the moratorium

It should be noted that in the Schemes of Arrangement which provide for a moratorium there is no statutory provision under which creditors and persons affected by it may challenge the stay. Therefore once the stay is imposed in a Scheme of Arrangement it cannot be challenged except perhaps on the basis of the court's inherent jurisdiction to grant relief to a party affected by its orders.

In the modern rescue regimes however provision is clearly made for a party affected by the moratorium to obtain leave of the court to commence or continue against the company or its property the activity stayed by the moratorium. It may be noted that in Canada a number of attempts have been made to circumvent the challenge procedure by the use of other provisions designed to bring the entire rescue procedure to an end. Some such attempts have been robustly rejected by the courts on the basis that they are an abuse of process.

Cost of the moratorium

There can be no doubt that a moratorium is an essential feature of the modern rescue procedure. Broadly, it would be adequate if the stay is directed at the categories described above.

Except in the case of a Receivership the procedures that do not provide for a moratorium do not contain provisions or have characteristics which are compensatory or provide a benefit similar to the moratorium. The quasi-moratorium that comes into force in a Receivership is a consequence of circumstance rather than design.

It is submitted that the other jurisdictions would do well to consider the Australian provision which restrains the enforcing of personal guarantees given by the directors or natural persons connected to them. Whilst this would not have the effect of protecting the company's property and goods being dismembered, it may act as an incentive to the directors to initiate the rescue at an early stage so as to maximise the chances of its success.

As a matter of further research, it would be useful if it were possible to determine whether the method of initiation has any impact on the attempts made at challenging the moratorium imposed during the rescue. Are there more challenges if the procedure is initiated without obtaining the opinion of an independent person as to the chances of its success, or is there no difference?

CHAPTER SIX

POST INITIATION PROCEDURE: TO THE MEETINGS OF CREDITORS (IF ANY)

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INTRODUCTION

The procedure that follows initiation varies considerably between the regimes. It is to some extent determined by the manner in which the rescue must be initiated. It was pointed out in Chapter Three that the procedures could be classified based on the mode of initiation, inter alia, as those which propose a "solution" at the outset and those which enable a "solution" to be formulated.

If the procedure is initiated by a "proposal" being made to the creditors, all that remains is for the meetings of creditors to be summoned to consider the proposal. For this purpose creditors, and sometimes even members, will have to be notified and documents and information made available to them. In the remaining regimes, excepting Receivership, a proposal will have to be formulated.

Whatever may be the objective of the proposed "solution", be it a full rehabilitation of the company, its business or a better realisation of the company's assets than would be possible in a winding up, it is often vital that its business continues to be managed and carried on while the remaining aspects of the procedure are being implemented. Without such management it will not be possible to preserve the company's going concern value and good will. Should a moratorium apply to protect a company's assets from disruptive creditor action during this period and the directors remain in control of its affairs, it is also a time where, from the creditors point of view, the company's assets are most vulnerable to abuse by the directors. It may therefore be appropriate to provide for the directors to be supervised during this period. Such supervision will also be critical where the procedure enables a "solution" to be formulated by the directors while protected by a moratorium.

It has been pointed out that whilst the causes of corporate failure and insolvency are many and varied it is often the result of inefficient or incompetent management and in such circumstances it may be risky to rely on any proposals made by the directors. The procedure may, therefore, be initiated by control over the company's business, property and assets being vested in an independent person while he examines the company's affairs and determines the appropriate outcome for the procedure. In some regimes that would involve drawing up proposals for consideration by the company's creditors and summoning meetings for that purpose. During this period the appointed person would usually have the power to manage the company's affairs and even maximise the value of the assets under his control.

This chapter considers these various aspects of the post initiation procedure in each regime up to the point at which the creditors' meetings to consider the proposals are held.

Meetings and the post meeting procedure are the subject of discussion in the next chapter. Cost, speed and efficiency continue to be of importance after initiation and these factors are naturally affected by the nature and length of the steps which must be taken after initiation.

POST-INITIATION PROCEDURE IN SCHEMES OF ARRANGEMENT

Summoning the meetings of the creditors and sometimes of the members

In England, Australia and Canada the relevant statute[1] only briefly describes the procedure which must be followed after a court order has been made requiring a meeting of a company's creditors and, in some cases, members to be summoned to consider a proposed scheme of arrangement. In fact, the English and Canadian provisions use identical words and leave the court with the discretionary power to direct the manner in which the meetings are to be summoned.[2] The Australian provision uses different words but does not widen the court's discretion. It merely specifies that the manner in which the meetings are to be convened and the place or places at which they are to be held as directed by the court.[3]

There is no statutory provision in any of the three jurisdictions which requires the court making the order to appoint any person to ensure that the meetings of the creditors and members, if any, are summoned and to take control of the company's business property and affairs until such time as the meetings are held. In Canada it has been specifically held that the court cannot appoint a trustee to summon the meetings.[4] Most schemes of arrangement compromises and arrangements would have to be administered until the objects contemplated by them are achieved and an approved scheme generally provides for the appointment of an "administrator" or "trustee" (hereinafter referred to as the "Scheme Administrator"[5] or "Scheme Trustee") for that purpose. However, generally ,such Scheme Administrator or Scheme Trustee can exercise his powers only after the scheme has been approved by the creditors and the court. A scheme proposed under the CCAA [Can.] may also provide for the appointment of a creditors' committee with powers analogous to those enjoyed by the inspectors in a bankruptcy.[6]

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1 *i.e.* the CA 1985 [U.K.], CL [Aust.] and the CCAA [Can.] respectively.

2 See s.425(1) CA 1985 [U.K.] and ss.4 & 5 CCAA [Can.].

3 See s.411(1) CL [Aust.].

4 *Re Canadian Bed and Breakfast Registry Ltd.*, (1986) 65 C.B.R. (N.S.) 115,

5 The use of "Scheme Administrator" also helps to distinguish such an administrator from the administrators in an English Administration (referred to in this thesis as an "English Administrator) and an Australian Voluntary Administration (referred to as an "Australian Voluntary Administrator").

6 Houlden L.W. & Morawetz C.H. *Bankruptcy and Insolvency Act* (Revised) Carswell Canada, §
(continued...)

The first task facing a successful applicant for the court's order would be to send out the notices convening the meetings to the creditors and members. This task would generally be performed by the company secretary[7] or the directors of the company unless the application to court was made by an administrator in England, a trustee in bankruptcy in Canada, or the liquidator in all three jurisdictions. In which event such administrator, trustee in bankruptcy or liquidator would have to perform that task. In England and Australia, the notices convening the meeting should be accompanied by an explanatory statement, a copy of which would have been placed before the court at the time the application was made. In Canada under the CCAA [Can.], the provision of an explanatory statement is not mandatory but is usually required by the Court. Since there is no obligation upon the applicant to attach the explanatory statement to its application to court, such a statement would have to be prepared before the notices are sent out. Attention has been drawn to the fact that the Canadian Courts have in some instances allowed the company to make an application without having prepared the proposal which is to be placed before the meeting(s) of the creditors. In such circumstances a proposal would have to be prepared and submitted to court before the order requiring the meetings to be summoned were made.[8]

Significantly, there is no requirement in either jurisdiction that the proposed scheme be examined by an independent financial expert. However, it appears that in England and Australia a practice has developed of sending the creditors and members, where applicable, a composite document comprising in addition to the statutorily prescribed documents, letters from the Chairman of the company and its financial advisors recommending the scheme together with other information as appropriate about the financial position of the company.[9]

Managing the company until the meetings are held

If a court orders that meetings of a company's creditors be summoned to consider a scheme of arrangement, the making of the order has no automatic effect on the conduct of the company's business, property and affairs.

6(...continued)
N.10.

7 *Re Commonwealth Oil Corporation Ltd., Petitioners,* 1951 SC 570, 1951 SLT 371, *Scottish Eastern Investment Trust Ltd., Petitioners,* 1966 SLT 285.

8 See Chapter Three at p.128 *supra.*

9 See Sherman, Ian *Shakleton on the Law and Practice of Meetings*, 8th ed., London, Sweet and Maxwell, p.177; *Atkin's Court Forms*, Vol 9. Table 5, Item 14; BCH Scheme.

In England, Australia and Canada there are no statutory provisions which govern the management and control of the company during the procedure leading to a Scheme of Arrangement proposed outside another insolvency regime.[10] During this period, the power to manage the company remains with the directors, and there is no legal impediment which stands in the way of their validly carrying out all the functions and duties expected of them and in so doing exercising all the powers conferred on them by law and the company's articles.

In England, the creditors would not be prejudiced by the directors retaining their managerial powers for the reason that at the slightest hint of mismanagement by the directors the creditors would be able to exercise any contractual or legal right to recover their dues. In contrast, in Australia and Canada owing to the protection of the moratorium creditors will not be able to exercise some of their rights against the company. If it appears that the company's property is at risk, in such circumstances in Canada it is customary to have a receiver appointed by the court to protect the company's property.

A significant deterrent in England and Australia to the wrongful or negligent exercise of such powers, for example to incur more debt on behalf of the company or to dispose of its assets, ought to be the fear that such actions would amount to wrongful or insolvent trading which, if the Scheme of Arrangement failed and the company proceeded into winding up or bankruptcy, could eventually lead to the directors being either called upon to make a contribution to the company's assets in order to compensate the company's creditors[11] or being disqualified from holding office as director for a period of time.

Whether the directors remain in control after the meeting depends very much upon the outcome of the meeting and, if the proposal or scheme has been approved, the terms of the approved proposal or scheme. After a scheme of arrangement has been approved by the creditors and the court in Australia, the business and property of the company or only the assets incorporated in the scheme should be administered by a scheme administrator. However, the creditors have the freedom to require that the business and assets of the company be administered in this manner, and should they do, the courts are unlikely to interfere with their wishes.

POST-INITIATION PROCEDURE IN A CVA

The role of the "Nominee"

It has been seen that under s.425(1) CA 1985 [U.K.] meetings of a company's creditors and members to consider a Scheme of Arrangement may be summoned only after an order giving

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10 That is outside a liquidation in England, Canada and Australia, a bankruptcy in Canada and an Administration in England.

11 s.214 IA 1986 [U.K.]

directions to that effect is made by the court. It will be seen that once a Scheme of Arrangement is approved by a three fourths majority of the creditors and sanctioned of the court, it becomes final and binding on the one fourth or less of creditors who voted against it at the meeting. One of the benefits of the court's involvement is that the procedure under which the sanction is obtained provides the creditors with a final opportunity to bring to the court's attention any irregularity or abuse of procedure by the debtor company which may have taken place or manifested itself after the initial court order.[12] The benefits associated with the court's involvement, however, cannot be enjoyed without suffering its disadvantages. The Schemes of Arrangement procedure has been criticized as slow and cumbersome and it is the courts involvement which has been identified as being mostly to blame.[13] The Cork Committee further doubted whether:

> "[P]ainstaking perusal of documents by Court officials with little or no experience of commerce or finance provides any real protection for creditors or contributories."[14]

Consequently, during the 1986 reforms when the new Administration Order Procedure and CVAs were introduced, an attempt was made to avoid the costs and delay connected with the court procedure by vesting some of the supervisory powers exercised by the courts in an individual who was an insolvency practitioner. In the case of a CVA, this individual is the "Nominee".

It may be recalled that the procedure in a CVA is initiated by the making of a proposal for a CVA to the creditors and the company. The proposal may be made by the directors of the company or during the course of an English Administration or a liquidation, by an administrator or liquidator. Whoever makes the proposal, the appointment of a "nominee" is an essential ingredient in a CVA. Indeed, CVA under Part 1 of the Insolvency Act, 1986, is identified with specific reference to the nominee. The nominee is associated with the procedure from the moment the proposal is made until the company and the creditors decide whether to accept or reject it. If it is accepted, the nominee may continue to be associated with the implementation of the approved proposal under the new title of the "Supervisor", should the company and the creditors decide at the meetings to retain his services. Thus, unlike in a Scheme of Arrangement under the new CVA procedure the court is not involved at the initiation and approval stages.

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12 The matters which are considered by the Court prior to sanctioning a Scheme of Arrangement are examined more fully in Chapter Seven *ante*.

13 See the *Cork Report* paras.400-430. Goode says the procedure is "cumbersome" and "best avoided where ever possible". See Goode, *"Principles"*, p.15.

14 *Cork Report*, para.419.

However, a total break with the old system has not been viewed as desirable, and in a CVA the court still has a limited ability to interfere with the procedure upon the application of an aggrieved party.

The nominee must be an Insolvency Practitioner.[15] Where the administrator or the liquidator makes the proposal, each has the option to appoint himself as the nominee.[16] An administrator and a liquidator (except in a voluntary liquidation) are both court appointees in a court driven insolvency procedure. Both owe a duty to the court, and where either nominates himself to act, in relation to the CVA, as trustee or otherwise for the purpose of supervising its implementation, they would at all times be subject to supervision by the Court. The exercise of this discretion by the administrator or the liquidator affects the procedure to be followed after the nominee is appointed, since it varies depending on whether or not the administrator or the liquidator is the nominee.

During the course of the ensuing discussion it will be examined whether the appointment of a nominee is indeed crucial to the implementation of a CVA, notwithstanding the identity of the person making the proposal and whether the nominee plays a significant part in distinguishing the CVA from other rescue procedures.

Role of Nominee who is not the Administrator or Liquidator

A single duty, performed exclusively by the nominee who is not the administrator or the liquidator, differentiates his role in the CVA from the role played by the nominee who is the liquidator or the administrator. Otherwise, barring a few differences the two roles are very similar.

The nominee must, within 28 days after being given notice of the proposal for a voluntary arrangement submit a report to the court stating whether, in his opinion meetings of the company and of its creditors should be summoned to consider the proposal.[17] If he opines that such meetings should be summoned, he must also state the date on which, and the time and place at which, he proposes that the meetings should be held.

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15 s.1(2) IA 1986 [U.K.]. N.B. The DTI Consultative Document, 1993 inquires in to the feasibility of removing this requirement. See paras.2.7 and 2.18.

16 Administrators and liquidators are required to be insolvency practitioners. See s.230 IA 1986 [U.K.].

17 s.2(2) IA 1986 [U.K.]. This report may be equated to the r.2.2. IR 1986 [U.K.] report which the court has the discretion to call for under in an English Administration. The cost of procuring a Rule 2.2 report, is/has been blamed for the low use of the Administration Order procedure. See the discussion at p.187 *infra*.

The act does not specify what constitutes notice for the purpose of s.2(2) IA 1986 [U.K.]. Although the report is submitted to the court, no order or decision of the court flows directly from the court as a result. The most obvious beneficiaries of such a report would be the creditors affected by the proposal, however they do not receive a copy, merely notice of the court in which it is filed so that they may independently peruse the report should they wish to do so.

In order that the nominee may prepare his report to the court, the person intending to make the proposal,[18] is required to submit to the nominee a document setting out the terms of the proposed voluntary arrangement and a statement of the company's affairs.[19]

S.2(3) IA 1986 [U.K.] does not specify that these documents should be given to the nominee at the time he is given notice of the proposed CVA. However, the 28 day period within which the nominee is required to make his report begins to run from the date on which he is given notice.

The particulars required to be set out in the proposal are the same whether the proposal is made by the directors, or the responsible insolvency practitioner and whether or not the latter, as liquidator or administrator, appoints himself as the nominee. In addition, an administrator is required to disclose the names and addresses of the company's preferential creditors with the amounts of their respective claims and both the liquidator and the administrator are required to disclose the matters which they consider appropriate to ensure that members and the creditors can make an informed decision on the proposal.[20]

The company's statement of affairs - its primary role under the Act

The purpose of the company's statement of affairs under the Act is to assist the nominee in making a report on the proposal to the court.[21] This role under the act applies only where the nominee is not the liquidator or the administrator. Nothing further is expected of the statement of affairs under the Act. It will be seen later that it has another role under the Rules, the importance of which is questionable, which applies whoever is the nominee.

The Act leaves it to the Rules to specify the timing and contents of the statement of affairs. The contents are merely described broadly as "such particulars of its creditors and of its

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18 This includes the administrator and the liquidator where neither intends to appoint himself the nominee.

19 s.2(3) IA 1986 [U.K.].

20 These particulars are discussed in Parts 4.3.2 and 4.8 *supra*.

21 s.2(3) IA 1986 [U.K.].

debts and other liabilities and of its assets as may be prescribed" and "such other information as may be prescribed".[22]

The timing of the statement of affairs

Where the proposal is made by the directors the Rules require that the statement of affairs should be delivered to the nominee within seven days of the proposal having been delivered to him.[23] However, it should have been prepared more than two weeks prior to giving notice of the proposal to the nominee.[24] The nominee has the discretion to extend this period to the nearest practicable date, as long as it is not more than two months before the date on which the proposal was notified to him. If the nominee does grant such an extension he must give his reasons in his report to the Court on the proposal.

Content of the statement of affairs

The matters required by the Rules to be covered in the statement of affairs go over some of the ground already covered in the proposal.[25]

In the statement of affairs the directors must list the company's assets, divided into such categories as are appropriate for easy identification, with estimated values assigned to each category.[26] Since the assets with an estimate of their respective values[27] would have already been dealt with in the proposal, the only new information provided by this disclosure is the division of the assets into categories and the estimation of the value of each category. The criterion to be met in dividing the assets into categories is that it must be appropriate for easy identification. Whether this means identification as fixed or movable, corporeal or incorporeal, encumbered or unencumbered, possessed or non possessed, is not clear.

The next matter that must be dealt with in the statement of affairs flows naturally from the former if the division of assets into categories was based on whether they were encumbered or not. In the case of any property on which a claim against the company is wholly or partly secured, particulars must be given of the claim and its amount, and how and when the security

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22 s.2(3)(b) IA 1986 [U.K.].

23 r.1.5(1) IR 1986 [U.K.].

24 r.1.5(3) IR 1986 [U.K.].

25 r.1.5(1) IR 1986 [U.K.].

26 r.1.5(2)(a) IR 1986 [U.K.].

27 This implies that each asset must be identified.

was created.[28] This information is also linked to the disclosure of under Rule 1.3(2)(a)(ii). However, the importance of this information lies in its the close connection to the disclosure required to be made under Rule 1.3(2)(c)(iii) in relation to preferences. Even if the proposal denies having preferred any creditors this information, which must be certified as correct, would disclose the existence of any preferences.

In connection with liabilities, only the nature and amount of the company's liabilities, together with the manner in which they are proposed to be dealt with need to be identified in the proposal. No disclosure is required of the identity of the persons to whom the company is liable. This lacuna is filled by requiring the names and addresses of the company's preferential and unsecured creditors with the amounts of their respective claims set out in the statement of affairs.[29]

Where the company stands as debtor or creditor to persons connected with it the particulars of such transactions should also be disclosed.[30] This will provide the nominee with information of, inter alia, any extortionate credit transactions which should have also been disclosed in the proposal.

Nowhere in the proposal is mention required to be made of the members of the company. The statement of affairs is the only document presented to the nominee, which must make any reference to the members. It requires the disclosure of the names and addresses of the company's members, with details of their respective shareholdings.[31]

The draughtsman of the Rules recognizes that some of the matters required to be stated in the statement of affairs relate to matters which have been, to a greater or lesser extent, already covered in the proposal. The disclosures in the statement of affairs are seen as supplementing, or amplifying, so far as is necessary for clarifying the state of the company's affairs, those particulars already given in the proposal.[32]

Finally the statement of affairs must set out any other particulars which the nominee may call upon in writing to be furnished for the purpose of making his report on the proposal to the Court.[33] If information on these particulars is to be contained in the statement of affairs then

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28 r.1.5(2)(b) IR 1986 [U.K.].

29 rr.1.5(2)(c) 1.5(2)(d) IR 1986 [U.K.].

30 r.1.5(2)(e) IR 1986 [U.K.].

31 r.1.5(2)(f) IR 1986 [U.K.].

32 r.1.5(2) IR 1986 [U.K.].

33 r.1.5(3)(g) IR 1986 [U.K.].

the request for it must be made before the statement of affairs is delivered to the nominee. Any information required after it has been delivered must be called for under Rule 1.6.

A minimum of two directors or the company secretary and a director must certify that the statement of affairs is correct to the best of their knowledge and belief.[34] Since the statement of affairs is made for the purpose of obtaining the approval of the company's members or creditors to a proposal, a false representation in the statement of affairs is an offence and makes the directors and/or the company secretary who signed the certificate liable to imprisonment or a fine or both.[35]

Unlike the directors, neither the liquidator nor the administrator, is given seven days to provide the nominee with a copy of the company's statement of affairs.[36] However, attention must be drawn to the fact that the statement of affairs required to be provided is not identified as being identical to the one described in Rule 1.5. Whereas Rules 1.2, to 1.4, 1.6 to 1.9 and where relevant Rule 1.10, are all referred to in Rule 1.12 as applying *mutatis mutandis* to a proposal by either the liquidator or the administrator, no reference is made to Rule 1.5. This means that neither the liquidator nor the administrator need certify that the statement of affairs is correct to the best of their knowledge and belief.

Additional disclosure for the assistance of the nominee

If the nominee takes the view that he cannot prepare his report on the basis of the information disclosed in the proposal or the statement of affairs he has the power to call upon the person making the proposal to provide him with further information.[37]

In addition to giving the nominee a wide discretion to call for "any" further information which he thinks necessary for the purpose of his report,[38] the rules specify two matters previously not required to be disclosed in the proposal or the statement of affairs.

First, he may call for further and better particulars as to the circumstances in which, and the reasons why the company is insolvent or (as the case may be) threatened with insolvency.[39] Among the statutory provisions and Rules relating to company voluntary arrangements contained

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34 r.1.5(4) IR 1986 [U.K.].

35 r.1.30 IR 1986 [U.K.].

36 r.1.12(5) IR 1986 [U.K.].

37 r.1.6(1) IR 1986 [U.K.]. This Rule applies equally to liquidators and administrators where either appoints another insolvency practitioner as the nominee.

38 r.1.6(1)(c) IR 1986 [U.K.].

39 r.1.6(1)(a) IR 1986 [U.K.].

in Part 1 of the Insolvency Act, 1986, and the Insolvency Rules, 1986, respectively, this is the only provision which identifies the company seeking a voluntary arrangement as being insolvent or on the threshold of insolvency. In fact this is the only provision which uses either "insolvent" or "insolvency" in connection with the company.[40] However, the insolvent, or near insolvent, state of a company is implied in this Part where the proposal is made by an administrator.[41] It is also implied where the liquidator has been appointed in a creditors' voluntary winding up or a winding up by court on the grounds of the company's inability to pay its debts.[42]

Second, he may require particulars of any previous proposals which have been made in respect of the company under Part 1 of the Act.[43] While this information does not by itself imply that the company is, or is likely to be, unable to pay its debts, it indicates whether the company has previously experienced similar financial difficulty.

Nominee's report to Court

Within 28 days of receiving notice of the proposal, the nominee is required to submit a report to the court.[44] The report must be accompanied with a copy of the directors' proposal and a copy or summary of the company's statement of affairs.[45] The report must state whether, in his opinion, meetings of the company and of its creditors should be summoned to consider the proposal. If meetings are to be summoned, the nominee must attach his comments on the proposal to the report. Where the nominee is of the view that meetings should not be summoned, he must give his reasons.[46]

If the nominee opines that the meetings should be summoned, he must also propose the date on which, and the time and place at which the meetings should be held.[47] Unless the court directs otherwise, the duty to summon the meetings falls upon the nominee.[48]

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40 The word "insolvency" is used many times as part of the phrase "insolvency practitioners".

41 s.8(1) IA 1986 [U.K.].

42 In principle there is no restriction on a liquidator appointed in a members voluntary winding up from making a proposal. It is likely however, to prompt an immediate conversion to a creditors voluntary winding up.

43 r.1.6(1)(b) IR 1986 [U.K.].

44 s.2(2) IA 1986 [U.K.].

45 r.1.7(1) IR 1986 [U.K.].

46 r.1.7(2) IR 1986 [U.K.].

47 s.2(2)(a)&(b) IA 1986 [U.K.].

48 s.3(1) IA 1986 [U.K.].

Summoning of meetings

If meetings of the company's creditors and members are to be summoned to consider the proposal, the meetings should be held not less than 14, and no more than 28, days from the date on which the nominee's report was filed in court. Since the creditors and members should have at least 14 days notice of the meeting the nominee is required to send the notices calling the meetings within 14 days of filing his report in court.[49]

Notices to the creditors and the members of the meetings should specify the court to which the nominee's report on the proposal has been delivered and be accompanied by, in addition to the proposal itself and the statement of affairs of the company, the nominee's comments on the proposal. Elements of the notice common to all proposals are discussed below.

Role of Nominee who is the liquidator or administrator

It has been mentioned earlier[50] that a proposal is identified with specific reference to the person called the nominee appointed to act in relation to the voluntary arrangement either as trustee or otherwise for the purpose of supervising its implementation.[51]

The role of the nominee who is not the administrator or the liquidator may be clearly distinguished from the role of the person(s) making and delivering the proposal to him. Once the proposal has been delivered to the nominee, the person who made and delivered it ceases to be able to exercise any real control over the procedure that is to follow. The role of such a nominee is clearly defined with regard to his obligation to file a report on the proposal and summoning and holding of creditors' and members' meetings.

In contrast, where the liquidator or administrator appoints himself as the nominee, (for the purpose of convenience such a nominee is hereafter referred to as the "administrator/liquidator nominee"), there does not appear to be any significant role which he is required to play as nominee which he cannot otherwise perform, or is distinguishable as significantly different from his role as administrator/liquidator. The administrator/ liquidator nominee is excluded from the scope of section 2 since it would be futile to require him to prepare a report on his own proposal.[52] Accordingly, the majority of the rules discussed in the preceding section, also do

49 r.1.9,(1)&(2) and r.1.12(7) IR 1986 [U.K.].

50 See the discussion at page 289 *supra*.

51 s.1(2) IA 1986 [U.K.].

52 Notwithstanding the inapplicability of this section and the attendant rules a statement of the company's affairs, is required to be prepared by the administrator or the liquidator under IR 1986 (continued...)

not apply to him.[53]

Besides making a report on a proposal, a nominee's only other duty under Part I of the Act is in connection with the meetings of the company's creditors and members which are summoned to decide whether to approve the proposed voluntary arrangement. Where an administrator or a liquidator is the nominee, whether these meetings are summoned by him in his capacity as the administrator or the liquidator or as the nominee is unclear. Section 3(2) provides that "Where the nominee is the liquidator or the administrator, he shall summon meetings of the company and its creditors....". However, meetings are summoned under Rule 1.11 by "the responsible insolvency practitioner" who is identified in Rule 1.1(3) as the liquidator or the administrator. Thus, while under the Act, the liquidator or the administrator is required *as the "nominee"* to summon meetings of the creditors and members, under the Rules the "nominee" has no role to play. Since the Rules should not be seen to vary or alter the statute, all references to the "insolvency practitioner" in Rule 1.11 should be read as referring to the "insolvency practitioner" acting in his capacity as the "nominee".

Although the line which demarcates the boundary between the dual roles of the responsible insolvency practitioner is, at best, blurred, there being no practical impact of the administrator/liquidator nominee on a company voluntary arrangement, an enquiry into the function of the administrator/liquidator nominee serves to highlight the limitations of s.1(2) IA 1986 [U.K.] which identifies a proposal for a CVA with reference to the appointment of a nominee.[54]

Meetings of the company and creditors

It is the duty of the nominee to summon meetings of the company and the creditors to consider the proposal. Each subsection in section 3 uses different words to identify the person whose obligation it is to summon the meetings. Under sub-section 3(1) it is the obligation of "the person making the report". In sub-section 3(2) it is "he" who is the liquidator or administrator. In sub-section 3(3) it is "the person summoning the meetings". Perhaps for this reason the Rules

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52(...continued)
[U.K.]. The purpose of this statement, which is to be discussed below, is limited compared to the purpose of the statement prepared under s.2 IA 1986 [U.K.] and r.1.5 IR 1986 [U.K.].

53 r.1.5 IR 1986 [U.K.] may, however, indirectly apply in ascertaining the contents of the Company's Statement of Affairs.

54 s.1(2) IA 1986 [U.K.].

refer to the "person summoning the meeting" as the "convenor"[55] and not as the nominee, although, under the Act only the nominee may in fact summon the meetings. The nominee as convenor, and therefore as chairman or selector of the chairman of the meeting, wields considerable influence on the outcome of the voluntary arrangement through the proxy mechanism which may vest in him the discretion to approve or reject the voluntary arrangement.

Timing, date and place of meetings

Under the Act the nominee has the absolute discretion to summon the meetings for the time date and place of his choosing. Sub-section 3(1) mandates the summoning for the time date and place proposed in the report. Since the report is prepared by the nominee there is no dilution of his discretion. If the nominee is the liquidator or the administrator sub-section 3(2) expressly allows the nominee to summon meetings for such time date and place "as he thinks fit".

The exercise of the nominee's unlimited discretion granted in the Act is restricted by the Rules. Rule 1.13(1) requires the nominee to have regard primarily to the convenience of the creditors in fixing the venue for the meetings. This may be appropriate since, traditionally, creditors' interests are considered the most important in an insolvency. Under Rule 1.13(2), separate meetings of the company and the creditors should be held on the same day and in the same place to consider the proposal. Perhaps for the reason that members of the company may also be its creditors, the meetings should be held separately with the creditors' meeting held in advance of the company meeting.[56] For practical reasons it is doubtful whether this is as appropriate a reduction of the nominee's discretion. For instance, if the company has a large number of creditors and members it may not be possible to conduct both meetings on the same day, particularly if there are members who are also creditors of the company. Although a possible solution would be to ask the creditor/ members concerned to give a proxy in favour of the chairman indicating his voting intentions, this would in turn deprive him of his right *qua* creditor or member to personally attend and vote at the meeting. The meetings should also be summoned for commencement between 10.00 and 16.00 hours on a business day. The same day Rule, although appearing sensible when read in isolation, may prove difficult to implement in the context of a single chairman for both meetings[57] and the requirement that if the meetings are

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55 r.1.13(1) IR 1986 [U.K.].

56 Notwithstanding the actual timing of the meetings, if the proposal is approved, by a legal fiction, it takes effect as if made by the company at the creditors meeting.

57 r.1.14 IR 1986 [U.K.].

adjourned, both should be adjourned for the same day.[58]

Who should be summoned?

Creditors

Every creditor of the company of whose claim and address the nominee is aware is entitled to be summoned to the creditors' meeting.[59] Thus, the identity of a person entitled to be summoned to a meeting is determined with reference to:

- whether that person is a creditor; and
- the nominee's awareness of that person's claim and address.

There is no definition of "creditor" in Part I of the Act but it is clear by the use of the word "claim" in sub-section 3(3) that it is to be given a wide interpretation and not be limited to persons to whom the company's indebtedness is liquidated and presently due. These creditors will include, but, it is submitted, ought not be restricted to, those persons to whom the liabilities disclosed in the proposal are owed.[60]

The receipt by a creditor of a notice to attend the creditors' meeting thus depends on the extent of the nominee's awareness of his claim and address. Under the Act, there is no obligation on the part of the nominee to enquire into and verify the identity and addresses of the company's creditors prior to summoning the meetings. The Rules however direct the nominee's attention to the statement of affairs, by providing that notices of the meeting should be sent to all the creditors identified in the company's statement of affairs. In addition it requires notices to be sent to those creditors of whom the nominee is otherwise aware.[61] Thus, the extent of the nominee's awareness of these creditors and their addresses may be ascertained objectively only in relation to the company's statement of affairs.[62] Any further knowledge will vary and depend upon the diligence and interest the nominee has in the voluntary arrangement. The absence of an imperative to the nominee to enquire into the company's creditors in no way detracts from the ability of a creditor to bring himself to the nominee's attention. Should a creditor do so, the

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58 r.1.20 IR 1986 [U.K.].

59 s.3(3) IA 1986 [U.K.].

60 See r.1.3(2)(c) IR 1986 [U.K.].

61 The limitation of the nominee's awareness that may be implied by the direction to the Rules are removed by this further requirement.

62 Except where the nominee is not the liquidator or the administrator, this statement of affairs is prepared by the nominee. The details which have to be included in this statement of affairs is examined further on.

nominee would be obliged to notify him of the meeting.

In a case[63] arising pursuant to section 262 of the Act and Rule 5.17(3) and (7), [individual insolvency - voluntary arrangement] it was argued that the Chairman's discretion at a creditors' meeting under Rule 5.17(4) extended to rejecting a claim which was obviously bad on the face of it, raising the spectre of non-creditors having been summoned to the meeting. Harman J observed *obiter*:

> "I find that a perfectly possible reading of the rules but on the other hand a slightly surprising one since sub-r(I) starts by dealing with creditors given notice of the meeting and one would not expect creditors who are not creditors of the debtor to be given notice of the meeting. I suppose a mistake could be made and if a mistake were made it might be convenient and desirable for the chairman to have power under sub-r (4) to rule upon that claimed creditor's position. However, that would not be truly 'rejecting a creditor's claim', it would be 'rejecting a claim to be a creditor', because the claiming creditor by definition would not be a creditor at all."[64]

His Lordship himself acknowledged the semantics involved. Since the reasoning was not germane to any of the issues decided in the case it has only persuasive value and may even be ignored altogether. It does however, prompt the question whether a person with a manifestly bad claim is nevertheless entitled to be summoned to the meeting.

It has been said that the nominee is not obliged to enquire into the existence of the creditors prior to summoning the meetings. At this stage he similarly does not have the power to make a decision on the validity of the claim. It is submitted therefore, that even if a claim is manifestly bad, if it is brought to the notice of the nominee, before notices for the meeting are sent out, he should summon the person claiming as a creditor to the meeting. If the nominee were to reject such a claim there is no procedure at this stage whereby the person concerned may appeal to the court against the decision of the nominee. Thus the proper place for the nominee to admit or reject that person's claim is at the meeting under r.1.17(4). The appeal procedure under r.1.17(5) is available to any dissatisfied claimant whose claim is disallowed.

Members

In contrast, beyond requiring the nominee to summon meetings of the members, the Act remains silent. The attempt to fill this lacuna in Rules is far from satisfactory. It provides that in the case of the company meeting notices are required to be sent to all persons who are to the

63 *Re a debtor (No 222 of 1990), ex parte the Bank of Ireland and others* [1992] BCLC 137 at 142.

64 *ibid*, at p.142 a-b.

best of the nominee's belief members of the company.[65] Once more reliance is placed upon the subjective level of the nominee's awareness and not on any documentation. It is significant that although the directors' statement of affairs is required to list the members of the company no reference is made to it in the rules. This list ought to give far fuller disclosure of the members in contrast to the corresponding disclosure of the creditors.

Directors

Every current director of the company has a right to attend the meetings of the creditors and the company. Thus, in addition to summoning the creditors and the members of the company to the meetings, the convenor is required to give at least 14 days notice of the meetings to all the directors of the company. He also has the discretion, if he thinks their presence would be required, to summon those persons who are officers of the company, or who were, within the two years immediately preceding the date of the notice, former directors or officers of the company.[66] The right of the directors to attend the meetings is subject to the chairman's right to exclude any director or officer from all or part of a meeting.[67]

Timing and content of notice

If meetings of the company's creditors and members are to be summoned to consider the proposal, the meetings should be held not less than 14, and no more than 28, days from the date on which the nominee's report was filed in court. Since the creditors and members should have at least 14 days notice of the meeting the nominee is required to send the notices calling the meetings within 14 days of filing his report in court.[68]

Notices to the creditors and the members of the meetings should specify the court to which the nominee's report on the proposal has been delivered and be accompanied by, in addition to the proposal itself and the statement of affairs of the company, the nominee's comments on the proposal.

The company's statement of affairs - its secondary role under the Rules

The sole purpose for which the company's statement of affairs is submitted to the nominee under the section 2(3) of Part I of the Act is to enable him to prepare his report on the proposal

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65 rr.1.9(2)(a) and (b), r.1.12(7) and r.1.11(1) IR 1986 [U.K.].

66 r.1.16 IR 1986 [U.K.].

67 r.1.16(2) IR 1986 [U.K.].

68 r.1.9,(1)&(2) and r.1.12(7) IR 1986 [U.K.].

to the Court. As has been seen the section which imposes this requirement has no application where the responsible insolvency practitioner is himself the nominee. No further mention is made of the statement of affairs in Part I of the Act. Thus, the responsible insolvency practitioner, who is himself the nominee, has no obligation under the Act to prepare a statement of the company's affairs.

Chapter 3 of the Rules, also does not expressly require the responsible insolvency practitioner to prepare a statement of the company's affairs. Rule 1.10 refers only to the preparation of, and the matters that should be specified in, a Proposal. Rule 1.11, however, which is captioned/side-noted as dealing with the summoning of creditors' and members' meetings, requires that notices of the creditors' meeting be given to all the creditors "specified in the company's statement of affairs",[69] Beyond this the Rules are silent as to the time at which this statement should be prepared by the responsible insolvency practitioner, and its contents.

As regards the timing, it is apparent that the statement of affairs should be prepared along with the proposal or thereafter, but in any event before the meetings are summoned. In contrast, the contents of the statement of affairs are not so easily ascertained. It would be convenient if Rule 1.5 applied to the responsible insolvency practitioner's statement of affairs as does Rule 1.3 to his proposal under Chapter 3 of the Rules. However, as in Chapter 4 of Part I of the Rules,[70] no reference is made to Rule 1.5 in Chapter 3 of the same Part. While Rules 1.5(2) may be persuasive in determining the contents of a statement of affairs prepared by the responsible insolvency practitioner it is in no means binding on him. A more reliable guide to what the contents of a statement of affairs ought to be is the specific role it plays in the procedure as a whole. This role falls to be determined from the single reference to the statement of affairs in Rules 1.11(1)(a) and (2)(b) in Chapter 3, where it is provided that notices of the creditors' meeting should be sent are those creditors specified in the statement of affairs and that notices should be accompanied by a copy of the statement of affairs, or a summary of it which must include a list of the creditors and the amounts of their debts.[71] Thus in theory, the statement of affairs prepared by the responsible insolvency practitioner must necessarily contain only a list of the company's creditors and the amounts of their debts. Critics would argue that it would only

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69 r.1.11(1)(a) IR 1986 [U.K.].

70 See r.1.12 (1) to (7) IR 1986 [U.K.] inclusive.

71 It is significant that the members to whom the notices are to be sent in all cases are those who are "to the best of the nominee's belief" members of the company despite the fact that the names and addresses of the company's members have to be detailed in the statement of affairs under r.1.5.(f) IR 1986 [U.K.].

be a maverick insolvency practitioner that did not furnish the creditors and the members with a statement of affairs setting out all the particulars contained in Rule 1.5(2) and that the foregoing analysis serves no purpose. However, in an age of upwardly spiralling professional charges an additional document or report represents an additional cost. Further, most of the particulars in Rule 1.5(2) are only an expansion on some of the particulars that should in any event be dealt with in the proposal.

It is submitted therefore that there appears to be no good reason why the statement of affairs should not be dispensed with by incorporating its features into the proposal. Where the proposal is made by the directors the certification in Rule 1.5(4) may just as well be made in the proposal. The nominee should however, retain the authority to call for further particulars as is provided for in Rule 1.6.

Failure to prepare a full statement of affairs.

Since the number and identities of creditors summoned to a meeting of the creditor' under r.1.11(1)(a) and r.1.12(7) are dependent upon the number of creditors' named by the author of the statement of affairs, is the author liable to any person for failing to identify and name any creditor.

Should the voluntary arrangement be approved by the creditors and the company it does not bind any creditor who did not have notice of the meeting. Consequently, the rights of a creditor who is not summoned for a meeting, as far as they relate to the recovery his debt, are not prejudiced. For example such a creditor would not be party to any agreed moratorium period and would be able to pursue the creditor without restraint. Failure on the part of the author of the statement of affairs to include a creditor in it does however prejudice the creditor's right to participate in the voluntary arrangement. If a sizable debt is owed to a creditor, it would prove most difficult after a voluntary arrangement has been approved, to include him in the voluntary arrangement without affecting the repayment terms and delaying the duration of the scheme.

Conversely, the sudden appearance of a creditor who stands outside the voluntary arrangement, who is not restrained by contractual moratorium clauses may be more prejudicial to the creditors who are a party to the voluntary arrangement. In the absence of an automatic termination clause, which restores the pre-proposal status quo between creditors, the creditors bound by the voluntary arrangement are vulnerable to any sudden winding up of the company, or other change in its status, during the course of the implementation of the voluntary arrangement. The question therefore, arises whether the author of the statement of affairs owes the other creditors and the company a duty of care to enquire into and ascertain who the company's creditors are.

It has been mentioned that the nominee has no obligation to enquire into the existence and identity of creditors at the stage of summoning the creditors' meeting and that primarily he should be guided by the statement of affairs. Where the statement of affairs is prepared by the directors, they are directed to mention in the statement of affairs all those details set out in r.1.5(2). Where the nominee is a responsible insolvency practitioner there is no such requirement, although a prudent responsible insolvency practitioner would be guided by this rule. In the absence of statutory direction on the preparation of the statement of affairs, it is submitted that the responsible insolvency practitioner should exercise care in preparing the statement of affairs.

Management of the company in a CVA

There is no requirement in the statutory provisions that when a proposal for a CVA is made by the directors that the powers of management and control over the company's business, property and affairs should be vested in an independent person. The management of the company in a CVA proposed by the directors therefore remains vested in them and they may exercise all such powers granted to them under the company's Articles of Association and the Law. In the case of a CVA proposed by the administrator or liquidator, the position is of course different. The administrator manages the company at his discretion by virtue of statutory authority[72] and the liquidator to the extent that it is necessary for the beneficial winding up of the company.[73]

Thus, the supervisory role of the nominee in a CVA proposed by the directors is clearly limited to examining the proposal for the purpose of determining whether meetings of the creditors should be summoned to consider it. The nominee is not required to monitor the conduct of the company's business by the directors.[74] The absence of such a person to monitor the conduct of the company's affairs until the meetings of the creditors are summoned may not worry the creditors for the reason that, as there is no moratorium, provided the creditors are vigilant, an abuse of managerial power may be halted by placing the company in liquidation or administration.[75]

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72 s.14(1) read with Schedule 1 IA 1986 [U.K.].

73 With the Court's sanction in a winding up by the Court. See Schedule 4 para.5 IA 1986 [U.K.].

74 *n.b.* No recommendation to this effect was made in the DTI Consultative Document 1993.

75 *cf.* the position in Canada in a Proposal under a Notice of Intention where the trustee assists and supervises the drafting of the proposal an also monitors the conduct of the company's affairs.

POST-INITIATION PROCEDURE IN CANADIAN PROPOSALS

The procedure leading to a Proposal is initiated by the insolvent or bankrupt company lodging a Proposal with a licensed trustee.[76] Before lodging a Proposal with a licensed trustee, however, an insolvent company may file a Notice of Intention to make a Proposal with the Official Receiver.[77] In the former instance the "solution" to the company's debt repayment crisis has been proposed whilst in the latter the "solution" is yet to be formulated. The post-initiation procedure up to the meetings of creditors in a Canadian Proposal, therefore, varies according to whether a Notice of Intention to make a Proposal has been filed or not. It is therefore necessary to consider the functions of the company and trustee under these two heads.

The company's and trustee's duties under a Notice of Intention

Informing the creditors of the Notice of Intention

The trustee named in the notice of intention is required, within five days after a filing of a notice of intention, to send to every known creditor, in the prescribed manner, a copy of the notice of intention.[78]

The company's projected cash-flow Statement

Within ten days of filing a notice of intention, *the company* is required to prepare and file with the Official Receiver a statement indicating its *projected* cash-flow.[79] The cash-flow statement would ordinarily be based on probable and hypothetical assumptions that reflect the company's planned course of action for the period covered by the intended Proposal.[80] The Canadian Insolvency Practitioners Association consider a hypothetical assumption to be one that assumes a set of economic conditions that are not necessarily the most probable in its author's judgement, but are consistent with the purpose of the cash flow projection.[81] Thus the purpose of the cash-flow statement is to establish that the company has or anticipates that it will have adequate finances to see it through the period covered by the Proposal. The corner-stone of any Proposal seeking to address a company's insolvency or likelihood of insolvency would, therefore,

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76 s.50(2) BIA [Can.].

77 s.50.4(1) BIA [Can.].

78 s.50.4(6) BIA [Can.].

79 s.50.4(2) BIA [Can.].

80 See the definition of "cash-flow statement" in Canadian Insolvency Practitioners Association *Standards of Professional Practice,* No.10, §2.01, quoted in full in Houlden L.W. & Morawetz C.H. *Bankruptcy and Insolvency Act* (Revised) Carswell Canada, E§4.1.

81 Canadian Insolvency Practitioners Association, *Standards of Professional Practice*, *supra.*

be its projected cash-flow statement. The company should also prepare a report regarding the preparation of the cash-flow statement.[82]

Should the insolvent person fail to file its projected cash-flow statement within the prescribed time, the question arises whether the Court has the authority under s.187(11) BIA [Can.] to grant an extension of time? In *Re IDG Environmental Solutions Inc*[83] it was held that the Court has no right to extend the time for filing. S.187(11) applies only if there is no intervening statutory event which occurs on default. Under the BIA [Can.] bankruptcy occurs immediately on the expiration of the 10 day period if no cash-flow statement has been filed. Thus it was held that an extension of time by the Court would amount to setting aside the assignment and abrogating the rights of the creditors and others acquired or occurring on bankruptcy. The matter is not, however, by any means settled. In *Re Casa Verde Health Centre Inc.*[84] the time for filing the cash-flow statement and connected reports under s.50.4(2) BIA [Can.] was extended retroactively and the deemed assignment in bankruptcy pursuant to s.50.4(8) BIA [Can.] was set aside.

Trustee to review the "cash flow statement"

The trustee is not required statutorily to prepare or assist in the preparation of the cash flow statement. The cash-flow statement must, however, be signed by both the company and the trustee and should have been reviewed for its reasonableness by the trustee.[85] The trustee is required to prepare for filing a signed report, in the prescribed form, on the reasonableness of the corporation's cash-flow statement.[86] Of the documents filed by the company, the trustee's report ought to be the most important in the eyes of the corporation's creditors because it originates from a relatively impartial third party.[87] Because the report follows a prescribed form it remains to be seen whether it will become a rubber stamping exercise.

Perhaps in order to prevent it becoming such an exercise the trustee is required to act in good faith and take reasonable care in reviewing the cash-flow statement. If the trustee does so he is not liable for loss or damage to any person resulting from that person's reliance on the cash-

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82 s.50.4(2)(c) BIA [Can.].

83 (1993) 16 C.B.R. (3d) 317.

84 (1994) 22 C.B.R. (3d) 24

85 ss.50.4(2)(a) s.50(6)(a) BIA [Can.].

86 ss.50.4(2)(b) s.50(6)(b) BIA [Can.].

87 As yet there are no reported decisions of cases on this point.

flow statement,[88] indicating that it is expected that persons affected by the notice of intention will rely on both the cash-flow statement, as reviewed by the trustee, and the trustee's report. BIA [Can.] leaves the scope of meaning of person open and undefined. From the context of ss.50 and 50.4 BIA [Can.] it is clear that it would be relied upon primarily by the creditors.

If any creditor requests it the trustee must furnish him with a copy of the cash-flow statement. The court may however restrain the trustee from doing so.[89] If the company fails to file a cash-flow statement or the trustee does not review it as reasonable, the company is deemed to have made an assignment.[90]

Trustee as a monitor

From the filing of the notice of intention until the proposal is filed, or until the company becomes bankrupt, the trustee under the Notice of Intention is required to monitor the company's business and financial affairs. For this purpose the trustee has access to and must examine the "corporation's property". The "corporation's property" is defined to include the corporation's premises, books, records and other financial documents to the extent necessary to adequately assess the corporation's business and financial affairs.[91]

If the trustee determines any material adverse change in the corporation's projected cash-flow or financial circumstances it must forthwith file a report with the official receiver on the state of the company's business and financial affairs.[92] The court may also require the trustee at any time to file reports on the same matters.[93] The filing of these reports is contingent upon the deterioration of the corporation's affairs or the court order, and in some instances the need to report may never arise.

Filing the Proposal under a Notice of Intention

Once the cash-flow statement has been filed with the trustee the next task facing the company is to file the Proposal. The content of a Proposal filed under a Notice of Intention

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88 ss.50.4(5) and 50(9) BIA [Can.].

89 Under s.50.4(4) BIA [Can.] the court has the power to order the trustee not to release the whole or part of a cash-flow statement to some or all of the creditors where it is satisfied the release would unduly prejudice the corporation and that non-release would not unduly prejudice the creditor(s).

90 s.50.4(8) BIA [Can.].

91 ss.50.4 (7) and 50(10) BIA [Can.].

92 The reports must contain such information as is prescribed under the Act.

93 ss.50.4 (7) and 50(10) BIA [Can.].

would be no different to the content of a Proposal filed without such notice, and therefore reference should be made to Chapter Three where the terms of a Proposal have been examined in detail. The Proposal must be filed with the trustee within thirty days of having filed the Notice of Intention with the Official Receiver. In the intervening period between the filing of the Notice of Intention and the filing of the Proposal, BIA [Can.] places an obligation upon the trustee to advise on and participate in the preparations of the Proposal.[94] It is important to note that BIA [Can.] does not make the trustee liable for a Proposal which may cause loss to the creditors, notwithstanding the trustee's close involvement. Nevertheless, it is submitted that it would be reasonable for the creditors to regard the trustee's involvement as an assurance that the Proposal which is eventually made will be viable.

Where the Proposal is not filed in time

A company may obtain an extension of time from the Court if it appears that it will not be able to file the Proposal within the stipulated time frame of thirty days.[95] It is however imperative that the extension be obtained before the expiration of the thirty days for the reason that a company which fails to file the Proposal within the thirty days is deemed to have made an assignment in bankruptcy to its creditors.[96] Although the trustee is required to be involved in the preparation of the Proposal he is not responsible for seeking the extension. The court may grant an extension of forty five days, per extension, up to a maximum of five months from the date the first thirty day period expired.[97]

In granting an extension of time the Court should be satisfied that: the insolvent company has acted and is acting in good faith and with due diligence; the company would be likely to be able to make a viable proposal if the extension were granted; and no creditor would be materially prejudiced by the extension.[98] In *Re High Street Construction Ltd.*,[99] the debtor filed a notice of intention to file a proposal in response to a demand by its bank for repayment of its debt. The debtor later applied to court for an extension of time to file the proposal. The bank opposed the application alleging that interest on the outstanding debt and realty tax had not been paid by the

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94 s.50.5 BIA [Can.].

95 s.50.4(9) BIA [Can.].

96 s.50.4(8)(a) BIA [Can.].

97 s.50.4(9) BIA [Can.].

98 s.50.4(9)(a)-(c) BIA [Can.].

99 (1993) 19 C.B.R. (3d) 213. (Ont.Bktcy.)

debtor. The fact that arrears of interest and realty taxes would accrue during the extension was evidence that the bank would be prejudiced by the extension. The court granted the extension noting the debtor was found to be acting in good faith and with due diligence and the extension would permit the debtor to make a viable proposal. The fact that arrears of interest and realty taxes would accrue during the extension was not sufficient evidence that the bank would be prejudiced by the extension. In contrast in *Re Baldwin Valley Investors Inc*[100] a secured creditor holding about 92% and 100% of the debt of two related companies served notice of intention to enforce its security.[101] The companies filed a notice of intention to make a proposal. Having sought and obtained an extension of time to file a proposal the debtor companies failed to file within the extended time. The companies sought a further extension which the secured creditor opposed claiming that it had lost all confidence in the debtor. The Registrar dismissed their application finding that, the debtor had failed to satisfy the court or the requirements of s.69.4(9) BIA [Can.]. He found that in view of the indebtedness to the secured creditor (i.e. 92% and 100%), a viable proposal, that is a proposal capable of implementation, was not possible. The Registrar found that the cash flow of one company was negative and the other non existent. They had no means of funding the proposal and were thus unable to meet the requirement of good faith. On appeal Farley in held that "viable proposal" should have to take on some meaning akin to one that seems reasonable on its face to the "reasonable creditor". This would ignore the possible idiosyncrasies of any specific creditor'. Nevertheless he took the view that the *draft* proposal floated by the debtor did not indicate that they would be likely to be able to make a viable proposal. He defined "likely" as found in the *Concise Oxford Dictionary of Current English* to mean "might well happen", "probable" or "reasonably expected". On all other counts Farley J concurred with the registrar's decision and dismissed the appeal.

Terminating the filing period

It is possible to terminate the period allowed for the purpose of filing the proposal with the trustee.[102] The trustee under the Notice of Intention or any interim receiver appointed to take over the company's property or any creditor may make an application to court for this purpose. The court may terminate the filing period if it is satisfied that: the company has not

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100 (1994) 23 C.B.R. (3d) 219. See further Cohn "Good Faith and the Single Asset Debtor" (1988) 62 *Am. Bankr. L.J.* 131.

101 Under s.244(1) BIA [Can.].

102 s.50.4(11) BIA [Can.].

acted, or is not acting, in good faith and with due diligence; the company will not be likely to be able to make a viable proposal, or one that will be accepted by the creditors, within the filing period; or that the creditors as a whole would be materially prejudiced by the filing period not being terminated. In the event of the filing period being terminated s.50.4(8) BIA [Can.] applies and the company is deemed to have made an assignment in bankruptcy.

Trustee's duties under a Proposal filed with or without a Notice of Intention

If an insolvent company has lodged a Proposal with the trustee under s.50(2) BIA [Can.] the trustee is required to file a copy of it with the Official Receiver.[103] Even where a Notice of Intention has been filed, it is imperative that the trustee file the Proposal with the Official Receiver as soon as possible for the reason that the moratorium under s.69.1 BIA [Can.] comes into effect from that point only.[104]

Where a trustee files a proposal with the Official Receiver under section 62(1) in respect of a corporation which is an insolvent person *the trustee* must file the corporation's projected cash-flow statement at the time of filing the proposal.[105] If a cash-flow statement had previously been filed together with a notice of intention[106] by the company a revised cash-flow statement must be filed by the trustee. As in the case of the projected cash-flow statement filed under a Notice of Intention, the cash-flow statement filed with the Proposal must be reviewed for its reasonableness by the trustee.

Trustee under a proposal must also monitor the company

From the moment the proposal is filed until it is approved by the court, or the corporation becomes bankrupt, the trustee under the proposal must monitor and assess the company's business and financial affairs in the same manner as a trustee under a Notice of Intention. The trustee under a Proposal enjoys the same right of access to the company's "property" for this purpose.[107] Like the trustee under a Notice of Intention, if the trustee under a Proposal determines any material adverse change in the corporation's projected cash-flow or financial circumstances it must forthwith file a report concerning the change with the official receiver.[108]

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103 s.62.(1) BIA [Can.].

104 See the discussion in Chapter Five *supra*.

105 s.50(6)(a) BIA [Can.].

106 s.50.4(2) BIA [Can.].

107 ss.50.4 (7) and 50(10) BIA [Can.].

108 The reports must contain such information as is prescribed under the Act.

The court also has the power to call upon the trustee at any time to file reports on the same matters.[109]

Once a proposal has been filed by a corporation which is an insolvent person however, the trustee is required, to send a report on its business and financial affairs to the creditors and the official receiver at least ten days before the meeting of the creditors called by the trustee. The report must contain certain prescribed information and be in the prescribed manner.[110] Unlike the other reports to the official receiver and the court referred to earlier, the report to the creditors and the official receiver in this instance is not contingent on the occurrence of any event and is mandatory. In either of these instances the court has the power to give the trustee directions.[111]

Summoning the meetings of the creditors

A meeting of the creditors must be called by the trustee and held within twenty-one days after the filing of the proposal with the official receiver under s.62(1) BIA [Can.].[112] Notice of the meeting should be sent to every known creditor and to the official receiver, at least ten days before the meeting and should indicate the date, time and place of the meeting. The notice should be accompanied by: a condensed statement of the assets and liabilities; a list of the creditors with claims amounting to two hundred and fifty dollars or more and the amounts of their claims as known or shown by the debtor's books; a copy of the proposal; prescribed forms, in blank, for the purpose of proof of claim, proof of secured claim (where appropriate), and proxy; and a voting letter.

An appraisal and investigation of the company's affairs and property must be made or caused to be made by the trustee for the purpose of estimating with reasonable accuracy the company's financial situation and the cause of its financial difficulties or insolvency. The trustee must thereafter report the result of such appraisal and investigation to the meeting of the creditors.[113]

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109 ss.50.4 (7) and 50(10) BIA [Can.].

110 The optional r.2.2 report under IR 1986 [U.K.] which most English Courts used to insist upon prior to making an administration order, bears the closest resemblance. The only party relying upon the r.2.2 report is the English Court to the extent of determining whether there is a likelihood of the purposes of administration being achieved.

111 s.47.1(2)(a)BIA [Can.].

112 s.51(1) BIA [Can.].

113 s.50(5) BIA [Can.].

After a proposal has been filed but before it is voted on at the meeting of the creditors, attempts have been made by one or more creditors, sufficient in number to veto the proposal at the meeting, to persuade the court that the proposal should not await a formal vote but be treated as turned down and that the insolvent person should be adjudged bankrupt with the bankruptcy dating back to the date of filing the notice of intention to make a proposal. Matters concerning such applications have been discussed more fully under the preceding Chapter which deals with the moratorium in a Canadian Proposal.[114]

Management of the company's business and affairs under a Notice of Intention and a Proposal

In neither instance described above is the trustee required to take possession and control of the corporation's property. All that is granted by statute is the right of access for the purpose of monitoring the corporation's affairs. The company remains in custody of its property and may dispose of its assets if it so chooses. Thus, any right to take possession and control of the corporation itself must be expressly granted by the corporation.[115] In *Re Ano Ltée; Franco v Basmadjian*[116], a case decided under the old procedure, the debtor corporation, after making the proposal sold some immovable property to a third party. Unaware of this the trustee entered into another contract, at a higher price, in respect of the same property. The Court held that since under the proposal the corporation's assets were not vested in the trustee the corporation's contract with the third party was valid. It may be presumed that the position would remain the same under the new procedure.

This is in marked contrast with the position prevailing under both the United Kingdom Insolvency Act, 1986, and the Australian Corporations Law. The framers of the administration procedure in each country viewed the vesting of the company's property in the administrator to be a fundamental feature of the rescue procedure. The independence of a corporation under a proposal in Canada is more akin to the freedom enjoyed by the "debtor in possession" under Chapter 11 of the United States Bankruptcy Act.

Since this would undoubtedly reduce the trustee's exposure it ought also to have the effect of reducing the cost of reorganizing a corporation which is an insolvent person through the medium of a proposal.

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114 See *Re Triangle Drugs Inc.* (1993) 16 C.B.R. (3d) 1; 12 O.R. (3d) 219 (Bktcy.). *cf. Re N.T.W. Management Group Ltd.*, (1993) 19 C.B.R. (3d) 162 at 167.

115 See Houlden, L.W., and Morawetz, C. H., *Bankruptcy and Insolvency Law of Canada, supra,* E§3(10).

116 (1981) 39 C.B.R. (N.S.) 263.

The trustee's duty only to monitor the affairs of the corporation under a proposal arises only where the proposal is made by a corporation which is an insolvent person.[117] Where the proposal is made by a bankrupt corporation the corporation's property has already vested in the trustee and the trustee would have greater powers to manage the corporation. In what capacity the trustee would do this is unclear.

Minimising operational expenses and maximising asset value

At any time between the filing of a notice of intention and the filing of a proposal, or on the filing of a proposal, a corporation may a repudiate commercial lease of real property, by giving thirty days notice to the landlord in the prescribed manner.[118] By this provision, companies which have leased property at uncommercial rates or property which they do not require for the running of their business may be able to reduce their running costs by giving up such property.

Where a company has repudiated a lease in this manner, the landlord of such property may, within fifteen days after being given notice of the repudiation of a lease, apply to the court for a declaration that the subsection under which the repudiation was made does not apply in respect of that lease. The court, is obliged to make such a declaration unless the corporation satisfies the court that it would not be able to make a viable proposal, or that the proposal it has made would not be viable, without the repudiation of that lease and all other leases that it has repudiated under subsection 65.2(1).[119]

Where a lease is repudiated pursuant to subsection (1), a proposal filed by the corporation must provide for payment to the landlord, immediately after court approval of the proposal, of compensation equal to the lesser of an amount equal to six months rent under the lease, and the rent for the remainder of the lease, from the date on which the repudiation takes effect.[120]

The landlord does not have any claim in respect of accelerated rent, damages arising out of the repudiation, or the compensation for the purpose of voting on any question relating to a

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117 In order to file a notice of intention a corporation must necessarily be an insolvent person.

118 S.65.2(1) BIA [Can.]. S.65.2 is not unconstitutional because in matters of bankruptcy, federal legislation prevails over provincial legislation and may therefore encroach upon civil law by governing the relationship between tenants and landlords in a particular fashion - *Re Janpur Produits de Bureau Inc.* (1993) 20 C.B.R. (3d) 8

119 s.65.2(2) BIA [Can.].

120 s.65.2(3) BIA [Can.].

proposal.[121]

The repudiation of the lease under s.65.2(2) of the BIA [Can.] is not effective even where a proposal has a slim chance of success even without extra lease payment. In *Re Carr-Harris & Co.*[122] a law firm filed a notice of intention to make a proposal and thereafter sought, under s.65.2(1) BIA [Can.] to repudiate some extra space leased from its landlord. The Landlord applied for a declaration that s.65.2(1) BIA [Can.] did not apply. It was held that the onus was on the law firm to show that the proposal was viable without the payment of extra rent. Master Paterson observed:

> "Simply put, the lease payment must be the factor that makes the proposal unworkable, it must be the straw that breaks the camel's back."

It was found that the proposal had a slim chance whether or not the extra rent was a factor or not and the landlord's application was allowed.

In *Re Janpur Produits de Bureau Inc.*[123] the debtor filed a notice of intention to make a proposal to its creditors. Thereafter, but prior to filing the proposal, the debtor, acting under s.65.2 BIA [Can.] gave its landlords notice of cancellation of its 13 commercial leases. The proposal provided, *inter alia,* that the corporation's debts would be paid by its sole shareholder provided that the proposal was approved by the creditors and ratified by the court. 99% of the creditors approved of the proposal. The petitioners contested the notices of cancellation arguing, *inter alia,* that:

- the debtor should have first attempted to negotiate the leases,
- the whole procedure was in fact an expropriation of the petitioners' property made without right of compensation,
- the proposal was neither necessary nor viable, whether the leases were cancelled or not.

The petitions for contestation of the notices of cancellation of the leases were dismissed on the grounds that:

- the Act did not require the debtor to undertake negotiations with its landlords prior to filing the proposal. The financial difficulties faced by the debtor gave it no time to negotiate the agreements for each of its 13 leases,
- insolvency entails certain consequences relating to the sharing of a debtor's assets among its creditors. The lack of sufficient resources cannot be considered an expropriation

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121 s.65.2(4) BIA [Can.].

122 (1994) 23 C.B.R. (3d) 74 (B.C.Master)

123 (1993) 20 C.B.R. (3d) 8.

without compensation.

- if the debtor filed for bankruptcy the landlords would receive less than the indemnity offered in the proposal. Further s.65.2 did nor refer to a "viable proposal" but a proposal [which] would not be viable without the repudiation of [the] leases".

If a company which has filed a Notice of Intention or made a proposal repudiates a lease in this manner, and becomes bankrupt after court has approved the proposal but before the proposal is fully performed, and after the statutory compensation to the landlord has been paid, the landlord has the right to make a claim against the estate of the bankrupt company for accelerated rent.[124]

POST-INITIATION PROCEDURE IN AN ENGLISH ADMINISTRATION

Publicising the administration order

An administrator is required to publicise the fact that an administration order has been made and give specific notice of it to certain prescribed persons. He must forthwith send the company notice of the administration order and also publish a notice of the order.[125] Within 14 days of the order being made, an office copy of the order should be sent to the registrar of companies.[126] Within 28 days of the order, he must notify all creditors of the company, so far as he is aware of their addresses.[127]

Every person dealing with the company should also be on notice of the fact that the company is in administration. Thus during the period within which the order is in force, every invoice, order for goods or business letter which is issued by or on behalf of the company or the administrator and on which the company's name appears must contain the administrator's name and a statement that the company's affairs, business and property are being managed by the administrator.[128]

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124 s.65.2 (5) BIA [Can.].

125 s.21(1)(a) of IA [U.K.]. Publication should be once in the Gazette and in one newspaper which the administrator thinks will bring the order to the notice of the company's creditors. Under r.2.10(3) IR 1986 [U.K.] the administrator is also required, forthwith, to give notice to any person who has or may be entitled to appoint an administrative receiver, if an administrative receiver has been appointed to him, if a winding up petition is pending to the petitioner, and the provisional liquidator, if any, and the Registrar of Companies.

126 s.21(2) IA 1986 [U.K.]. The Act requires that notice should be given in 14 days to "such other persons as may be prescribed", however, under the rules the persons prescribed should be given notice immediately.

127 s.21(1) IA 1986 [U.K.]. Under s.21(3) If the administrator, without reasonable excuse, fails to comply with this section, he is liable to pay a penalty in the form of a fine. If the administrator continues to contravene this sub-section he may even be liable to a daily default fine.

128 s.12(1) IA 1986 [U.K.].

Ascertainment and Investigation of Companies Affairs by the Administrator

Although ss.21&22 IA 1986 [UK] are contained under the heading "Ascertainment and Investigation of Companies Affairs" neither section confers upon the administrator a positive obligation to actually examine the company's books of account, obtain financial information about the company and prepare a cash-flow statement. If the administrator or his firm prepared a rule 2.2 report to be filed with the petition for the administration order then the administrator would be in possession of the information contained in the report. However, if no such report was prepared, or if it was prepared by someone else, then the administrator would at least have a copy of the statement of the company's financial position which would have been attached to the affidavit supporting the petition for an administration order.

Under s.22 IA 1986 [U.K.] however, upon an administration order being made the administrator must, forthwith, by notice[129] require some or all[130] of certain specified persons to submit to him, within 21 days of the notice[131] a statement[132] regarding the affairs of the company.[133] The persons, from amongst whom the administrator may decide to whom the notice may be sent and who, once in receipt of a request, are statutorily obliged to comply with the notice are:

- those who are or have been officers of the company;
- those who have taken part in the company's formation at any time within one year before the date of the administration order;
- those who are, or have been in the year preceding the administration, in the company's employment,[134] and are in the administrator's opinion capable of giving the information required;
- those who are or have been within that year officers of or in the employment of a company which itself is, or was, an officer of the company.[135]

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129 r.2.11(1) IR [U.K.].

130 It is interesting to note that s.22(1) IA [U.K.] is couched in mandatory terms whereas its corresponding rule, r.2.11(1) IR 1986 [U.K.] has a more discretionary tone to it. While the administrator need not require all the person described in s.22(3) to forward to him a statement of the company's affairs it does seem that the request should be made of at least "some" of them.

131 s.22(4) IA [U.K.].

132 Which should be in a prescribed form.

133 s.22(1) IA 1986 [U.K.].

134 The term "**employment**" is defined to include employment under a contract for services. s.22(3) IA [U.K.].

135 s.22(3) IA [U.K.].

A statement which is furnished in such circumstances must be in Form 2.9,[136] verified by an affidavit and show, in addition to any specific information requested by the administrator, particulars of the company's assets, debts and liabilities; the names and addresses of the company's creditors; the securities held by the creditors and the dates on which the securities were created.[137] There is a penalty for non compliance.[138]

Although the administrator may make the request from more than one person it appears that he may not demand more than one statement of affairs notwithstanding the somewhat misleading wording of the notice in Form 2.8 of the Rules. Form 2.8 reads "Take notice that (name of administrator) require you ... to submit a statement as to the affairs of the company within ... days." There is no indication in the notice that action to prepare the statement should be collective. Under the Act the administrator may require some or all of certain specified persons to submit to him *a* statement in the prescribed form. S.22(2) refers to "*The* statement" which is required to be verified by affidavit by the "persons required to submit *it*". While neither of these sub-sections could be said to refer definitely to one statement, s.22(4) which reads "Where any persons *are* required [as opposed to any person is required] ... to submit *a* statement of affairs..." indicates that it is one statement to be prepared collectively. Thus Rule 2.11(1) provides that where the administrator "determines to require *a* statement of affairs to be made out" he should send notice to the relevant persons requiring them to "prepare and submit *the* statement. Under r.2.11(2) the notice should inform its recipients,[139] inter alia, of the names and addresses of the other persons to whom the same notice has also been sent and the time frame within which *the* statement of affairs must be delivered.[140] Thus the intention of the legislature appears to have been that the recipients of the notices under s.22(1) should co-operate in furnishing one statement of affairs. This seems logical in view of the confusion and delay which may be caused by a number of contradictory statements. However, given the wording in Form 2.8 and the fact that each person to whom notice is given also receives the forms required for the preparation of the statement it is submitted that a recipient of a notice under s.22(1) could

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136 r.2.12(1) IR 1986 [U.K.].

137 s.22(2) IA [U.K.].

138 s.22(6) IA [U.K.]. The penalty for contravention is a fine and, for continued contravention, to a daily default fine.

139 In the rules referred to as "The deponents".

140 The other information required to be given is a warning of the penalty for non-compliance and the application of s.235 IA [U.K.] (i.e. duty to co-operate with the administrator).

legitimately submit a statement on his/her own without reference to the other recipients of the notice.

Even if only one statement is to be prepared, the unanimity among the persons who are required to submit the statement cannot be assured. Thus the Rules provide for the administrator to obtain an "affidavit of concurrence" from any one of the persons who is liable to be called upon to submit the statement of affairs, stating that he concurs with the statement.[141] The affidavit of concurrence may be qualified in respect of matters dealt with in the statement if the maker of the affidavit. Thus the administrator is able to verify by "affidavits of concurrence", the truth of a single statement or if, indeed, more than one statement is provided to cross-refer contrasting or contradictory statements.

The administrator has the power at any time, should he consider it appropriate, to release a person from the obligation to either submit the statement of affairs or to disclose any particular piece of information as may be required under the Act or in the notice. He also has the power either when giving notice of his request for information or thereafter to extend the 21 day time period within which the statement should be furnished.[142]

The administrator's obligation and corresponding power to ascertain and investigate the company's affairs is buttressed by the powers contained in ss.235 and 236 IA [UK].

Under s.235 IA [UK], the persons from whom the administrator may obtain a statement of the company's affairs under s.22, are further obliged to give to the administrator such information concerning the company and its promotion, formation, business, dealings, affairs or property as the administrator may reasonably require at any time after the administration order has been made.[143] These persons should also attend on the administrator at such times as the administrator may reasonably require.[144] As with the statement of affairs there is a penalty for non compliance.[145]

S.236 IA [UK] empowers the administrator to obtain the assistance of court in carrying out his investigations. The administrator may make an application to court for an order summoning any of the following persons to appear before the court:

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141 r.2.12(2) IR 1986 [U.K.].

142 s.22(5) IA [U.K.] If the administrator refuses to exercise a power conferred by s.22 the court, if it considers it appropriate, may exercise it.

143 s.235(2)(b) IA [U.K.].

144 s.235(2)(b) IA [U.K.].

145 s.235(5) IA [U.K.].

- any officer of the company;
- any person known or suspected to have in his possession any property of the company or supposed to have been indebted to the company; or
- any person whom *the court* thinks capable of giving information concerning the promotion, formation, business, dealings, affairs or property of the company.

The court has the power under this section to require any such person to submit an affidavit to the court containing an account of his dealings with the company.[146] The court may also[147] require him to produce any books papers or other records in his possession or under his control which relates to the company or to the promotion, formation, business, dealings, affairs or property of the company.[148] If the person so summoned fails to appear before the court or to produce anything which the court may have required him to produce, the court has the power to cause a warrant to be issued for the arrest of the person and the seizure of the items which he was required to produce.[149]

Ss.235 and 236 IA 1986 [UK] are discussed in greater detail under the headings "Special facilitatory powers of the administrator" and the "Role of Court". Although it may not be necessary to utilise the powers in ss.235 and 236 to obtain financial information on the company for the purpose of determining whether or not the company has a financially viable future, they would prove invaluable in obtaining information for the purpose of determining whether action need be taken to set aside antecedent transactions.

What ever the source from which the administrator may choose to obtain his financial information it would appear that the administrator could not avoid examining the company's books himself. As pointed out by Coopers & Lybrand:

> "The basic information on the company's financial position will come from its own books of account. It may be necessary to bring those books up to date. Even in the best run companies the accounting records may not reflect the current financial position completely. At any given moment, there may be supplies obtained for which invoices have not yet been received from the suppliers (particularly for continuous supplies such as electricity and telecommunications services) and invoices received but not yet posted. The administrator will want to make sure that all transactions relating to the period before his appointment have been posted in the books if only to ensure that they are differentiated from transactions after the date of the order.
> If the company's undertaking is to be continued the administrator will wish to establish the extent to which the existing liabilities need to be paid in order to maintain the

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146 s.236(3) IA [U.K.].

147 The word used is "or". It is submitted however that it should be read as and/or.

148 s.236(3) IA [U.K.].

149 s.236(4) and 236(5) IA [U.K.].

business's viability. In most cases, existing liabilities will simply rank as claims against the company, to be handled in accordance with the proposals eventually approved by the creditors."[150]

The point to note is that in an administration the administrator is able to make a personal investigation of the company's books without relying on financial information furnished to him by the management of the company.[151]

Important details of which the administrator should take note during his enquiries are the existence (if any) of security interests in the company's property and hire-purchase, chattel leasing, conditional sale and retention of title agreements. Details of creditors security would in any event be contained in the affidavit supporting the petition for administration.[152] If the goods which are the subject matter of a hire-purchase, chattel leasing, conditional sale or retention of title agreement are critical to the continued operation of the company's business, the administrator would not be able to so operate without continuing to pay the hire, lease rental or the outstanding purchase price.[153]

Based on the results of his investigations the administrator should determine whether the purposes specified in the administration order may be achieved. Depending on the nature of the purposes specified in the order the administrator would also decide whether all or part of the business of the company should be continued and whether funding sources are available for that purpose. However, if a r.2.2 report had been prepared by the administrator or his firm for the purpose of obtaining an administration order then the decision whether the company or aspects of its business was viable, and whether short term finance to keep the company going could be arranged would have been made at the time the report was made up. This in turn would reduce the time period between the making of the order and the first meeting of the creditors and the duration of the moratorium. If it appears to him that the purposes, in their original or even

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150 Fletcher I. M., Higham J., and Trower W., *The law and practice of corporate administrations*, London, Butterworths, 1994, p.152-153.

151 In a CVA proposed by the directors under IA 1986 [U.K.] and a Proposal made by a company under BIA [Can.] responsible insolvency practitioner has no part to play in actually formulating the proposal. His role is limited to giving an opinion on the proposal or a cash-flow statement prepared by the company.

152 r.2.3(3) IR 1986 [U.K.].

153 Except in the case of goods subject to a floating charge, where no approval need be obtained, the administrator has right to ask for the court's approval to dispose of property affected by such interests or agreements. However it is a condition of such approval being given that the receipts from the disposal be handed over to the holder of the security interest or the owner of the property. On this point see below.

varied form, cannot be achieved then he is obliged to seek an order from Court discharging the administration order.[154]

Administrator's proposals

If the administrator does not take the view that the purposes specified in the administration order are incapable of achievement, the administrator must, within three months of the administration order being made, submit to the Registrar of Companies and to all creditors of whose addresses he is aware a statement of his proposals for achieving the purpose or purposes specified in the order.[155] The court may enlarge the time period within which the administrator's proposal should be submitted. In addition to submitting the proposal to the creditors the administrator must also lay a copy of the statement of his proposals before a meeting of the company's creditors which give the creditors the opportunity to accept or reject the proposal.[156] If the proposals are accepted then the administrator continues to manage the affairs and business and property of the company in accordance with the proposals.[157]

Although the administrator is allowed a statutory period of 3 months to formulate his proposals and present them to the company's creditors, as Harman J pointed out in *Re Charnley Davies Business Services Ltd*,[158] he should do so as soon as he is properly able to. It appears that the court will be reluctant to grant an extension of time to the administrator unless it is shown that the case is complex and no workable proposal could in any event be formulated within the statutory three month period. Such an extension was granted in *Re NS Distribution Ltd*[159]. If the administrator fails, without reasonable excuse, to submit his proposal with the 3 month time period or as enlarged by the court, he is liable to a fine. and, for continued contravention, to a daily default fine.[160]

Copies of the proposal must also be sent within the same time period of 3 months, or as enlarged by the court, to the members of the company of whose addresses the administrator is

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154 s.18(1)and (2) IA 1986 [U.K.].

155 s.23(1)(a) IA [U.K.].

156 s.23(b) IA [U.K.]. The creditors must be given at least 14 days notice of the meeting.

157 s.17(2)(b) IA 1986 [U.K.]. On the meeting of creditors to approve the proposals see the discussion in Chapter Seven *infra.*

158 (1987) 3 BCC 408 at 410. See also *Consumer and Industrial Press Ltd (No.2)* (1988) 4 BCC 72.

159 [1990] BCLC 169

160 s.23(3) IA 1986 [U.K.].

aware.[161] Alternatively the administrator may publish a notice in the London Gazette and the newspaper in which the administration order was advertised stating an address to which members of the company should write for copies of the proposal to be sent to them free of charge.[162]

The most important requirement is that the proposals must be directed towards achieving the purpose or purposes specified in the order. If it appears to the administrator that the purposes specified in the initial order cannot be achieved, but some other purpose[163] may yet be achieved, he should first make an application to court for a variation of the order[164] before making any proposals along those lines to the creditors. He should not pursue any purpose which has not been included in the order, for to do so would open the door to allegations of misconduct, notwithstanding the fact that the purpose pursued is included in s.8(3) IA 1986 [UK].[165]

There is no statutory statement of any particulars which the administrator should include in his proposals under s.23. It appears that in the early days following the introduction of the administration order procedure "it was thought by some that the administrator might be required to set out in specific detail how he might wish to achieve such purposes or indeed seek approval of detailed terms for the sale of particular assets."[166] However, the practice seems to have evolved differently with administrators seeking approval for their proposals in *general terms* only. It is to be expected that the contents of a proposal will vary according to the needs of each company, but it likely that an administrator will seek to retain as much discretion as is possible in the circumstances in order to pursue every viable option without having to seek directions from court.[167] It has been said that the proposals would usually include simple provisions for the administrator: to manage the company with a view to achieving one or more of the purposes stated in the administration order; dispose of assets for the benefit of the creditors generally; to report to the creditors' committee regularly and obtain their approval for significant disposals of assets; and to apply for a discharge of the administration order when the purposes stated in the

161 s.23(2)(a) IA [U.K.].

162 s.23(2)(b) IA 1986 [U.K.] and r.2.17 IR 1986 [U.K.].

163 Which in any event, it is submitted, should be more beneficial than liquidation.

164 s.18(1) IA 1986 [U.K.].

165 See *Re Sheridan Securities Ltd.*, (1988) 4 BCC 200.

166 Fletcher I. M., Higham J., and Trower W., *The law and practice of corporate administrations*, London, Butterworths, 1994, p.44.

167 *Ibid.* p.44.

administration order are achieved.[168]

The administrator's statement of proposals under s.23 should be distinguished from the statement which he is obliged under r.2.16 to annex to the proposals. The information in this statement is vital to any creditor considering whether to accept or reject the administrator's proposals under s.23 since it contains the all important information on the financial position of the company[169] and the manner in which the affairs and business of the company have been, and if the proposals are approved, will be managed and financed. The administrator should also give such other information (if any) which he thinks would influence the creditors vote for or against his proposals. It has been suggested that it may be useful to creditors if the administrator refers to possible alternatives considered by him in making his proposal and the reasons for their rejection.[170]

The general nature of the proposals presented by the administrator is in marked contrast to the detailed proposals which should be presented for the purpose of a Company Voluntary Arrangement under IA 1986 [UK], a Commercial Re-organization under Part III of BIA [Can.] and even a Scheme of Arrangement under the English Canadian or Australian statutes. In a proposal under the first and second regimes detailed information must be provided on how various categories of creditors will be paid.

The administration order procedure seeks to achieve a rescue through the management of the company by a third party with the agreement and perhaps under the directions of the creditors. In the other procedures the rescue is sought to be achieved through the implementation of an agreement between the company, its creditor and (except in the case of a Canadian Proposal) its members. Under such proposals the management of the company or its assets may or may not be vested in the hands of a third party.

Once the proposals have been approved the administrator must act in accordance with those proposals as from time to time revised whether by him or any predecessor of his.[171] Thus, it appears that even after his proposals have been voted upon by the creditors of the company, the administrator has the power should he so desire, to revise the proposals. Such

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168 *Ibid.* p.44.

169 The statement of affairs submitted to the administrator, or a summery of it, would be annexed with the administrator's comments, if any, or if no statement of affairs had been furnished to the administrator then details of the financial position of the company should be given as at the latest practicable date after the administration order.

170 *Ibid.* p.161.

171 s.17(2)(b) IA 1986 [U.K.].

revisions ought to be "insubstantial", for, if the revisions appear to the administrator to be substantial he cannot make them unless they are approved by the creditors in meeting. For this purpose, as in case of his original proposals, he must send a statement of his proposed revisions to all the creditors of the company of whose addresses he is aware[172] and lay a copy of the statement before a meeting of the company's creditors summoned for the purpose on not less than 14 days notice. As regards members he should follow the same procedure set out for the making of proposals in their original form. There has however, been at least one case where the court has, in the exercise of its residual jurisdiction, allowed an administrator to deviate from an approved scheme where it was clear that to summon a further meeting of the creditors would result in a substantial loss to the company.[173]

Management of the company during an English Administration

In addition to the duties imposed upon the English Administrator, discussed above, IA 1986 [U.K.] further requires that the administrator must, on his appointment, take into his custody or under his control all the property to which the company is or appears to be entitled,[174] and manage the affairs, business and property of the company.[175] As the English Court of Appeal observed in *Re Atlantic Computer Systems plc*[176]:

> "[O]ne of the primary functions of an administrator is that frequently, if not normally, he will continue to carry on the company's business, and, hence, will continue to use the land and goods currently being used by the company for the purposes of its business. Indeed, it is of the essence of his appointment that an administrator should do these very things in cases when the purpose sought to be achieved by the administration order is purpose (a) in s 8(3), viz, the survival of the company, and the whole or any part of its undertaking, as a going concern"[177]

The question that arises is whether the administrator has the power to try an achieve a "rescue" purely through the exercise of his powers of management supported by the special powers conferred upon for the purpose of maximising the number or if not the value of the assets which are at that stage notionally available for distribution to the creditors. The Receiver and Manager on whom the English Administrator is based undoubtedly has the power to do so, and it was this

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172 s.25(1)&(2)(a) IA 1986 [U.K.].

173 *Re Smallman Construction Ltd.* (1988) 4 BCC 784.

174 s.17(1) IA 1986 [U.K.].

175 s.17(2) IA 1986 [U.K.].

176 [1992] 1 All ER 476 [C.A.].

177 *ibid*, pp.487-488.

managerial power of the Receiver and Manager under a floating charge which made that regime attractive to the Cork Committee.[178]

The affairs business and property of the company should be managed at all time before proposals have been approved (with or without modifications) in accordance with any directions given by the court. It is submitted that where no specific directions have been given by the court, the administrator should manage the company with the purposes for which the administration order was made clearly in mind.[179] Although there is no specific statutory requirement to this effect the administrator would be constrained by the duty to make an application to the court to have the administration order varied or discharged if it appears to him that the purpose or each of the purposes specified in the order is incapable of achievement.[180] The management should therefore be directed towards achieving these purposes. Thus in principle, if the administration order specifies "the survival of the company and the whole or any part of its undertaking as a going concern", the administrator ought to be able to exercise all his powers of management, like a Receiver would, for the purpose of achieving this goal. Similarly, a voluntary arrangement, scheme of arrangement, or a more advantageous realisation of the company's assets *than would be effected in a winding up* would be better achieved if all or part of the company's business was carried on.

The English Administrator, however, lacks the flexibility and the freedom enjoyed by the Receiver to manage the company as he chooses even if the stated object of the administration order is the survival of the company or the preservation of the whole or part of its undertaking as a going concern.[181] The main constraints on the administrator's freedom of management are time and the company's creditors. On the first count, the administrator is limited by the fact that he has only three months to formulate his proposals for achieving the purpose of the administration order. If the company is to trade out of its difficulties under the control and management of the administrator, three months would, in almost all cases, be totally inadequate. Further, since the administrator's proposals may be rejected by the creditors there is a risk that any steps taken by the administrator in the exercise of his managerial powers may prove futile.

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178 See the *Cork Report*, para.495.

179 See s.8(3)(a)-(d) IA 1986 [U.K.].

180 s.18(1)&(2) IA 1986 [U.K.].

181 It should be noted that the Receiver's freedom was to some extent curbed by the decision in *Re Paramount Airways (No.3)* [1994] BCC 172 under which a Receiver was made personally liable for "adopting" workers contracts of employment. The *Insolvency Act* 1994 limited the Receiver's personal responsibility to certain "qualifying liabilities". See ss.44(2A-D) IA 1986 [U.K.].

In order that the administrator may carry on the business of the company it is critical that the company should have working capital. If the company's accounts receivable are not subject to a fixed charge or a floating charge which has crystallised, the administrator would ordinarily be able to obtain such working capital through the collection of the accounts.[182] Special problems arise however where the company has given a fixed charge over its book debts. These issues are considered more fully below. Where the company has no significant unencumbered receivables and perhaps even where the receivables are subject to a fixed charge the administrator will have to seek additional financing from other sources.

The English Administrator's status vis à vis the company's director's.

The directors of the company in respect of which the Administrator is appointed do not immediately cease to hold office as a result of the appointment. They remain as directors of the company but cease to be able to exercise any power conferred upon them by statute[183] or the company's memorandum or articles of association, which could be exercised in such a way as to interfere with the exercise by the administrator of his powers. The English Administrator may however authorise the directors to exercise these powers either generally or in relation to particular cases.[184]

Powers exercisable in managing the company

IA 1986 [U.K.] authorises the administrator in general terms to do "all such things as may be necessary for the management of the affairs, business and property of the company".[185] Without prejudice to the generality of the authority so conferred the administrator is also specifically granted the powers listed in Schedule 1 of IA 1986 [U.K.].[186] These powers may be summarised as follows: to take possession of and control the company's property and take proceedings for that purpose; to borrow and create securities over the company's property; to employ professionals; to bring or defend legal proceedings in the company's name; to refer questions affecting the company to arbitration; to insure the company's business and property; to use the company's seal; to execute deeds, receipts and documents in the company's name; to

182 Collection of the debts would come within the administrator's power in para.1 of Schedule 1 IA 1986 [U.K.].

183 *i.e.* IA 1986 [U.K.] and CA 1985 [U.K.].

184 Sec.14(4) IA 1986 [U.K.].

185 s.14.(1)(a) IA 1986 [U.K.]. *cf.* The powers of the English Administrative Receiver and the Australian Voluntary Administrator.

186 s.14.(1)(b) IA 1986 [U.K.].

draw and endorse any bills of exchange or promissory note; to appoint agents; to do everything necessary for the realisation of the company's property; to make payment necessary or incidental to the performance of his functions; to carry on the company's business; to form subsidiaries; to hive down the company's assets to subsidiaries; to handle leases; to make arrangements or compromises; to make calls for the company's uncalled capital; to prove a claim in any debtor's insolvency; to present or defend a petition to wind up the company; to change the location of the company's registered office; and to do every thing incidental to the exercise of the foregoing powers.[187] The powers so granted cover a broad spectrum which would ordinarily be enjoyed by the directors of a company under its Articles, the CA 1985 [U.K.] and at Law.

In addition he is also specifically empowered to remove any director of the company and to appoint any person to be a director of it, and to call meetings of the members and creditors of the company. Although the directors are not by virtue of the making of the administration order automatically removed from office, they are generally "displaced." They are, however, obliged to fulfil the company's statutory obligations. It may be noted that unlike under s.14(1)(b) IA 1986 [U.K.] it is not provided that these powers are granted without prejudice to the general authority conferred under s.14(1)(a).

The generality of the authority conferred upon the administrator under s.14(1)(a) is comparable to art.70 in Table A which provides that the business of the company shall be managed by the directors who may exercise all the powers of the company. The directors' authority is subject to the provisions of the Act, the memorandum and the articles and to any directions given by special resolution of the members. In a vein similar to s.14(1)(b), Art.70 also provides that the general powers granted are not to be limited by any special powers given to the directors by the articles. In view of the width of the administrator's general powers it appears that an administrator may do every thing that the directors of the company may have previously done in carrying out their managerial functions. But can the administrator do more?

In the Act the administrator's authority is framed with reference to the need to manage the affairs, business and property of the company and not with reference to the powers exercisable by directors, who in turn may exercise only those powers with which the company is vested, *prima facie,* the administrator's authority does seem wider than that of the directors. Indeed the power to remove a director before the expiration of the period of his office[188] and to appoint

187 Schedule 1, IA 1986 [U.K.].

188 This may be done by the members only by special notice and ordinary resolution of the company.

directors,[189] granted to the administrator under s.14(2), are powers which ordinarily belong exclusively to the members of a company and are exercisable only in general meeting.

The position is not quite as clear with regard to the power to summon meetings of the creditors and the members. The only instance where a meeting of the company's creditors may be summoned outside insolvency proceedings and without a court order[190] is when it is intended to put the company into a creditors' voluntary winding up. Although the directors are authorised to present a petition for a winding up by court or administration, under the Act a meeting of the creditors for the purpose of a voluntary winding up may be summoned only by *the company*. The company may do so only if at a meeting of *the company* it is intended to propose a resolution to wind up the company and the directors are unable to make a statutory declaration of the company's solvency. In contrast, the power to summon meetings of the members is a power which is well within the general authority of the directors of a company outside insolvency proceedings.[191]

It should be noted that s.14.(2), does not commence with the disclaimer contained in s.14.(1)(b) that the generality of the authority conferred under s.14(1)(a) is not prejudiced by the specific enumeration of the powers contained therein. What is the effect of the absence of the disclaimer on the scope of the administrator's authority? Does it mean that the power to remove and appoint directors and to summon meetings of the creditors and the members, were not included within the general authority conferred under s.14(1)(a)? If they were included, then why did not the draughtsman include them within 14(1)(b)?

One possible line of reasoning would be to treat the authority conferred upon the administrator by s.14(1)(a) as analogous to the authority conferred upon the directors of the company by the articles. Such reasoning appears attractive since both the directors and the administrator are charged with the task of managing the business of the company.[192] However, if such reasoning is accurate, firstly, every specific power enumerated in Schedule 1 must be within the scope of the authority of directors. Secondly, the powers conferred on the administrator by s.14(2) should be outside that scope of the directors' authority. It is difficult to

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189 As opposed to the appointment of a person to fill a vacancy or as an additional director, which the directors are usually authorised to do under Art.79 of Table A (where adopted).

190 An order of court is necessary before meetings may be summoned to consider a Scheme of Arrangement under s.425 CA 1985 [U.K.].

191 In companies which have adopted Table A the enabling provision is Art.37.

192 In the case of the administrator he is specifically required to manage the company's affairs and property in addition to its business.

establish whether the first of these requirements is satisfied due to the amorphous nature of the directors' authority. It is possible that all the powers in schedule 1 of the Act do come within the directors' powers. The second requirement however is not fully satisfied with regard to all the powers conferred. While the power to remove and appoint directors and to summon a meeting of the company's creditors is vested solely in the company, the power to appoint additional directors and to summon meetings of the company is shared by the directors with the company. This line of reasoning therefore does not unequivocally lead to the conclusion that the powers of the administrator are wider than the directors.

In the case of *Re Home Treat Ltd*[193] it was argued that management of the company must mean the "lawful" management of the company, which in turn must mean in accordance with the objects of the company as laid down in the memorandum. The powers in Schedule 1 of the Act which given to administrators by s.14(1)(b) should also be used to carry on a lawful business and the same submission was said to apply. Further, since under s.14(5) the administrator is deemed to act as the company's agent, and as agent has no greater powers than his principle, the administrator must therefore act in accordance with the company's powers. Finally the sub-s.(4) of s.14 would be unnecessary if the administrator had powers greater than those provided by the memorandum of association. These submissions were accepted by the court.

In *Re Home Treat Ltd.*, the company concerned was engaged in the business of running nursing homes. The company had been incorporated with an objects clause in the memorandum which enabled it to carry on business as general merchants and such other objects. The memorandum which was given to the administrators contained a different clause which allowed the company to carry on the business of nursing home proprietors. This clause did not appear in the register at the Companies House and the administrators feared that the business that they were carrying on was *ultra vires* the company and made an application to court for directions. Although there was no shareholders' resolution to that effect, it was held that the administrators were entitled to carry on a trade which had the approval of 99% of the shareholders.

Transactions entered into by the company are subject all the constraints that they would be otherwise have been subject to. For example if it is proposed to sell the company's property to the directors or to purchase property from them approval of the shareholders must first be obtained. Likewise, a company in administration continues to be subject to all the legal

193 [1991] BCLC 705

restrictions affecting its particular industry.[194]

English Administrator's status

One of the clues to the origins of English Administration being in Receivership is the fact that in exercising his powers the administrator is statutorily deemed to be acting as the agent of the company.[195] In contrast with the English Administrative Receiver, however, it should be noted that the administrator is not deemed to be the agent of the company.[196] The benefit of this statutory agency is that it avoids the administrator incurring any personal liability in the course of managing the company's business, property and affairs and in otherwise exercising the powers conferred by the Act.

It may be noted that the original Insolvency Bill[197] did make the administrator personally liable on any contract entered into or adopted by him in carrying out his functions.[198] These provisions were, however, deleted during its passage through Parliament. Similar provisions were retained in the administrative receivership procedure.[199]

Administrator's powers regarding the company's executory contracts

The making of an administration order does not have the effect of terminating contracts entered into by the company unless the contract expressly provides. The question arises whether, during the course of the administration, the administrator, like an administrative receiver,[200] has the power to repudiate the company's pre-administration contracts free of restraint by injunction or otherwise by the other contracting party. Although under the Cork Committee's proposals and the Government's White Paper the administrator was to have all the powers normally conferred upon a Receiver and Manager appointed under a floating charge[201], as will be seen, the administrator's power to repudiate contracts was not necessarily a power which was conferred upon him by the debenture. Thus in the absence of an express statement to that effect, it is not

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194 See Totty and Jordan, *op cit* C.5.12.

195 s.14(5) IA 1986 [U.K.].

196 See s.44(1)(a) IA 1986 [U.K.].

197 No.29 of 1984.

198 *ibid.*, cl.23.

199 See s.44 IA 1986 [U.K.].

200 For a discussion on the administrative receiver's powers to repudiate pre-receivership contracts see *infra*.

201 See the *Cork Report* p.122 para.520 and the *"Revised Framework of Insolvency Law"*, Cmnd.9175 p.51, para.155.

entirely clear whether either the Cork Committee or the Government actually intended that the administrator should have this power. Judicial opinion on the matter is not entirely clear, despite one judgement clearly holding against the administrators. However in the light of the other powers conferred upon the administrator, it is submitted there appears to be a strong case that the administrator should, at least in limited circumstance, be allowed to exercise the power to repudiate contracts. But first the judicial position must be considered.

The first reported case in which this matter was considered was the case of *Astor Chemicals Ltd v. Synthetic Technology Ltd.*[202] Synthetic Technology Ltd, (Syntec) had been placed in administration pursuant to an application by the company. Syntec was engaged in the manufacture, under licence from an overseas company, of a cold pump gel used for filling copper telecommunication cables carrying optical fibres. Under a distribution agreement, the cold pump gel was distributed for Syntec by Astor Chemicals Ltd (Astor) who, on its own, produced a hot melt compound which was also used for the purpose of filling optical fibre cables.

There was no doubt that the licence to manufacture and distribute the cold pump gel was Syntec's most valuable asset. The administrators of Syntec sought to terminate the distribution agreement with Astor on the ground that it had been breached in a serious manner by Astor. At no stage before the administration order or in the affidavits in support of the petition had the directors of Syntec suggested that Astor had not taken proper steps to advertise and promote the cold pump gel and that it was this failure on Astor's part that was the cause of Syntec's difficulties. Nor was it suggested that if Syntec was free of the encumbrance of the distribution agreement it could exploit an expected boom which it would be unable to do if the distribution agreement were to remain in force. Further the administration order had been based on financial forecasts which contemplated the continuance of the distribution agreement with Astor. Astor had applied under s.11(3)(d) IA 1986 [U.K.] for an order for leave to issue proceedings claiming that the distribution agreement had not been breached and injunction to prevent Syntec from appointing another person to distribute the cold gel. An interlocutory injunction had been granted by the court and, in the proceedings under consideration, Astor sought leave to continue the injunction. The grounds adduced for this purpose were that if the distribution agreement was terminated, Astor would suffer damage to its reputation which would be difficult to quantify and Syntec did not have the assets to satisfy any award of damages that may be made against it.[203]

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202 (1990) BCC 97; [1990] BCLC 1.

203 When the administration order was made the court had also made an order that the documents filed (continued...)

It was submitted on behalf of the administrators, *inter alia,* that an administrator appointed by the court is in the same position as an administrative receiver who is able to repudiate a company's pre-receivership contracts without being subject to restraint by or owing any liability to the other contracting party. If this submission succeeded the administrators would not have to rely on any breach on the part of Astor in order to terminate the agreement. Vinelott J. rejected the analogy with the power of the receiver. He observed:

> "Under a debenture in usual form a receiver when appointed is the agent of the company and not the debenture holder, but he owes a duty to the debenture holder. He is appointed to get in the assets of the company so far as charged for the benefit of the debenture holder. The court will not prevent him from getting in and realising the charged assets for the benefit of the debenture holder merely on the grounds that to do so would involve a breach of contractual obligations binding upon the company. For as Graham J. observed, that would involve *preferring the other party to the contract to other unsecured creditors* and, indeed, would *give him a security ahead of the debenture holder*. The question is one of priority. So the receiver will be restrained from acting in breach of an obligation entered into by the company if the consequences would be to deprive the plaintiff of an *equitable interest ranking ahead of the debenture* or, I would think, any proprietary or contractual right binding on the debenture holder. It does not follow that a receiver can otherwise always act in disregard of contractual obligations binding upon the company. He may not be entitled to do so if, for instance, there is doubt whether there will be a surplus of assets available to the company and the other creditors after meeting the debt due to the mortgagee and if the breach might seriously damage the reputation of the company and impair its goodwill, or if the charge does not extend to all the assets of the company and the breach might affect the ability of the company to continue to trade with its assets."[204]

In Vinelott J's view, there could be no analogy between the position of an administrator and an administrative receiver because the administrator is appointed to manage the affairs of the company and not to realise them for the benefit of one of the creditors.

The case of *Re P&C and R&T (Stockport) Ltd.*[205] (hereafter *Re Stockport*) is also instructive in this respect. The facts in this case are complex and it is necessary to set them out in some detail. P&C and R&T (Stockport) Ltd., ("the company") was a vehicle in a joint venture agreement to develop a business park in Stockport. The parties to the Joint Venture Agreement

203(...continued)
in the proceedings for the appointment of the administrator were not to be open for public inspection without the leave of court presumably owing to the fact that some of the evidence relied on was commercially sensitive. Astor in this case also sought leave of the court to inspect these proceedings. However this application and the court's order thereon are not directly relevant to the issue of repudiation.

204 *ibid.* at p.11.

205 (1991) BCC 98.

which were PCP, RTG, RTP[206] and the company. The business park to be developed had been leased by PCP from the Stockport Borough Council for a period of 199 years further to an agreement which contained detailed provisions for the development of the park by PCP. RTG had guaranteed PCP's obligations both as lessee and developer.

The role of the company in the joint venture was to be the corporate vehicle in the name of which the development was to be carried out. The company was to raise the finance required for the development and to enter into the necessary contracts with contactors and sub-contractors. Clause 4(a) of the joint venture agreement provided, *inter alia,* that PCP and RTG would procure the novation of the lease in favour of the company thereby releasing PCP from its obligations under the lease. It also contained provisions which entitled PCP to act as project co-ordinator of the development and to receive a fee for its services.

At a stage where the only asset of the company was represented by the work in progress at the building site (the realisable value of which was nil), RTG went into receivership and administrators were appointed to the company. The crucial fact was that at this point the lease had not been vested in the company. In their proposals to the creditors, the administrators sought approval to complete at least the first phase of the development. The company's bank had, during negotiations with the administrators, agreed in principle to advance further funding to enable the completion of the first phase. The bank had however required that it be given a charge over the lease to secure these advances and that the administrators have complete un-encumbered executive control of the company. Since the lease had not been transferred to the company by PCP, the company was not in a position to grant the security called for by the bank.

The administrators argued that under the joint venture agreement the company was entitled to call on PCP to transfer the lease. PCP contended that since the company did not intend, and was not in a position, to perform its contactual obligations with PCP under the joint venture agreement, the company was not entitled to call upon PCP to perform its obligations under the same joint venture agreement. The administrators also proposed to dispense with PCP's services as a project co-ordinator owing to bank requirement that they have complete un-encumbered executive control of the company. PCP countered stating that the company was bound by the contractual provisions of the joint venture agreement and could not simply choose to ignore PCP's contractual rights thereunder - a liquidator could disclaim onerous contracts but an administrator had no such power.

206 The part played by RTP is not mentioned in the report and may be discounted as of no significance to the issues which arose.

Scott J opined that PCP could not object to the administrators' proposals simply on the grounds that those proposals were inconsistent with the contractual rights enjoyed by PCP under the joint venture agreement. He summarised his reasons for arriving at this conclusion as follows:

> "(1) that in view of the insolvency of the joint venture, PCP, as at least a quasi-partner, has no equity to obtain specific performance, whether by injunction or otherwise, of its *contractual quasi-partnership* rights against the company;
>
> (2) that to permit the management provisions and the project co-ordinator provisions of the joint venture agreement to be specifically enforced against the administrators would be inconsistent with the spirit and purpose of s.14(4) of the 1986 Act; and
>
> (3) that the insolvency of the joint venture and of the company has frustrated the purpose of the joint venture agreement."[207] (italics added)

Regarding the transfer of the lease to the company Scott J. held that the company had more than a mere contractual interest in the lease since firstly, it had been agreed in the joint venture agreement that pending the transfer:

> "the parties as are parties to the agreement for lease and the lease shall hold the same as trustees for the benefit of the company and the company shall perform all of the obligations of PCP thereunder."[208]

Consequently, the company had a beneficial interest in the lease which took effect in equity immediately regardless of the performance or non-performance of the other provisions in the joint venture agreement. Secondly, any other construction of clause 4(a) would leave PCP in a position in effect of being a preferred creditor of the company.

Scott J, therefore made a declaration that:

(i) the administrators were entitled, if they could procure a release of PCP of its obligations under the agreement for the lease and the lease agreement to have the lease vested in the company free of any proprietary interest therein of PCP; and

(ii) that the various contractual rights of PCP and RTG under the joint venture agreement could not be enforced against the company by injunction or otherwise so long as the company remained subject to an administration order.[209]

It is important to note that Scott J felt that it would be inconsistent with the spirit and purpose of s.14(4) of IA 1986 [U.K.] if certain provisions of the joint venture agreement were allowed to be specifically enforced against the administrators. This statement is in marked contrast to the view taken by Vinelott J who does not appear to have given any weight to the

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207 at p.106(B-D).

208 at p.106(H)-107(A).

209 At p.107(E-F).

spirit and purpose of the act in coming to a decision in the *Astor* case.

It is difficult to rationalize the remaining grounds upon which PCP was denied the right to object to the administrators' proposals. According to Mr Justice Scott's analysis: PCP enjoyed contractual rights under the joint venture agreement; PCP was also at least a *quasi-partner* of the company; and the joint venture was insolvent. It is submitted, that the legal consequences, which attach to each of the circumstance described are mutually contradictory and may not co-exist in one legal relationship under English Law.

The description of PCP as a *quasi-partner* follows a statement by Mr. Justice Scott's that it was not his intention to express a conclusion that under the joint venture agreement PCP and RTG became partners engaged in a joint venture enterprise, but only to draw attention to the nature of their relationship and draw *an analogy* with partnership. The term *quasi-partner* does not appear to be a legal term to which any legal consequences attach under the Law of Partnership.[210] Principles of the Law of Partnership ordinarily do not apply to Corporate Partnership or Consortia.[211] If partnership principles are to apply to PCP in its dealings with the company and RTG under the joint venture agreement the relationship between the parties should have been identified as a Partnership.

Insolvency as such is not a condition to which legal consequences attach. These occur only after some formal proceeding has not been instituted such as the commencement of a winding up or the appointment of an administrator or administrative receiver.[212] Elsewhere in

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210 Before the Partnership Act was enacted, it appears that "partnership" was defined in various ways but there had been no authoritative definition of the word. Individuals, although not partners, could incur liabilities as if they were. Thus in early editions of Lindley's *The Law of Partnership*, the term *"quasi-partner"* had been used to describe such persons in order to distinguish them from those who were in fact partners. The current edition of Lindley's classic work states that "Although apt, this expression did not find its way into section 14 of the Act, which specifically provides for liability on the basis of "holding out," or indeed into any other section and was accordingly not used in any subsequent edition of this work." See Banks, R.C.I'Anson *Lindley and Banks on the Law of Partnership*, 16th Ed., London, Sweet and Maxwell, 1990 p.3. Jowitt's Dictionary of English Law equates a *quasi partnership* to a partnership as regards third persons where one person is liable for the debts of another as if he were his partner, although no true partnership exists. "The cases in which this occurs are referrable to one of two principles. The first is where a person carries on business as agent for another, the latter is liable to third persons for the debts of the business...The second principle under which a person may be subject to the liabilities of a partner is that where a person holds himself out to third persons as a partner in the firm, he is liable to those person for debts contracted by the firm (Partnership Act, 1890, s.14); such a person is called an ostensible partner. Neither of the circumstance described by Jowitt apply to PCP.

211 See Milman D., and Flanagan T.,*Modern Partnership Law*, Croom Helm Ltd, London, 1983. p.3.

212 See Goode, R.M. *Principles of Corporate Insolvency Law*, p.25, In relation to a company it (continued...)

the judgement it is stated that:

> "the evident intention of PCP and RTG was that the company should be the corporate vehicle in the name of which the development of the business park would be carried out. It was intended that they should jointly own and control the company"

If the company was the embodiment of the joint venture then the appointment of administrators to the company would be equivalent to the insolvency of the joint venture. In this event principles of company law would govern the rights and obligations of its shareholders. PCP would stand both as a creditor and as a member in the administration. However, if the joint venture is more than the company and is in fact a partnership which subsists between PCP, RTG and the company, the appointment of administrators, although it may give rise to grounds for the dissolution of the partnership, does not result in the joint venture being automatically subject to an insolvency procedure applicable to the winding up of insolvent partnerships.

Thus, unless the decision in *Re Stockport* is treated as developing a hybrid jurisprudence of company-partnership law peculiar to joint ventures as a legal entity, in the absence of argument and a finding on the partnership issue, it is difficult to rationalise it from the standpoint of either the Law of Partnership or Company Law. Therefore it is not possible to say with any degree of certainty whether in the absence of the remaining characteristics described by Scott J., PCP would have been able to enforce its rights under the joint venture agreement against the administrators.

What remains to be seen is whether it is possible to reconcile the decisions in *Astor Chemicals* and *Re P&C and R&T (Stockport)*. The question that arises is whether the decision in *Astor Chemicals* is authority for the proposition that throughout the entire duration of an administration order an administrator does not have the power to repudiate contracts of the company? Although this appears to be the view taken by some commentators[213] it cannot be said to have been accepted unreservedly by all.[214] There a number of significant features in the

212(...continued)
includes the approval of a voluntary arrangement under Part 1 of the Act, the making of an administration order or the appointment of an administrative receiver. See s.247(1) IA 1986 [U.K.].

213 Moss and Segal writing on "Trading by administrative receivers and administrators" take the view that: "This case therefore underlines an important disadvantage that the administrator has against the administrative receiver. An administrator has no priority upon which he can rely in order to cause the company to repudiate contracts in such a way that the company cannot be injuncted. Nor, it should be noted, does an administrator have the right that a liquidator may possess to disclaim an unwanted contract."(1994) 7 *Insolvency Intelligence*, p.49, at p.50

214 Totty & Jordan take the view that "as yet the law is still developing in relation to existing contracts" in *Insolvency*, (Revised) Longmans, at C5.11A. See also Goode, R.M. *Principles of Corporate Insolvency Law*, p.129.

Astor Case which, it is submitted, throw doubt on the validity of deriving a proposition of general application to English Administrations.

First, the administrators did not seek to repudiate Syntec's contract with Astor and rely on their agency for immunity from liability for wrongful repudiation. Instead they sought to repudiate on the grounds that Astor had acted in breach of the distribution agreement. This gave Astor the opportunity to deny its beach and to seek an injunction restraining termination of the agreement until it had been established whether or not there had been a breach. Secondly, whatever the grounds for repudiation, administrators decision to make alternative arrangements for distribution was taken without reference to and approval from the creditors. Would it have made any difference to the outcome of the *Astor* case if the administrators had sought to terminate the distribution agreement during the course of implementing a proposal approved by the creditors?

The crucial difference between the administration order procedure and administrative receivership is that in the latter case the administrative receiver is appointed under a debenture in respect of the whole or substantially the whole of the company's property. The debenture holder has a priority over those assets ahead of all creditors. A priority on which an administrative receiver can rely in declining to perform current contracts of the company he does not have the right to allege a breach of contract on the part of the other contracting party. According to the *Astor* case it is the absence of this priority in favour of any particular creditor which deprives the administrator of the ability to repudiate current contracts.[215]

While this argument is attractive it does appear to have certain weaknesses. The Act recognises that an administration order may be made even where a creditor is entitled to appoint an administrative receiver under a floating charge where the creditor concerned has consented to the making of the order. If it were assumed for the purpose of argument that such a floating charge existed in the Astor case, the charge-holder may have been able to restrain the administrator from disposing of assets subject to the charge.[216] In so doing the charge holder would of course be relying on his priority ahead of the contracting party. But logically the administrator would not be required to wait until he is restrained by order of the court. He would be obliged to respect the property rights of the charge holder and the priority he is entitled to.[217]

215 See Moss and Segal, *supra.*

216 The charge holder would have to make an application under s.27(1)(a) and seek an order under s.27(4)(b) IA 1986 [U.K.].

217 s.15 IA 1986 [U.K.].

It is now well established that the administration order procedure is a creditor controlled procedure during the course of which the administrator is obliged to act in the interests of all the creditors.[218] This is evidenced by the fact by the making of the administration order the administrator is not granted *carte blanche* to run the company as and how he chooses. In managing the affairs, business and property of the company the administrator is required at all time before proposals have been approved to do so in accordance with any directions given by the court. After the proposals have been approved by the creditors, management should be in accordance with those proposals.[219] Thus, the administrator must formulate his proposals for the running of the company and present them to the creditors and obtain their approval before he may proceed. As will be seen the creditors approval is discretionary. The overriding factor is that the administrator's proposals should be in the interests of the creditors. Thus, if it is the administrators opinion that it is in the general interest of the creditors of the company that the contract between the company and one of its creditors should be terminated then he would be able to include that in his proposals to the creditors. The creditor whose interests are to be affected would, *qua* creditor, have the right to attend the meeting and voice his objections to the termination. Scott J takes the view that such a creditor cannot object to administrators proposals simply on the ground that those proposals are inconsistent with his contractual rights.[220] In order to ensure that the creditor is given a full opportunity to express his dissent it may be appropriate to take the possible damages that he may suffer in the event of the termination in calculating the amount of his debt for voting and re-payment purposes.[221] If the administrator's proposal is approved despite the contracting creditor's dissent then the administrator should have the authority to terminate the contract.

It has been seen that the administrator's powers include the power to establish subsidiaries of the company and to transfer to subsidiaries of the company the whole or any part of the business and property of the company. It is further to this power that an administrator may "hive down" the assets of a company to a subsidiary.[222] The essential feature of a hive down is that

218 A Revised Framework for Insolvency Law, Cmnd. 9175, London, HMSO, 1984. p.20, para.32. See also *Re Atlantic Computers Ltd* (1992) 2 WLR 367.

219 s.17.(2) IA 1986 [U.K.].

220 See the comments of Scott J in *Re P&C and R&T (Stockport) Ltd* at p.106, (A-B).

221 There may be problems in actually calculating the contracting creditor's voting rights since it does not appear that the administrator has the power to value a creditor's claim for voting purposes. Ways around this problem will have to be sorted out.

222 See Totty P., and Jordan M., *Insolvency*, C.5.12.

the assets of the insolvent company are transferred to a specially formed subsidiary which is disposed of as a company with assets but no liabilities. Unless the administrator is able to transfer the assets free of liabilities the purpose of the hive down, which is a more advantageous realisation of the assets than would be possible in a winding up of the company, will be frustrated. Indeed the administrator's power to hive down any aspect of the company is buttressed by the provision which enables him, with the permission of court in certain circumstances, to dispose of property which is subject to a security as if the property were not subject to that security. Thus, the buyer of the asset, receives it free of all encumbrances even though a creditor had a security interest in that asset. Having granted an administrator the power to so dispose of assets which are secured in favour of third parties could it be said that the legislature intended that an administrator should be constrained by contractual rights of third parties?

Thus, the *Astor* case may be distinguished as applying only to cases where an administrator has sought to terminate a contract either without having a proposal for termination approved by the creditors or on the grounds of wrongful breach by the other contracting party and that party is able to present a *prima facie* case that such a breach has not taken place. Where the administrator has received the approval of the creditors then the contracting party should have no grounds for restraining the administrator since the damages he has suffered would have been taken into account in calculating his entitlement to vote.

English Administrator's power to deal with charged property etc.

Property rights and perfected security interests[223] are generally sacrosanct under the laws of bankruptcy and insolvency.[224] They are altogether unaffected by a winding up. In an administrative receivership the administrative receiver may not interfere with such rights or interests which have priority over or are equal to the rights and interests of the charge holder.[225]

223 If the security interest constitutes a registrable charge under s.396 of the Companies Act, 1985 it will be void against the liquidator or administrator and any creditor of the company unless the prescribed particulars of the charge and the instrument (if any) by which the charge is created or evidenced is not registered within 21 days of its creation with the registrar of companies. See further Goode, Professor R.M. *Legal Problems of Credit and Security*,(2nd Ed) London, Sweet and Maxwell, 1988 pp.27-28.

224 Provided of course that they are not liable to be invalidated by an administrator or liquidator under the Insolvency Act, 1986.

225 Unless the security interest with priority or equality was created later in time in breach of a negative pledge in favour of the charge holder.

Upon default by the debtor the secured party or the owner has the right to restrict the debtor's use of or disposition of the property or goods, and to take possession of the property or to sell.[226] An administrator is however, in a different position. He has under s.15 IA 1986 [U.K.] the unique right to dispose of and in some cases deal with property owned by the company but in which a third party has a security interest. He has a similar right of disposal over property owned by a third person but in the custody of the company under certain specified agreements. In either case he may do so without reference to the holder of the security interest or the owner of the property.

If the property is subject to a security which as created was a floating charge[227] the administrator may, without reference to the charge holder, or even the court, dispose of the property or otherwise exercise his powers in relation to that property as if the property were not subject to the security.[228] The definition of the floating charge with reference to its point of creation effectively ensures that an administrator would continue to enjoy the power granted under s.15(1) IA 1986 [U.K.] despite a crystallisation of the charge.[229] In view of the fact that the consent of floating charge holder is necessary before an administration order may be made it may be inferred that the charge holder has in consenting to the administration order, also consented to the exercise by the administrator of the powers under s.15 IA 1986 [U.K.].[230] Once an administrator disposes of charged property under s.15(1) the floating charge holder has the same "priority" in respect of any property of the company which directly or indirectly represents the property disposed of as he would have had in respect of the property which was subject to the security.[231]

If the property is subject to any security other than a floating charge or is held by the company under a hire-purchase agreement, which includes conditional sale, chattel leasing and

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226 In the case of a security interest subject to the debtor's equity of redemption and duties of a mortgagee in possession.

227 ss.15(3) and 251 IA 1986 [U.K.].

228 s.15(1) IA 1986 [U.K.].

229 Upon crystallization a floating charge ceases to float and becomes a fixed charge. Thus if not for this provision the administrator would have had to seek the approval of court before disposing of the property subject to the charge.

230 Thus a flagrant disregard by the administrator of the purposes specified in that order a should be necessary before a floating charge holder is allowed to object the exercise of these powers.

231 s.15(4) IA 1986 [U.K.].

retention of title agreements, (hereafter a "hire-purchase agreement as defined")[232] the administrator may not dispose of the property unless he obtains authorization from the court. In such an instance the administrator should satisfy the court that the disposal of the property would be likely to promote the purpose or one or more of the purposes specified in the administration order.[233] If the court is so satisfied, it may, by order, authorise the administrator to dispose of the property as if it were not subject to the security or to dispose of the goods as if all rights of the owner under the hire-purchase agreement were vested in the company.[234] In *Re ARV Aviation Ltd.,* Knox J indicated that the power of the court under s.15(2) IA 1986 [U.K.] "could not be exercised otherwise than in a final manner". The court has no power to make any order which may be regarded as an interim order since once the order is made the security is lost.[235]

Under the act, no restrictions are placed on the timing of the administrators application to court under s.15(2) IA 1986 [U.K.]. The Courts however, frown upon applications made prior to the creditors approving the administrator's proposals.[236] In *Re Consumer and Industrial Press Ltd (No.2)*[237] joint administrators made an application under s.15(2) IA 1986 [U.K.] seeking authorization for the disposal of the company's principle asset, the title to a magazine, which was subject to two fixed charges. The administrators had not laid their proposals before the company's creditors. Since the proceeds of the sale of the asset would have been inadequate to meet the claims of the charge holders and it was not likely that the unsecured creditors would receive any thing, the administrators' argued that the need to submit their proposals to the creditors did not arise and the court could make an order under s.15(2). Rejecting this argument Peter Gibson J pointed out that the scheme of the act required an administrator to send a statement

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232 s.10(4) IA 1986 [U.K.].

233 The court has *prima facie* jurisdiction to authorise the disposal of the property or goods if the property in question is subject to a security and the disposal of the land is likely to promote any one of the purposes specified in the administration order. See the comments of Knox J in *Re ARV Aviation Ltd.,* [1989] BCLC 664 at 667.

234 s.15(2) IA 1986 [U.K.].

235 [1989] BCLC 664, at p.668. While this may be the case where the court makes an order in favour of the administrator, it is submitted that if the secured creditor succeeds then the administrator should be able to return to the court if he is able to obtain better terms which do not prejudice the secured creditor.

236 See Anderson "Administration: Creditor control of asset disposals *(1989) 2 Insolvency Intelligence,* p.49 which discusses a number of unreported cases wherein it appears to have been opined that an administrator may properly enter into an agreement for a sale of the company's assets before a creditors' meeting.

237 (1988) 4 BCC 72.

of his proposals to all the creditors, to enable the creditors to have their say before and not after the proposal is implemented. In his view:

> "quite exceptional circumstances would be needed for the court to frustrate that part of the Act which requires a meeting of the creditors to consider proposals by the administrators."[238]

While Mr. Justice Peter Gibson's reasoning is attractive in some respects it does not seem to accord with the scheme of s.15. Why is it that the administrator should first present his proposals to the creditors and obtain their approval before seeking courts permission to dispose of an asset secured by a fixed charge or owned by another party, when he may at any time before or after the proposals are approved dispose of or deal with assets subject to a floating charge.? The scheme of s.15 is to protect the interests of those with certain proprietary interests in assets. If in *Re Consumer and Industrial Press Ltd* the asset sought to be disposed of had been subject to a floating instead of a fixed charge, the administrators may have sold it with impunity without the approval of the charge holder, the unsecured creditors or the court. The role of the court in an application under s.15(2) IA 1986 [U.K.] is to protect the holders of the particular proprietary interests. However, where the application is made prior to the approval of the administrator's proposal it has the right under s.17 IA 1986 [U.K.] to give directions to the administrator taking into account the interests of both secured and unsecured creditors. In circumstances similar to those in which the administrators of the Consumer and Industrial Press Ltd., found themselves, the court could very well direct an administrator to obtain approval for his proposal before authorising the disposal because of the likelihood of the cupboard being bare for the unsecured creditors. In doing so, the court would of course have to take into account the added costs the administrator would incur in taking that course of action. If, as in the Consumer and Industrial Press Ltd, the assets are all subject to a fixed charge and the receipts from their sale are inadequate to meet the debt secured by the charge how could the administrator meet the expenses of summoning a meeting of the creditors to consider his proposals? The administrator cannot recover his remuneration and expenses properly incurred by him out the proceeds of disposal of a fixed charge. Thus it is submitted that an administrator should be allowed to make an application to court under s.15(2) at any time during the currency of an administration order without having to wait until his proposals are approved by the creditors.[239]

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238 *ibid* at p.73.

239 An administrator takes control of the company as he finds it (See *Re Synthetic Technology Ltd.* [1990] BCLC 378)and should be allowed to achieve the best possible result incurring the least (continued...)

Once an administrator make an application to court under s.15(2) the court should fix a time, date and place for the hearing of the application.[240] The administrator should forthwith give notice of the time, date and place of the hearing to the person whose property or security interest is to be affected.

Before making the order the Court is obliged to establish the value which would be realised by the sale of the property or goods in an open market by a willing vendor. This is due to the fact that it must be a condition of the order that the net proceeds of the disposal together with such sums, if any, which are required to make up the deficiency between the net proceeds and the market value given by the court, should be applied towards discharging the sums secured by the security or the relevant agreement. If there are two or more holders of security in respect of the property to be disposed of then the net proceeds of the disposal together with the sums, if any, which may be required to make up the deficiency between the net proceeds and the market value given by the court should be used in discharging the sums secured by the securities in the order of their priorities.[241] The expression "sum secured by the security" covers not only the capital sum secured by the security but all interest properly payable thereunder and any costs which the holder of the security is entitled to add in accordance with the terms of the security and the law and includes the costs involved in proceedings in relation to the realisation or otherwise in connection with the security.[242] This provision appears to be designed to ensure that the administrator does not dispose of such property or goods at prices below at least their market value, thus depriving the secured creditors and the hire purchase creditors of the opportunity they

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239(...continued)
possible expense. The Act makes allowance for circumstances where it is not possible to achieve all the purposes specified in the administration order. In such an instance the administrator may *at any time* make an application to court to have the administration order discharged if the purposes specified in the order appear to him to be incapable of achievement[s.18(2)(a)]. But this should not deprive him of the opportunity to make the most of the powers he has at his disposal to achieve the best possible result taking into account the interests of all the creditors of the company. The question that then arises is whether the administrator would in so acting be attempting to achieve a better realisation of the company's assets than would be possible in a winding up and whether in such circumstances he may conduct himself towards that end without placing his proposals before the creditors?

240 r.2.51(2) and r.13.6 IR 1986 [U.K.].

241 s.15(6) IA 1986 [U.K.].

242 *Re ARV Aviation Ltd.*, [1989] BCLC 664 at 669. Knox J was of the view that there was no difference in principle between the costs that a secured creditor is involved in connection with an application under s.15 of the Insolvency Act on the one hand, and proceedings that might be involved in the realisation of his security absent the provisions of s.15.

would have had, but for the stay imposed by ss.10 and 11, to realise at least the market value of the property or the goods.[243]

The Act gives no details on how the Court is expected to make a valuation. In *Re ARV Aviation Ltd.,* Knox J said:

> "It appears to me that the court has to make a balancing exercise between the prejudice that would be felt if the order is made by the secured creditor, against the prejudice that would be felt by those interested in the promotion of the purposes specified in the administration order if it is not." (i.e. the unsecured creditors or even floating charge holders)[244]

This is an useful guideline to follow in cases where the court is faced with differing valuations presented by the administrator and the secured creditor/owner. However it does not address the issue of whether the valuation should be a "going concern" or a "break up" valuation. Earlier Knox J seems to indicate that the valuation should be with reference to what the particular secured creditor concerned would himself be able to realise. Such a view does however seem to be too restrictive since the secured creditor may well not disclosed all his reasons for not wishing the asset to be sold.[245]

There is a clear distinction between the powers which may be exercised by the administrator in respect of property secured by a floating charge and those that may be exercised in respect of property subject to any other form of security and goods held by the company under a hire-purchase agreement.[246] Except in the case of property secured by a floating charge, all

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243 In *Re ARV Aviation Ltd.,* [1989] BCLC 664, Knox J said obiter at p.668:
"I accept that the intention of sub-s 15(5) should be assumed to the protection to the maximum possible extent of the rights of a secured creditor and, without necessarily deciding the point, because I doubt whether it is necessary for the purpose of deciding of this application it does seem to me that it was not the intention of s 15(5)(b) to introduce a figure for the amount which would be realised on the sale of the property in the open market by a willing vendor, any thing which was significantly less than what one would anticipate a secured creditor would him self realise. That would seem to me to be an intention that would be capricious to attribute to Parliament which, a priori would not be anxious to dilute the rights and security of a secured creditor."

244 [1989] BCLC 664, at 668.

245 For example he may take the view that he is able to obtain more for the asset by retaining it and disposing of it at a later date; or the asset may have special value in the context of the creditor's/owner's business. It should be noted that the administrator does not have the power a liquidator has under r.4.99 to require a secured creditor to offer the property comprised in the security for sale.

246 It may be noted that in the case hire-purchase or chattel leasing agreements such a right of disposal, albeit with the permission of court, would *ipso facto* terminate the agreements that subsisted between the company and those creditors.

that the administrator may do is seek the court's approval to dispose of the property or goods. If the property is subject to a floating charge the administrator's may as an alternative to disposal "otherwise exercise his powers" in relation to any property of the company that is subject to the floating charge.

Administrator's power to avoid antecedent transactions

An English Administrator has the power to make an application to court for the purpose of setting aside or avoiding a number of prescribed transactions which may have been entered into in respect of the company under administration. The transactions that may be challenged are: transactions at an undervalue; preferences; extortionate credit transactions; floating charges created by the company for past value and transactions defrauding creditors.[247] The power to set aside or avoid such transactions is also enjoyed by the liquidator of a company. Whilst it is true that some of these transactions were first introduced by the insolvency reforms in 1985/6, it is, nevertheless, not proposed to examine the types of transactions and the manner in which they may be set aside or avoided in any detail. The reason is that in the context of an English Administration what matters most is not the mechanics of avoidance but the fact that the Administrator has been granted a power hitherto enjoyed only by a liquidator. By setting aside or avoiding such transactions the administrator would, in theory, be swelling the assets which are notionally available for distribution to the creditors. It is not entirely clear, however, whether the fruits of such steps being taken would enure to the benefit of the company's unsecured creditors or come within any floating charge which the company may have created.[248]

POST-INITIATION PROCEDURE IN AN AUSTRALIAN VOLUNTARY ADMINISTRATION

Publicising the Australian Voluntary Administration

The first step facing an Australian voluntary administrator is to give requisite notice of the fact that the company is in administration. Before the end of the next business day after his appointment, notice should be given to the Australian Securities Commission (ASC). Within 3 business days after the appointment, notice should also be published in a newspaper as prescribed.[249] If the appointment is made by a "substantial chargee" then written notice of the

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247 See ss.238-241 and 244-245 IA 1986 [U.K.].

248 See the arguments in Prentice, D.D., "Creditors' Interests and Directors' Duties" (1990) 10 *OJLS* 265; Oditah, F., "Wrongful Trading" (1990) *LMCLQ* 205; Hicks, "Advising on Wrongful Trading" (1993) 14 *Company Lawyer* 16 & 55 which apply even in these circumstances.

249 s.450A(1)(b) CL [Aust.] The newspaper should be a national newspaper (i.e. one with which has (continued...)

appointment should also be given by the administrator to the company as soon as is practicable but in any event before the end of the next business day after the appointment was made.[250] Whoever made the appointment, notice should also be given within this same time period to the holder of a charge over the whole or substantially the whole of the company's property and the holder of two or more charges which together constitute a charge over the whole or substantially the whole of the company's property.[251] In addition, every public document and every eligible negotiable instrument issued by the company should carry the legend "administrator appointed" after the company's name where it first appears.[252]

The first meeting of creditors

Chronologically the next task facing the administrator is to convene a meeting of the company's creditors to be held within five business days of the appointment of the administrator.[253] The purpose of this meeting is to enable the creditors to determine whether to appoint a committee of creditors and if so, which creditors should be the members of the committee.

The administrator must give written notice of the meeting to as many of the company's creditors as reasonably practicable and cause notice of the meeting to be published in a newspaper in the same manner as notice is given of the appointment of the administrator. These notices should be given and published at least 2 business days before the meeting. Thus the time allowed for the publication of the notice of the 1st meeting of creditors in the newspapers is in effect the same as that which is allowed for the publication of the notice of the administrator's appointment. Unlike s.439A(6), s.436E does not provide for the court to grant an extension of time to the administrator to convene the first meeting of the creditors.

It should be noted that the Harmer Committee did not recommend that a meeting of the creditors should be held at this stage and that doubts have been expressed about the practicality

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249(...continued)
a circulation generally in each State, the Capital Territory and the Northern Territory). Alternatively, publication may be made in each jurisdiction in which the company has its registered office or carries on its business, by publication in a daily newspaper which circulates generally within such jurisdiction.

250 s.450A(2) CL [Aust.].

251 s.450A(3) CL [Aust.].

252 s.450E(1) CL [Aust.].

253 s.436E(2) CL [Aust.].

of this requirement.[254] A view has been expressed that owing to the shortness of the time allowed, the administrator will have to take "only reasonable steps to endeavour to ensure that the meeting is fairly convened" and that it is unlikely that the meeting could be challenged and avoided unless the "circumstances under which the meeting was convened and conducted were unfair or prejudicial in the extreme".[255]

There is no statutory requirement that an administrator should file a report as to the affairs of the company. However, some administrators have taken the step of filing such a report at the first meeting of the creditors.[256]

At the meeting, in addition to appointing a committee of creditors, the company's creditors may also resolve to remove the administrator from office and to appoint someone else as administrator of the company. This power may be exercised by the creditors whoever may have made the appointment of the administrator. Thus even an administrator appointed by a "substantial chargee" or a liquidator may be removed by the creditors. The removal and replacement is not automatic and takes place only after enquiry has been made by the administrator in office into the validity of the claims of the creditors seeking to make the change. CReg [Aust.] require the administrator or his nominee to be the chairman of the meetings.[257] In *Re Ballan Pty Ltd (admin apptd)*[258] this regulation was held to be inconsistent with the application of the principle of Natural Justice that a person should not be a judge in his own cause and that the administrator in office should vacate the chair when an application is made to remove him from office. In any event, although the appointed administrator may be removed, the creditors do not have the right to terminate the procedure at a meeting convened under s.436E.

Investigation of the company's affairs and the duty to consider possible courses of action.

The administrator is required, as soon as practicable after the administration of a company begins, to investigate the company's business, property affairs and financial circumstances.[259]

To this end he is assisted by having a statutory right to possession of the company's books. Generally, no person is entitled, as against the administrator of a company under

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254 See *Butterworth's Corporations Law* (Revised), [5.3A.0215]

255 *ibid* at note 10.

256 See *Re Ballan Pty Ltd (admin apptd)* 12 ACSR 605 at 607.

257 reg.5.6.17(1)(c) Creg [Aust.].

258 12 ASCR 605 at 609

259 s.438A(a) CL [Aust.].

administration, to retain possession of books of the company.[260] Neither is a person able to claim or enforce a lien on such books.[261] Thus, during the administration the administrator of a company may give written notice to any person requiring him to deliver to the administrator, as specified in the notice, books of the company which are in that person's possession.[262] The person so noticed must comply unless that person is entitled, as against the company and the administrator, to retain possession of the books. The administrator's right to possess the company's books does not apply to books which a secured creditor of the company is entitled to possession otherwise than because of a lien. However the administrator is entitled to inspect, and make copies of, such books at any reasonable time.[263]

The administrator's statutory right to possession of the company's books is further buttressed by statutory obligation upon each director of the company to deliver to the administrator all books in his possession that relate to the company. This duty must be performed as soon as practicable after the administration begins. However, a director is not required to deliver books which he is entitled as against the company and the administrator to retain. If such director also knows where other books relating to the company are, he must pass on this information to the administrator.[264]

The administrator may also expect and require the assistance and co-operation of the directors of the company. Each director is obliged to attend on the administrator at such times and give such information about the company's business, property, affairs and financial circumstances, as the administrator may reasonably require.[265] In addition to the personal obligation of each director, the directors are obliged collectively to give the administrator a statement about the company's business, property, affairs and financial circumstances within 7 days after the administration of a company begins.[266] The administrator may allow a longer period than 7 days.

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260 s.438C(1)(a) CL [Aust.].

261 S.438C(1)(b) CL [Aust.]. The right to a lien, if available, is not otherwise prejudiced

262 S.438C(3). The notice must specify a period of at least 3 business days as the period within which the notice must be complied with.

263 s.438C(2) CL [Aust.].

264 s.438B(1) CL [Aust.].

265 s.438B(3) CL [Aust.].

266 s.438B(2) CL [Aust.].

The statement furnished by the directors should be in Form 507[267] which should be dated as at the date of the administrator's appointment.[268] According to Form 507 it must contain cost or net book amount valuations and the estimated realisable values of the company's assets, distinguishing between those which have and have not been specifically charged. The assets not specifically charged should be further broken down into interests in land,[269] sundry debtors,[270] cash at bank, cash at hand, stock, work in progress, plant and machinery[271] and any "other" assets.[272] Turning to assets subject to specific charges, the amount owing under the charges should be deducted from their cost/ net book and realisable values.[273]

From the total cost or net book values and the total estimated realisable values of the company's assets should be deducted the company's liabilities. In making the deductions the liabilities should be divided as follows: the amount payable in advance of secured creditor(s); the amount owing for tax instalment deductions and prescribed payments of tax; the amount owing for employee entitlements;[274] the amount owing and secured by debenture or floating charge over assets; the amount payable to preferential creditors who rank behind secured creditors.[275] The balances due to partly secured creditors[276] and the amount due to unsecured creditors[277]

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267 Schedule 2, CReg [Aust.].

268 See Direction (e) in Form 507, Schedule 2, CReg [Aust.].

269 Detailed particulars of the company's interests in land should be given in the schedule marked "A" including, the address and description of the property, its valuation for rating purposes,, particulars of tenancy, where the deeds may be obtained and short particulars of title.

270 The sundry debtors should be identified in a separate schedule marked "B" and particulars should be given of the amount owing to the company, the realisable value and should there be a deficiency, the amount of and an explanation for that deficiency.

271 These three items should be inventoried and a copy of the inventory annexed to the report.

272 The company's "other assets" should be detailed in schedule "C" which identifies "deposits" and "investments" as falling into that category.

273 Descriptions of the asset, and the charge; the date the charge was given; the identity of the charge holder; the terms of repayment of the debt secured by the charge; the value of the asset charged; the estimated realisable value; and the amount owing under the charge should be specified in a schedule marked "D".

274 Schedule E should identify each employee by name, give his address and itemise the sums due as under wages, holiday pay and long service leave.

275 Here again the name and address of the preferential creditor and a description of the amount owing should be given in Schedule F.

276 Schedule "G" requires, the directors to estimate the value of the security, deduct it from the amount owing to the creditor and arrive at an estimate of the amount which ranks as unsecured. The names and addresses of the creditors, the particulars of the security held and its name should also be given.

should also be specified together with details of any contingent assets and liabilities. The report/statement should also contain particulars relating to the company's issued and paid up share capital.

Having carried out his investigation and examined the documents and reports submitted to him, the administrator should prepare a report about the business, property, affairs and financial circumstances of the company. In addition to making the report, the administrator should also form an opinion about each of the following matters:

(i) whether it would be in the interests of the company's creditors for the company to execute a deed of company arrangement;
(ii) whether it would be in the creditor's interests for the administration to end;
(iii) whether it would be in the creditor's interests for the company to be wound up;[278]

and prepare a statement setting out each of these opinions and his reasons for forming them. If he decides that a deed of company arrangement should be executed then a statement setting out the details of the proposed deed should also be prepared.

Contents of administrator's report/statement and the proposed Deed of Company Arrangement (if any).

Unlike in an English Administration under IA 1986 [U.K.] and IR 1986 [U.K.], CReg [Aust.] and Schedule 8 prescribe in some detail the information that should be contained in the administrator's report and the proposed Deed of Company Arrangement, if any. The report is required to be in Form 507.[279] This report should also be in Form 507 and made as at the date of his appointment.[280] Thus, the administrator is not statutorily required to go further than the date of the directors' statement furnished to him under s.438B(2) and it would appear the reports may be even identical. Thus it is not necessary to elaborate on the contents of the administrator's report since they have already been discussed with reference to the statement furnished by the directors. However, two Schedules in the report may be singled out for comment. In Schedule "G" of the report the administrator must in dealing with partially secured creditors estimate the value of the security, deduct it from the amount owing to the creditor and arrive at an estimate of the amount which ranks as unsecured. Likewise in Schedule "H" which refers to unsecured

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277(...continued)
277 In Schedule "H" the directors are required give the name and address of each unsecured creditor and set out the amount claimed by each unsecured creditor and the amount admitted as owing. If there is a difference between the amount claimed and that which is admitted, then reasons for the difference should be specified.

278 s.438A. CL [Aust.].

279 Schedule 2, CReg [Aust.].

280 See Direction (f) in Form 507, Sch 2, CReg [Aust.].

creditors, the amount claimed by each unsecured creditor and the amount admitted as owing should be stated. If there is a difference between the amount claimed and that which is admitted, then reasons for the difference should be specified. As will be seen, this information would prove significant at the meeting of the creditors when the creditors claims have t be valued for voting purposes.

Regarding the administrator's statement of opinion as to the future of the administration, it would not be sufficient for the administrator to merely decide, for example, that the creditors should execute a deed of company arrangement. He should give his reasons for forming that opinion and also state why he opines that it would not be in the interests of the creditors for the administration to end, or for the company to be wound up.

It should be noted that, if the administrator recommends that the company enter into a deed of company arrangement, he is not required to prepare a draft deed for consideration by the creditors. The instrument setting out the terms of the deed is required to be prepared by the administrator only after the creditors resolve that the company execute a deed.[281] All that he is required to do at this stage is to prepare a *statement* setting out the details of the proposed deed. Nevertheless, the matters set out in s.444A(4) CL [Aust.][282] would be are fundamental to any deed to be executed and an administrator may wish to deal with them even in his statement. Provision is further made in s.444A(5) CL [Aust.] that certain prescribed provisions are taken to be included in a deed of company arrangement unless otherwise provided.[283] The administrator may wish to consider whether in his view any of these provisions should be excluded from the deed which he is proposing. If neither of these provisions are to be excluded it would be appropriate for him to say so.

Further reports by the Australian voluntary administrator

In certain circumstances the administrator may find himself obliged to prepare another type of report which he should submit to the ASC and not the creditors. Thus, in addition to carrying out an investigation for the purpose of forming an opinion on the progress of the administration, the administrator should during the course of the administration look out for any

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281 s.444A(3) CL [Aust.].

282 Under s.444A(1) CL [Aust.], these provisions must be included in a deed of company arrangement only if the company's creditors resolve that the company execute such a deed. However, by implication these terms would have to be included in the administrator's statement setting out the details of the proposed deed.

283 s.444A(5) should be read with reg.5.3A.06 and Sch.8A, CReg [Aust.].

evidence of what are described as "offenses" or "misconduct". If it appears to the administrator that a past or present officer, or a member of the company may have been guilty of an offence in relation to the company or that a person who has taken part in the formation, promotion, administration, management or winding up of the company:

(i) may have misapplied or retained, or may have become liable or accountable for, money or property (in Australia or elsewhere) of the company; or

(ii) may have been guilty of negligence, default breach of duty or breach of trust in relation to the company;

the administrator must lodge a report about the matter with the ASC as soon as practicable. He must also give the ASC any information that it may require and if called upon to do so give it access to and facilities for inspecting and taking copies of documents.[284]

The administrator also has a general discretion to lodge further reports specifying any other matter which in his opinion is desirable to bring to the ASC's notice.[285]

If the administrator does not lodge a report with the ASC and it appears to the Court that an "offence" has been committed or that there has been "misconduct" of the type described, the Court has the power on the application of an interested person or of its own motion, to direct the administrator to lodge such a report.[286]

Completion of investigations and the second meeting of creditors.

The administrator must generally complete his investigation of the company's business, property, affairs and financial circumstances and prepare the relevant reports and convene a second meeting of the creditors within the prescribed "convening period" to consider the administrator's statement as to the future of the administration.[287] Generally the "convening period" is 21 days beginning with the day the administration begins. However if the administration begins in December or within a 28 day period before Good Friday, the convening period is extended to 28 days.[288] Thus in addition to carrying out the investigation the administrator is required send out the relevant notices of the meetings to the creditors.

Taking into account the fact that within this period the administrator would have also had

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284 s.438D(1) CL [Aust.].

285 s.438D(2) CL [Aust.].

286 s.438D(3) CL [Aust.].

287 s.439A(1) CL [Aust.].

288 s.439A(5) CL [Aust.].

to convene and hold the 1st meeting of the creditors described above, the time frame allowed is indeed short. No mention is made in the statute of the fact that if the whole or part of the company's business is to be saved by the sale of the assets representing that business to a third party, then the administrator would also have to find time to seek out prospective purchasers and engage in negotiations in order to obtain the best deal possible for the creditors. If the company has assets overseas the administrator may also have to take steps to ensure that these assets are and remain subject to his control or that the foreign jurisdiction recognises and gives effect to the statutory moratorium under the CL [Aust.].

However, the view has been expressed that owing to the fact the greater majority of the companies in Australia may be described as small with straight forward, localised assets and liabilities, the 21 days will often prove adequate. Should it prove inadequate, the proper course of action for the administrator to take would be to make an application to court to extend the convening period.

Applying for an extension of time to convene second meeting of creditors

Paragraph 449 of the Explanatory Memorandum issued by the Attorney General with respect to the CL [Aust.] indicates that "it is of the essence that there be speed of administration and "minimisation of expensive and time consuming court involvement and formal meeting procedures." With reference to s.439A it is said:

> "The court will be given powers to extend these periods... though it is not expected that this power will be exercised frequently, since it is an important objective of the new provisions for creditors to be fully informed about the company's position as early as possible and have an opportunity to vote on its future as soon as possible."

In *Mann v Abruzzi Sports Club Ltd*[289] an administrator made an application to court under s.439A(6) for an order extending the statutory time period of 21 days to convene the second meeting of the company's creditors under s.439A(1). Young J. pointed out that the section gives no guidance to the court as to the grounds on which such an extension may be granted. Having examined the Explanatory Memorandum issued by the Attorney General with respect to the Act [CL(Aust.)] he said:

> "Indeed there is much in Pt 5.3A, and particularly in Div 6 of that Part, to underline the necessity of an administration proceeding very speedily. Whilst the administration is in place no winding up can be commenced or enforcement process carried out and *thus it would be contrary to the whole spirit of the Part to allow administration to be unduly extended or, indeed, to over- encourage administrators to apply to the court.*" (italics added)

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289 (1994) 12 ACLC 137; 12 ASCR 611

However, Young J also pointed out that when exercising its powers under the Division the Court should keep the spirit and object of the Division as set out in s.435A firmly in view. On the facts it was found that there would be no prejudice to the creditors or the members in extending the time. If the meeting was summoned without an extension of time the administrator, having done his best, would not have adequate material to give a meaningful account of his administration to the creditors. The administrator was granted the extension requested. In so doing Young J said:

> "I am a little reluctant to do so because I do not wish to invite a spate of these applications whenever administrators find that they run out of time to comply with the Act. On the other hand I do not want it thought that administrators can only apply where they have special grounds. In all cases one must keep in mind the objects of the Division."

Re ATG Developments Pty Ltd.,[290] came up before Young J a few months after he had handed down his decision in *Mann v Abruzzi Sports Club Ltd.* In this case the application for an order extending the statutory time period to convene the second meeting of the company's creditors was heard on the last day of the statutory time period set out in s.439A(5) notwithstanding the fact that the administrator had come to the conclusion earlier that he would not be able to meet the deadline. In the application the administrator did not furnish any specific reasons for seeking the extension. The court observed that in this case there was no committee of inspection, the creditors were comprised of a significant number of insiders and that the proposal being considered appeared speculative in the extreme. Thus, there appeared to be much in favour of the proposition that no extension should be granted if a Voluntary Administration could not be concluded within the time allowed by the Act. Nevertheless, Young J allowed the administration to continue for the apparent reason that the creditors should have had an opportunity to express their views before an administration is terminated.[291]

Sandwiched between *Mann v. Abruzzi* and *Re ATG Developments* is *Re Vanfox Pty Ltd.*,[292] where the second meeting of creditors was held out of time without any application being made by the administrator for an extension. There also were a series of irregularities in convening both the first and second meetings[293] and the conduct of the second meeting reads

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290 (1994) 13 ASCR 261

291 Young J further opined that if applications are made on the last day without adequate reasons for the delay the court may order the administrator to personally bear the costs of the application or even appoint the administrator as liquidator. However no such order was made in this case. *Ibid* at p.262.

292 (1994) 13 ASCR 209

293 Although notice of the first meeting of the creditors was given by post to the creditors no (continued...)

like a comedy of errors.[294] Prior to the administration being initiated, the Australian Deputy Commissioner for Taxation (DCT) had made an application to wind up the company. The company appointed an administrator and the application for winding up was adjourned. At the meeting the DCT was the only creditor out of 38 who voted against the scheme of arrangement.[295]

The DCT sought to resurrect its application to wind up the company on the grounds that the irregularities which occurred in summoning the meetings were so serious that the meetings should be treated as invalid. The DCT further submitted that the irregularities were so serious that they could not be cured under s.1322 CL(Aust.) which allowed the Court to cure procedural irregularities.

In the Court's opinion, the weight of authority[296] regard the steps in calling and advertising meetings of creditors to be essentially procedural in nature. The Court also found that the administrator had acted honestly at all material times and that no injustice had been or was likely to be caused to any person as a result of the irregularities. Only one creditor, DCT, contested the views of the majority and it was in the public interest that the majority view should not be defeated by the irregularities complained of. It was held therefore that the irregularities were curable and the meetings were declared to have been validly held and the creditors resolutions not invalidated by the contravention of the law.

The decisions in *Mann v. Abruzzi, Re ATG Developments* and *Re Vanfox Pty Ltd.,* are all decisions in the first instance. Even if inconsistent in detail, the overriding theme that emerges

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293(...continued)
newspaper advertisement had been place in a newspaper as required be s.436E(3) CL(Aust.). After investigating the affairs of the company the administrator the second meeting of creditors was held 8 days after the prescribed 21 day period had elapsed. An advertisement, which contained an error regarding the day of the week on which the meeting was to be held, had also been place in the newspaper. It should be noted however, that at the first meeting the creditors resolved to enter into a deed of arrangement although the act does not provide for a resolution to be passed at that stage.

294 Once the creditors arrived at the venue they were told that the meeting was in fact being held at another. One creditor (the DCT), refused to attend the meeting at the other venue and all the creditors at that other venue were asked to asked to attend at the first venue.

295 The DCT further proposed a resolution that the company be placed in winding up but that resolution was not seconded.

296 *Broadway Motor Holdings Pty Ltd (in liq.), Re* (1986) 1 ACLR 495; 4 ACLC 598; *Testro Brothers Consolidated (Ex parte Attorney General), Re* [1969] VR 199; *Bell Resources v. Tunbridge Pty Ltd., (No.2)* (1988) 13 ACLR 762; 6 ACLC 970; *Mamourney v. Solimon* (1992) 9 ACLR 63; 10 ACLC 1674.

is that the Australian Courts are adopting a favourable approach towards voluntary administration.

Managerial powers of the Australian administrator

The appointment of Australian Voluntary Administrator has two very important consequences as far as the control and management of the company's business, property an affairs are concerned. The voluntary administrator takes control of these matters and the powers of other officers of the company are suspended.[297] In addition to granting the administrator *control* of the company's business property and affairs, he is also given the wide discretion to *carry on* the business and to *manage* the property and those affairs and to *terminate* or *dispose* of all or part of the business or any of its property.[298] The voluntary administrator has the right to perform any function, and exercise any power, which the company or any of its officers could perform or exercise if the company were not under voluntary administration.[299] Since the exercise of these powers is discretionary it should be noted that such powers may or may not be exercised by the voluntary administrator during the course of an Australian Voluntary Administration. The provisions conferring such power/authority are couched in general terms and it is specifically provided that their generality is not in any way limited by other specific powers conferred by the CL [Aust.].

More specifically, the administrator has the power to remove from office a director of the company. He may also appoint a director, to fill a vacancy or otherwise. He able to execute documents and to bring or defend proceedings, or do anything else, in the company's name and on its behalf. More generally he is authorised to do whatever else is necessary for the purpose of Part 3.5A of the Australian Corporations Law.[300]

When the voluntary administrator performs a function or exercises a power as the administrator of a company under voluntary administration, he is taken to be acting as the company's agent.[301] This statutory agency will serve to protect the administrator from any liability he may expose himself to in performing or carrying out his functions as administrator. Despite being considered the company's agent, the administrator is nevertheless made personally liable for the debts he incurs in respect of procuring goods and services and in the company

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297 ss.437A(1) and 437C(1) CL [Aust.].

298 s.437A(1)(b) and (c) CL [Aust.].

299 s.437A(1) CL [Aust.].

300 s.442A CL [Aust.].

301 s.437B CL [Aust.].

hiring, leasing, using or occupying any property belonging to a third party during the administration. The administrator is further statutorily precluded from contracting out of such liability.[302] The purpose of imposing such a personal liability on the voluntary administrator is to "encourage suppliers of goods and services to continue to deal with the company while its affairs are being reviewed and, also to repose a proper responsibility in the administrator."[303]

As in an English Administration, the question that arises is whether the Australian Voluntary Administrator may seek to achieve a rescue of the company through the management of its affairs. It is submitted that the very nature of the Australian Voluntary Administration procedure precludes such an eventuality. It has been seen that the first meeting of the creditors must be held within five days of the voluntary administrator being appointed and if the company is not placed in liquidation by the creditors the next meeting would ordinarily be held within 28 business days of the first meeting. Thus the time frame within which the entire procedure is implemented is extremely short and insufficient for purpose of enabling the benefits of sound management to be realised. Whilst the time frame of the entire voluntary administration procedure may be extended, as has been pointed out, speed is an essential feature of the procedure and it is unlikely that the extensions would be granted for the purpose of enabling the administrator to continue managing the company. The power to manage the company during an Australian Voluntary Administration is therefore granted essentially for the purpose of ensuring that the company's going concern value and goodwill may be preserved until the creditors have an opportunity to vote on the administrator's proposals. Thus the procedure meets the stated objective of the Harmer Commission which was to provide a constructive approach to corporate insolvency by the "preservation, if practical and possible, of the property and business of the company in the brief period before the creditors are in a position to make an informed decision."[304]

Limitations on administrator's powers

The administrator of a company under administration or of a deed of company arrangement is restrained from disposing of property of the company that is subject to a charge. A like prohibition applies to the disposal of property that is used or occupied by, or is in the

302 s.443A CL [Aust.]

303 See Harmer, R., "Up and Over Down Under" (1993) *2 IIR* 81. See also the *Harmer Report*, paras.88-93.

304 *Harmer Report*, para.53.

possession of, the company but of which someone else is the owner or lessor.[305] This does not prevent, however, a disposal made in the ordinary course of the company's business. It also does not prevent a disposal made with the written consent of the chargee, owner or lessor, as the case may be, or the leave of the Court.[306] If an application is made to the court for such permission the Court can only give its leave if it is satisfied that arrangements have been made to protect adequately the interests of the chargee, owner or lessor of the property.[307]

Where a charge on property of a company under administration was a floating charge when created but has since become a fixed or specific charge[308] subject to the limitations described above[309] the administrator has the power to deal with any of that property as if the charge were still a floating charge.[310] If a "substantial chargee" has acted to enforce a charge under s.441A CL [Aust.], the administrator's functions and powers are subject to the functions and powers of the chargee or a receiver.[311] If the charge relates to perishable property the fact that the functions of a receiver who is not a manager are suspended by the appointment of a voluntary administrator does not preclude the receiver from enforcing the charge.[312]

POST-INITIATION PROCEDURE IN RECEIVERSHIP

Unlike the other procedures considered in this thesis, Receivership is a means whereby a single creditor, secured by a charge over the whole or substantially the whole of the debtor company's property, may, in the event of default in payment or on the occurrence of any other event causing the charge to crystallize, recover its dues.[313] Consequently, the procedure which follows a Receiver's appointment does not move inexorably towards a meeting of the company's unsecured creditors at which the procedure may be brought to an end by the creditors rejecting proposals placed before them for their approval.

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305 s.442C(1) CL [Aust.].

306 s.442C(2) CL [Aust.].

307 s.442C(3) CL [Aust.].

308 s.442B(1) CL [Aust.].

309 ss.442C and 442D, CL [Aust.].

310 s.442B(2) CL [Aust.].

311 ss.441A(3)(b) 442D(1) CL [Aust.].

312 s.442D(2) CL [Aust.]

313 See the discussion in Chapter One *supra*. See also Goode, R.M., *Principles of Corporate Insolvency Law* p.77.

Source of the Receiver's powers and duties

The Receiver's powers and duties and the post-appointment procedure in a Receivership are directed primarily towards the achievement of the objective for which he is appointed.[314] Historically, these powers and duties have been governed almost exclusively by the terms of the debenture and Common Law. Although, a non-collective procedure, Receivership has the potential to benefit or adversely affect the company's employees, unsecured creditors, third parties that might deal with it and guarantors of the company's liability to the charge holder. Over the years, in particular following the recent reform process in the late '70s and throughout the '80s, several statutory provisions which impact on the post initiation procedure have been enacted for the benefit of both the charge holder and the other persons who might be affected by the Receivership. The post initiation procedure in a Receivership today is consequently governed by the terms of the debenture[315] under which the Receiver is appointed, Common Law and statute.[316]

The Cork Committee was concerned to ensure that every receiver appointed under a floating charge should have certain powers and that there should be no necessity to refer to each debenture to ascertain the scope of the Receiver's powers.[317] When the Committee's recommendations found their way on to the statute books, provisions were included which, among others, enshrined the more important powers conferred upon an English Receiver and Manager by a debenture.[318] Subject to the overriding qualification that they are not inconsistent with the debenture,[319] every English Administrative Receiver has the powers contained in Schedule 1 to IA 1986 [U.K.],[320] which are also enjoyed by an English Administrator. For the apparent purpose of avoiding any ambiguity, modern English debentures usually provide for the statutory

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314 *Re B. Johnson & Co. (Builders) Ltd.*, [1955] 1 Ch. 634, *Gomba Holdings U.K. Ltd., v. Homan & anor*, [1986] BCLC 331.

315 See for *e.g.* Millett, The Hon. Sir Peter., (ed.) *The Encyclopaedia of Forms and Precedents,* London, Butterworths, 1992, Vol.10; *Australian Encyclopaedia of Forms and Precedents,* (3rd ed. Revised), Butterworths, Australia, 1993, Vols.4 & 9; *O'Brien's Encyclopaedia of Forms,* (11th ed. Revised), Canada Law Book Inc., 1994, Division II, Vol.2,, Chap.22.

316 Part III, IA 1986 [U.K.]; Part 5.2, CL [Aust.]; Part XI BIA [Can.]; Part IX CBCA [Can.].

317 *Cork Report*, paras.495-496.

318 See s.42 read with Schedule 1, IA 1986 [U.K.].

319 s.42 IA 1986 [U.K.].

320 These powers have been summarised at 6.5.4. *supra* under the heading *Management of the company during an English Administration.*

powers to be incorporated into the debenture.[321]

The Australian Receiver's power to generally carry on the business of the company and to exercise a number of more specific powers to that end has been conferred by statute since 1983, and Australian debentures usually provide that the Receiver may exercise all the rights or powers conferred upon the Receiver by the relevant statute.[322] Such a provision appears to be followed up by a number of specific rights/powers which may be exercised by the Receiver.[323] Statutorily, the Australian Receiver of property of a corporation is given the general power to do all things necessary or convenient to be done for or in connection with, or incidental to the attainment of the objectives for which the Receiver was appointed. These wide powers may be exercised both in Australia and elsewhere.[324] For the purpose of attaining the objectives for which he was appointed, a Receiver is in addition granted a number of specific powers. These powers are substantially the same as the powers granted by statute to the English Receiver[325] and include the power to enter into possession and take control of the property and to carry on its business.[326] These specific additional powers are without prejudice to the wider general authority conferred on an Australian Receiver, but subject to any limitation in the instrument under which the Australian Receiver's appointment was made.

There is no statutory enunciation of a Canadian Receiver's powers in BIA [Can.] or in CBCA [Can.]. Therefore, the Canadian Receiver's power to carry on the business and to otherwise manage its affairs and other powers are derived solely from the debenture. A typical Canadian debenture in favour of a bank would provide, *inter alia*:

"Subject to the provisions of the instrument appointing such [Canadian] Receiver, any

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321 "...[A]nd such Receiver so appointed shall have all the powers conferred from time to time on receivers by statute...." Millett, The Hon. Sir Peter, (Ed) *The Encyclopaedia of Forms and Precedents* (5th Ed) London, Butterworths, 1992, Vol.10, Form 321, Cl.13.1.

322 "...[W]ithout limitation, a receiver may in relation to that property exercise:
(i) the rights capable of being conferred upon receivers and receivers and managers by the Corporations Law and statutes and laws of any relevant jurisdiction;...." *The Australian Encyclopædia of Forms and Precedents,* (3rd Ed.) Butterworths, Australia, 1992, Vol.4, Pr.5.1, Cl.8.

323 See *The Australian Encyclopædia of Forms and Precedents,* (3rd Ed.) *supra* Vol.4, Paras.5105 and 5110; *The Encyclopaedia of Forms and Precedents* (5th Ed) *supra* Vol.10, Form 321, Cls.13.1:1 to 13.1:10.

324 s.420(1). CL [Aust.].

325 As mentioned, these powers are in turn identical to the powers conferred upon an English Administrator and for a description, reference should be made to p.326 *supra.*

326 s.420(2) CL [Aust.].

such Receiver or Receivers so appointed shall have power to take possession of the Mortgaged Property or any part thereof and to carry on or concur in carrying on the business of the Borrower and to sell or concur in selling all or any part of the Mortgaged property ... The rights and powers conferred by this paragraph are supplemental to and not in substitution for any rights or powers the Bank may from time to time have as the holder of this Debenture and every such Receiver may at the discretion of the Bank be vested with all or any of the powers of the Bank."[327]

Under the debenture the bank would, specifically, have the power to take possession of the property secured and to sell or dispose of it,[328] and to borrow money on the security of it.[329] Owing to the fact that the Receiver is solely dependent on the debenture for his powers, in the absence of such a provision the Receiver would be unable to take such steps.[330]

Publicising the Receivership

A major criticism levelled at Receivership during the reform process in both England and Canada was the fact that the other creditors of the company had no way of ascertaining whether a Receiver had been appointed in respect of the company.[331] The Cork Committee recommended that it would be sufficient if notice was given to the company alone. However it admitted that this did not address the problem of notice to the creditors.[332] The Harmer Commission was not too concerned with this particular problem because the CL [Aust.] already required the person appointing the Receiver to lodge notice of the appointment within 7 days with the ASC and to publish the notice within 21 days in the *Gazette*.[333] The person appointed as Receiver also had serve notice of his appointment as soon as possible on the company[334] and to lodge a notice of his address with the ASC.[335] These requirements are still part of CL [Aust.].[336]

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327 See *O'Brien's Encyclopedia of Forms* (11th ed. Revised), Canada Law Book Inc., 1994, Division II, Vol 2, Form 22:02.2, para 9.01. See also Bennett, F., *Receiverships*, The Carswell Company Ltd, Toronto, 1985, pp.18. and 116.

328 *Ibid.* para 9.02

329 *Ibid.* para 9.03.

330 Unless the Receiver is acting in respect of the Security coming within the ambit of Provincial Personal Property Legislation.

331 *Cork Report*, para.s 470 *et seq. Colter Report*, p.37.

332 *Cork Report*, para.472.

333 s.429(2) CL [Aust.] (prior to amendment in 1992)

334 s.429(2)(a) CL [Aust.]

335 s.427(2) CL [Aust.] (prior to reform.).

336 See s.427(1A),(1B) and (2) CL [Aust.].

The English and Canadian legislatures accepted these recommendations and today a Receiver is obliged to give notice of his appointment. However, the type of notice required differs significantly in comparison with the Australian requirement. The only similarity is that, in Canada, notice must be given to a public regulatory body. In England notice must be given forthwith to the company, and unless the court directs to the contrary, within 28 days to all the company's creditors to the extent that he is aware of their addresses.[337] In Canada the requirements are somewhat more stringent. Such notice must be given, "as soon as possible but not later than 10 days after becoming a Receiver." The parties to whom notice must be given are the same as in England but they also include the Superintendent in Bankruptcy, and if the company is bankrupt, the trustee in bankruptcy.[338] The Receiver is assisted in his duty to notify the creditors by the obligation placed upon the company, on being notified, to provide the Receiver with a list of all its creditors.[339] If the company is an insolvent person, the Receiver remains obliged to give the said notice to every creditor whose name and address he becomes aware of during the Receivership.[340] In addition to giving notice of his appointment, a Canadian Receiver is obliged forthwith after taking possession or control, which ever is the earlier, to file a statement of affairs containing prescribed information relating to the Receivership with the Superintendent in Bankruptcy.[341] The information prescribed concerns detailed information about the company's assets and liabilities, including names of individual creditors and the intended plan of action of the Receiver during the Receivership, to the extent that such a plan has been determined.[342] A copy of this report should also be given to the company or the trustee in bankruptcy if the company has been declared bankrupt and to every creditor of the company who asks for one (*n.b.* there is no obligation to send each creditor a copy). The creditors have the right to ask for such a report up to six months after the Receivership has come to an end.[343]

337 s.46(1) IA 1986 [U.K.].

338 s.245(1) BIA [Can.]

339 s.245(3) BIA [Can.].

340 s.245(2) BIA [Can.].

341 s.246(1) BIA [Can.]. The Colter Committee did not recommend that the Receiver should be required to give notice of his plan of action. But it should be borne in mind that the Colter Committee's recommendations were based on its earlier proposal that the appointment of a Receiver by a secured creditor should be by leave of court. See *Colter Report,* p.39 and 46.

342 r.113.3 B&IR [Can.].

343 s.246(1)(a)&(b) BIA [Can.].

In addition to giving notice of his appointment, in England and Australia every person dealing with the company should also have notice of the fact that a Receiver has been appointed in respect of the company. Thus, in England, when a Receiver has been appointed in respect of property of a company, every invoice, order for goods or business letter which is issued by or on behalf of the company or the Receiver or the liquidator, which is a document on which the company's name appears must contain a statement that a Receiver has been appointed.[344] In Australia this statement is required to be made on every public document and in every eligible negotiable instrument of the company.[345] The phrase "public document" has a wide meaning and would include documents such as those referred to in the English statutory provision.[346] An "eligible negotiable instrument" means a bill of exchange, promissory note, cheque or other negotiable instrument and the indorsement on such an instrument, and a letter of credit which is the company's, or is purported to be issued or signed by the company.[347] In Canada there is no such requirement.

Thus, today in all three jurisdictions every creditor of a company has a right to be notified if a Receiver is appointed in respect of that company. In England and Australia any person seeking to deal with the company would also be placed on notice. It may be noted that the English and Canadian requirement that notice be given to every creditor, places what is likely to be a heavy burden on the Receiver and the funds of the company, which, from the date of the appointment of the Receiver, rightly belong to the debenture holder. As the Harmer Commission pointed out in discussing the need to require Receivers to furnish information regarding the conduct of the Receivership, "[S]such a requirement should not be unnecessarily burdensome or expensive...It should be recognised that postage is a significant cost in many cases."[348]

Investigating and ascertaining the company's affairs

One of the first tasks a prudent Receiver would perform on being appointed would be to carry out a full investigation of the company's affairs, in order to ascertain where the company's assets are located, their value, whether any steps need be taken to protect them, the company's liabilities in general and in particular to preferential creditors, the immediate cause of the

344 s.39(1) IA 1986 [UK].

345 s.428(1) & (2) CL [Aust.].

346 For the definition of "public document" see ss.9 & 88A(1) CL [Aust.].

347 See s.8 CL [Aust.].

348 *Harmer Report*, para.206.

company's insolvency, whether it is possible to carry on the company's business for any length of time, to what extent the company's liabilities will have to be met, or property belonging to others used, for this purpose, and what course of action would result in the best possible return for the debenture holder.

In all three jurisdictions, there is no express statutory requirement that such an investigation must be carried out. In England a number of statutory provisions are found under the heading "Ascertainment and Investigation of Company's Affairs."[349] These provisions are mostly similar to provisions contained under an identical heading in Part II IA 1986 [U.K.] which deals with the Administration Order Procedure.[350] However, in none of the provisions under that heading is there an express requirement that the Administrative Receiver should carry out an investigation of the company's affairs. What one of these provisions requires the English Administrative Receiver to do forthwith on his appointment is to call upon some or all of a specified group of persons to prepare and submit to him a statement as to the company's affairs. The statement should be in the form prescribed by IR 1986 [U.K.].[351] The persons from whom the Administrative Receiver may demand a statement are the same persons as from whom the administrator may demand his statement of affairs.

In Australia too there is no express statutory requirement that the Receiver should investigate the company's affairs.[352] There is however a mandatory requirement that any director or secretary of the company must, within 14 days of the company receiving the notice of the Receiver's appointment, make out and submit to the Receiver a report about the affairs of the company as at the date of the Receiver's appointment.[353] The Australian Receiver may also require the same classes of persons from whom an English Administrative Receiver may make a request under the relevant English provision, to make out and submit to him a report as to the affairs of the company. The Australian Receiver has the power to specify the information that is required by him.[354] The Australian Receiver also has the right to inspect the company's

349 ss.46-49 IA 1986 [U.K.].

350 See the discussion at p.316 *supra*.

351 r.3.4 & r.3.2 IR 1986 [U.K.].

352 Contrast the mandatory requirement in s.438A CL [Aust.] which applies in an Australian Voluntary Administration.

353 s.249(2) CL [Aust.]

354 s.430 CL [Aust.].

books at any reasonable time.[355]

None of the Receivers have the right to examine an officer of the company as to the conduct of that company's affairs or the location of the company's property. If winding up or bankruptcy proceedings have been commenced the Receiver may seek to achieve this task through the liquidator or trustee in bankruptcy. It should be noted that in Australia, although the Australian Receiver does not have the statutory right to examine an officer or employee of the company he may seek authorization in writing from the ASC to make an application to court under s.596A CL [Aust.] to carry out a mandatory examination.[356]

It may be argued that there is no need to impose a statutory obligation on the Receiver to carry out an investigation of the company's affairs when this objective would in most cases be accomplished.

Taking control of the company's property and the management of its affairs

One of the most important powers conferred upon the Receiver at the instance of the debenture holder[357] has been the power to manage the company. By virtue of this power the Receiver has the ability to carry on the business of the company and thereby preserve its goodwill and maintain its going concern value. It may be viewed as being necessary for the purpose safeguarding the assets comprised in the security and enabling the Receiver to act in the best interests of the debenture holder.[358]

The Cork Committee was of the view that, by carrying on the company's business, the Receiver has been able to restore the company to profitability, eventually returning it to the former owners or being able to sell all or part of the business as a going concern, thereby achieving the survival of the company or the viable part of its business or a better realization of assets than would be possible in a liquidation.[359] The English Administrative Receiver's power

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355 s.431 CL [Aust.].

356 s.596A CL [Aust.] read with the definition of "eligible person" in s.9 pt.1.2 CL [Aust.].

357 See *Gaskell v. Gosling,* [1896] 1 Q.B. 669, per Rigby L.J. at 692-3. Judgement subsequently approved by the House of Lords.

358 See Goode, *Principles of Corporate Insolvency Law, supra,* p.95.

359 See *Cork Report*, para.495. Prof. Rajak queries the foundation of this statement, pointing out that "while many members of the Cork Committee were very experienced in insolvency practice, the Committee commissioned no research on this or any other issue." See Rajak, H. "The Challenges of Commercial Reorganizations in Insolvency: Empirical Evidence from England" in Ziegel, J., (Ed) *Current Developments in International and Comparative Corporate Insolvency Law,* Clarendon Press, Oxford, 1994, p.191 at 195.

of management is now statutorily enshrined and, unless it has been expressly excluded by the terms of the debenture, every Receiver may through the continued management of the company, seek to achieve the beneficial result described by the Cork Committee. In Canada as well, the Colter Committee formed the view that Receivership also provides a means for the reorganization of the debtor's affairs.[360] But this did not lead to the Canadian Receiver's powers of management being given statutory recognition. As mentioned above the Australian Receiver's power of management also has a statutory foundation.

Keeping in mind the primary purpose of his appointment, as a first logical step in the recovery process following his appointment the Receiver would take into his possession and control the property subject to the charge[361] to which the company is or appears to be entitled. Continuing the company's business, while not mandatory, is often a necessary step in trying to realise the maximum for the company's assets,[362] but, as pointed out above, it takes place not for the benefit of the company and the other unsecured creditors but the debenture holder alone. Thus, it true to say that Receivership is a not a regime which deliberately sets out on every occasion to achieve a corporate rescue but one which allows for a rescue, of the company itself or the viable parts of its business, if such a rescue would result in the best possible return to the debenture holder. As Lord Templeman expounded on behalf of the Privy Council in *Downsview Nominees v. First City Corporation*:[363]

> "The duties owed by a Receiver and Manager do not compel him to adopt any particular course of action, by selling the whole or part of the mortgaged property or by carrying on the business of the company or by exercising any other powers and discretions vested in him."[364]

Therefore, if a debenture provides for the appointment of a Receiver and Manager and an appointment is made, the Receiver and Manager is not obliged to manage the company and attempt to dispose of the assets at a going concern value rather than on a break up basis. In other words, there is no implied agreement between the debenture holder and the borrower that, before

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360 *Colter Report*, p.50. *cf.* its views expressed at p.37. See also the discussion in Chapter Three at p.195 *supra*.

361 For *e.g.* see Millett, The Hon. Sir Peter., (ed.) *The Encyclopaedia of Forms and Precedents*, Vol.10; Cl.13.1:1; *O'Brien's Encyclopaedia of Forms and Precedents*, Division II, Chap,22., Form.22:02.2, Cl.9.02.

362 See Lightman and Moss, *ibid, supra*, p.94.

363 [1993] 2 WLR 86.

364 *ibid.* at 97; See also the judgement of Jenkins LJ in *Re B Johnson & Co. (Builders) Ltd.*, [1955] Ch. 634 at 661-663 cited with approval by Lord Templeman in *Downsview, supra*.

the company's assets are sold off at a break up value, a reasonable attempt will be made by the Receiver to trade out of the insolvency or to obtain a going concern value for the assets subject to the security. The Receiver will be perfectly within his rights to immediately proceed to liquidate the assets without even attempting to procure a better return for the company's assets.

A notable feature of Receivership in comparison to all the other insolvency regimes discussed in this thesis is the absence of any fixed statutory time frame within which the receivership must be completed. The Receiver may, as a result, continue to manage the company so long as he deems it viable to do so. This may in some cases be until the cost of management begins to erode the debenture holder's security and continued management will not increase the amount recoverable out of a liquidation of the assets.

The Receiver's status vis à vis the company's director's

With a Receiver taking over the management of the company there would clearly be a conflict between the exercise of his powers and the exercise of the powers of the company's own directors who are authorised to manage the company under its articles of association. This situation was usually dealt with by including a provision in the debenture which prohibited the directors from interfering with the exercise of the Receiver's powers.

Generally, on the commencement of bankruptcy or winding up proceedings, which are usually terminal from the company's point of view, the directors of a company cease to be able to exercise any of their powers.[365] The effect that the appointment of a Receiver has on the company and its directors is that the directors cease to be able to do anything which would interfere with the proper discharge of his functions by the Receiver.[366] But the directors retain the right to exercise all residuary powers and duties such as to convene meetings of the

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365 On the making of the winding up order in England, the appointments of the directors are terminated immediately. See *Measures Bros Ltd. v. Measures* [1910] 2 Ch. 248. In both a creditors' and members' voluntary winding up, however, only the powers of the directors cease on the appointment of a liquidator. See s.91(2) and s.103 IA 1986 [UK]. In Australia the powers of the "officers of the company" are suspended during a winding up in insolvency and by the Court. See s.471A(1) CL [Aust.]. In neither instance is the director or "officer" removed from office. See also s.471A(3) CL [Aust.]. At the extreme end of the scale, in Canada, the powers of the directors and officers of the company are not affected by the bankruptcy of a corporation. *Re Canada Cereal and Flour Mills Co.* (1921) 2 C.B.R. 158, 51 O.L.R. 316, 67 D.L.R. 234. (S.C.) *National Trust Co v. Ebro Irrigation and Power Co.* [1954] O.R 463, [1954] 3 D.L.R. 326 (H.C.) But, because the corporation's property has been vested in the trustee, it is the trustee and not the directors who may give directions relating to that property. *Re Credo Porcupine Mines Ltd.*, 23 C.B.R. 261, [1942] O.W.N. 205 (S.C.).

366 See *Moss Steamship Co. v. Whinney* [1912] A.C. 254 per Lord Atkinson at p.263; *Re Emmadart Ltd.* [1979] 1 Ch 540 *per* Brightman J. at p.544.

shareholders, file statutory returns and accounts and even to bring action against the debenture holder challenging the debenture holder's action of appointing the Receiver, and to sue the debenture holder or the Receiver for misconduct.[367]

It may be noted that in the case of a company incorporated under the CBCA [Can.] the appointment of a Receiver does not automatically remove the directors from their positions. Nevertheless, the Common Law principle continues to apply in Canada. In *Nova Metal Products v. Comiskey*[368] the Court of Appeal of Ontario held that the appointment of a Receiver divested the directors of their power to issue an "instant trust deed" for the purpose of invoking the jurisdiction of the court under the CCAA [Can.].[369]

The Receiver's legal status

Although appointed by the debenture holder and for the primary purpose of realising the company's assets for the debenture holder's benefit, it is usually provided in the debenture that the Receiver shall be the agent of the company.[370] The origins of this clause may be traced to the early practice of Receivership in England, where it was first used in mortgage deeds in respect of land to avoid the onerous responsibilities which befell the mortgagee who took possession of the mortgaged property.[371]

While relieving the debenture holder and the Receiver of such a burden, the clause has also enabled the Receiver to manage the company effectively for the benefit of the debenture holder (and perhaps the other unsecured creditors). For example, subject to any statutory provision[372] or agreement to the contrary, neither the Receiver nor the debenture holder would

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367 *Hawkesbury Development Co. Ltd. v Landman Finance Pty Ltd.* [1969] 2 NSWR 782; *Newhart Development Ltd., v, Co-op Commercial Bank Ltd.,* [1978] QB 814. *First Investors Corpn. v. Prince Royal Inn Ltd.* (1988) 69 C.B.R. (N.S.) 50, *TD Bank v Fortin* (1978) 26 C.B.R. (N.S.) 165.

368 (1990) 1 C.B.R. (3d) 101

369 As to "instant trust deeds" see the discussion in Chapter Four, part 4.2.2 at p.176 *supra.*

370 See the specimen debentures in Lingard, J., *Bank Security Documents,* 3rd Ed, Butterworths, London, 1993, p.356; *The Encyclopaedia of Forms and Precedents, supra,* Vol.10, Form.321, Cl.13.1; *Australian Encyclopaedia of Forms and Precedents, supra,* Vol.4. Pr.5.1, Cl.8(1); *O'Brien's Encyclopaedia of Forms, supra,* Division II, Vol.2, Chap.22, Form.22:02.2, Cl.9.01. See also O'Donovan, J., *Company Receivers and Managers,* 1st Ed, Law Book Company Ltd, Australia, 1981, p.7; *Australian Corporations Law,* Butterworths 5.2.0065; Leonard, E. Bruce, *supra* at 11-6; and Milman, D., "Receivers as Agents" (1981) 44 *MLR* 658.

371 *Chaplin v. Young* (1864) 33 Beav. 330, *White v. City of London Brewery Co.,* (1889) 42 Ch.D 237. See also *Gaskell v. Gosling* [1896] 1 Q.B. 669, *per* Rigby L.J. at p.692-693.

372 s.44(1)(b) & (c) IA 1986 [U.K.], s.419(1) CL [Aust.].

be liable on any contract entered into by the Receiver.[373] Further, if the Receiver is not considered the agent of the company he would not be able to decline to perform pre-Receivership contracts without incurring tortious liability for inducing a breach of a contract.[374] The company would be liable for the breaches.[375] Provided the Receiver does not needlessly damage the company's business, he incurs no liability so long as his actions are directed towards the protection of the debenture holder's interests.[376]

Despite being identified as the agent of the company, the Receiver's relationship with the company is best described as unusual. Unlike an ordinary agent, he does not "owe a duty of undivided loyalty to his principal".[377] The company has no control over the Receiver. It does not even have the basic power, which may be expected of a principal, to terminate the Receiver's agency.[378] Unusual though the relationship is, the courts in England, Australia and Canada have recognised the parties freedom to contract, and given effect to agency clauses in debentures. It may be said that the debtor's acceptance of the Receiver as its agent is part of the price paid by the debtor for the debenture holder's loan.[379]

In England an Administrative Receiver is now deemed by IA 1986 [UK] to be the agent of the company.[380] Thus, an English Administrative Receiver would be the agent of the company whether or not the debenture so provided. There is no such statutory provision in relation to Receivership either in Canada or Australia.

Except in Australia, the Receiver's agency does not invariably last till the end of the Receivership. It is terminated by the commencement of liquidation proceedings.[381] The fact that the Receiver's agency is terminated does not mean that the Receiver automatically becomes

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373 *Gaskell v. Gosling* [1896] 1 Q.B. 669, *per* Rigby L.J. at p.692-693.

374 *n.b.* a similar deeming provision makes the administrator in England, s.14(5) IA 1986 [UK], and in Australia, s.437B CL [Aust.], the agent of the company.

375 *George Barker (Transport) Ltd., v. Enyon* [1974] 1 All ER 900.

376 See Goode, Prof. R.M. *Principles of Corporate Insolvency Law, supra,* p.82.

377 *Gomba Holdings UK Ltd v. Homan* [1986] 3 All ER 94 at 98.

378 *Gaskell v. Gosling, supra, Telemetrix plc v. Modern Engineers of Bristol (Holdings) plc* (1985) 1 BCC 99,417; [1985] BCLC 213. See also Milman., D., "Receivers as Agents" (1981) *44 MLR* 658, at 660 *et seq.*

379 *Gaskell v. Gosling* [1896] 1 Q.B. 669, *per* Rigby L.J. at p.693.

380 s.44 IA 1986 [UK].

381 *Gosling v. Gaskell* [1897] A.C. 575.

the agent of the debenture holder[382] but he may become so if the mortgagee treats him as such. In Australia however, subject to personal liability on the contracts entered into, even after liquidation is commenced the Receiver continues to act as the agent of the company.[383]

The Receiver's duties in preserving and realising assets

The Receiver's primary responsibility is to the debenture holder for whose benefit he acts,[384] and his duties to the debenture holder arise in contract and in tort.[385] Although not a trustee, he also owes a fiduciary duty to the debenture holder.[386]

He also has a general duty to exercise his powers in good faith for the purpose of preserving and realising the assets comprised in the security and obtaining payment of the sum secured.[387] In *Re B Johnson & Co (Builders) Ltd.,*[388] Jenkins L.J., in the English Court of Appeal, said:

> "[I]n the absence of fraud or mala fides...the company cannot complain of any act or omission of the receiver and manager, provided that he does nothing that he is not empowered to do, and omits nothing that he is enjoined to do by the terms of the appointment."[389]

On the basis of this judgement, provided he acted in good faith, the Receiver was not liable if he was negligent in the exercise of his powers. In two later decisions, one of which is by the English Court of Appeal, it was held that the Receiver did owe a duty of care to guarantors of the company's debts secured by the charge.[390] These two decisions were based upon a previous decision of the Court of Appeal in *Cuckmere Brick Co. v. Mutual Finance Ltd.,*[391] which concerned the duties owed by a mortgagee to the mortgagor in realising the mortgaged property.

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382 *Re Wood* [1940] 4 All ER 306.

383 s.420C(3) CL [Aust.].

384 *Gomba Holdings UK Ltd v Homan* [1986] BCLC 331.

385 See Picarda, H., *The Law Relating to Receivers Managers and Administrators,* (2nd ed.), London, Butterworths, 1990, 115; Lightman, Sir Gavin and Moss, G.,*The Law of Receivers of Companies,* London, Sweet and Maxwell, 1994, 134-135.

386 Picarda, *supra,* 115, and Lightman and Moss, *supra,* 135.

387 See Lightman, Sir Gavin, and Moss, G., *The Law of Receivers of Companies,* London, Sweet and Maxwell, 1994, 112.

388 [1955] Ch. 634.

389 *ibid.,* at 663.

390 *Standard Chartered Bank Ltd., v Walker* [1982] 1 WLR 1410, *American Express Banking Corp. v Hurley* [1986] BCLC 52.

391 [1971] Ch 949

Salmond LJ said:

> "There are some dicta which suggest that unless a mortgagee acts in bad faith he is safe. His only obligation to the mortgagor is not to cheat him. There are other dicta which suggest that in addition to the duty of acting in good faith, the mortgagee is under a duty to take reasonable care to obtain whatever is the true market value of the mortgaged property at the moment he chooses to sell it...The proposition that the mortgagee owes both duties, in my judgement, represents the true view of the law."[392]

There can be no doubt from the language used, here and later on in this judgement that Salmond LJ was referring to the duty of care in the law of negligence. Salmond LJ does not expressly refer to *Re B Johnson & Co (Builders) Ltd,* nor does it appear to have been cited. Nevertheless, Mann J in *American Express Banking Corp. v. Hurley* took the view that the law was as stated in *Cuckmere Brick Co* and not *Re B Johnson & Co (Builders) Ltd.* It should be noted that neither *Standard Chartered Bank v Walker* nor *American Express Banking Corp v. Hurley* sought to impose a general duty of care applicable at all times on the Receiver. The duty was restricted to the situation where the Receiver was exercising his power of sale under the debenture.

Downsview Nominees v. First City Corporation[393] was a case stated to the Privy Council from the Court of Appeal in New Zealand, in which one of the issues was whether a first debenture holder and the Receiver appointed by him owed a general duty of care to a subsequent debenture holder or the company. The Privy Council had no hesitation in robustly rejecting any attempt to impose such a general duty of care. Lord Templeman who delivered the judgement of the Privy Council said:

> "The general duty of care said to be owed by a mortgagee to subsequent encumbrancers and the mortgagor in negligence is inconsistent with the right of the mortgagee and the duties which the courts applying equitable principles have imposed upon the mortgagee...If a mortgagee exercises his power of sale in good faith for the purpose of protecting his security, he is not liable to the mortgagor even though he might have obtained a higher price and even though the terms might be regarded as disadvantageous to the mortgagor".[394]

It has been pointed out that s.345B of the New Zealand Companies Act, 1955 expressly provides that a Receiver who sells property of the company must exercise all reasonable care in obtaining the best price reasonably obtainable and that, inexplicably, no reference is made by the Privy Council to this provision in its judgement.[395] As regards English Law some statements made

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392 *ibid.* at 965-966.

393 [1993] 2 WLR 86.

394 *ibid.,* at p.98.

395 See Keay, A., *Insolvency: Personal and Corporate Law and Practice,* (2nd ed.) Melbourne, (continued...)

elsewhere in the judgement do not reflect the true relationship the debenture holder has with an English Administrative Receiver or the impact of that procedure on English Administration.[396] Nevertheless the reduction in the scope of negligence in its application to pure economic loss is consonant with the recent decisions of the House of Lords.[397]

The Colter Committee observed that a Receiver is required to deal with the property in a timely and appropriate manner having regard to the nature of the property and the interest of the debtor.[398] It nevertheless recognised the practical limitations of receivership as a rescue regime by stating

> "Since there has been default and interest arrears are accumulating the creditor has the right to recover expeditiously whatever can reasonably be obtained from the assets without incurring the additional expense that a private owner might in order to recover the maximum return on the property."[399]

Under the BIA [Can.] and CBCA [Can.] a Receiver must act in good faith and deal with any property of the company which is in his possession or control in a commercially reasonable manner.[400] BIA [Can.] adds the word "honestly" before the words "good faith". The Canadian requirement to act in a "commercially reasonable manner" appears to impose a wider duty than does *Downsview*.

During the course of its deliberations the Harmer Commission recommended that a new provision containing a clear statement of the duties of a Receiver in exercising its powers of management and sale:

> "In Australia at least, the duty of a receiver would be confined to a duty to act in good faith (including a duty not to sacrifice the mortgagor's interest recklessly). A receiver who exercises a power in a negligent manner may not breach that duty. This is not the position in England. Recent authorities have determined that a receiver does have a duty to take reasonable care in the exercise of the receiver's powers. If a Receiver acts negligently that duty is breached and the Receiver is liable. The Commission considers that this should be the law in Australia." [401]

In making this recommendation the Harmer Commission appears to have been acutely aware of

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395(...continued)
Longman, 1994, p.161.

396 *Downsview Nominees, supra,* at p.99.

397 *eg. Caparo Industries Ltd., v. Dickman* [1990] 2 AC 398.

398 *Colter Report,* p.37.

399 *Colter Report,* p.37.

400 s.247 BIA [Can.] and s.99 CBCA [Can.].

401 *Harmer Report,* para.231.

the theoretical difficulty in reconciling the Mortgagee's and Receiver's equitable duty with the common law action for negligence.[402] These recommendations were accepted by the Australian legislature. Today an Australian Receiver owes a statutory duty, in the exercise of his powers and the discharge of his duties to exercise a degree of care and diligence that a reasonable person in a like position in a corporation would exercise in the corporations circumstances.[403] A Receiver also owes a statutory duty to take care in exercising a power of sale in respect of a company's property. If, when the property is sold it has a market value, the Receiver must take care to obtain that value. If the property has no market value, the Receiver must take reasonable care to sell the property for the best price that is reasonably obtainable, having regard to the circumstances which exist when the sale takes place.[404] Prior to the enactment of these provisions the Australian Receiver's position in Equity and at Law was what it is today in England and New Zealand under *Downsview.*[405] It remains to be seen whether, in the light of the decision in *Downsview* the Australian courts are likely to give a restrictive interpretation to these statutory provisions.

Liability for post-receivership contracts

As the Receiver is the agent of the company, according to the terms of the debenture or due to a statutory deeming provision, if ordinary principles of the law of agency apply the company, as principal, ought to be liable for all acts and defaults that are within the Receiver's express and implied authority. The liability should in all cases extend to the contracts entered into by the agent in the performance of his duties. This is the case in Canada. S.114 of the Company Act of British Columbia[406] expressly provides that a Receiver does not incur any personal liability in entering into contracts.[407]

The position is different in the case of an English and Australian Receiver under a floating charge. In England, unless the contract provides to the contrary, a Receiver as agent is statutorily personally liable for any contract entered into by him in the course of carrying out his function as Receiver of the company.[408] The position is similar in Australia, except that the liability is

402 *ibid,* para.232.

403 s.232(1) & (4) CL [Aust.].

404 s.420A(1) CL [Aust.].

405 See *Expo International Pty Ltd. v. Chant* [1979] 2 NSWLR 820.

406 RSBC. 1970 c.59.

407 See Bennett, F. *Receiverships*, Toronto, The Carswell Company Ltd, 1985, p.226.

408 s.44(1)(b) IA 1986 [U.K.]. *cf* the position of an English Administrator who is the company's agent (continued...)

absolute since the Receiver does not have the power to contract out his personal liability.[409] The basis of imposing such a liability on the Receiver is the fear that the Receiver could, under cover of his agency, increase the value of the debenture holder's security by ordering goods which became subject to the charge, unless supplied subject to retention of title, or in trust until payment is made.[410] It should be noted that the statutory provision governing the liability of the Australian Receiver covers debts only and specifies particular transactions.[411]

Where an English Receiver assumes liability in this manner he is statutorily entitled to an indemnity out of the assets of the company.[412] The Australian Receiver does not enjoy a similar statutory indemnity but has the benefit of an equitable lien on the company's property to the extent that the liability has been properly incurred.[413]

There is no liability for pre-receivership contracts *continued* by the Receiver with the exception in England in the case of contracts of employment and in Australia in the case of property used by the company.

An English Administrative Receiver is personally liable to the extent of any "qualifying liability" on any contract of employment adopted by him.[414] A "qualifying liability" means a liability to pay a sum by way of wages or salary or contribution to an occupational pension scheme provided the liability is incurred while the Administrative Receiver is in office and it is in respect of services rendered wholly or partly after the adoption of the contract.[415] The words "qualifying liability" were inserted into s.44(1)(b) IA 1986 [U.K.]. only on 15 March 1994. Prior to that date there was no such limitation and there was much controversy as to whether an Administrative Receiver could continue to retain the services of employees without "adopting" their contracts of employment. Administrative Receivers successfully sought to do so under the blessing of the Court which validated the issue of "Specialized Mouldings" letters (derived from

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408(...continued)
but does not face a similar liability. See s.14(5) IA 1986 [U.K.].

409 s.419(1) CL [Aust.].

410 See Keay, A., *Insolvency: Personal and Corporate Law and Practice,* (2nd ed.) Melbourne, Longman, 1994. p.165.

411 See Harmer Report, *supra,* para.216 p.96.

412 s.44(1)(c) IA 1986 [U.K.].

413 *Hill v. Venning* (1979) 4 ACLR, 555 and *Re Just Juice Corporation Pty Ltd (receivers and managers appointed)* (1992) ACSR 444.

414 s.44(1)(b) IA 1986 [U.K.].

415 s.14(2A) IA 1986 [U.K.].

the name of the case) informing the employees that the Receiver was not adopting their contracts of employment but nor was he assuming any personal liability.[416] The issue of such letters was checked by the Court of Appeal in *Re Paramount Airways (No.3)*.[417] This immediately exposed the English Receiver to considerable liability, thus reducing the prospects of a Receiver opting to carry on the company's business and thereby being able to "rescue" a company. The British Government responded swiftly by enacting the Insolvency Act 1994 which inserted the words "qualifying liability" and thereby reduced the quantum of the liability to which the Administrative Receiver may be exposed. It has not however eradicated the, albeit smaller, risk to which the Administrative Receiver exposes himself and made the use of Administrative Receivership as a rescue regime more attractive.

If an Australian Receiver continues to use property under a pre-existing agreement to which the company is a party, he is personally liable to pay rent or other amounts payable by the company in respect of that property from the seventh day after his appointment for as long as the company uses that property.[418] This section is founded on a recommendation made by the Harmer Commission which felt that it was inequitable to allow a Receiver to have the benefit of the use of any property without attracting any liability.[419]

Receiver's powers regarding the company's executory contracts

One of the most important powers a Receiver enjoys, until such time that the company is placed in winding up, is the ability to repudiate certain pre-receivership contracts which have been entered into and are binding on the company.[420] For example, if under certain contracts entered into by the company there are obligations which remain to be performed by the company, the Receiver has the right to refuse to perform such remaining obligations of the contract. The basis of this power is the fact that the Receiver is appointed by the debenture holders for the primary purpose of recovering the debt due to the debenture holder out of the assets subject to the floating charge. If the performance of the contract would result in the assets subject to the floating charge being utilised for the benefit of another creditor this would in the words of Vinelott J., involve:

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416 *Re Specialized Mouldings Ltd.* (unreported - 13 February 1987).

417 (1994) BCC 172.

418 s.419A CL [Aust.].

419 Harmer Report, *supra*, para.218, p.97.

420 See Moss, G., and Segal, N., "Trading By Administrative Receivers and Administrators", *(1994) 7 Insolvency Intelligence* 49 at 49.

> "preferring the other party to the contract to the other unsecured creditors and indeed would give him a security ahead of the debenture holder."[421]

Ordinarily, a company cannot put it out of its own power to perform contracts it has entered into.[422] But where the debenture holder has priority over the affected party, the company cannot be restrained by injunction at the suit of that party although the company would become liable in damages for its own breach.[423] The Receiver would not be liable to the company for a breach of a duty to preserve the company's goodwill owing to the superior duty owed by him to the debenture holder.[424] The Receiver, is consequently in a better position than the company qua current contracts.[425]

The question that arises is whether the Receiver is personally liable to the other contracting party for the tort of inducing a breach of contract[426] and may be restrained by injunction at the suit of that other party?[427] Where the debenture holder's security has priority over contracting party whose rights are affected, it would be clearly paradoxical to impose such a liability on the Receiver.[428] If the debenture holder does not have such priority, the Receiver would still be immune from liability because it is the agent of the company. The principle in Tort that any person inducing another to breach a contract becomes liable in damages to the injured party does not apply where an agent of one of the parties procures the breach. The injured party can only sue the principal for the breach of contract.[429] This principle has been held to apply to a Receiver by the Court of Appeal in *Welsh Development Agency v. Export Finance Co. Ltd.*[430]

The Receiver does not enjoy a complete and unfettered freedom to terminate or cause the breach of all executory contracts to which the company is a party. If it is likely that at the end

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421 See *Astor Chemicals Ltd. v. Synthetic Technology Ltd.*, (1990) BCC 97 at 105. See also *Airline Airspares v. Handley Page Ltd.*, [1970] 1 Ch 193.

422 *Southern Foundries (1926) Ltd., v. Shirlaw* [1940] AC 701.

423 *Re Newdigate Colliery Ltd.*, [1912] 1 Ch. 468.

424 *Re B. Johnson & Co (Builders) Ltd.*, [1955] Ch. 634, the dictum of Evershed MR.

425 See the dictum of Graham J in *Airline Airspares Ltd., v. Handley Page Ltd.*, [1970] 1 Ch.193.

426 See *Lumley v. Gye* (1853) 2 E & B. 216; *D.C. Thomson Ltd., v. Deakin* [1952] Ch. 646.

427 *eg.* as in *Astor Chemicals Ltd v. Synthetic Technology Ltd.*, (1990) BCC 97.

428 See Moss, G., and Segal, N., "Trading by administrative receivers and administrators" *(1994) 7 Insolvency Intelligence,* p.49 at 50.

429 See *D.C.Thomson Ltd., v. Deakin supra.*

430 (1992) BCC 270.

of the Receivership there will be some assets remaining which will permit the company to continue to trade the Receiver must not, by his action damage the good will of the company.[431] Further, if the other party to the contract has acquired an equitable interest in the subject matter of the contract, as for example in a contract for the sale of land, that party will be able to obtain specific performance of that contract.[432]

Disposal of property subject to fixed charges with priority

Both England and Australia give the Receiver the power to make an application to court seeking authorization for the disposal of property which is subject to a security which has priority over the debenture under which the Receiver has been appointed.[433] The grant of such a power to the Receiver may be considered as evidence of the Receivership's potential as a rescue regime since it would prevent the dismantling of a company's assets piece meal and encourage the sale of assets as part of a company's business. It may equally be construed as evidence of the legislature's preferential treatment of debenture holders.

Indeed in England when making the order the Court need only be satisfied that the disposal of charged assets in this manner would be likely to promote a more advantageous realisation of assets than would otherwise be affected and that the other secured creditor does not receive less than the open market value of the property. This value must be determined by the court in the same manner as in an English Administration.[434]

In comparison, in Australia the court must ascertain, inter alia, that the sale or disposal of the property is in the best interest of the company's creditors and of the company.[435] The section does not go on to identify any particular class of creditors that must benefit from the sale. It is also not clear how the benefit flowing to the company is to be measured. Must the company survive the Receivership or is payment to the debenture holder sufficient benefit? The Harmer Commission, at whose recommendation this provision was enacted,[436] was of the view that both these interests would be satisfied if the sale or disposal of the property in this manner would be

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431 *Airline Airspares Ltd., v. Handley Page Ltd., supra.*

432 *Freevale Ltd. Metrostore (Holdings) Ltd and (anor)* [1984] Ch. 199.

433 See s.43 IA 1986 [U.K.] and s.240B CL [Aust.].

434 s.43(3) IA 1986 [U.K.] see also s.15 IA 1986 [U.K.] and the discussion at Section 6.5.6. under the heading *English Administrator's power to deal with charged property etc.* at p.339 *supra.*

435 s.420B(2)(c) CL [Aust.].

436 See *Harmer Report,* para.210-214, p.95 & 96.

likely to promote a more advantageous realisation of assets than could otherwise be effected.[437] This accords with the Harmer Commission's basic premise that insolvency law should promote an orderly dealing with the assets. If the courts adopt the Commission's view of "best interest" then the difference between the English and the Australian provisions narrow.

CONCLUSION

The preceding discussion has focused upon the steps that are taken from the moment each rescue procedure is initiated up to the point the creditors' meeting to consider the merits of the rescue, if any, is held. It is evident that the purpose and nature of the procedure which must be followed after initiation varies considerably between the regimes. The classification of the procedures in Chapter Three based on whether a proposal for a rescue is made on initiation or only an "opportunity for a rescue" is provided, remains central to the analysis of the post-initiation procedure, with emphasis on the framework within which the "opportunity" to formulate the rescue must be pursued. Other aspects of importance are: the issue of control over the company's property and affairs, and the limitations placed on the exercise of managerial powers; the duration of the post-initiation procedure up to the meetings; and whether it is conducted publicly.

Duration of the procedure

The length of the post-initiation, pre-meeting procedure would have a notable impact on the risk to which the creditors are exposed, the overall cost of the rescue, and the return payable to the unsecured creditors. The ideal would be to ensure that the company spends as little time as possible at this, or indeed any, stage, of a rescue procedure, provided that the time allowed is adequate to perform the tasks required to be carried out during this period. Maximum time frames are in most cases specified by the statute. These vary between the regimes.

The actual time that a company spends at this stage of the procedure would vary, depending on the complexities of the case and the extent to which extensions of time, based on enabling statutory provisions, are obtained for the purpose of implementing the post initiation procedure. It would be reasonable to expect that the initial time frame permitted by statute should be shorter in the procedures which require the making of a "proposal for a rescue on initiation" and longer in those which merely provide an "opportunity for a rescue on initiation". This is not, however, always the case.

The time period required in the former procedures should be short because, once the

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437 *supra.* para.213.

proposal has been made, the next step ought to be the holding of the meeting of the creditors. In a Canadian Proposal without a Notice of Intention the meeting should be summoned within an initial time period of 21 days.[438] In a scheme of arrangement the date of the meeting is the date specified in the court order summoning the meeting. In a CVA, where the nominee is not the liquidator or administrator, meetings of the creditors and members must be summoned within 28 days of the nominee filing a favourable report on the proposal in court. Since this report must be filed within 28 days of the nominee receiving notice of the proposal, the duration of the post initiation procedure in such a CVA, where the meetings are to be held, is 56 days.[439] If the nominee is the administrator or liquidator there is no time frame which is specified and the nominee may proceed to summon the meeting even immediately after the proposal is made.[440]

Turning to the procedures which provide an "opportunity for a rescue on initiation" the shortest time frame is in an Australian Voluntary Administration where the second meeting must be held within 21 days of the administrator being appointed, if the creditors do not place the company in liquidation at the meeting held within 5 days.[441] Next in line is the Canadian Proposal under a Notice of Intention. The proposal must be filed with the trustee within 30 days of notice been given to the Official Receiver[442] and the meeting must be summoned within 21 days of the proposal being filed,[443] giving a total of 51 days. The longest time period allowed is three months in an English Administration. A similar time frame of three months is given to an English Receiver but this period is concerned only with the making of a report to the unsecured creditors and does not have any impact on the length of the procedure. According to the *Consultative Document,* published by the Insolvency Service in October, 1993, the meetings in the proposed new CVA procedure will have to be summoned within 28 days of the moratorium coming into effect. During this period the proposal for the CVA must also be filed.

Subject to the unspecified time frames in schemes of arrangements and CVAs proposed by an administrator or a liquidator being shorter, the shortest initial statutory time frame is shared by the procedure leading to a Canadian Proposals without a Notice of Intention and the Australian Voluntary Administration procedure. The former has the advantage of a proposal having already

438 s.51(1) BIA [Can.].

439 s.2(2) IA 1986 [U.K.] read with r.1.9 IR 1986 [U.K.].

440 See r.1.11 IR 1986 [U.K.].

441 28 days if initiation took place during Christmas or Easter.

442 s.50.4(8) BIA [Can.].

443 s.51(1) BIA [Can.]

been made, leaving only the meetings to be summoned and the management of the company's affairs to be monitored by the trustee. In the latter, there is more to do before meetings may be summoned. The company's finances and affairs must be investigated and a proposal must be prepared by an independent person who is an outsider to the company's affairs.[444] It should be borne in mind that within this 21 day period, a meeting of the creditors would already have been summoned. Next in line is the proposed new CVA procedure. The Insolvency Service's *Consultative Document,* of 1993 does not indicate clearly who will be obliged to prepare the proposal, but it appears that it may be the directors.

The public nature of a rescue

Without exception, all the procdures considered in this thesis are required to be executed publicly and in some cases with specific notice to each of the company's creditors. Publicity is essential to warn persons who may otherwise unknowingly become creditors of the company, that it is or may become insolvent and that it is seeking to enter into some kind of arrangement with its creditors. Such post-initiation creditors would therefore be warned that unless care is taken to ensure that pre-payment is made by the company or third party guarantees are bargained for, there is a risk that payment may have to be recovered under the rescue package. This may well be less than the full amount. Any goods supplied to the company during this period, unless pre-paid for or supplied under a retention of title, hire-purchase, conditional sale or chattel leasing agreement or subject to a trust, could either come within the scope of any floating charge given by the company or form part of the assets available to the general body of creditors. In some cases the person who entered into the contract on behalf of the company may be made personally liable on the contract.

Formulating the rescue where the opportunity to do so has been provided

The formulation or attempted formulation of a rescue is necessary in a Canadian Proposal under a Notice of Intention, an Australian Voluntary Administration, an English Administration and a Receivership. In all but Receivership, this takes the form of the preparation of a written proposal to be considered by the creditors at meetings summoned for that purpose. In a

444 Out of 423 Australian Insolvency Practitioners who responded to a survey by the Centre of Excellence for Insolvency and Reconstruction of the Australian Society of Certified Practising Accountants, 63% took the view that 21 days was inadequate time to convene the second meeting in an Australian Voluntary Administration. See Centre of Excellence for Insolvency and Reconstruction of the Australian Society of Certified Practising Accountants, *First Survey,* August 1994.

Receivership, whilst the Receiver may decide to rescue the company or dispose of its assets on a break up basis, he is not required to obtain the sanction of any creditor, before his plans for obtaining the best possible return for the debenture holder are implemented.

The identity of the person/persons on whom the burden of formulating the rescue is placed varies between the procedures. In a Canadian Proposal under a Notice of Intention the burden is placed on the directors of the company. In an English Administration, an Australian Voluntary Administration and a Receivership, this task must be carried out by an independent insolvency practitioner. The 1993 proposals for the new CVA procedure does not indicate whether the directors or the nominee would be required to prepare the proposal.

A disadvantage which may be associated with the preparation of the proposal by the company's directors is that, unless the objective of the rescue is the survival of the company as a whole resulting in the preservation of their own positions, the directors have nothing but a moral incentive, to make a proposal which results in the company's demise but with the creditors receiving a better return than in a liquidation. Such a proposal may be made where the directors themselves are major creditors of the company or risk facing the prospect of being required to make a contribution to the company's assets in the event of a liquidation. Where no such incentives exist, the directors may be more likely to prefer to make a proposal which ensures the survival of the company as an entity, and the preservation of their positions as directors rather than the sale of its viable parts. There is a risk that such proposals may not be viable. (*n.b.* Such a risk is clearly present in a Scheme of Arrangement, a CVA or a Canadian Proposal without a Notice of Intention if directors have prepared the proposal for a rescue on initiation. It would be avoided where the proposal is made by an administrator, a trustee or a liquidator.)

The Canadian procedure under a Notice of Intention seeks to address this problem by providing for the nominee to assist in the preparation of the proposal. English Administration and Australian Voluntary Administration attempt to avoid this problem by charging the administrator with the task of formulating the proposal.

It is interesting to note that only an Australian Voluntary Administrator has a positive obligation under the relevant statute to investigate the company's affairs for the purpose of preparing his proposal. In English Administration and Receivership the responsible insolvency practitioner may in principle rely on the statements furnished to him by the directors. Nevertheless, the prudent English Administrator and Receiver would ensure that a full investigation of the company's affairs is carried out before any proposal is formulated. Concerning the proposal itself, the administrator in an Australian Voluntary Administration and an English Administration would not be constrained by self interest and be able to make the most of the company's limited assets for the benefit of the creditors.[445]

The benefit of having an independent person preparing or assisting in the preparation of a proposal would be fully realised only if that person has the power to terminate the procedure if it becomes apparent that a viable proposal cannot be made. If either the Canadian trustee, or the English administrator concludes that a viable proposal cannot be made and rescue in any form is not feasible, they both have the power to bring the procedure to an end by making an application to the court. No proposal will be made and a meeting of the creditors will not have to be summoned. The Australian Voluntary Administrator can also bring the procedure to an end without making a proposal but must nevertheless summon the meeting of the company's creditors. At this stage there is a risk that, if the majority of the creditors do not attend, the company's "friendly" creditors who do attend may yet resolve that the company should enter into a deed of company arrangement. In a Receivership if the Receiver determines that any form of a rescue is not viable then he may proceed to liquidate the company's assets immediately. Under the proposed new CVA procedure the nominee will have the power to withdraw his consent to act if it appears that there is no reasonable prospect of a CVA being successful.

The upshot is that in a Canadian Proposal under a Notice of Intention, an English Administration, Australian Voluntary Administration and a Receivership an independent person who is in all cases an insolvency practitioner acts as a safeguard against a non-viable rescue being attempted.[446]

Procedure once a proposal has been made

Once the proposal in an English Administration and an Australian Voluntary Administration has been made the procedure is mostly simple and short involving only the sending out of notices summoning the meetings of the creditors and in the English procedure the members. The position would be much the same in a Scheme of Arrangement and a Canadian Proposal with and without a Notice of Intention except that in the case of the latter the trustee would be obliged to supervise the management of the company. (See below.)

The procedure in a CVA where the nominee is an insolvency practitioner who is not the

445 The English Administrator may however be limited by the scope of the order made by court at the stage of initiation. If the English Administrator's proposals are not consonant with the order, it would be necessary for the administrator to make an application to court to have the order amended accordingly.

446 See the comments on the scope of the viable proposal in the conclusion to Chapter Seven.

administrator or liquidator stands out as different, with the proposal having to be examined before any meetings may be summoned. It has been seen that in the procedures which provide an "opportunity for a rescue on initiation" if a rescue is not viable a proposal does not have to be made to the creditor. In a CVA of the type referred to, the nominee's examination is directed at determining the viability of the proposal and whether the meetings of the creditors should be summoned. Thus, the viability of the CVA is determined after it has been drafted and not before.

The management or the supervision of the management of the company

Turning to the subject of the management of the company during the rescue it is clear that in the regimes under consideration, the management or the control of the company may either remain with the directors or be vested in an office holder appointed for the purpose of, or charged with the task of, implementing the procedure.

Regimes which leave the "debtor in possession"

Rescue regimes which allow the directors of a company to remain in control are commonly referred to as "debtor in possession" or "debtor driven" reorganizations. Neither of the relevant statutes applicable to English CVAs, Canadian Proposals or Schemes of Arrangement in England and Canada specifically provide that the directors of the company should remain in control of the company's management while the procedures are pending. This result is in fact achieved by the absence of any provision which automatically puts an "appointed person" in control of the company's property, business and affairs[447] and allows him to carry on its business. The person having control over the property of a company, has effective control of that company.

In England, Canada and Australia such "debtor in possession" rescues have been possible for the better part of this century. The directors of companies in these three countries have been able to remain in control of their companies after initiating a scheme of arrangement in England under the CA 1985 [U.K.], in Australia under CL [Aust.] and Canada under the CCAA [Can.] and after making a Proposal to unsecured creditors under the BA [Can.]. An Australian company's Scheme of Arrangement with its creditors must still be classified as a "debtor in possession" regime notwithstanding the fact that provision is made for the administration of the

447 See s.17(1) and (2) read with Schedule 1, para.1, IA 1986 [UK] (Administrators); s.42(1) read with Schedule 1, para.1, IA 1986 [UK] and the relevant provision in the debenture - Administrative Receivers); s.420(2)(a) CL [Aust.] read with the relevant provision in the debenture (Receivers); s.437(1) CL [Aust.] (Voluntary Administrators); and ss.243(2) and 246(1) BIA [Can.] (Receivers).

scheme by a scheme administrator.[448]

The Cork Committee perceived cost and the protracted time required to complete the procedure leading to a scheme of arrangement as the main reasons for failure of Schemes of Arrangement as a rescue procedure in England.[449] In Canada, the inability to make a Proposal to secured creditors under the Bankruptcy Act and the need for an outstanding issue of bonds or debentures issued under a trust deed for the purpose of a scheme, were recognised by the Colter Committee to be the flaws in each of the Canadian regimes.[450] Neither of these reformers attributed the desuetude of these regimes to the fact that they allowed the debtor to be in possession. In fact CVAs is an additional debtor in possession regime adopted by the U.K. in 1986.

Until the adoption of the new Bankruptcy and Insolvency reform legislation in Canada in 1992, the common characteristic of the debtor driven regimes in these jurisdictions has been the absence of an *automatic* moratorium.[451] A Court order staying the continuation or commencement of actions and proceedings could be obtained in Canada and Australia after a scheme of arrangement had been proposed.[452] "Debtor in possession" reorganization supported by an automatic moratorium was adopted in 1978 by Chapter 11 of the U.S. Bankruptcy Code. By enacting the new provisions which enables an insolvent company, which is not bankrupt, to file a notice of intention to make a proposal, which in turn triggers a moratorium, Canada provided for a similar "debtor in possession" reorganization with an automatic moratorium. Under the Canadian system the debtor remains under the supervision of a trustee.

The CVA regime introduced in the U.K. in 1986 is also not supported by a moratorium triggered either automatically or at the court's discretion. Not surprisingly, Company Voluntary Arrangements have not proved to be a run away success.[453] The Insolvency Service's *Consultative Document* proposes however, that a moratorium should be available during a CVA, while the directors remain in control of its affairs. This should make it more attractive to the

448 See Fisher, R., "Schemes of Arrangement" *Laws of Australia,* Vol 5 (Loose Leaf) Butterworths Australia, 1993, para 7.2.

449 See the discussion at p. *supra.*

450 Colter Report pp.50 and 51.

451 Indeed an automatic moratorium applied only in the event of a winding up and a receivership neither of which were debtor driven.

452 see s.11 CCAA [Can.] and s.411(16) CL [Aust.].

453 Views have been sought whether such a moratorium should be made available in a CVA. See Insolvency Service, *Consultative Document,* October 1993,

directors but give rise to concern among creditors.[454]

In dealing with regimes which leave the "debtor in possession", a distinction may be drawn between those which provide for an automatic moratorium, those where a moratorium may be imposed by order of court and those where no moratorium applies. The sole regime within the first category is the insolvent person's Proposal under BIA [Can.]. Into the second category fall Schemes of Arrangement proposed by a company under CCAA [Can.] and CL [Aust.]. In the final category are CVAs proposed by the directors under IA 1986 [UK] and schemes of arrangement proposed by a company under the Companies Act, 1985 [UK].

Extent of the directors' control

What is the nature of the control exercised by the directors during the currency of a rescue regime? Theoretically, the absence of any statutory provisions which divests the directors of their control over the company during the course of a debtor driven regime implies that the directors would continue to carry on the business of the company in the manner provided by the company's articles. In reality however, the bounds of directorial freedom depend upon the existence and, if available, the extent of a statutory moratorium which supports the procedure.

Where there is no statutory moratorium as is the case in a CVA proposed by the directors or a Scheme of Arrangement in England, the directors must try and negotiate an informal moratorium based upon the goodwill and unanimous support of its creditors. Even if the directors are successful in putting together such an informal moratorium, the directors' control over the company's property is constantly in danger of being diminished by the exercise of judicial and lawful "self-help" actions of its other creditors. From the creditors' point of view such action or the threat thereof may be used to prevent against the possible abuse of authority and control by the directors. Since any such action will destroy any fragile consensual moratorium and scupper the whole reorganization process as well, the threat of such action may also be used by weaker and smaller creditors who stand to be out voted at a meeting of the creditors for the purpose of obtaining more favourable terms.

What are the benefits of a debtor driven regime?

It has been said that "a management team already familiar with the company's business would be more likely to reorganize a troubled firm than would a newly appointed trustee".[455]

454 See Totty, P., "New Insolvency Law Reforms: A Wolf in Sheep's Clothing?" (1994) *7 Insolvency Intelligence* 1., and Rajak, H., "Company Rescues" (1993) *9 Insolvency Law and Practice* 111.

455 Bradley and Rosenzweig "The Untenable case for Chapter 11" *101 Yale Law Journal 1049*. It (continued...)

Further the management would be more likely to initiate a "debtor driven" rescue since it allows them to keep their jobs, at least for a while. "Management" should however be distinguished from the "directors" because, specifically in the case of a CVA and impliedly in the case of Proposals and Schemes of Arrangement, it is the directors that have the authority to initiate the procedure on behalf of the company.

One of the problems associated with management of the company by its own directors is that unless the objective of the proposed rescue is the survival of the company as a whole together with the interests of its shareholders, there may be potential conflict of interest in the management. Any risk, even one which is foolhardy, would be in the shareholders interests if the proposed plan of rescue did not provide for any return to the shareholders. Such risks would not be in the interests of the creditors.[456]

Supervision of management

If the procedure is supported by a moratorium, as it is in Canada under Notice of Intention to make a Proposal and in a Scheme of Arrangement, the risk of having the whole rescue regime destroyed at the whim of a creditor disappears to the extent and duration of the moratorium. During the moratorium, which may be either automatic, as in a Proposal, or at the discretion of the court, as in a Scheme of Arrangement, a different set of checks and balances apply. In both a Proposal and Schemes of Arrangement, if a creditor believes that the company's directors are acting in a manner which prejudices his interests he may take steps to have the moratorium lifted.[457] However, in order to use such a right cost effectively the petitioning creditor should have monitored the company's affairs closely.

With the recognition of the importance of a moratorium to a successful rescue, the modern trend in the "debtor in possession" rescue culture appears to be to present a more "creditor friendly" face by providing for the management in possession to be supervised by an independent person. Supervision achieves the dual objectives of keeping the persons most familiar with the company's affairs in charge, whilst giving the creditors the confidence that the directors will be unlikely to abuse their position and the moratorium since they are likely to be

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455(...continued)
would appear that the authors refer to the directors as the management.

456 See Bebchuk, L.C., " A New Approach To Corporate Reorganizations" [1988] 101 *Harvard Law Review* 775, at p.780, f.n.80.

457 See ss.69.4 BIA [Can.]. These checks and balances are examined fully in Chapter Five under the heading "Challenges to the Moratorium".

detected by the supervisor. Among the three jurisdictions, the first to embrace such an approach has been Canada. There the trustee under a Notice of Intention or in a Proposal is required to monitor the debtor's affairs and to report any adverse change in the company's projected cash-flow or financial circumstances to the Official Receiver.[458] The trustee may also make an application to court to have the procedure terminated. The proposed new CVA procedure will, like Canadian Proposals, contain provision for such supervision.

Regimes which involve a "change in management"

Where the management of the company is vested in an "appointed person" some form of automatic moratorium usually applies and no distinctions may be drawn on that basis. The rescue regimes which clearly provide for the company's business to be carried on by an appointed person are English Administration, Australian Voluntary Administration, and Receivership. CVAs and Schemes of Arrangement proposed by an English administrator and Proposals and Schemes of Arrangement proposed by a Canadian trustee also appear to fall within this category, but, the management of the company remains in an appointed person only because it is vested in that person by the previously initiated procedure.

A distinction may be drawn between procedures where powers of management supplement a mandatory statutory procedure which is initiated for the purpose of trying to achieve a rescue and those which *allow* for a rescue solely through the management of the "appointed person". In the former category are English Administration and Australian Voluntary Administration. In the latter category are Receiverships in all three jurisdictions.

It is important to establish the extent to which the power of management may be exercised by the independent person. English Administration was born out of the admiration the Cork Committee had for the Receiver's powers to manage a company under a floating charge. The Receiver could through the exercise of his powers of management let the company trade out of its difficulties or preserve its goodwill and going concern value, until the viable aspects of its business could be hived off. The Receiver's power to manage a company is therefore, central to his ability to procure the best return possible for the debenture holder and where possible to save the viable aspects of a company's business. The Australian Voluntary Administrator's powers of management have similar roots.

Compared with Receivership, however, the administrator in both these regimes must act

458 Although there is no express provision for supervision in Schemes of Arrangement and CVAs it may be noted that it is possible to have a Receiver appointed to protect the company's property during this period.

subject to strict time constraints and does not have the flexibility and freedom enjoyed by a Receiver. The management of the company may definitely be carried on by an administrator only until the meetings of the creditors are held or he determines that a rescue is not viable. During the period, which is longest in the case of an English Administration, the most the appointed person may hope to achieve is a preservation of the company's going concern value and an assurance that the directors will not be able to dissipate the company's assets during the moratorium.

Consequently, it is unlikely that in an English Administration or an Australian Voluntary Administration a rescue can be achieved only through the management of the company. The classic management based rescue is only possible in a Receivership. This is because the Receiver is not bound by statutory time frames or other obligations which limit the pursuit of a rescue solely through management. The Receiver further enjoys the power to repudiate the company's executory contracts which will result in the diminution of the debenture holder's security. As such he is able to effectively hive off aspects of the company's business, thereby breaking ongoing contracts. This power does not appear to be enjoyed by any of the independent managers.

Affirmative action for the benefit of the rescue

Not all the procedures provide for affirmative action to be taken for the benefit of a rescue. In Canada, the only power of this nature enjoyed by the directors under a Notice of Intention is their ability to repudiate a commercial lease of real property which is a hinderance to the making of a viable proposal. The Receivers in all three jurisdictions enjoy the power to repudiate the company's executory contracts which will result in the diminution of the debenture holder's security by standing in the way of a better realization of the assets. Although there is strong opinion to the contrary, it is submitted that a similar right should be enjoyed by an English Administrator as well. The power of a Receiver and an Administrator in England and Australia to dispose of assets subject to a prior charge, with the consent of the court, also facilitates a better realisation of the company's assets.

The consensus among the reform committees which examined insolvency and bankruptcy law was that one of its objectives should be to ensure and encourage commercial morality. In terminal insolvency procedures the power to investigate the company's affairs is buttressed by far reaching powers to set aside antecedent transactions and take action against delinquent directors.

Where an important or extremely valuable asset has been disposed of by the company at an under value, certain creditors have been preferred over others, or where a floating charge has been given for past value, by challenging these transactions, it may be possible to swell the assets available for distribution amongst unsecured creditors and thereby increase the prospects of a better return to the creditors. Where the company is to be rescued such powers may be of considerable use. For example if a floating charge is successfully in set aside in its entirety then it may be easier to obtain financing for the rescue by pledging the released assets as security. Powers of this description are currently available only in an English Administration and under the terms of a Canadian Proposal. It should be noted that any antecedent transaction may be set aside only pursuant to an order of court. Thus, even if such powers are made available they may not be a viable option to pursue owing to high costs and time delays.

CHAPTER SEVEN

MEETINGS, AND THE POST MEETING PROCEDURE

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INTRODUCTION

A notable feature of the present law of corporate rescues in England, Canada and Australia is that no attempt has been made to devise one or more model forms setting out standard terms of a rescue or for a better realization of assets than would be possible in a winding up. What the legislatures in these countries have done, except in the case of Receivership, is to create procedures within which a proposal for the repayment of the company's debt may be placed before a meeting of the company's creditors for the purpose of obtaining their approval. The creditors' approval and indeed disapproval is measured by the manner the creditors vote at the meeting. Votes are allocated to the creditors according to their claims against the company. Whether a proposal has been accepted or not is determined according to the votes cast by the creditors. Critics of this type of procedure argue that it leads to creditor bargaining[1] and room for a dissentient minority to hold out for better terms, thereby driving up the cost of achieving this objective and reducing the ultimate return to the creditors.

Except in the case of a Receivership, the most important event which follows the initiation of a rescue procedure is the creditors' meeting. It determines the future of the rescue and thereby that of the company. The conduct of the meeting, the voting rights of creditors and the implementation of their decision(s), are, among others, matters which give rise to many important legal issues.

Where the proposal is accepted by the creditors it does not mean that the objective of the proposals have been achieved and the whole rescue process is at an end. In some procedures an accepted proposal must thereafter be sanctioned by the court.

The terms of the proposal approved by the creditors would have to be implemented and payment made to the creditors and the overriding policy in all three jurisdictions is to generally leave this aspect of the procedure to the agreement of the parties.

Except in an English Administration the proposals in respect of which the creditors cast their votes finally settle the manner in which payments will made to meet the debts owing to the creditors. In an English Administration such matters should, in principle, be covered in the English Administrator's proposals to the creditor. Nonetheless, even if the creditors approve the English Administrator's proposals no distribution may be made by an English Administrator under an administration order and therefore a separate CVA or a Scheme of Arrangement would have to be entered into for this purpose. The very nature of the procedure leading to a scheme of

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1 Bebchuk, L.C., " A New Approach To Corporate Reorganizations" [1988] 101 *Harvard Law Review* 775.

arrangement and a CVA would make it near impossible for an administrator to make arrangements for the creditors to move immediately from a vote on his proposals to a decision on a scheme or a CVA. Thus, except in an English Administration the meeting of the creditors to consider the proposed solution to the company's repayment problems, followed in some cases by a court hearing, marks the end of the statutory rescue procedure.

Meetings and the post-meeting procedure in Schemes of Arrangement

Conduct of meetings

The statutes are silent on the manner in which the meetings of the creditors and members, if any, are to be conducted.[2] For example there is no guidance on who should chair the meeting or how each creditor's voting right is determined. In Canada the court has the power to appoint a person to act as chairman at the meeting with instructions to oversee the counting of the votes.[3] The practice in England and Australia is that the person nominated by the applicant in his affidavit supporting the application, is appointed by the court to chair the meeting.[4] Since the meeting is convened on the order of the court, it must be held strictly in accordance with the terms of the order. If it is not so held, (i.e. if it is held at a different time and place or with a different chairman) the meeting would not be considered to be the one ordered by the court but by someone else and would be invalid.[5]

Creditors' and Members' Voting rights

On the issue of the creditors' voting rights, in the absence of any statutory provisions to that effect, there is no requirement that each creditor should prove his claim against the company before the meeting. There do not appear to be any English, Canadian or Australian decisions on the issue, nor any commentary in the standard texts on the subject. Members' voting rights on

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2 In comparison the rules governing CVAs, English Administration, and Australian Voluntary Administration set out the procedure in considerable detail.

3 *Re Northland Properties Ltd.* (1988) 73 C.B.R. (N.S.) 175 (B.C.S.C.).

4 In England, the name of the chairman is generally suggested in the affidavit supporting the petition for the order. See *Atkin's Court Forms* Vol.9, Form 79. The Australian Federal Court Rules require the person making the application to court for the order to file an affidavit stating the identity of the chairman, or his willingness to act, his relationship with the company and that there is no conflict. See r.22(b), Federal Court Rules [Aust.].

5 *Re High Spirits Cellars Pty Ltd.*, (1987) 13 ACLR 418. If the advantages offered by a scheme were to be obtained, strict adherence to the procedure was necessary since a scheme has a very serious effect on the rights of creditors. See also *Re Ferro Constructions Pty Ltd.*, (1976) 2 ACLR 18, *Re Anglo Spanish Tartar Refineries Ltd.*, (1924) 68 Sol Jo 738, *Re J Stanice and Sons Pty Ltd.*, [1968] SASR 156.

the other hand would be determined by the rights attaching to the shares held by each member and the provisions of the company's articles.[6]

In view of the fact that the majority required to signify the agreement to a scheme of arrangement is dual in character, (*i.e.* a simple majority in number and three fourths in value) each creditor would be entitled to one vote with a value being attributed to that vote according to his claim against the company. Ordinarily, where creditors' claims are liquidated and admitted by the company, there would be little difficulty in determining the voting rights of such creditors. Difficulties may arise where the proposed scheme is intended to bind all the company's creditors, including those with contingent and prospective claims and unliquidated claims for damages.[7] The practice in some cases has been to value such claims at one unit of currency and place him and others like him in a separate class merely for the purpose of giving that creditor the right to vote.[8] Unless such creditors were placed in a separate class, they would only be able to influence the numerical aspect of the dual majority, and have little or no impact on the assessment of three-fourths majority on the basis of value.

In Australia, a scheme would ordinarily provide for payment to be made to the creditors by the "Scheme Administrator". Before such payments are made, the creditors wishing to receive payment under the scheme would ordinarily have to file a proof of claim with the Scheme Administrator.[9] The valuation of claim at a meeting to consider a scheme would only be for "voting purposes" the neither the creditor nor the Scheme Administrator would be estopped from respectively making or accepting a higher claim at this stage. But unless creditors with unliquidated claims for damages were placed in a separate class the Scheme Administrator would find it difficult to accept a proof of claim for a higher sum than the Chairman of the meeting placed on it for "voting purposes". If he did, the result may be that the creditor with an unliquidated claim for damages could have voted only for AUS$ 1.00, thereby influencing the simple majority in number but not the three fourths majority in value, but be able to prove for a larger sum in the payout. There are also no statutory provisions under which a creditor may

6 Regarding members' voting rights the position in Australia appears to be that it is the nominal value of the share that is taken into account and not the paid up value. See *Forde's Principles of Corporations Law*, para 1913.

7 See the discussion at Chapter Three at p.130 *supra*.

8 A creditor's claim for damages in *Re Cranley Mansions* (1994) BCC 576, which arose under CVA provisions in IA and IR 1986 [U.K.] was valued at £1.00 but was not placed in a different class.

9 See Vol.5 *Australian Encyclopædia of Forms and Precedents*, (3rd Revised Ed.), Butterworths, Australia, 1992, Pr 1.25, Cl.10.

appeal to the court on the ground that his claim has been incorrectly valued.[10] In Schemes of Arrangement the protection against an unfair valuation of an unliquidated claim lies in the burden placed on the person summoning the meetings to divide the creditors into classes.[11]

In England the absence of a valuation procedure would matter little since any creditor who was dissatisfied with his valuation would be able bring the procedure to an end by initiating a winding up.

Voting and computing the majority required for approval of a scheme

A scheme of arrangement is approved if a majority in number representing three fourths in value of the creditors or members or class thereof, present and voting in person or by proxy, agree to the compromise or arrangement which has been proposed. There must first be a simple majority in number of those present and voting either in person or by proxy. No account need be taken of creditors who were given notice but did not attend or send a proxy and those who attended but decided to abstain. Such creditors do not affect the vote.[12] Secondly, that simple majority in number should total three fourths in value of the creditors or members or class thereof.

As explained by Brightman J in *N.F.U. Development Trust Ltd.*,[13] the purpose of the additional three-fourths majority is to "prevent a numerical majority with a small stake out voting a minority with a large stake, *e.g.* to prevent 51 members with one share each out-voting 49 members with 10 shares each."

If separate meetings of classes of creditors or members have been ordered by court those classes must be strictly adhered to since a majority of votes in a class binds only the dissenting creditors who are members of that class. It has been suggested in Canada that a joint meeting of the classes would not be invalid provided the vote of each class is taken separately.[14]

The view has been expressed that considering the dual nature of the majority required,

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10 If a creditor is dissatisfied with the value attributed to his claim and if the scheme of arrangement is approved by the creditors, the proper procedure appears to be for the dissatisfied creditor to oppose the application to court to sanction the approved scheme.

11 *Practice Note* [1934] WN 142. See also *Re Hellenic and General Trust Ltd.*, [1976] 1 WLR 123; *Re Weymouth Guarantee and Finance Discount Co Ltd* (1975) 10 SASR 407, *Re International Harvester* (1983) 7 ACLR 796 the dictum of Lush J at p.801.

12 *Re Bilton Bros. Ltd.*, [1939] 4 D.L.R. 223 (S.C.).

13 [1972] 1 W.L.R. 1548.

14 *Re Langley's Ltd.* [1938] 3 D.L.R. 230 (C.A.)

voting at the meeting should be by a poll and not by a show of hands.[15] In Canada it has been held that since a creditor has the right to vote both in person and by proxy, a vote by a show of hands is prohibited.[16] This would cause some difficulty in England in the case of a Company which has adopted Table A as its Articles of Association since Table A expressly gives a member a right to one vote for every share of which he is a holder. In this event the member may validly split his vote but it would make the numerical majority impossible to determine.

If a debt is owed to a subsidiary of the company the subsidiary will not be allowed to vote at the meeting since that would amount to allowing the debtor to vote in its own reorganisation.[17]

What the creditors or members may approve

It has been recognised that the creditors may not necessarily agree to the scheme of arrangement as proposed. The creditors and/or members should be able to approve a scheme which has been amended. This is specifically recognised by s.6 CCAA [Can.] which provides for the creditors to "agree to any compromise or arrangement either as proposed or as altered or modified at the meeting or meetings.

S.7 of the CCAA empowers the Court to direct adjournments of meetings that have been summoned to accommodate any alteration or modification of any scheme. The Court is also empowered to direct that it is not necessary to adjourn or convene any meeting of any class of creditors or shareholder, that, in the opinion of the Court, is not adversely affected by the alteration proposed, and also to sanction any altered or modified scheme. Indeed it has been held that alterations or modifications may be made right up to the time of voting.[18] It must be noted that the Canadian Courts are not permitted to make any alterations to a scheme. The alteration must flow from the company or the creditors.

Obtaining the court's sanction for an approved scheme

Once the scheme is approved by the required majority, an application to sanction it must be made to Court. The power conferred upon the court in all three jurisdictions is discretionary and not mandatory. The court is not obliged to sanction a scheme merely because it has had the

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15 Shearman, I. (Ian). *Shackleton on the law and practice of meetings*, p. 177.

16 *Re Langley's Ltd.* [1938] 3 D.L.R. 230 (C.A.)

17 *Re Northland Properties Ltd* (1988) 32 BCLR (2d) 309 (C.A.). See also *Re Hellenic and General Trust Ltd.*, [1976] 1 W.L.R. 123.

18 *Re Keddy Motor Inns Ltd.*, (1992) 90 D.L.R. (4th) 175, 13 C.B.R. (3d) 245.

approval of the requisite majority(ies) of the creditors[19] or the members. In *Re Dorman Long and Co Ltd.,*[20] Maugham J was of the view that the court has two duties in determining whether the compromise or arrangement should be sanctioned by the court.

> "The first is to see that the resolutions are passed by the statutory majority in value and number in accordance with [the relevant statutory provision] at a meeting or meetings duly convened and held. Upon that depends the jurisdiction of the court to confirm the scheme. The other duty is in the nature of the discretionary power.[[21]]... whether the proposal is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve."[22]

The Court will not refuse to sanction a scheme if the persons summoned on are of the view that the scheme is for their benefit.[23]

Once the scheme has been duly agreed to by the required three fourths majority in England and Canada there is no remedy for dissentient creditors as the relevant provision does not confer a right of appeal. Nor does it permit the judge to alter the agreed scheme. In Australia the position is different. The Court has the power to vary or modify the scheme. In *Re V & M Diagnostic Services Pty Ltd.,*[24]the court approved the scheme, but amended it so as to give the Pay-Roll Tax Commissioner priority over other creditors.

Effect of the court's sanction

If the compromise or arrangement is sanctioned by Court, the compromise or arrangement is binding on all creditors or members or class of creditors or members, the company, the liquidator, (if the company is being wound up) and contributories of the company.[25] Under the

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19 *Re 229531 B.C. Ltd.* (1989) 72 C.B.R. (N.S.) 310 (B.C.S.C.).

20 [1934] 1 Ch. 635

21 *ibid.* at p.655.

22 *ibid.* p.657. The court applied the test enunciated in *Re Alabama, New Orleans, Texas and Pacific Junction Railway Co.,* [1891] 1 Ch 213 C.A. See also Re Anglo Continental Supply Co Ltd. [1922] 2 Ch 723, p 736; Re Hellenic & General Trust Ltd [1976] 1 W.L.R. 123; [1975] 3 All E R 382. It is submitted that it is not the court's commercial or financial expertise which is relevant to the exercise of the court's discretion granted under s.425(2) CA 1985 [U.K.].

23 *Re English, Scottish, and Australian Chartered Bank* [1893] 3 Ch 385, C.A.; *Re Paterson Laing & Bruce Ltd.* [1902] 18 TLR 515.

24 [1984] 9 ACLR 663

25 s.425(2) CA 1985 [U.K.] It should be noted that an approved scheme does not bind an administrator. This is due to the fact that an administrator unlike a liquidator has no power to make a distribution to the creditors even under a scheme. Further the administration should be brought to an end if the scheme proposed by the administrator is sanctioned by the court.

CCAA [Can.][26] it additionally binds any trustee for any class of creditors whether secured or unsecured and the company. If the company has made an assignment under which a receiving order has been made under the Bankruptcy Act or is in the course of being wound up under the Winding Up Act, it also binds the trustee in bankruptcy or liquidator and the contributories of the company.[27] The contributories are bound by the Court's sanction under the CCAA only if the arrangement is entered into in the course of specific proceedings under the Bankruptcy Act or the Winding Up Act. If the contributories are to be bound otherwise then, constitutionally, it must be under the applicable Companies Act, provincial or federal. In Australia the provision which makes the scheme binding on all creditors, members or class of either of them, and the liquidator is in principle similar to the English and Canadian provisions. The wording however is considerably different.[28] It is important to note the scheme does not bind an Australian Scheme Administrator.[29]

Once a scheme of arrangement has been sanctioned by the Court an office copy of the order must be delivered to the Registrar of Companies for the Order to take effect. Further, a copy of the order must be annexed to every copy of the company's memorandum that is issued after the order is made, and where the company does not have a memorandum it must be annexed to every copy of the constitution or instrument constituting the company.[30] In Australia the person appointed as the Scheme Administrator must lodge a notice in writing of his appointment.[31]

MEETINGS AND THE POST-MEETING PROCEDURE IN CVAS

Conduct of the meetings

The chairman of both the company's and the creditors' meetings or a combined meeting should be the person who summoned the meetings (referred to in the rules as the "convenor"[32]). If the convenor is unable to attend he can nominate a person to act as chairman in his stead,

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26 Once again this section was originally based on section 153(2) of CA 1927 [U.K.] - now s.425(2) of CA 1985 [U.K.].

27 s.6 CCAA [Can.].

28 Introduced by Sch.3, CL [Aust.] Amending Act, 110 of 1990.

29 *Re Glendale Land Development Ltd., (in liq.)* (1982) 1 ACLC 540 applied in *Re Sessions Video Distributors Pty Ltd.,* [1993] 10 ACSR 421.

30 s.425(3). CA 1985 [U.K.]. First introduced by the CA 1929 [U.K.].

31 s.415(1) CL [Aust.].

32 r.1.14(1) IR 1986 [U.K.].

provided that such person is qualified to act as an insolvency practitioner in relation to the company or is an employee of the convenor or his firm.[33]

The convenor, as chairman, may be in a position to exercise considerable influence on the outcome of the meetings should he hold the proxy of a number of creditors or members with the discretion to vote as he chooses on the voluntary arrangement.[34] Where this discretion has been granted, he cannot use it to vote for an increase or reduction in the remuneration or expenses of the nominee or the supervisor of the proposed arrangement who is in fact himself or his appointor.[35]

Voting rights

Creditors' Voting Rights

Every creditor who was given notice of the creditors' meeting is entitled under sub-r.1.17(1) IR 1986 [U.K.] to vote at the meeting of creditors or any adjournment of it.[36] On the basis of this sub-rule alone, it appears that the issue of notice to a creditor *ipso facto* entitles him to vote at a meeting of the creditors.[37] This entitlement is subject to the provisions of the remaining sub-rules within rule 1.17. It is also subject to the requirement that every creditor intending to vote at the meeting should give written notice of his claim to the chairman or the convenor either at the meeting or before it.[38] If he does not do so he runs the risk of any vote allocated to him being subsequently left out of account in calculating the majority required to pass a resolution.[39] Before proceeding to examine the sub-rules in some detail it should be pointed out that the quality of draughtsmanship of this rule alone, leaves much to be desired. The words debt and claim seem to be used inter-changeably giving rise to much confusion and doubt in interpretation.

Calculating the creditors' votes

The votes of a creditor are calculated according to the debt owed by the company to that

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33 r.1.14(2) IR 1986 [U.K.].

34 form.8.1. IR 1986 [U.K.].

35 r.1.15 IR 1986 [U.K.].

36 r.1.17(1) IR 1986 [U.K.].

37 See *Re a debtor (No.222 of 1990) ex parte Bank of Ireland and others* [1992] BCLC 137, (a case arising under parallel provisions relating to individual voluntary arrangements) at p.142.

38 r.1.19(3)(a) IR 1986 [U.K.].

39 r.1.19(3) IR 1986 [U.K.].

creditor.[40] Since it fixes on the creditor's debt, the calculation appears to be automatic, and no person is burdened with the responsibility of calculating a creditor's votes.

The date as at which the debt is calculated varies according to whether or not the company is in an administration or a winding up. If the company is in neither winding up nor administration, a creditor's votes are calculated according to the amount of his debt as at the date of the meeting. If the company is being wound up or is in administration, the relevant dates are respectively, the date of its "going into liquidation" or the date of the administration order.[41] A company "goes into liquidation" on the date that a resolution for a voluntary winding up is passed or an order for its winding up is made by a court, provided a resolution has not been passed previously.[42]

No distinction is drawn between secured and unsecured creditors in the sub-rules pertaining to the "entitlement to vote"[43] and the "calculation of votes". It appears that secured creditors are "entitled to vote" and the entirety of their debt should be taken into account when calculating votes. This is further borne out by sub-r.1.19(3)(b) which provides that votes in respect of any claim or part of a claim which is secured should be left out of account when determining the majority at the creditors' meeting. If votes had not been allocated in the first instance there would be no necessity to leave them out in calculating the majority at the meeting.

Although sub-r.1.17(2)IR 1986 [U.K.] does not invest the chairman with the responsibility of calculating a creditor's vote, under sub-r.1.17(4) he nevertheless exercises overall control over the vote a creditor may cast at the meeting of the creditors by being able to admit or reject the whole or part of a creditor's claim "for the purpose of his [the creditor's] entitlement to vote".[44] (*n.b.* the change in terminology from "debt" to "claim".) Rule 1.17 IR 1986 [U.K.] itself does not require every creditor to make a "claim" for the purpose of enabling the chairman to exercise this power. The chairman is made to face a "claim" from a creditor only by the operation of sub-r.1.19(3)(a) IR 1986 [U.K.]. As mentioned above, this sub-r imposes a mandatory requirement on every creditor intending to vote at the meeting to give written notice of his "claim" to the

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40 sub-r.1.17(2) IR 1986 [U.K.]

41 r.1.17(2) IR 1986 [U.K.].

42 s.247(2) IA 1986 [U.K.].

43 sub-r.1.17(1) IR 1986 [U.K.].

44 The power granted under this sub-rule may be compared with the liquidator's power, under Chapter 9 of the IR 1986 [U.K.] to admit or reject a creditor's proof of claim for a dividend.

chairman or the convenor, either at the meeting or before it.[45] The rules themselves appear to use the words "debt" and "claim" almost inter-changeably. Given that the "claim" must be made by a "creditor", in ordinary usage, it could be restricted to claims for a "debt" which is liquidated.[46] As argued in Chapter Three, since the word "creditor" includes persons with contingent and prospective claims, the "claim" filed by a "creditor" could also be for an unliquidated amount[47] and accordingly "creditor" would also include a person "claiming to be a creditor".[48] It is submitted that these sub-rr.1.17(4) 1.19(3)(a) when read together, have an important bearing on the interpretation of r.1.17 as a whole.

First, since the chairman is given an overall power to "admit" as well as "reject" a creditor's claim it is submitted that a creditor's "debt" for voting purposes becomes ascertained only once it is admitted by the chairman. Receipt of notice of the meeting does not by itself entitle a creditor to a given number of votes. The chairman may even reject a claim of a creditor to whom notice of the meeting had been given and who had lodged a claim for the amount stated as due to him in the debtor's statement of affairs, or its summary attached to the notice.[49] If the chairman was only granted the power to reject a creditor's claim, the debts of all creditors to whom notice of the meeting was given would be calculated according to the debt admitted in the company's statement of affairs or its summary.[50] The Chairman's authority to act in this manner would appear to operate as a safeguard against the admission for the purposes of voting any debts which may have been mistakenly or even falsely included in the statement of affairs.

The width of the chairman's authority under this provision raises an interesting question whether the chairman, who is also the administrator or liquidator of the company may utilise this provision to reject a creditor's claim on the basis that it may be challenged under ss.238-245 IA 1986 [U.K.] without taking steps under those sections. If a creditor's claim may indeed be

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45 r.1.19(3)(a) IR 1986 [U.K.].

46 As argued for by Professors Sealy and Milman in the *Annotated Guide to the Insolvency Legislation*, 4th Ed (Revised), 1994, p.28

47 *cf.* the view expressed by Ferris J in *Re Cranley Mansions Ltd.*, that sub-r. 1.17(4) is confined to "disputed claims for liquidated amounts. See (1994) BCC 576 at 589 G-H.

48 *cf.* the comments of Harman J in *Re a debtor (No.222 of 1992)* [1992] BCLC 137 at 142 D-E.

49 r.1.19((3)(b), r.1.11(2)(b) and r.1.12(7) IR 1986 [U.K.]. *cf.* the interpretation of "claim" by Harman J. in *Re a debtor (No.222 of 1992)* [1992] BCLC 137 at 142 C-E.

50 As opposed to a selective power only to reject in which event the debts of all creditors to whom notice of the meeting was given would be calculated according to the debt admitted in the company's statement of affairs or its summary.

challenged under any of these provisions, it is submitted that the better procedure would be to first challenge the creditor's claim under the appropriate provision. If the administrator or liquidator is successful the other party will either cease to be a creditor or have its claim reduced. It is submitted that it would be difficult for the chairman to reject a claim where it has been admitted in a statement prepared by him as the liquidator or administrator of the company under r.1.11(2)(b) IR 1986 [U.K.].

Second, it may be argued that, since the chairman has the power to reject any creditor's claim and not necessarily one to whom notice of the meeting has been given, this sub-rule implies that a creditor who has not received notice of the meeting may attend and notify the meeting of his claim. But a creditor may find it to his advantage to remain outside and not be bound by any contractual moratorium that may be agreed unless it is in his interest to be part of the CVA .[51]

Where the Chairman entertains a doubt regarding a claim.

If the chairman entertains a *doubt* whether a creditor's claim should be admitted or rejected, the proper course of action open to him under the rules is to mark the claim as objected to and to permit the creditor to vote, subject to the vote being declared invalid if the objection to the claim is sustained. The process to be followed by a chairman under r.1.17 was spelled out by Harman J in *Re a debtor (No.222 of 1992)*[52] as follows:

> "[T]he chairman must look at the claim; if it is plain or obvious that it is good he admits it, if it is plain or obvious that it is bad he rejects it, if there is a question, a doubt, he shall admit it but mark it as objected."[53]

There is no specific provision in the Act or the Rules under which the chairman is obliged to refer his doubts on the claim to the court.[54] If the doubts regarding a creditor's claim were raised by the chairman himself, then he would be morally, if not legally obliged to refer his doubts to the court. The chairman may make such an application in his own name only if he is the nominee.[55] If the chairman entertained no doubts regarding the validity of the claim and the objections were raised by another creditor or even the members, he may validly leave it to the creditors or the

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51 This might particularly be the case with creditors having an unliquidated claim for damages.

52 [1992] BCLC 137.

53 *ibid.* at p.144 G-H.

54 Only a supervisor has the authority under s.7(1) and (4) IA 1986 [U.K.] to seek the directions of court after a voluntary arrangement has been approved.

55 If the nominee does so, he would have to seek his costs under r.1.28(1)(b) IR 1986 [U.K.] read with ss.14(3) and 19(4) IA 1986 [U.K.].

members to take matters further should they wish to do so.[56]

Voting rights of creditors with "debts" for an unliquidated amount

Under sub-r.1.17(3) IR 1986 [U.K.], a creditor whose debt is for an unliquidated amount or is of unascertained value cannot vote at the meeting unless the chairman *agrees* to put upon the debt an estimated minimum value for the purpose of determining his entitlement to vote.[57] Professors Sealy and Milman have queried the legitimacy of r.1.17(3) IR 1986 [U.K.] on the ground that the procedure in Part I IA 1986 [U.K.] does not apply to creditors with a contingent or prospective claim or with an unliquidated claim for damages.[58] As submitted in Chapter Three, this interpretation of the word "creditor" does not accord with the broad remedial purpose of the CVA procedure and the inter-relationship of that procedure with English Administration and Winding Up, both of which may involve creditors with such claims.[59]

There are a number of key elements in sub-r.1.17(3) IR 1986 [U.K.]. First, it establishes correctly that a creditor whose *debt* is unliquidated or unascertained may vote at a meeting of the creditors to consider a CVA. Second, such a creditor may vote only in respect of the estimated minimum value of that claim. Third, the chairman must agree to give that debt an estimated minimum value.

It is in respect of the third element that the greatest difficulty has been experienced. In *Re Cranley Mansions*[60] Ferris J, in a judgement which by his own admission caused him "some anxiety", took the view that "agrees" in this sub-r requires some element of bilateral concurrence between the chairman and the creditor in question" on the "estimated minimum value" given to the unascertained debt. Ferris J came to this conclusion after having considered the argument that a "disaffected creditor could stultify proposals for a voluntary arrangement by the simple

56 Although the chairman may not do so under the Rules, the nominee may be able to make an application to court under s.6(2)(b) IA 1986 [U.K.]. The nominee would have to show court that as a result of the creditor, on whose claim the chairman entertained doubts, being entitled to vote either:
(i) a voluntary arrangement which unfairly prejudices the interests of a creditor, member or contributory of the company has been approved; or
(ii) there has been some material irregularity at or in relation to either of the meetings.

57 r.1.17(1) IR 1986 [U.K.].

58 See Sealy, L.S., and Milman, David, *Annotated Guide to the Insolvency Legislation* (4th Revised ed.) CCH Editions Ltd, 1994, pp.28 and 641.

59 See the discussion in Chapter Three at p.137, 485 *supra* and see (1995) 4 *International Insolvency Review*, 104 at 105-107.

60 (1994) BCC 576.

expedient of failing to concur in a value being put on his claim". This decision has provoked strong criticism from a number of practitioners, being labelled as an "unimaginative approach" which is "likely to lead to confusion, uncertainty, litigation, loss of public confidence in insolvency procedures and more unjustified complaints concerning the costs of insolvency."[61] London solicitors, Clifford Chance, point out this could give rise to an acute problem for lenders since most of their claims against a company undergoing a CVA would be certain and, as a result of the decision in *Re Cranley Mansions*, such lenders would be likely to find themselves bound by a CVA unless it has the voting strength to prevent the CVA being approved.[62] It is submitted that lenders would be in such a position only where their claims are unsecured. It has been suggested that agreement in the context of sub-r.1.17(3) could mean agreement of the chairman to *allow* the creditor to vote as opposed to agreement on the value.[63] In *Re a Debtor No.162 of 1993: Doorbar v. Alltime Securities Ltd*[64] Knox J, declined to follow *Re Cranley Mansions: Saigol v. Goldstein*[65] and held that sub-r.1.17(3) IR 1986 [U.K.] required the chairman's agreement to put a minimum value on a debt and not an agreement on the minimum value.[66]

Whilst this interpretation seems to accord more with the remedial purpose of the statute, still it does not sit too comfortably with a standard interpretation of "debt" in that sub-rule. It is arguable that the words "debt for an unliquidated amount, or any debt whose value is not ascertained" in s-rule 1.17(3) imply that the company's liability is not in doubt and that only the *amount* or *value* of the debt remains to be ascertained. The chairman's power under this sub-rule would, consequently, be limited to valuing the unliquidated or unascertained debt. This in turn implies that the chairman has no authority under this s-rule to refuse to give a debt a valuation because if indebtedness is acknowledged, it must be capable of valuation in excess of zero.[67]

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61 See Goldring and Whiteson, "New Blow to Rescue Culture" [1994] 10 *Insolvency Law and Practice,* 110 at p.110; Clifford Chance, "Opting out of Voluntary Arrangements" [1994] *International Business Lawyer,* 345 reprinted from *Legal Risk in the Financial Sector,* June 1994, London; Allen & Overy (London) "The Value of a Creditor's Claim for Voting Purposes", [1994] *Butterworths Journal of International Banking and Financial Law,* 414.

62 Clifford Chance, "Opting out of Voluntary Arrangements" *supra.*

63 Goldring and Whiteson, "New Blow to Rescue Culture" [1994] 10 *Insolvency Law and Practice,* 110 at 112.

64 (1994) BCC 994.

65 (1994) BCC 576.

66 *Re a Debtor No.162 of 1993: Doorbar v. Alltime Securities Ltd* (1994) BCC 994 at 1,005-1,007.

67 In the event of the company admitting liability but also maintaining a counter claim against its "creditor" the chairman should take the company's counterclaim into account in evaluating the

As has been mentioned earlier, the words "debt" and "claim" are used almost inter-changeably in the rules,[68] and this problem could be overcome if "debt" in r.1.17 IR 1986 [U.K.] is given the same meaning as "claim" in that rule and r.1.19 IR 1986 [U.K.].

In *Re a debtor (No.222 of 1990)*,[69] a case arising under the parallel provisions applicable to individual voluntary arrangements, it was argued that the chairman's power is not limited to estimating minimum values of debts for an unliquidated amount but extends to determining the validity of a creditor's claim itself.[70] The argument is founded on the differences in the wording of the two sub-rules. The words "debt for an unliquidated amount, or any debt whose value is not ascertained" in s-rule 1.17(3) IR 1986 [U.K.] acknowledge that a debt is in fact due and that only the *amount* of the debt remains to be ascertained. In contrast, the word "claim" in s-rule 1.17(4) brings within its compass all types of claims, the validity of which are disputed by the company, whether it be for a liquidated or unliquidated amount. While Harman J, found this reading of the rules to be perfectly possible he nevertheless expressed the view that it was:

> "a slightly surprising one since sub-r (1) starts by dealing with creditors who are given notice of the meeting and one would not expect creditors who are not creditors of the debtor to be given notice of the meeting. I suppose a mistake could be made and if a mistake was made it might be convenient and desirable for the chairman to have power under sub-r (4) to rule upon that claimed creditor's position. However, that would not be truly 'rejecting a creditor's claim', it would be 'rejecting a claim to be a creditor' because a claiming creditor by definition would not be a creditor at all."[71]

Finally, Harman J took the view that the debts in that case were not within sub-r(3) but disputed debts within sub-rule (4).

Interpreting Harman J's judgement for the purpose of distinguishing *Re a debtor (No.222 of 1990)*,[72] Ferris J., opined in *Re Cranley Mansions Ltd.*,[73]:

> "In one sense all claims which are for unliquidated sums, or sums which have not yet been ascertained, are disputed debts, because there is a dispute about their quantum. But it cannot, in my judgement, be the case that such debts are within subr.(4) as well as

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debt. If the company's claim is greater then the "creditor" becomes a "debtor" of the company. Such a determination extends beyond a simple valuation of a debt and should be made further to the powers vested in the chairman under r.1.17(4) IR 1986 [U.K.].

68 See Ch.9, IR 1986 [U.K.].

69 *supra.*

70 See also the discussion at pp.299 to 300 *supra.*

71 *ibid.* at p.142 C-D.

72 *ibid., supra.*

73 (1994) BCC 576.

> subr.(3). The machinery of the two subrules is quite different and a single debt cannot, in my view, be covered by both of them...The scheme of the rules makes sense in my view only if subr.(3) is treated as the only rule which is relevant to unliquidated or unquantified claims and subr.(4) and (6) are confined to liquid claims for disputed amounts.[74]

It is submitted that this construction does not accord with the wide construction given to the word "claim" in the discussion above.

Simplifying the vote allocation procedure

Except in cases where the nominee was not aware of the creditor concerned and did not summon him to the meeting, or where the creditor's claim is greater than that which the nominee was aware of when summoning the meeting, there appears to be no logical justification for the sub-rules which require each creditor to give notice of his claim and the chairman to accept or reject it. The chairman of the meeting, as the nominee or, if not the nominee, as his appointee, is aware of the extent of each creditor's claim and should be equipped with that information at the time of the meeting. Where there are a large number of creditors and every creditor gives notice of his claim to the chairman, it is inevitable that the chairman would have to correlate each claim with the debt acknowledged by the company in its statement of affairs. It is submitted that this would lead to an unnecessary increase in the number of documents the chairman will be required to examine at the meeting. A possible alternative would be to inform the creditor concerned of the amount of the debt admitted as due by the company as verified by the nominee, and the number of votes the creditor would be entitled to on account of that debt and the basis on which the votes were allocated.[75] If the creditor accepts the quantification he need do nothing more except to be present at the meeting either in person or by proxy. Alternatively, if the creditor does not accept the quantification of his claim he should be required to give notice to the nominee of the amount he claims as due. Failure to do so should be construed, for the purpose of the meeting and the voluntary arrangement only, as an acceptance of the quantification of his claim and the allocation of votes due to him. If this procedure is followed, then the chairman will be required to deal only with claims disputed by the company and unliquidated claims at the meeting.

Members' Voting rights

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74 *Re Cranley Mansions, ibid.*, at p.589 F-H.

75 The basis on which the votes are allocated must of course be uniform and could be set out in the statement of affairs or in the summery thereof which is required to include a list of the creditors and the amounts of their debts. See r.1.9(3)(b) and r.1.11(2)(b) IR 1986 [U.K.].

In principle, members vote according to the rights attaching to each of their shares and in accordance with the company's articles of association.[76] In contrast to the control exercised by the chairman over the creditors' entitlement to vote, he exercises no such control in the case of the members.

Although the members' voting rights are expressed in terms of the rights granted under the shares themselves and the company's articles, the rules go on to grant each member whose shares do not confer upon him a voting right, an entitlement to vote either for or against the proposal or any modification of it.[77] Even so the vote of such a shareholder is not taken into account for the purpose of determining whether the CVA has been approved by the company's members.

Challenging the Chairman's decision.

Under s-rule 1.17(5) any creditor or member of the company may appeal to the court against the chairman's decision on a creditor's entitlement to vote.[78] A member's right to make such an application is noteworthy in view of the fact that the chairman has no control over a member's entitlement to vote at the meeting of the members. If the court reverses or varies the chairman's decision or declares the creditor's vote to be invalid, the court may either order another meeting to be summoned or make such other order as it thinks just.[79] The court's power to make such an order under this paragraph of the rules is confined to circumstances where it considers that the matter is such as gives rise to "unfair prejudice" or "material irregularity". In *Re Cranley Mansions: Saigol v. Goldstein* a decision by the chairman to value a contingent creditor's claim at £1 where that creditor had no entitlement to vote was held to be a "material irregularity.[80]

It should be noted that an application may also be made to court under s.6 IA 1986 [U.K.] which also mentions "unfair prejudice" and "material irregularity".[81] The right to make an application under this section is not restricted to members and creditor since the nominee and,

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76 sub-r.1.18(1) IR 1986 [U.K.].

77 sub-r.1.18(2) IR 1986 [U.K.].

78 r.1.17(5) IR 1986 [U.K.].

79 r.1.17(7) IR 1986 [U.K.].

80 (1994) BCC 576 at 594.

81 N.B. s.6 IA 1986 [U.K.] is the only provision in Part 1 under which a creditor, member or contributory may make an application to the court against a decision taken at a meeting summoned under s.IA 1986 [U.K.].

if appropriate, an administrator or a liquidator may also make an application. Both creditors and members would be entitled to make an application only if they have been entitled to vote at the meeting. If the chairman in the exercise of his powers has denied a creditor the entitlement to vote, such a creditor would not have the standing to present an application under s.6 IA 1986 [U.K.].[82]

Under s.6 IA 1986 [U.K.] an application on the grounds of "unfair prejudice" may be made only if the voluntary arrangement *has been approved at the meetings* and it unfairly prejudices the interests of a creditor, member or contributory of the company. Should the meetings be adjourned for another day without the voluntary arrangement being approved no application would be possible on the grounds of "unfair prejudice" being suffered. The position would be the same where the voluntary arrangement had failed to gain the required majority even if the failure was due to an incorrectly calculated entitlement to vote. As far as "unfair prejudice" in sub-r.1.17(7) IR 1986 [U.K.] is concerned both circumstances described above may be viewed as having "unfairly prejudicial" results.

The circumstance in which the "material irregularity" must arise are not so circumscribed in s.6(1)(b). Under this section the material irregularity should occur at or in relation to either of the meetings. Consequently, the appellant need not wait until the proposal is approved and would be able to appeal even during an adjournment of the meeting. If the application concerns the admission or rejection of a creditor's claim all that need be established is that the chairman's decision was wrong. This would constitute an irregularity which, since it occurred at a meeting, would be *ipso facto*, "material".

A creditor or member who is dissatisfied with the chairman's determination of an entitlement to vote may make applications in the alternative under s.6 IA 1986 [U.K.] and sub-r.1.17(5) IR 1986 [U.K.].[83]

As pointed out, under sub-r.1.17(7) the court may reverse or vary the chairman's decision and declare the vote invalid. It may further order another meeting to be summoned, or make such other order as it thinks just. Under s.6 IA 1986 [U.K.] whilst the court may in effect declare a vote to be invalid by revoking or suspending approvals given at the meeting, a variation of the chairman's decision may only be made as supplemental direction under s.6(6) IA 1986 [U.K.].

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82 *Re Cranley Mansions: Saigol v. Goldstein* (1994) BCC 576 at 595.

83 *Re Cranley Mansions: Saigol v. Goldstein* (1994) BCC 576.

Voting on the proposed CVA and other resolutions

S.4 provides that the meetings of the creditors and the company should decide whether to approve the proposed voluntary arrangement with or without modifications.[84]

Modifying the proposal

Modifications may be made to the proposal, provided that by virtue of the modification the proposal does not cease to be a proposal as defined under section 1 of the Act. No further limitation is placed upon the modifications that can be made.

The Act expressly provides that the modifications which may be made include replacement of the nominee by the appointment of another insolvency practitioner in his place. Consequently, the creditors are able to replace any nominee appointed by the directors, the liquidator or the administrator, including where either of the latter pair has appointed himself the nominee, with an insolvency practitioner of their choice.

Approving a Proposal

S.4 IA 1986 [U.K.] is silent as to what constitutes an "approval" of a voluntary arrangement. By requiring the meetings to be conducted in accordance with the rules,[85] it is left to the rules to establish the criteria required for approval. This is in marked contrast to the position applicable to schemes of arrangements under the Companies Act, 1985 where the majority required for the acceptance of a scheme has been fixed by statute since 1870.[86]

Entrenched rights - the answer to class meetings

Subject to three express limitations, whereby the rights of two categories of creditor are entrenched,[87] the creditors and members of a company may approve any proposal or modification of it at their meetings. The categories of creditor whose rights are entrenched are secured creditors and preferential creditors. Other classes of creditors who do not fall into either of these categories are liable to have their rights altered by the approval of a proposal.

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84 s.4(1) IA 1986 [U.K.].

85 s.4.(5) IA 1986 [U.K.].

86 First under the JSCAA 1870 [U.K.] and then the various Companies Act, since 1907. The majority required has remained very much the same except that in 1928 it was amended from a majority in number representing three fourths in value of those present either in person or by proxy, to a majority in number representing three fourths in value of those present ***and voting*** either in person or by proxy.

87 s.4(3) and 4(4)(a)&(b) IA 1986 [U.K.].

(i) Secured Creditors

English Law has always jealously guarded the position of a secured creditor and that protection is continued in both IA and IR 1986 [U.K.]. A meeting may not approve any proposal or modification which affects the right of a secured creditor of the company to enforce his security, except with the concurrence of the secured creditor concerned.[88]

A secured creditor of a company is defined as a creditor who holds in respect of his debt a security over property of the company.[89] It may be recalled that the meaning of "security" and "secured creditor" was examined fully for the purposes of ss.10(1)(b) and 11(3)(c) IA 1986 [U.K.][90] and it was established that "security" is given a restrictive as opposed to a functional interpretation for the purpose of English Administration, thereby excluding persons with rights under hire-purchase agreements, as defined in s.10(4) IA 1986 [U.K.]. Owing to the inter-relationship between CVAs and English Administration, it is submitted that the lawyer's question "who is a secured creditor for the purpose of a CVA ?" also receives a similarly restricted reply. Thus, persons who have rights under such agreements and who are creditors of the debtor company may in principle run the risk of their rights being affected by a CVA.

A number of questions arise when reading this provision in connection with the remaining provisions of Part 1 of the Act and the Rules, in particular s.5(2), r.1.13(3) and r.1.19(3)b). With whom must the secured creditor concur that his right to enforce his security be affected? Is it with the company or the other creditors? Where must he signify his concurrence - at the meeting of the creditors or may he do so earlier to the proposer of the voluntary arrangement? Does a secured creditor's concurrence give rise to a binding agreement between him and the company and/or the other creditors? If it does, what is the consideration that flows from the secured creditor to the company and/or the other creditors?

(ii) Preferential Creditors

The second and third express prohibitions entrench the rights of preferential creditors. A meeting may not approve any proposal or modification under which any preferential creditor is to be paid otherwise than in priority to other non-preferential creditors[91] or a single preferential creditor is to be paid an amount less than the pari passu equivalent payable to other

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88 s.4(3) IA 1986 [U.K.].

89 s.248(a) IA 1986 [U.K.].

90 See the discussion in Chapter 6 at p.247 *supra*.

91 s.4(4)(a) IA 1986 [U.K.].

preferential creditors.[92] As in the case of a secured creditor, these entrenched rights of a preferential creditor may be varied with the concurrence of the creditor concerned.

Preferential creditors are entitled to preferential treatment only in the event of a winding up. Apart from the position accorded to preferential creditors by the IA there is no difference under the Act between such creditors and other unsecured creditors. The general rule is that, subject to payment of pre-preferential creditors, preferential creditors must be paid in full out of the pool of assets available for the payment of general creditors prior to payment being made all other unsecured creditors.[93] If the pool of assets is insufficient to meet the claims of general creditors, preferential creditors are entitled to be paid out of assets subject to a floating charge in priority to the charge holder.[94] Among themselves preferential creditors rank equally, and, if not paid in full, are entitled to *pari passu* treatment out of the available assets after the expenses of the winding up are paid.[95] What s.4(4) seeks to do is to ensure that these preferential creditors are not deprived of their status without their consent. In the absence of such a provision, the approval of a proposal which provides for a composition of the company's debts may, unless express provision is made, deprive such creditors of their preferential status. S.4(4) also has the effect of ensuring that the preferential creditors' right to payment in full is not affected even outside a liquidation.

There has been some doubt since the decision of the House of Lords in *National Westminster Bank v. Halesowen Presswork and Assemblies Ltd*[96] whether a creditor is able to subordinate his claim in winding up to a claim of equal rank because such a subordination infringes the *pari passu* rule, which is a rule of public policy for the orderly administration of estates.[97] The legal fraternity has recently heaved a sigh of relief following the two decisions of Vinelott J., in *Re Maxwell Communications Corporations plc* and in *Re British & Commonwealth Holdings plc* where it was held that a debt subordination agreement and a debt

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92 s.4(4)(b) IA 1986 [U.K.].

93 s.175(1) IA 1986 [U.K.].

94 s.175(2)(b) IA 1986 [U.K.]. This means that pre-preferential creditors are also entitled to such treatment out of assets subject to a floating charge.

95 s.175(2)(a) IA 1986 [U.K.].

96 [1972] A.C 785. In this case it was held (with Lord Cross of Chelsea dissenting) that a debtor could not contract out of statutory right of set off on the ground that it contravened rules of public policy laid down to ensure the orderly administration of insolvent estates.

97 Professor Goode has however maintained that such subordination agreements do not contravene public policy. See Goode., Professor R.M., *Principles of Corporate Insolvency Law, supra,* p.65.

subordination trust were effective.[98] It is submitted that at least since 1985, the legislature has recognised through s.4.(4) that a debt subordination agreement is a valid means of effecting a corporate rescue since a preferential creditor may expressly agree to subordinate itself to other preferential creditors with whom it would otherwise stand *pari passu*. A debt sub-ordination agreement by way of a CVA is not a contravention of the application of the *pari passu* rule.

(iii) Other classes of creditors

What is the position of the creditor who is neither secured nor entitled to preferential treatment but who, like a secured creditor, obtained a position superior to unsecured creditors because he "bargained for it"? A creditor under a hire-purchase,[99] conditional sale[100] or chattel leasing agreement (hereafter collectively referred to as hire-purchase agreements[101]) certainly falls into such a category. In administration proceedings the administrator must first obtain the authorization of the Court before disposing any property held by the company under any such hire-purchase agreement. Further, any creditor under such an agreement is required to make allowance for the value of the property which would be recoverable under the agreement before voting on the administrator's proposals implying that such property stands outside the administration. If the position is not the same in a CVA, the approval of a proposal which grants the company a moratorium and perhaps allows it further credit would (since the CVA is binding upon all creditors who were given notice of and were entitled to vote at the meeting) preclude any creditor under any of the special agreements referred to above from proceeding to enforce its rights under the agreement.[102] In the absence of any express statutory provision referring to

98 Bean, Dr. Gerard M.D., "Debt subordination validated", *15 The Company Lawyer*, p.52. See also the comments of Professor Ian F. Fletcher, in "Case Law Developments - Subordination agreements and the *pari passu* rule" (1992) *Business Law Journal* p.283.

99 An agreement for the bailment of goods under which the bailee may buy the goods or under which the property in the goods will or may pass to the bailee. Such an agreement differs from a conditional sale inasmuch as the hirer does not agree to buy. He merely has an option to buy on fulfilment of certain conditions, or he may return the goods on payment of the sum stated in the contract.

100 An agreement for the sale of goods or land under which the purchase price is payable by instalments and the property in the goods or land is to remain in the seller until the instalments are paid. - s.189(1) of the Consumer Credit Act, 1974 [U.K.].

101 N.B. Unlike in s.10(4), IA 1986 [U.K.] the words "hire-purchase agreement" as used in this chapter do not include "retention of title agreements".

102 For example, a lessor of equipment would be greatly prejudiced by such a moratorium imposed against its wishes if it is unable to recover its property. The product would be subject to value depreciation and may well become obsolete (e.g. computer hardware and software) before the moratorium period is over.

hire-purchase agreements, creditors under such agreements would be protected only if they could come within the scope of s.4(3) discussed above, which, as it has been pointed out, they do not.

Majorities required to pass a resolution

The passage of any resolution at a creditors' meeting depends upon the satisfaction of the rather complex criteria in r.1.19 IR 1986 [U.K.]. The criteria they may be briefly described as the *existence* of a *positive* majority of the creditors present and voting,[103] (the quantum required depends on the type of resolution) and, the *absence* of a *negative* majority in excess of one half of a specific group of creditors also present and voting. In calculating the *positive* majority certain votes are to be left out of account. These votes left out in calculating the *positive* majority are also not accounted for in assessing the *negative* majority. But in addition, certain other votes which may or may not have been taken into account in assessing the *positive* majority must also be left out.

Computing the positive majority

Where the resolution to be passed is for the approval of any proposal or a modification thereof, under r.1.19(1) IR 1986 [U.K.] the *positive* majority required is in excess of three-quarters in value of the creditors present and voting on the resolution.[104] For any other resolution the *positive* majority required is reduced by reading one half in place of three quarters.[105]

In calculating the *positive* majority certain votes in respect of a claim or part of a claim are to be left out. This is so despite express provision to the effect that every creditor of whose claim and address the nominee is aware is entitled to be summoned to the creditors' meeting.[106] The categories to be left out are:

(a) where written notice of the creditor's claim was not given, either at the meeting or before it to the chairman or convenor of the meeting;
(b) where the claim or part is secured;
(c) where the claim is in respect of a debt wholly or partly on, or secured by, a current bill of exchange or a promissory note, unless the creditor is willing-
   (i) to treat the liability to him on the bill or note of every person who is liable on it

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103 In person or by proxy.

104 r.1.19(1) IR 1986 [U.K.].

105 r.1.19(2) IR 1986 [U.K.].

106 s.3(3) IA 1986 [U.K.]. A creditor whose vote is left out in calculating the majority may well argue that the legislature would not have granted him a statutory right to be present at the meeting unless he also had a right to influence the outcome of the meeting.

antecedently to the company, and against whom a bankruptcy order has not been made (or in the case of a company, which has not gone into liquidation), as a security in his hands, and

(ii) to estimate the value of the security and (for the purpose of entitlement to vote, but not of any distribution under the arrangement) to deduct it from his claim.[107]

The first category is directed at ensuring that only creditors who have provable claims against the company are able to influence the outcome of a meeting of the creditors summoned to consider the proposal for a CVA. As has been seen, the giving of written notice of a claim does confer a right to vote since the chairman has the power to admit or reject a claim for the purpose of a creditor's *entitlement* to vote. This rule may have been more appropriately contained in r.1.17 which deals with the voting rights of creditors. Its appearance in this part of the rules nevertheless underscores the requirement that only creditors' with valid claims should be permitted to influence the decision at the meeting. It precludes a company seeking to rig the vote in its favour by creating false liabilities.[108] The origins of this rule may be traced to the winding up rules where every creditor is required to prove his debt with the liquidator.[109] It may be noted that in a scheme of arrangement there is no requirement that each creditor should give written notice of his claim at or prior to the meeting.

The second and third categories restrict voting upon the proposal to unsecured creditors only. It may be argued that these sub-rules are ultra vires the authority of the Lord Chancellor since in effect they restricts voting on the proposed voluntary arrangement to the company and its unsecured creditors[110] only. Nowhere in Part 1 of the Act is it expressly or impliedly stated that a voluntary arrangement should be voted upon only by the unsecured creditors of the company. The mandatory, requirements in section 3 that "every creditor of the company of whose claim and address the person summoning the meeting is aware," should be summoned to the creditors' meeting, and section 4 that "the meetings summoned under section 3 shall decide whether to approve the proposed voluntary arrangement" establish that the legislature intended that every creditor, without distinction, of whom the person summoning the meeting was aware,

107 r.1.19(3)(a)-(c) IR 1986 [U.K.].

108 This was a major concern during the 1860s prior to the enactment of the JSCAA [1870] when attempts were made to use the provisions in CA [1862] for the purpose of entering into schemes of arrangement. See the discussion at pp.62-64, *supra*.

109 Companies (Winding Up) Rules 1949 r.106(1). Should he fail to do so he is excluded from the benefit of any distribution made before proof and in any case from objecting to such a distribution.

110 Unsecured creditors would include preferential creditors.

should be a party to the decision making process.

While a secured creditor may under section 4(3) expressly consent to the approval of a proposal or a modification thereof which affects his right to enforce his security, under sub-rules 1.19(3) and 1.19(4) he is restricted from directly influencing the proposed voluntary arrangement by proposing an amendment or by voting in favour of the arrangement. Indirectly of course, if a secured creditor wished to make any amendments to a proposed voluntary arrangement, all such amendments could be made a precondition to his consent to the modification of his rights. Such secured creditor should take care to retain the right to withdraw his consent at any time, or delay giving it until just before vote for approval of the proposal, to take into account any other subsequent modification thereto which may be against his interest or with which he may disagree, and which may be prior to approval of the voluntary arrangement. Notably the *Consultative Document,* published by the Insolvency Service, in October, 1993, proposes that *all* creditors should vote at the meeting of the creditors. No distinction is drawn between secured and unsecured creditors.[111]

There has been some debate as to whether this provision prevents secured creditors, whose security in respect of a single claim is inadequate, from voting in respect of the amount for which they are unsecured.[112] In its *Consultative Document*[113] the Insolvency Service takes the view that a secured creditor should be allowed to vote in respect of the unsecured balance, if any, of its debt since it would be bound to observe any moratorium which the CVA enforces.

Computing the negative majority

The votes cast against the approval of a CVA matter as much as the votes cast in favour. Even if the requisite majority in favour of the CVA is procured, such a resolution would still be invalid if more than half in value of a specific group of creditors vote against it. This group of creditors is limited to those:

(a) to whom notice of the meeting was sent;

(b) whose votes have not been left out of account in calculating the *positive majority*; and

(c) who are not, to the best of the chairman's belief, connected with the company.[114]

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111 Insolvency Service, *Consultative Document,* October, 1993, para.4.6, p.27.

112 See Gregory, R., "Voting rights of partly secured creditors in VA" *(1992) 5 Insolvency Intelligence 71*; Harding, D. "Voting rights of partly secured creditors in VA" *(1993) 6 Insolvency Intelligence 6*; Oditah, F., "Individual Voluntary Arrangement" *(1994) LMCLQ 210.*

113 See Insolvency Service, *Consultative Document,* October, 1993, para.2.40, p.18.

114 r.1.19(4) IR 1986 [U.K.].

It has been pointed out above that a creditor who had not been given notice of the meeting could (although it may be unlikely) give written notice of his claim to the chairman, and be entitled to vote. Such a creditor would fall outside the scope of paragraph (a) and would not be a member of the body of creditors whose negative vote matters. Paragraph (b) incorporates the provisions of r.1.19(3) into sub-rule (4) thereby excluding secured creditors and creditors who had not given notice of their claims. So far there is little difference between this group of creditors and those which comprise the *positive majority*. The most important aspect of sub-rule 1.19(4) is paragraph (c) which excludes creditors who are connected with the company. The rules themselves do not define "connected with the company" and reference must be made to the statute for guidance. A person is connected with a company if he is a director or shadow director of the company or is an "associate" of either or of the company.[115] A person is an "associate" if he comes within the definition of that word in s.435 IA 1986 [U.K.]. Generally this means that persons who are related by blood or marriage and persons who are employees or form part of corporate structure of the company are excluded from this body of creditors.[116] By virtue of this provision the company and its directors are prevented from rigging the vote by having "friendly" creditors vote for a proposal which may not benefit the other "unconnected" unsecured creditors.

The majorities as a whole

Although they do not appear to accord with some of the express provisions of the Act, sub-rules 1.19(3) and 1.19(4) certainly have circumvented one of the problems associated with schemes of arrangement which the Cork Committee did not recommend for this particular procedure.[117] Namely, the problem of class meetings. Since section 425 of the Companies Act, 1985 provides for class meetings the agreement of secured creditors to a scheme is achieved through that medium. If classes of creditors are be summoned the responsibility for deciding who are to be summoned to a meeting as constituting a class is the applicant's[118] and that a "class"

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115 s.249 IA 1986 [U.K.].

116 See s.435 (1)-(11) IA 1986 [U.K.].

117 Although no recommendation for class meetings in a voluntary arrangement was made by the Cork Committee, as far as Administration is concerned the Cork Committee could see no way of avoiding them. At page 426 it is stated:

> "We see no way of avoiding this difficulty. The Administrator will have to take a view as to the appropriate class meetings. He should however be able to apply to the Court for guidance and that guidance although not binding upon the Court which later determines the issue whether or not the scheme shall be sanctioned, will be both helpful and persuasive."

118 *Practice Note* [1934] WN 142.

of creditors must be confined to persons with a commonality of interest.[119] It will be recalled that in a scheme, classification of secured creditors is particularly difficult.[120] By dispensing with class meetings the rules have avoided the costs arising out of litigating disputed classification.

As far as the positive majority required to approve a voluntary arrangement is concerned, a subtle difference between the wording here and in s.425 of the Companies Act, 1985 should be noted. All that is required for the acceptance of a scheme of arrangement by the creditors or a class of creditors, is a majority in number representing three fourths in value of the creditors or a class present and voting either in person or by proxy in favour of the scheme. In the case of a voluntary arrangement, the majority required is in *excess* of three quarters in value, of those creditors present in person or by proxy and voting in favour of the resolution. What is meant by an "excess" is not defined. Neither has there been any judicial pronouncement on its meaning.[121] Technically any fraction in addition to three quarters should be sufficient. Equally, a voluntary arrangement which receives the support of precisely three quarters in value of the creditors present and voting could not be considered as approved by the meeting and could not take effect and become binding under section 5 of the Act.

When compared with s.425 of the Companies Act, 1985 rule 1.19(1) increases, albeit slightly, the majority required for the approval of a voluntary arrangement between an insolvent company and its creditors. It may be argued that the slight increase in the difficulty in achieving a majority is perhaps off-set by the gains achieved by not requiring the approval of the court, and that the word *excess* acts as a check.

It is interesting to note that the framers of the rules saw fit to depart from the guidelines set out by the Cork Committee. The majority recommended by the Cork Committee for the purpose of accepting an *individual voluntary arrangement* for the benefit of creditors generally was a simple majority in number of those creditors present at the meeting or voting by proxy.[122] This is unusual to say the least since it has long been recognised that debtors can fraudulently increase the number of its creditors by creating nominal debts and that what really matters is a

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119 The test first enunciated by Bowen L.J.in *Sovereign Life Assurance Co v. Dodd* [1892] 2 Q.B.573, p.583, C.A.

120 See the discussion at pp.134 to 134 *supra*.

121 The wording is the same in the parallel provisions of the rules dealing with individual voluntary arrangements and likewise there is no judicial dicta on the meaning of excess.

122 *Cork Report*, para. 381(b).

majority in value. The succeeding paragraph which says that each creditor would be entitled to one vote for each £100 or part thereof of his claim[123] indicates that a simple majority in value is what the Cork Committee intended. In the brief guideline given for the adaptation of this procedure for use by companies the Cork Committee hoped that:

> "a meeting of the creditors listed would be convened and the approval of the arrangement would depend on a similar majority."[124]

The majority suggested by the Cork Committee is generally in line with the majority formerly required for the acceptance by creditors of a Deed of Arrangement under the Deeds of Arrangements Act, 1914 (now repealed).[125] It is not clear why the framers of the rule moved away from the Cork Committee's recommendations with respect to both individual and company voluntary arrangements. It is also difficult to say whether the majority required by the Cork Committee would in practice be more difficult to achieve than that required under the rules. Under the rules the majority is calculated in relation to the votes cast for and against. If a creditor abstains, his vote is not taken into account as a vote against the resolution. In calculating the majority stipulated by the Cork Committee those who did not vote at all were counted as voting against the resolution.[126]

Effect of the approval of a CVA

Once the meetings are concluded the Chairman of the meetings is obliged to report the result of the meetings to the court. This obligation applies to all nominees whether or not he is the responsible insolvency practitioner.

If the proposed CVA has been approved, the directors must forthwith do everything which is required to put the Supervisor of the arrangement into possession of all the assets of the

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123 *ibid,* para. 381(c).

124 *Cork Report*, para.429(c).

125 Deeds of Arrangement Act, 1914, s.3(1) which provided as follows:

> "A deed of arrangement which either is expressed to be or is in fact for the benefit of a debtor's creditors generally, shall be void unless, before or within twenty-one days after the registration thereof, or within such extended time as the High Court or the court having jurisdiction in bankruptcy in the district in which the debtor resided or carried on business at the date of the execution of the deed may allow, it has received the assent of a majority in number and value of the debtor."

Under s.3(3)

> "The assent of a creditor for the purpose of subsection (1) of this section shall be established by his executing the deed of arrangement or sending to the trustee his assent in writing attested by a witness, but not otherwise."

126 *Labouchere v Earl Wharncliffe* (1879) 13 Ch D 346, 354.

company included in the arrangement.[127] It is not clear to what extent this obligation exists where the approved voluntary arrangement authorises or requires the Supervisor of the arrangement to carry on the business of the company.[128] Where the Supervisor is not required to carry on the business of the company, the directors cease to have any control over the assets comprised in the arrangement. Such assets are held by the Supervisor in trust for the creditors.[129]

MEETINGS AND THE POST-MEETING PROCEDURE IN CANADIAN PROPOSALS

What the creditors may resolve at the meetings

The meeting of the creditors summoned under s.51(1) BIA [Can.] is held in order that the creditors to whom the proposal is made may resolve to accept or reject it.[130] The proposal which is accepted or rejected need not necessarily be the proposal as originally made by the company and may be an altered version of it. There is no separate statutory provision which empowers the creditors to alter the Proposal, but, the power to alter is derived from s.54(1) BIA [Can.].[131] The only restriction placed under s.54(1) BIA [Can.] is that the alteration(s), if any, should have been made at the meeting or at any adjournment of it. It has been held in several cases which arose under the relevant provision applicable prior to the 1992 reforms[132] that the consent of the debtor was necessary before any alteration or modification was made.[133] It will

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127 r.1.23(1) IR 1986 [UK].

128 It is clear from r.1.26 IR 1986 [UK] that the Supervisor may be required to do so.

129 See *Re Leisure Study Group Ltd.* [1994] 2 BCLC 65 where it was held that such funds are outside the reach of a subsequently appointed receiver.

130 s.54.(1) BIA [Can.].

131 See *Re Ilford Riverton Airways Ltd* (1974) 19 C.B.R. (N.S.) 186 (Man.Q.B.) a case which was decided according to the old provisions.

132 The exact wording of which was:
"Subject to the rights of secured creditors, the creditors may by special resolution resolve to accept the proposal as made or as altered or modified at the meeting or any adjournment thereof." s.54(1) BA [Can.]

133 See *Re Richardson* (1921) 19 O.W.N. 194, 61 D.L.R. 175 (S.C.), 1 C.B.R. 417; *Martin v. Riman* [1931] 1 D.L.R. 773 (S.C.) (1930) 66 O.L.R. 392, 12 C.B.R. 417; *Re Ferguson* [1935] 2 D.L.R. 473 (S.C.), [1935] O.R. 223, 16 C.B.R. 261. This accords with the view that proposal is a contract between the debtor and his creditors"- *Employers' Liability Assurance Ltd v. Ideal Petroleum (1959) Ltd* (1976) 26 C.B.R. (N.S) 84 (S.C.C.), per de Grandpré, J, at p.92. For earlier formulations of the same principle see *Re Caplan; Lawrence v. Dashiff et al.* (1969) 15 C.B.R. (N.S.) 191.(Que S.C.); *Re Lipson; (Sterling Dress Company)* (1923), 3 C.B.R. 640 (Ont.S.C.) per Fisher J. at p.643. *Abacus cities Ltd., (Trustee of) v. AMIC Mortgage Investment Corp.* (1991) 2 C.B.R. (3d) 196 (Alta.Q.B.) In this case however, Forsyth J pointed out that important to note that it is not completely a voluntary agreement because [unlike in a contract] a

be recalled that under the old provisions a Proposal could only be made by the debtor as an insolvent person or a bankrupt. Whilst this interpretation ought to still hold where a Proposal was made by the debtor himself in identical circumstances, except in the case of one of the alterations described below, it may not necessarily apply where the Proposal was made by any of the categories of person now authorised to do so under s.50(1) BIA [Can.].[134]

In the statutory provisions that follow s.54(1) BIA [Can.], mention is made of only two matters that may be included by the creditors in the proposal. It is submitted that it would be too restrictive and not in keeping with the remedial purpose of Part III in the framework of BIA [Can.], to argue that the creditors' power to alter the proposal is limited to these two matters only.

The first matter that may be included by the creditors in the proposal relates to the supervision of the debtor's affairs. Provided the debtor consents, the creditors have the right to insert into the proposal any provisions or terms, they may deem advisable, regarding the supervision of the affairs of the debtor.[135] Secondly, the creditors may appoint one or more, but not exceeding five, inspectors of the estate of the debtor. The company's consent is not required for the appointment of the inspectors. If it were necessary to obtain the company's consent for an alteration it would appear that the appointment of inspectors would not constitute an amendment of the Proposal. The inspector or inspectors so appointed will have the powers of an inspector under this Act, subject to any extension or restriction of those powers by the terms of the proposal.[136]

Conduct of the meeting

Chairman of the meeting

Unlike in the other procedures under consideration, where the meeting is chaired by a private individual or professional who is not a public officer, in a Canadian Proposal the Official Receiver or his nominee must be the chairman of the meeting of the creditors summoned under s.51(1) BIA [Can.].[137] The Official Receiver is deemed to be an officer of the court.[138]

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proposal imposes the will of the majority of the creditors on the minority: at p.201.

134 Namely, (b) a Receiver, (c) a liquidator and (e) the trustee of the estate of the bankrupt.

135 s.55. BIA [Can.].

136 s.56. BIA [Can.].

137 s.51.(3) BIA [Can.].

138 See s.12(2) BIA [Can.].

Consequently, in a Canadian Proposal the Court or its officers play a more active part in the conduct of the meeting of the creditors.

It may be noted that in bankruptcy proceedings under BIA [Can.] more than one meeting of creditors may be held and the Official Receiver is required to be the chairman only at the first of these meetings. The trustee takes over thereafter.[139] In the case of a Canadian Proposal only one meeting of the creditors is held, which is to consider a proposal, and Official Receiver must be the chairman. Where a meeting to consider a proposal is adjourned, there is no prohibition against the trustee taking over. Any questions or disputes arising at the meeting must be decided by the chairman and any creditor has the right to appeal against such a decision to the court.[140]

Quorum

Part III BIA [Can.] does not specify the quorum required to validate a meeting summoned under s.51(1) BIA [Can.]. There must be a quorum since s.54.(2.2) BIA [Can.] states that if there is no quorum of secured creditors in respect of that class of secured claims the secured creditors having claims of that class are deemed to have voted for the refusal of the proposal.[141] Thus, the quorum provisions specified in Part V BIA [Can.] under the sub-title Procedure at Meetings would appear to apply.

Under s.106.(1) BIA [Can.] one creditor entitled to vote, or the representative of such a creditor constitutes a quorum for a meeting of creditors. This appears to apply to both secured and unsecured creditors. The qualifying requirements are presence in person or by proxy and the entitlement to vote. As will be seen, every creditor summoned to the meeting or entitled to respond to the proposal is not necessarily entitled to vote. Under the new "voting letter" provisions[142] described below, a creditor who proves a claim and votes in this manner is considered to have been present and to have voted.

Adjournment of meeting

The creditors may require that the meeting of creditors be adjourned, but only for either or both of the following purposes. That is, to enable a further appraisal and investigation to be made of the debtor's affairs and property, or for the debtor, or such other person as may be believed to have knowledge of affairs or the property of the debtor, to be examined under oath.

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139 See s.105(1)&(2) BIA [Can.].

140 s.51.(3) BIA [Can.].

141 s.54.(2.2) BIA [Can.].

142 s.53 BIA [Can.].

The adjournment may be called for by the passage of an ordinary resolution by the creditors, but the time and place for the adjourned meeting must be fixed by the chairman.[143]

Proof of claims and allocation of votes to creditors

BIA [Can.] appears to distinguish between the creditor's right to *respond* to the proposal and to *vote* on the proposal. Every unsecured creditor has the right to respond to a Proposal "made to the creditors generally" by filing a *proof of claim* with the trustee.[144] In the case of secured creditors, only a secured creditor to whom the proposal has been made in respect of a particular secured claim may respond by filing a *proof of secured claim* with the trustee.[145] A secured creditor in respect of whose secured claim a proposal has *not* been made has no right to file a proof of secured claim.[146] It will be recalled that if a Proposal is made to one or more secured creditors in respect of secured claims of a particular class, the Proposal should mandatorily have been made to all secured creditors having claims in that class.[147] Once a proof of claim, be it secured or unsecured, is filed and proved in the manner set out in BIA [Can.] a right to *vote* accrues to that creditor.[148] While a right to *respond* to a proposal accrues to every creditor on the proposal being made, the right to *vote* accrues only upon the claim being proven.[149]

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143 s.52 BIA [Can.]. The testimony of the debtor or such other person, if transcribed must be placed before the adjourned meeting. It may also be read in court on the application by the trustee for the approval of the proposal.

144 s.50.(1.6) BIA [Can.].

145 s.50.1(1) BIA [Can.]. Proof of secured claim must be made in the prescribed form and, in so far as they are applicable, ss. 124 to 126 BIA [Can.] apply, *mutatis mutandis*, to proofs of secured claim. If an insolvent person makes a Proposal to one or more secured creditors in respect of secured claims and thereafter becomes a bankrupt, any proof of secured claim filed pursuant to section 50.1 ceases to be valid or effective. See s.50.3 BIA [Can.].

146 s.50.2 BIA [Can.]. In principle a secured creditor ought to be able to respond in respect of any unsecured balance. However, s.127(1) BIA [Can.] which provides for proof of claims by secured creditors generally, requires the secured creditor seeking to respond in respect of an unsecured balance to have first realised his security. Such an action would not be possible owing to the moratorium which comes into effect on the filing of the Notice of Intention or the Proposal. However such secured creditors may also give up their security for the general benefit of the creditors and prove the entirety of his claim. See s.127(2) BIA [Can.] and *Re Gaspari Construction Co.* (1958) 37 C.B.R. (N.S.) 74 (Ont.S.C.). However contrast *Re Anderson* (1991) 6 C.B.R. (3d) 170 (Ont.Bktcy.).

147 s.50(1.3) BIA [Can.].

148 ss.53 and 54.(2)(a) BIA [Can.]. In the event the chairman entertains a doubt as to whether to claim should be admitted the right to vote that accrues and any vote that is cast is defeasible.

149 Contrast the position in CVA where a creditor's right to vote accrues in the first instance upon

Where a proposed assessed value of the security has been made in a proposal made to a secured creditor, and the secured creditor files a proof of secured claim, he can only vote in respect of the lesser of the amount claimed by him, and the proposed assessed value of the security.[150] If the proposed assessed value is less, then the secured creditor may exercise one of two options. The secured creditor is not obliged to accept the debtor's proposed assessed value without complaint and has the right to have the valuation revised within 15 days of the Proposal being sent to the creditors. If the court revises the proposed assessed value, the revised value applies thereafter.[151] Alternatively, the secured creditor may vote on the difference between the proposed assessed value and his claim as an unsecured creditor after having filed an ordinary proof of claim.[152]

Part III BIA [Can.] does not provide for the manner in which claims should be proved and votes allocated to the creditors.[153] These matters are dealt with in Part V BIA [Can.] "Administration of Estates" which deals with Meetings of the creditors in general and the Procedure at the meeting. These provisions would apply to meetings of creditors under Part III, BIA [Can.].[154]

S.108(1) BIA [Can.] provides that the Chairman of any meeting of the creditors has the power to admit or reject creditors proofs of claim for the purpose of voting. If s.108(1) is read with Part III BIA [Can.], although proofs of claim are lodged with the trustee prior to the meeting,[155] the power to admit or reject votes is in the hands of the Official Receiver. Furthermore, although the trustee is required send out blank, prescribed forms of proof of claim, creditors are not obliged to return the same forms and their respective proofs will not be affected if they do so since the Official Receiver has the power to accept any letter or printed matter transmitted by any form or mode of telecommunication as a creditor's proof of claim.[156]

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notice of the meeting of the creditors being given to that creditor. See r.1.17(1) IR 1986 [U.K.].

150 s.50.1(2) BIA [Can.].

151 s.50.1(4) BIA [Can.].

152 s.50.1(3) BIA [Can.].

153 See s.53(1) BIA [Can.] however.

154 See Houlden & Morawetz, E§13(1).

155 See ss.50(1.6), 50.1(1), 109(1), 124-126 BIA [Can.]. Contrast s.50.1(5) which gives a secured creditor the right to file a proof of claim at the meeting.

156 s.108(2) BIA [Can.]. This would mean that proof of claim may be sent by fax telex telegram and even electronic mail, provided what is received by the trustee is in the printed format.

S. 53 BIA [Can.], which makes provision for creditors to vote at the meeting through a "voting letter" indicates that:

> "Any creditor who *has* proved a claim, whether secured or unsecured may indicate assent to or dissent from the proposal in the prescribed manner to the trustee *prior* to the meeting and any assent or dissent, if received by the trustee at or prior to the meeting, has effect as if the creditor had been present and had voted at the meeting."[italics added]

Plainly, under s.53 BIA [Can.] the creditor intending to indicate his assent or dissent should have proved his claim *prior* to indicating his assent or dissent. The assent or dissent may however, be received by the trustee either *at* or *prior* to the meeting. Part III BIA [Can.] makes no further reference to the timing of the proof of claim and is silent on the procedure that should be followed in the event that the trustee entertains a doubt whether a claim should be accepted or rejected. Although under Part V, BIA [Can.] the trustee may chair meetings of the creditors after the first meeting has been held, it would appear that in Part III, only the Official Receiver has the power to chair a meeting of the creditors summoned under s.51(1).[157] Further, under Part V, the trustee has no authority to admit or reject a proof of claim prior to a creditors meeting being held. There is no case law on point, but a functional interpretation would indicate that whilst creditor could indicate assent to or dissent from the proposal by a voting letter to the trustee prior to the meeting, the proof of claim submitted by that creditor would nevertheless have to be admitted or rejected by the Official Receiver as chairman before the votes cast by the voting letter are taken into account.

As in all other rescue regimes, if the chairman entertains a doubt as to whether a proof of claim should be admitted or rejected, he must mark the proof as objected to an allow the creditors to vote.[158] Any decision taken by the chairman in respect of a proof of claim is subject to an appeal to the court.[159] If the objection made against a claim in respect of which the chairman entertained a doubt is sustained, the vote cast by the creditor in respect of that claim is declared invalid.

The boundaries of the chairman's authority also applies to the court which adjudicates on objections made against claims. If a court declares a proof of claim to be valid it has no jurisdiction in equity to thereafter set aside the vote. In *Meublerie Andre Viger Inc. v. Wener*, a case which arose under the old provisions, a creditor's loan to the bankrupt was secured by the

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157 See s.51(3) BIA [Can.].

158 s.108(3) BIA [Can.].

159 s.51(3) BIA [Can.].

transfer of property in stock. When the bankrupt was in financial difficulties and the creditor realized its security. Following this the bankrupt made a proposal and the appellant filed a proof of claim (for the unsecured balance). The trustee dismissed the claim and the appellant's vote was not taken into account. The creditor appealed to the Superior Court of Quebec which took the view that although the creditor's claim was valid, principles of equity justified the dismissal of the vote. This decision was reversed on appeal and the secured creditor was allowed to vote in respect of its unsecured balance.[160]

A creditor's entitlement to vote should be determined solely on the basis of the proof of claim which is filed and issues such as a conflict of interest between the creditor and the debtor should not be taken into account. In *Bédard Louis Inc., c. Teac Canada Ltd.,*[161] another case arising under the old provisions of the BA [Can.], creditors had had the bankrupt's goods seized prior to the bankruptcy. The bankrupt claimed damages against the creditors on the ground that the seizure was unlawful, and one of the respondent-creditors petitioned for a receiving order. The debtor objected on the grounds that since its claim for damages exceeded the creditor's claim it was not a creditor. Nevertheless the debtor was declared a bankrupt. The bankrupt then made a proposal to its creditors. The trustee refused to allow the respondent-creditors to vote on the ground that there was a conflict of interest between the bankrupt and the creditors. On appeal the trustee's decision was reversed by the Superior Court of Quebec and the respondent creditors were allowed to vote on the basis that a trustee under a proposal has no right to deprive a creditor who had a provable claim in bankruptcy of the right to vote on the proposal, despite the fact that there is a conflict of interest between the creditor concerned and the bankrupt. The Trustee's further appeal to the Quebec Court of Appeal was also dismissed.

If a proposal has been made in respect of a particular secured claim, the secured creditor's votes are logically calculated in respect of the entirety of his claim.[162] This is an important recognition of the role a secured creditor may play in a corporate rescue and is in marked contrast to a secured creditor's rights in a CVA [U.K.]. Although a secured creditor may expressly agree to the variation of his rights in a CVA, the secured portion of his claim is not taken into account in counting votes cast in respect of the CVA.[163]

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160 (1992) 45 Q.A.C. 245, [1992] R.J.Q. 1461, [1992] R.D.J. 509; see also [1993] R3 Supp. p.54.

161 (1991) 52 Q.A.C. 108, 22 C.B.R. (3d) 218; See also [1993] R3 Supp.pp.55-56.

162 s.50.1(1) BIA [Can.].

163 See r.1.19(3) IR 1986 [U.K.].

Where a proposal has been made in respect of a particular class of secured creditor and none of the creditors having a claim of that class files a proof of claim at or before the meeting, then every creditor belonging to that class is statutorily deemed to have voted against the Proposal.[164]

For the purpose of voting each creditor is entitled to one vote for each dollar in a claim which is not disallowed.[165] The date for determining creditors' claims is the date on which the proposal was filed with the Official Receiver.[166] A creditor having a claim on that date may vote on the proposal and the proposal is properly approved even though shortly after the claim of a creditor who voted is discharged.[167]

Voting at the meetings

Every unsecured creditor, and every secured creditor in respect of whose secured claim the proposal was made, who has proved a claim, has a statutory right to vote on the proposal.[168]

When voting, creditors are required to do so according to the class of their respective claims. For this purpose, unless the proposal provides for more than one class of unsecured claim, all unsecured claims are deemed to constitute one class of claim.[169] Unless the proposal has identified them as such there does not seem to be any way in which unsecured creditors such as those with an unliquidated claim for damages may be classified together.[170] In the case of secured claims, classification is dependent upon a sufficient commonality of interest[171] which may be determined by the debtor when making the proposal or by the Court upon an application made to it under s.50(1.3) BIA [Can.] after the proposal has been made.

Secured and unsecured creditors need not personally attend the meeting of the creditors in order to express their opinion on the proposal. Nor is it necessary that a proxy be appointed for that purpose. It is sufficient under BIA [Can.] if a creditor has indicated his assent to or dissent from the proposal in a "voting letter" to the trustee prior to the meeting. Provided it is

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164 s.50.1(5) BIA [Can.].

165 s.115 BIA [Can.].

166 s.62(1) CBA [Can.]

167 *Re Slavik* (1992) 12 C.B.R. (3d) 157 (B.C.S.C.)

168 54.(2) BIA [Can.].

169 54.(2) BIA [Can.].

170 The requirement that any classification of unsecured creditors should be made by the company accords with the established position in Schemes of Arrangement.

171 s.50.(1.4) BIA [Can.]. See also p.147 *supra* at ftn.108.

received by the trustee at or prior to the meeting, an assent or dissent, made by a "voting letter" has effect as if the creditor had been present and had voted at the meeting.[172]

A creditor who is related to the debtor may vote against but not for the proposal.[173] If the trustee is either a secured or an unsecured creditor he has no right to vote on the proposal.[174]

A proposal is deemed to have been accepted by the unsecured creditors if all classes of unsecured creditors vote for the acceptance of the proposal by a majority in number and two thirds in value of the unsecured creditors of each class present, personally or by proxy, at the meeting and voting on the resolution.[175] If this requirement is not strictly fulfilled, the proposal will not have been accepted. If a proposal had been made to secured creditors in respect of any class of secured claim, the proposal is accepted by that class if a majority in number and two thirds in value of the secured creditors in that particular class present, personally or by proxy, at the meeting voted on the resolution to accept the proposal.[176]

Having acknowledged that in some cases, if not most, the support of secured creditors is of vital importance to the success of a proposal,[177] the Canadians are stuck with class meetings. The question whether creditors fall into one class or into separate classes is often a difficult one with the distinctions being very fine. Where disputes arise they may be the subject of costly litigation.

An important difference between a the requirements for the approval scheme of arrangement and a Proposal is that a scheme could be approved by each class of creditor. Once approved and sanctioned it was binding on that class. Whilst the position is the same with regard to secured creditors in a proposal, in the case of unsecured creditors all classes of unsecured creditors must vote for the acceptance of the proposal by the requisite majority.

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172 s.53. BIA [Can.]. This section does not however, excuse creditors who have decided to vote through a "voting letter" from proving their claims although it is not clear whether such creditors may prove their claims before the trustee prior to the meeting.

173 s.54.(3) BIA [Can.].

174 s.54.(4) BIA [Can.].

175 54.(2)(d) BIA [Can.]. Claims by the Crown or a province for amounts that could be subject to a demand under subsection 224(1.2) of the *Income Tax Act* or under any substantially similar provision of provincial legislation should not be construed as having been classified as secured claims by subsection 224(1.2) of the *Income Tax Act*. See. s.54.(2.1) BIA [Can.]

176 See s.62.(2) BIA [Can.].

177 See *Colter Report*, p.52.

The majority required which is dual in nature is identical to the majority required to approve a scheme of arrangement. Indeed no attempt has been made to make it easier or more difficult to obtain creditor approval for a proposal. First a head count would have to be taken to determine the majority in number, followed by a count of one vote for each dollar in a claim which is not disallowed[178] in order to determine the majority in value.

Effect of the creditors' refusal to accept a Proposal

If at a meeting summoned under s.51(1) BIA [Can.], or any adjournment thereof, the creditors refuse to accept the proposal the procedure set in motion by the filing of a Notice of Intention or a Proposal, together with the moratorium, comes to an end. It was pointed out that where the procedure had been initiated by the company as an insolvent person, the management of the company remained in control of the company after initiation. The status quo is not preserved on the creditors refusing to accept the proposal. Instead, immediately on the refusal of a proposal made by a company as an insolvent person, the company is deemed to have made an assignment in bankruptcy on the day the Notice of Intention, the Proposal or the first petition, if any, for a receiving order, in respect of the company was filed, which ever is the earlier.[179] The company ceases to be able to dispose of or otherwise deal with its property and, subject to the rights of secured creditors, the property vests in the trustee who was the trustee under the proposal.

A report of the assignment must be filed by the trustee forthwith with the official receiver, who must thereupon issue a certificate of assignment which has the same effect for the purposes of this Act as an assignment filed pursuant to section 49 BIA [Can.]. The steps to be followed thereafter are those that should be taken after an assignment in bankruptcy has been made.[180]

Getting the Court's approval after the creditors approve a Canadian Proposal

If the creditors approve the proposal the next step the trustee should take is to make an application to court for an appointment for a hearing of an application for the court's approval of the proposal. There is no fixed time frame within which the application should be heard by the court. All that the trustee is required to do is to make an application to court within five days of the acceptance of the proposal by the creditors. The date on which the hearing is to take place is fixed by court and would be dependent upon the court's calendar. Once the date for the

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178 s.115 BIA [Can.].

179 s.57(a) BIA [Can.]

180 s.57. BIA [Can.].

hearing is fixed the trustee must send a notice of the hearing of the application to the debtor, every secured and unsecured creditor who has proved a claim, and to the official receiver least fourteen days before the date of the hearing. The notice should be in the prescribed manner. The trustee is also obliged to prepare a report on the proposal which must be filed with the court at least ten days before the date of the hearing. A copy of this report should also be forwarded to the official receiver.[181] Assuming that (a) the trustee is able to make an application to court on the day that the proposal is approved, (b) the court's calendar permits and (c) the trustee can have the notices of the meeting prepared and sent out to the creditors the same day, the earliest on which the hearing may be held is the fifteenth day after the creditors' meeting to approve the proposal.

Consideration of an approved proposal by the court.

On an application for the approval of a proposal the court may, subject to certain statutory provisions, either approve or refuse to approve the proposal.[182] Under some of these provisions the court's refusal is mandatory. Under the others the court has the discretion whether or not to accept the proposal.

In addition to ascertaining whether these statutory conditions are satisfied or not, at the hearing for the approval and before approving the proposal, the court is required to hear a report from the trustee regarding the terms of the proposal and the conduct of the company. The trustee's report to the court should be in the form prescribed by the rules. In addition, the court must also hear the trustee, the debtor, any opposing, objecting or dissenting creditor and any further evidence which the court may consider necessary.[183]

Having conducted its hearing the court is obliged not to approve the proposal where it is of the opinion that the terms of the proposal are not reasonable or are not calculated to benefit the general body of creditors. Once it forms this view it has no discretion but to refuse approval.[184] The standard of benefit is that as a result of the proposal the creditors must obtain an advantage over bankruptcy.[185] In *Re Mernick,*[186] the debtor had declared that he had no

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181 s.58. BIA [Can.].

182 s.60.(5) BIA [Can.].

183 s.59.(1) BIA [Can.].

184 s.59.(2) BIA [Can.].

185 See *Re Allen Theatres Ltd.*, (1922) 3 C.B.R. 147 (Ont.S.C.), *Re Tridont Health Care Inc.*, (1991) 4 C.B.R. (3d) 290 (Ont.Bktcy) and *Re First Toronto Mining Corp.*, (1991) 3 C.B.R. (3d) 246

assets of any value, and in particular no business operational assets and no income and made a proposal for the payment of his debts without any security or stating the source of such payments. The Court took the view that it was in the public interest not to approve the proposal since the proposal was neither a reorganization nor a restructuring but a bankruptcy without the benefit of the investigative procedures available in a bankruptcy. The conduct of the debtor is also a factor to be considered and if there is any suggestion of collusion or secret advantage, the matter should be particularly scrutinised.[187]

The court must also refuse to approve the proposal if any of the following facts are proved in relation to the company. Namely that:

(a) its assets are not equal to 50¢ in the dollar on the amount of its unsecured liabilities;

(b) it omitted to keep proper books;

(c) knowingly continued to trade while insolvent;

(d) failed to account satisfactorily for loss or deficiency of assets;

(e) its insolvency/bankruptcy was brought on by rash or hazardous speculation, by unjustifiable extravagance, by gambling, or culpable neglect of business affairs;

(f) it made any creditor incur an unjustifiable expense by a frivolous or vexatious defence to a legal action properly brought against it;

(g) within three months preceding the filing of the Notice of Intention or the Proposal it incurred an unjustifiable expense by bringing a frivolous or vexatious legal action;

(h) within the same time period described in (g) above, and while unable to pay its debts it gave an undue preference to any creditor;[188]

(i) within the same time period described in (g) above, it incurred liabilities with a view to making its assets equal to 50¢ on the dollar on the amount of its unsecured liabilities;

(j) that it has previously made a proposal;

(k) it has been guilty of fraud or a fraudulent breach of trust;

(l) it has committed an offence under BIA [Can.]; and

(Ont,Bktcy.)

186 (1994) 24 C.B.R. (3d) 8.

187 See insolvent person *Re Gardner* (1921) 1 C.B.R. 242 (Ont.S.C.) and *Man With Axe Ltd, Re* (1961) 2 C.B.R. (N.S.) 8. (Man.Q.B.)

188 *n.b.* proof of this however does not have the effect of setting aside the undue preference.

(m) it has failed to perform a duty imposed under BIA [Can.] to obey an order of court.[189]

The burden of establishing these facts is on the person making the allegation. If any of the facts mentioned above are established the court is required in the first instance to refuse to approve the proposal. The Canadian legislature has taken a pragmatic view that the existence of any of the above facts does not by itself mean that the proposal which has been approved by the creditors is not in their wider interests or that bankruptcy is the better option. The court is nevertheless given the discretion to approve the proposal if it provides reasonable security for the payment of not less than 50¢ on the dollar of unsecured claims or such percentage of these as may be directed by the court.[190] A refusal by the court to approve the proposal would automatically place the company in bankruptcy, and it appears that a dividend of 50¢ on the dollar appears to be the statutory bench mark of a better return than in a bankruptcy.

In comparison to the mandatory requirement that the proposal must be refused, if it is established that any of the offenses set out in ss.198 and 200 BIA [Can.] have been committed by the company the court is given the discretion to refuse to approve a proposal.[191]

In Chapter 4 attention was drawn to certain payments which every proposal must mandatorily provide for. The court is precluded from approving a proposal unless it provides for certain priority payments to be made. These payments are:

- all claims that are directed by the court to be paid in priority in the distribution of the property of the debtor;
- all proper fees and expenses of the trustee on and incidental to the proceedings arising out of the proposal or in the bankruptcy together claims which have been so directed to be paid;[192]
- certain Crown claims that were outstanding at the time the Notice of Intention was filed or if no Notice of Intention is filed when the proposal was filed.[193]

In the following two cases, not only should the proposal provide for the payments to be made in priority to the other creditors, but the court must also be satisfied that the company can

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189 s.173 BIA [Can.]

190 See *Re Dolson* (1984) 49 C.B.R. (N.S.) 255 (Ont.S.C.), *McNamara v. McNamara* (1984) 53 C.B.R. (N.S.) 240 (Ont.S.C.), *Re Tridont Health Care Inc., supra.*

191 s.59.(2) BIA [Can.].

192 s.60.(1) BIA [Can.].

193 s.60.(1.1) BIA [Can.].

and will make these payments, namely:

- moneys which employees and former employees of the company would be qualified to receive under paragraph 136(1)(d) BIA [Can.] if the employer became bankrupt on the date of court approval of the proposal;[194] and
- if the company has repudiated a lease of real property pursuant to subsection 65.2(1) BIA [Can.], the compensation described in subsection 65.2(3) which is payable to the landlord immediately after the court's approval.[195]

In deciding whether to accept or reject the proposal the court acts both on its own observations, such as the perusal of the proposal, and on evidence presented to it by interested parties, primarily the creditors. But its statutory powers are limited only to approving and rejecting the proposal. It does not have any power to amend the proposal or to return it for reconsideration by the creditors. It has been held in at least two cases that the court has the power to amend a proposal should it prove unworkable.[196] But these cases concerned amendments made after the proposal had become operational after obtaining the court's approval and not during the application for approval. Nevertheless, even in these cases there is no statutory basis for this power which has been exercised. The principal justification for denying the court this power is that any amendment would convert the proposal into something which did not achieve the requisite majorities at the creditor's meeting.

Where the court approves a Proposal

Once a proposal which has been accepted by the creditors is approved by the court it is binding on creditors in respect of all unsecured claims. As regards secured claims it binds only those creditors having secured claims in respect of which the proposal was made and that were in classes in which the secured creditors voted for the acceptance of the proposal by a majority in number and two thirds in value of the secured creditors present, personally or by proxy, at the meeting and voting on the resolution to accept the proposal.[197] The important feature here is that the proposal binds these creditors whether they were present at the meeting or not. What

194 s.60.(1.3) BIA [Can.]. It should also be noted that, although employees have a preferential right to receive such a payment under a proposal, such a right does not translate into a claim in respect of which a proof of claim may be lodged for voting purposes. s.60.(1.4) BIA [Can.].

195 s.60.(1.5) BIA [Can.].

196 See *Re City Construction Co.*,(1961) W.W.R 557, 29 D.L.R. (2d) 568 (B.C.C.A.) 2 C.B.R. (N.S.) 245 followed in *Re Skalbania; Re N.M.Skalbania Ltd.*,(1991) 2 C.B.R. (3d) 205 (B.C.S.C.)

197 s.62.(2) BIA [Can.].

matters is whether the proposal was made to the creditors concerned.

By the approval of the proposal creditors lose their pre-proposal rights against the company in return for rights under the proposal. Ordinarily this would extend to all unsecured claims against the company. However, the court's approval of a Canadian Proposal does not release the company from all unsecured debts and liabilities. The company would be still bound to honour certain obligations which are specified in s.178 BIA [Can.] unless the creditors agree.[198] Whilst some of them would affect individual debtors only, the others could apply to both individuals and companies. The other category of debts which are not released by a proposal are those debts owed by third parties other than the company.[199]

If the company had made an assignment in bankruptcy or had had a bankruptcy order made against it the approval of the proposal by the court automatically annuls the bankruptcy. Consequently, the right title and interest in the property of the company, which hitherto would have been vested in the trustee in bankruptcy, revests in the debtor, or such other person as the court may approve, unless the terms of the proposal provides to the contrary.[200]

Implementing the approved proposal

All moneys payable under the proposal must be paid to the trustee.[201] The trustee may also be required to recover debts or sell the company's property. The recovery of debts might involve an assignment of a bankrupt's accounts receivable to a trustee for the purpose of collection. If the accounts receivable subject to a floating charge the assignment would not crystallise the charge. In *Re Timar Holdings (1982) Inc.*,[202] a bankruptcy company had assigned all of its accounts receivable to a trustee under the terms of a proposal a bankrupt corporation. The trustee proceeded to collect the accounts receivable. A debenture holder applied for an order declaring that the assignment was of no force and effect against the debenture holder and that the trustee should pay over to the debenture holder all moneys collected under the proposal. The debenture holder took no steps for two years after learning of the proposal. The application was dismissed. The court found that the assignment was absolute and given pursuant to the proposal to enable the corporation to continue its business. The debenture did not prohibit

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198 s.62.(2) BIA [Can.].

199 s.62.(3) BIA [Can.].

200 s.61.(1) BIA [Can.].

201 s.60.(2) BIA [Can.].

202 (1989) 74 C.B.R. (N.S.) 276 (B.C.S.C.)

the corporation from carrying on its business and the proposal did not cause the corporation to cease carrying on its business. Consequently, the proposal did not crystallise the debenture. At the time the debenture holder took steps to demand payment and to crystallise the debenture the moneys in the hands of the trustee were no longer subject to the debenture and were not attached by crystallisation.

In selling the company's property the trustee must respect security rights of creditors not bound by the proposal. In *Bruncor Leasing Inc. v. Zutphen Bros. Construction Ltd.*[203] Zutphen Bros. Construction Ltd., (Zutphen) entered into a conditional sale agreement for the purchase of a dump truck. The agreement was assigned to Bruncor Leasing Inc (Bruncor). Zutphen filed a notice of intention to make a proposal. The proposal when made was sanctioned by the creditors and approved by the court. In the proposal Bruncor was designated as a secured creditor. The trustee under the proposal asked Bruncor to file a proof of security. The proof which was filed was disallowed by the trustee. Bruncor appealed to the Registrar in Bankruptcy against the trustee's decision. The Registrar dismissed the application on the grounds that the trustee had the authority to disallow the applicant's claim after the proposal had been approved by all classes of the creditors and sanctioned by the court. Bruncor appealed against the Registrar's decision. The Supreme Court of Nova Scotia held that the BIA [Can.] did not grant to a trustee under a proposal the power to disallow a claim for security.

The moneys which have been handed to the trustee must be distributed by him to the creditors after payment of all proper fees and expenses. In making his distribution the trustee may call upon the creditor to file proof ma

Only the moneys payable under the proposal need be paid to and remain under the control of the trustee. Unless the proposal otherwise provides there is no statutory need for the management of the company to pass to the trustee or any other party.

It was noted in Chapter Three that the proposal may confer on the trustee the power to set aside voidable transaction. This is not a statutory right enjoyed by the trustee, but one that should be granted under the terms of the proposal.

In *Relcor Ltd, a bankrupt v. Neiff Joseph Land Surveyors Ltd*[204] the court opined:

> "A proposal which provides that the trustee can attack any preference payment or fraudulent conveyance as defined by the **Bankruptcy Act**, if such payment could have

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203 (1994) 23 C.B.R. (3d) 70 (N.S.S.C.)

204 (1976) 18 N.S.R. (2d) 394; 20 A.P.R. 394, 23 C.B.R. (N.S.) 172 (N.S.C.C.) affd., (1976) 18 N.S.R. (2d) 370, 20 A.P.R. 370, 23 C.B.R. (N.S.) 258 (N.S.C.A.)

> been set aside if the debtor had made an assignment in bankruptcy, permits the trustee under the proposal to attack any preferential payment or fraudulent conveyance, if such transaction could have been set aside if the debtor had made an assignment in bankruptcy"

In *Re Seward; Marcoux v. Bank Toronto-Dominion*[205] the debtor's account with his bank was in overdraft. He planned to make a proposal to his creditors and the bank asked him to pay off the overdraft first which he did. Within the next three months the debtor's proposal was approved by his creditors and ratified by the court. The trustee under the proposal obtained a judgement setting aside the debtor's payment to the bank as a preferential payment. The bank in turn obtained judgement annulling the proposal and declaring the debtor a bankrupt. The bank also appealed against the order setting aside the debtor's payment to the bank arguing that the annulment of the proposal moved forward in time the date from which the three month period for determining preferential payments was computed and therefore the debtors payment of his overdraft ceased to be preferential. The Quebec Court of Appeal held, dismissing the appeal, that the trustee had the power under the proposal to take the required steps to have preferential payments cancelled. The judgement which cancelled the preferential payment was rendered before the proposal was set aside. Although the annulment of the proposal ended its existence, it did not affect anything which was done under it including the cancelling of the preferential payment.

Refusal by the Court to approve a Proposal

If the court refuses to approve the proposal at the hearing the company deemed to have made an assignment thereby ensuring a smooth and rapid transition from the rescue regime to a terminal regime. The assignment automatically dates back to earliest of the day on which the proposal was filed, the day on which the notice of intention, if any, was filed, or the day on which the first petition, if any, for a receiving order in respect of that company person was filed.

The trustee must forthwith file a report of the assignment with the official receiver and the Official Receiver must issue a certificate of assignment. Within five days after the day the certificate is issued, the trustee must send notice of a meeting of creditors under section 102. At this meeting the creditors may by ordinary resolution, affirm the appointment of the trustee or appoint another licensed trustee in lieu of that trustee.[206]

Perhaps the most significant feature of all is that no costs incurred by the debtor on or incidental to an application to approve a proposal, other than the costs incurred by the trustee,

205 [1991] R.J.Q. 1832, 41 Q.A.C. 213.

206 s.61.(2) BIA [Can.].

can be allowed out of the estate of the debtor if the court refuses to approve the proposal.[207] By this simple mechanism the court ensures that the costs of setting up a failed proposal are not fully charged from the dividend payable in the company's bankruptcy.

MEETINGS AND THE POST-MEETING PROCEDURE IN AN ENGLISH ADMINISTRATION

What the creditors may approve

Except to the extent that the proposals should be directed at achieving one or more of the purposes specified in the administration order there are no statutory limits to the proposal which the administrator may put to the creditors.[208] Thus unlike under a company voluntary arrangement where limits are placed upon the type of proposal which may be approved,[209] in an administration the creditors have the right to approve or reject *any* proposal put to them by the administrator.

At the meeting summoned under s.23 the creditors must decide whether to approve the proposals made by the administrator. However, the Act remains silent as to what constitutes an "approval" of a voluntary arrangement and leaves it to the rules to establish the criteria required for approval.[210]

Voting rights of creditors

Every creditor who was given notice of a meeting of creditors by an administrator has no automatic right to vote at that meeting.[211] Before a creditor may vote on the administrator's proposals at a meeting summoned for that purpose, he should have given to the administrator details in writing of the debt claimed by him as due from the company.[212] Such details should have been lodged with the administrator not later than 1200 hrs on the day prior to the

207 s.61(4).

208 It has been seen that in practice administrators seek approval of proposals which are expressed in general terms only. See the discussion at p.322 *ante*.

209 See sub-ss.4(3) and (4) IA 1986 [UK].

210 s.24(3) IA 1986 [UK].

211 Contrast the position in a company voluntary arrangement where every creditor who was given notice of the creditors' meeting is entitled to vote at that meeting.

212 Contrast the position under r.1.19(3)(a) IR 1986 [UK] which requires every creditor intending to vote at the meeting to give written notice of his claim to the chairman or the convenor either *at the meeting or before it*. If he does not do so he is nevertheless allowed to vote but runs the risk of any vote allocated to him being subsequently left out of account in calculating the majority required to pass a resolution.

meeting.[213] If the creditor intends to vote by proxy, that proxy should also have been lodged with the administrator.[214] If a creditor fails to give details of his claim, he may nevertheless be allowed to vote if the chairman of the meeting is satisfied that the failure was due to circumstances beyond the creditor's control.[215] The votes to which a creditor is entitled to are calculated according to the amount of his debt as at the date of the administration order deducting any payments made in respect of that debt after that date.[216]

A creditor whose debt is for an unliquidated amount or is of unascertained value cannot vote at the meeting unless the chairman agrees to give the debt an estimated minimum value for the purpose of determining his entitlement to vote and admits the claim for that purpose.[217]

In determining a creditor's entitlement to vote the chairman has the power to admit or reject the whole or part of a creditor's claim.[218] If the chairman entertains a doubt whether a creditor's claim should be admitted or rejected, the proper course of action open to him under the rules is to mark the claim as objected to and to permit the creditor to vote, subject to the vote being declared invalid if the objection to the claim is sustained.[219] The chairman is not obliged under the rules to seek the Court's direction if in doubt about a claim. It is up to the creditors to take matters further should they wish to do so.

Thus, any creditor, be it the creditor affected by the chairman's decision or any other creditor, has the right to appeal against the chairman's decision accepting or rejecting a claim or in calculating an entitlement to vote provided that the appeal is not made later than 28 days after the administrator delivers his reports of the outcome of the meeting to the Court and the Registrar of Companies.[220] If the court reverses or varies the chairman's decision or declares the creditor's vote to be invalid, the court may either order another meeting to be summoned or make

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213 See Form 2.11 IR 1986 [UK] Unusually, although the Act requires the administrator to give all creditors a copy of his statement of proposals, Form 2.11 does not require the Notice to enclose a copy but merely gives an address from which a copy may be obtained.

214 r.2.22(1)(b) IR 1986 [UK].

215 r.2.22(2) IR 1986 [UK].

216 r.2.22(4) IR 1986 [UK].

217 r.2.22(5) IR 1986 [UK].

218 r.2.23(1) IR 1986 [UK].

219 r.2.23(3) IR 1986 [UK].

220 R.2.23(2) IR 1986 [UK] and s.24(4) IA 1986 [UK]. It is interesting to note that s.24(4) also requires the report of the meeting to be delivered to "such persons as may be prescribed". The rules make no further provision except in r.2.30(1) which requires the administrator to send "notice" of the result of the meeting within 14 days of the conclusion of the meeting.

such other order as it thinks just.[221] In contrast to the position in company voluntary arrangements the court's power to make such an order under this paragraph of the rules is not confined to circumstances where it considers that the matter is such as gives rise to "unfair prejudice" or "material irregularity".

Under the rules, the origins of which may be traced to statutes enacted in the second quarter of the 19th Century,[222] secured creditors and creditors holding current bills of exchange or promissory notes are generally precluded from voting at meetings of creditors. A secured creditor may vote only if, according to his own estimate, the value of his security is inadequate to cover the whole of the debt owing to him.[223] He is entitled to vote only in respect of the amount remaining after having deducted the value of his security, which is the unsecured debt due to him by the debtor.[224] A holder of a current bill of exchange or promissory note may vote only if he is willing to treat the liability to him on the bill of every person who is liable upon it antecedently to the company and against whom a bankruptcy order has not been made as security in his hands, to estimate the value of such security for the purpose of his entitlement to vote and to deduct it from his claim.[225]

Creditors who have retained title to property in the possession of the company for which payment has not been made are entitled to vote at a creditors meeting only if the creditor deducts from his claim the value as estimated by him of any rights arising under the agreement of retention of title in respect of such goods.[226]

Passing the resolutions

The criteria which must be satisfied before a resolution approving the administrator's

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221 r.2.23(4) IR 1986 [UK].

222 See Bankruptcy Act, 1833 Schedule 1 paras.10 and 11. It should be noted however that at one time it was held that the Bankruptcy provisions did not apply to the winding up of a company under the Companies Act, 1862 and that therefore a secured creditor was entitled to prove for the whole amount that was due to him, and not merely, as in bankruptcy, for the balance remaining due after the realizing or valuing his security. - See *Barnard's Banking Co., Re* [1867-68] 3 L.R. Ch App 769.

223 A secured creditor, as defined means a creditor who holds in respect of his debt a security over property of the company. The word security in turn is defined as meaning, in relation to England and Wales, any mortgage charge lien or other security. In relation to Scotland it means any security (whether heritable or movable) any floating charge and any right of lien or preference and any right of retention (other than the right of compensation or set off). s.248 IA 1986 [UK].

224 r.2.24 IR 1986 [UK].

225 r.2.25 IR 1986 [UK].

226 r.2.26 IR 1986 [UK].

proposal may be considered as passed are less complex than the requirements which must be satisfied for the approval of a CVA. However, as in the case of the CVA, two majorities should be computed. First there *must exist* a simple *positive* majority[227] in value of the creditors present and voting (in person or by proxy).[228] At the same time there *must not exist* a simple *negative* majority[229] in excess of one half of the creditors who are not, to the best of the chairman's belief, persons connected with the company.[230]

Post-approval procedure

Once the meeting is concluded in accordance with the rules, the administrator is required to report the result of the meeting to the court. He must also give notice of the result to the registrar of companies[231] and to the creditors who received notice of the meeting under the rules.[232]

The administrator appears to have the power to make insubstantial revisions to the proposals approved by the creditors.[233] Where the revisions required are "substantial" the administrator must obtain the approval of the creditors prior to implementing such a revised proposal. The administrator's revised proposals may be modified by the creditors provided that the administrator consents to each modification.[234] Once the meeting to consider the revised proposals is concluded the administrator must give notice of the result of the meeting to the registrar of companies and to the creditors in the same manner as after the first meeting which approved the administrator's original proposals.[235]

Creditor control in the procedure

If the creditors approve the administrator's proposal the creditors may at the same meeting establish a committee called "the creditors committee".[236] Approval of the administrator's

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227 i.e. a majority in favour of the administrator's proposal.

228 r.2.28(1) IR 1986 [UK].

229 i.e. a vote against the proposal.

230 r.2.28(1A) IR 1986 [UK]

231 s.23(4) IA 1986 [U.K.].

232 r.2.30 IR 1986 [U.K.].

233 s.25(1)(b) IA 1986 [U.K.].

234 24(2) IA 1986 [UK].

235 s.25(6) IA 1986 [U.K.] read with r.2.30 IR 1986 [U.K.].

236 s.26(1) IA 1986 [U.K.].

proposals is a pre-requisite to the formation of a creditors's committee. If the proposals are not approved then a committee cannot be constituted and the administration order must be discharged.

The functions of the creditors committee are described as those which are conferred on it by or under IA 1986 [U.K.]. This is the power to require the administrator, on giving him at least 7 days notice, to attend before it at any reasonable time and furnish it with such information relating to the carrying out of his functions as it may reasonably require.[237] Other than seeking such information the committee has no authority to give the administrator directions in the performance of his functions.

Meetings and the post-meeting procedure in Australian Voluntary Administration

It has been seen in the preceding chapter that two meetings of the creditors must be mandatorily be held in an Australian Voluntary Administration. The first mandatory meeting must be convened under s.436E and held within five business days of the appointment of the Voluntary Administrator. The second mandatory meeting must ordinarily be convened under s.439A within 21 days of the day the voluntary administration begins and held within five days after the end of that 21 day period.[238] Hereafter, for convenience the meeting convened under s.436E is referred to as the "first meeting" and the meeting convened under s.439A as the "second meeting")

To the extent that the mandatory procedure which follows the first meeting of the creditors has already been discussed in the previous chapter, the Australian voluntary administration procedure does not fit very neatly under the title "Meetings and the post-meeting mandatory procedure". Nonetheless, it is convenient to consider the conduct of both the first and second meetings in a Voluntary Administration together with the conduct of meetings under the other regimes because the same regulations apply to the convening, conduct and voting at both meetings.[239] Reference should be made to chapter six for the procedure which follows the first meeting of the creditors up to the point that the second meeting is convened.

Resolutions that may be carried at a meeting

Although the same regulations govern the conduct of both meetings there are important

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237 s.26(2) IA 1986 [U.K.].

238 The exception is where the voluntary administration begins in a day in December or within 28 days prior to Good Friday - s.439A(5)(a) CL [Aust.].

239 Reg.5.6.11(2) CReg [Aust.]. Except where the application of the regulations are inconsistent with the specific requirements of the CL [Aust.], the CReg [Aust.] or the rules. See reg.5.6.11(3)(c) CReg [Aust.].

differences in the nature of the resolutions that may be adopted by the creditors at the first and second meetings.

The first meeting is held for the purpose of giving the creditors the opportunity to appoint a committee of creditors, and if they do, to select the committee's members.[240] Should they wish to do so, the creditors may, at this meeting also remove and replace the Australian voluntary administrator.[241] There is no provision in the statute for the passage of any other resolutions at the first meeting.

The second meeting is held for the purpose of allowing the creditors to determine the company's future. The creditors may resolve that the company execute a deed of company arrangement, that the voluntary administration should end, or that the company be wound up.[242] The deed the company may be required to execute is the "deed specified in the resolution".[243] In deciding that a deed of company arrangement be executed by the company the creditors are not bound to accept the terms of the deed proposed by the Australian voluntary administrator. They are able to amend the Australian voluntary administrator's proposals. It should also be noted that there are no statutory provisions which stipulate as to what the deed specified in the resolution should or should not contain.[244]

If any part of resolution affects the right of a secured creditor to realise or otherwise deal with the security, the adoption of that resolution has no effect unless the secured creditor who is affected also votes in favour of its adoption.[245] Similarly, a right an owner or lessor of property has in relation to that property cannot be affected without the approval of that owner or lessor.[246]

Conduct of the meeting

Attention has been drawn to the limited time period within which the voluntary administrator must convene and hold both the first and second meetings of the creditors.

The second meeting may be adjourned from time to time, provided it is not adjourned for

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240 436E.(1)(a)&(b) CL [Aust.].

241 436E.(4)(a)&(b) CL [Aust.].

242 s.439C CL [Aust.].

243 s.439C(a) CL [Aust.].

244 Contrast the position under a CVA where the creditors cannot adopt certain types of proposals.

245 s.444D(1) CL [Aust.].

246 s.444D(2) CL [Aust.].

a day that is more than 60 days after the first day on which the meeting was held.[247] Part 5.3A CL [Aust.] does not provide for the adjournment of the first meeting of the creditors. Reg.5.6.18 makes provision for the chairman of a meeting to which the regulations apply to adjourn the meeting from time to time and from place to place, at the direction of the meeting or on his own volition, with the meeting's consent. The regulations apply only so far as they are not inconsistent with the specific requirements of CL [Aust.].[248] The absence in s.436E of a provision which enables an adjournment may be construed as a deliberate omission in the light of specific provision for the same purpose in s.439B(2). Reg.5.6.18(1) may therefore be said to be inconsistent with the requirements of CL [Aust.] pertaining to the first meeting of the creditors.

Both the first and second meetings of the creditors must be chaired by the voluntary administrator or a person nominated by him.[249]

Voting rights of creditors

The regulations which determine the voting rights of creditors in an Australian winding up apply to detrmine the voting rights of creditors on a voluntary administration.

For the purpose of voting at the first or second meeting of the creditors, one of the following two requirements should be satisfied. Either the creditor's debt or claim should have been admitted wholly or in part by the voluntary administrator[250] or the creditor should have lodged particulars of or, if required, a formal proof of the debt or claim. Such particulars or formal proof of the debt or claim should have been lodged with the voluntary administrator as chairman of the meeting or the person nominated for that purpose, in the notice convening the meeting.[251] If *proof* of debt or claim is filed it must state whether the creditor is a secured creditor or not, and, if so, the value and nature of the security and whether the debt is secured wholly or in part. There appears to be no such requirement of disclosure if only *particulars* of a debt or claim are required. It should be noted that the regulation which provide for the votes of secured creditors do not apply to a meeting of creditors convened under Part 5.3A CL

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247 s.439B(2) CL [Aust.] and reg.5.6.18(1A) CReg [Aust.].

248 reg.5.6.11(3)(c) CReg [Aust].

249 s.439B(1) CL [Aust.] and reg.5.6.17(1) CReg [Aust.].

250 reg.5.6.23(1)(a) CReg [Aust.].

251 reg.5.6.23(1)(b) CReg [Aust.].

[Aust.].[252] This regulation provides, inter alia, that unless the creditor proposes to surrender the security, particulars of the security, the date on which it was given and the creditor's estimate of its value must be furnished in the proof of debt or claim. A secured creditor is entitled to vote only in respect of the balance, if any, due to him after deducting the value of his security as estimated by him. If a secured creditor votes in respect of the whole of his debt the creditor is deemed to have surrendered his security.[253] Accordingly, at the first or second meeting of the creditors in a voluntary administration secured creditors are entitled to vote in respect of the full amount of their debt rather than the unsecured balance. The need for this voting right becomes apparent when one takes onto account the fact that a "substantial chargee" is able to appoint a voluntary administrator.

If the creditor's debt or claim is unliquidated or contingent in nature or the debt's value is not established no vote may be cast unless a just estimate of the value[254] has been made by the voluntary administrator.[255]

Further, under a regulation similar in terms to r.2.25 IR 1986 [U.K.], no vote may be cast in respect of a debt or a claim on or secured by a bill of exchange, promissory note or other negotiable instrument or security unless the creditor is willing to treat the liability to him on the instrument or security of a prescribed person as security in his hands, or to estimate its value and for the purpose of voting to deduct it from his debt or claim.[256] A prescribed person is defined as a person who is liable under a bill of exchange, promissory note or other negotiable instrument or security and is liable to the company directly or may be liable to the company on the default of another and who at the time of voting is not an insolvent under administration or a person against whom a winding up order is in force.[257]

For the purpose of voting[258] the chairman has the power under reg.5.6.25 CReg [Aust.]

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252 reg.5.6.24(4) CReg [Aust.].

253 reg.5.6.24(1)-(3) CReg [Aust.].

254 Contrast the requirement in an English Administration which requires the administrator to give the claim a minimum valuation.

255 reg.5.6.23(2) CReg [Aust.].

256 reg.5.6.23(3) CReg [Aust.].

257 reg.5.6.23(4) CReg [Aust.].

258 As opposed to the creditor's entitlement to vote, which the wording in the rules pertaining to English Administration - r.2.23(1) IR 1986 [UK].

to admit or reject a proof of debt or claim.[259] If the chairman is in doubt whether a proof of debt or claim should be admitted or rejected, the proper course of action open to him under the rules is to mark the proof as objected to and to permit the creditor to vote, subject to the vote being declared invalid if the objection is sustained.[260] There is no reference to the admission or rejection of *particulars* of a debt or claim which the creditor may have submitted under reg.5.6.23(1) CReg [Aust.]. Through out reg.5.6.25 CReg [Aust.] all references are to a creditor's *proof of debt or claim*. On a plain reading of the regulations it appears that unless the voluntary administrator has called on the creditors to lodge a formal proof of debt or claim, the chairman would have no grounds to reject *particulars* of the debt or claim lodged under reg.5.6.23(1) CReg [Aust.].

As in an English Administration the chairperson is not required to seek the Court's direction if in doubt about a claim. the burden is on the creditor(s) to take matters further should they wish to do so. An appeal may be made against the chairperson's decision to admit or reject a proof of debt or claim for the purpose of voting, provided the appeal is made within 14 after the decision.[261]

Voting at the meetings

The regulations provide for a single or dual vote on any resolution proposed at the first or second meeting of the creditors.

Such a resolution must first be sought to be decided on "the voices", unless a poll is demanded before or upon the declaration of the result of the voices.[262] Since the point at which a poll may be demanded is before or on the declaration of the *result*, and not prior to the vote being taken, it appears that the "voices" must mandatorily be heard and the votes recorded before a poll may be demanded. Voting by voice, has been possible only since 23 June 1993 after an amendment to reg.5.6.19(1) CReg [Aust.].[263] Prior to amendment the first vote was carried out by a show of hands. No specific majority is referred to and unless a poll is demanded the chairperson must declare that the resolution has been carried unanimously or by a particular

259 reg.5.6.26(1) CReg [Aust.].

260 reg.5.6.26(2) CReg [Aust.]. See also r.2.23(3) IR 1986 [UK] which is framed in identical terms.

261 The time allowed for appeal under an English Administration is double that and runs only after the administrator delivers his reports of the outcome of the meeting to the Court and the Registrar of Companies - R.2.23(2) IR 1986 [UK] and s.24(4) IA 1986 [UK].

262 reg.5.6.19(1) CReg [Aust.].

263 reg.25.1-25.4 SR 1993 No.135.

majority, or lost on the voices. Unless a poll is demanded, such a declaration is deemed to be conclusive evidence of the result and no proof is required of the proportion of the vote recorded in favour or against the resolution.

A voice vote is defined as a vote taken by noting the relative strength of calls of *aye* and *no*.[264] Being based on an assessment of the strength of the call, it is submitted that a vote on the voices does not lend itself towards making a declaration that a resolution has been carried by a particular majority, particularly where there are a large number of creditors. Difficulties may also be anticipated where a number of proxies have been submitted to one person with the discretion to vote as he chooses on certain resolutions. Indeed the opinion has been expressed that "It would be unlikely for this method to be used where any formal business is to be transacted".[265] Proponents of the voice vote may argue that if legislation, which may affect the rights of every resident of that country, may be passed by legislative bodies on the strength of a voice vote, in principle there should be no reason why the same system may not be adopted for the passage of resolutions by creditor. It should be pointed out that Parliamentarians do not have right to vote in the legislative chamber by proxy nor is there any need to make a declaration that a resolution has been carried by a particular majority. The need to dispense with the show of hands would have been prompted by the new provision which permits a creditor to participate in the meeting by telephone.[266]

The second method of voting is by a poll. As previously stated, a poll cannot be held without a vote being taken on the voices since the demand for a poll may be made only before or upon the declaration of the result of the voices. The persons authorised to demand a poll are the chairperson, a minimum of two creditors or a single creditor who represents not less than 10% of the total voting rights of all the creditors entitled to vote at the meeting. The creditors should be present in person, by proxy or by attorney and entitled to vote at the meeting.[267] It is up to the chairman to determine the manner in which the poll is to be taken and the time at which it is taken, provided that if it is demanded on a question of adjournment it must be taken at once.[268]

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264 *Concise Oxford Dictionary of Current English*, 8th ed.

265 *Shakleton*, *supra*, 6-16.

266 reg.5.6.13B CReg [Aust.].

267 reg.5.6.19(1)(a)-(c) CReg [Aust.].

268 reg.5.6.20 (1)&(2) CReg [Aust.]. It must also be taken at once if demanded on the election of the chairperson. However, such a demand cannot be made at either the first and second meetings

At a poll, the majority required to carry a resolution is two fold. For a resolution to be carried at a meeting of the creditors, there should be a majority in number of the creditors voting in person, by proxy or by attorney should vote in favour of the resolution. In addition that majority should also represent the majority in value of the total debts owed by the company to all the creditors voting in person, by proxy or by attorney.[269] It is specifically provided that a resolution is not carried if a majority in number and value of creditors voting, vote against the resolution.[270] The chairperson is given a casting vote which may be exercised if no result is achieved. This would mean that only one majority, in number or value, in favour or against the resolution is obtained. The chairperson may then exercise the casting vote as he chooses, either for or against the resolution. The voluntary administrator's power, as chairperson, to influence the outcome of the meetings is significant. It is submitted that it would have been preferable if the regulations specified that the casting vote must be exercised by the chairperson in support of the position taken, either for or against the resolution, by the majority in value of the creditors. As the regulation stands a numerical majority in favour of a resolution may, on the strength of the chairperson's casting vote, overcome even an overwhelming majority in value which is against the resolution. In such circumstances, much depends upon the integrity of the voluntary administrator.

It may be noted that the provision which grants the chairperson the casting vote is, along with the rest of that regulation, a recent addition to CReg [Aust.] and came into effect only 23 June 1993.[271] The former provision only specified the circumstances in which a resolution may be considered to have been carried.

If conference telephone facilities are available at the venue of the creditors meetings, and the voluntary administrator has decided to make use of such facilities. A creditor may participate at a meeting by telephone by giving notice to the voluntary administrator of his wish to do so. In such an event the voluntary administrator must take reasonable steps to ensure that that creditor is contacted before the start of the meeting on the telephone number provided by that creditor and that he can hear the proceedings and also be heard by the other creditors.[272] It may be noted that under the previous regulations such creditor would be unable to vote on the first vote since

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of the creditors since the chairperson must be the voluntary administrator or his nominee.

269 reg.5.6.21(2) CReg [Aust.].

270 reg.5.6.21(3) CReg [Aust.].

271 Inserted by reg.26, SR 1993 No.135.

272 reg.5.6.13B(1)&(2) CReg [Aust.].

it was by a show of hands. Now that the first vote is by the voices, and a poll may be vocal, even a creditor many hundred miles away would be able to vote by having his voice heard. Such a creditor who joins in by telephone is considered to be "present" in person at the meeting.[273]

The procedure which follows the second meeting of the creditors

The mandatory procedure which follows the second meeting of the creditors depends upon the outcome of the said meeting. As mentioned, the main resolutions that may be passed at the second meeting are that the company execute a deed of company arrangement as specified in the resolution, that the voluntary administration should end or that the company be wound up.

If the creditors resolve that the company execute a deed of company arrangement, the voluntary administrator or the person appointed as the administrator of the deed should prepare an instrument setting out the terms of the deed. The instrument setting out the terms of the deed must be prepared within a twenty one days after the end of the meeting of the creditors.[274]

There are a number of matters which must be specified in a deed of company arrangement and it would appear that the administrator of the deed must ensure that they are specified even if the voluntary administrator did not include them in his proposed draft deed presented to the creditor or creditors themselves did not specify them in their resolution passed at the second meeting of the creditors. The matters are:

(a) the administrator of the deed;

(b) the property of the company (whether or not owned by the company when it executes the deed) that is to be available to pay the creditors claims;

(c) the nature and duration of the moratorium period for which the deed provides;

(d) the extent to which the company is to be released from its debts;

(e) the conditions (if any) for the deed to come into operation

(f) the conditions (if any) for the deed to continue in operation

(g) the circumstances in which the deed terminates;

(h) the order in which the proceeds of realising the property referred to in paragraph (b) are to be distributed among creditors bound by the deed;

(i) the day (which must be not later than the date on which the voluntary administration began) on or before which claims must have arisen if they are to be admissible under the

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273 reg.5.6.13B(3) CReg [Aust.].

274 A 21 day limit is imposed by the fact that the instrument once prepared must be executed by the company within 21 days of the second meeting being held. S.444B.(2)

deed.[275]

Once the instrument setting out the terms of the deed has been prepared, the company must execute it within 21 days after the second meeting of the creditors. If it appears that the administrator of the deed will not be able to prepare the instrument setting out the terms of the deed or that the company will be unable to execute it before the expiration of that 21 day period, an application for an extension of time should be made to court before that period expires.[276] The administrator of the deed is also required to execute the deed either before or after it is executed by the company.[277]

Effect of the execution of a Deed of Company Arrangement

Once a deed of company arrangement has been executed by the company and the administrator of the deed, it binds every creditor who has a claim against the company which arose on or before the date specified in the deed for that purpose.[278] This date cannot be a date later than the date on which the voluntary administration began.[279] The significant feature about the effect of the deed of company arrangement is that is not dependent upon any sanction of the court but solely upon the execution of the deed.

The deed of company arrangement, cannot affect the right of a secured creditor to realise or otherwise deal with the security, unless the secured creditor who is affected had voted in favour of the resolution which resulted in the execution of the deed.[280] Similarly, a right an owner or lessor of property has in relation to that property cannot be affected by the deed of company arrangement without the owner or lessor having voted in favour of the resolution.[281]

Even where the secured creditor, or the owner or lessor of property had voted against the resolution, the court may, on the application of the administrator of the deed, in certain limited circumstances, by order limit the rights of the secured creditor to realise or otherwise deal with the property[282] or order the owner or lessor of property not to take possession of the property

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275 s.444A(4) CL [Aust.].

276 s.444B(2)(b) CL [Aust.].

277 s.444B(5) CL [Aust.].

278 s.444D(1) CL [Aust.].

279 s.444A(4)(i) CL [Aust.].

280 s.444D(1) CL [Aust.].

281 s.444D(2) CL [Aust.].

282 s.444F(2) CL [Aust.].

or otherwise recover it.[283]

MEETINGS OF CREDITORS IN A RECEIVERSHIP

Keeping other creditors appraised of the progress in a Receivership

A common problem identified by the Cork and Colter Committees in the U.K. and Canada and the Harmer Commission in Australia was the paucity of information the unsecured creditors of a company received after a Receiver had been appointed.[284] The Harmer Commission observed:

> "There seems no good reason, why in the majority of cases, why a Receiver should not be required to make relevant information available to all unsecured creditors. However such a requirement should not be unnecessarily burdensome or expensive."[285]

Summoning meetings

In comparison with the meetings considered so far, the meetings that must be summoned in a Receivership are very different.

In an English Administrative Receivership a meeting of the unsecured creditors of the company must be summoned by the Administrative Receiver for the statutory purpose of laying before it a copy of his report prepared under s.48(1) IA 1986 [U.K.].[286] At this meeting the creditors may, if they think fit, establish a committee of creditors (known as the creditors' committee) to exercise functions conferred upon it by or under the IA 1986 [U.K.].

The only power granted by IA 1986 [U.K.] to the creditors' committee is the power to require Administrative Receiver to attend before it at a reasonable time and to provide the committee with information "relating to the carrying out by him of his functions as the committee may reasonably require".

Creditor control in an Administrative Receivership

One of the major differences between English Administration and Receivership on which the former is based is that the administrator's achievement of the purposes specified in the administration order are dependent upon the creditors' approving his proposals. The courts also view the administration procedure is a creditor controlled procedure. In contrast an Administrative Receiver is subject to little or no control. He has to report to a committee of

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283 s.444F(4) CL [Aust.].

284 *Cork Report*, para.452, *Colter Report*, p.36 & 37, *Harmer Report*, para.206.

285 *Harmer Report*, para.206.

286 s.48(2) IA 1986 [U.K.]. *Cork Report*, para.477.

unsecured creditors in accordance with provisions introduced by the 1985 reforms. However the control those creditors have over his conduct of the procedure is superficial compared to the Administrative Receiver.

CONCLUSION

The creditors' meeting is the stage at which all the procedures except Receivership draw somewhat level. Although the nature of the proposals vary slightly between the procedures the objective of the meeting is for all or certain categories of creditors to consider these proposals. The creditors' views on the proposals are expressed through a vote and for this purpose votes are allocated to the creditors usually according to the size of the creditors claim against the company. The result of the meeting largely determines whether the attempted rescue has been a success or not.

In Schemes, CVAs and Canadian Proposals and Australian Voluntary Administration if a given majority approves the proposal a statutorily binding agreement between the company and the company's creditors comes into being. The type of creditor bound by such an agreement varies between the procedures. If the proposal is rejected at the meetings the procedure experiences a "sudden death". In an English Administration, rejection *per se* does not bring the procedure to an end, since the administration order will have to be discharged.

Involving secured creditors' in a rescue

There is a considerable difference in the manner in which secured creditors are involved at the meeting stage of each procedure.

At meetings convened under bankruptcy and winding up proceedings a secured creditor has no right to vote in respect of the secured component of its debt. In such proceedings a secured creditor is required to deduct the value of the security from its debt before voting. If the value of the security matches the debt, that secured creditor has no vote. Alternatively, such a creditor may give up its security for the benefit of all the creditors and vote on the entire debt. The *raison d'être* for these rules may be found in the very nature of the bankruptcy and winding up procedures. These procedures were originally designed solely for the purpose of ensuring a *pari passu* distribution of the debtor's available assets amongst its unsecured creditors. In modern day liquidation proceedings the total dividend, if any, received by an unsecured creditor is generally, a small fraction of the total debt. Secured creditors on the other hand are those who have preferred, or have been able to obtain the exclusive right to seek satisfaction of their debts from certain assets. Hence, these assets stand outside the pool of assets available to unsecured creditors. By having the exclusive right to certain assets the secured creditor often recovers a greater fraction of his debt, if not full payment, compared to the unsecured creditor. Since the secured creditor has no standing to benefit from a dividend pay out in winding up and bankruptcy proceedings it also has no right to influence the conduct of these proceedings by voting at meetings of the creditors.

While this may be true of bankruptcy and winding up, it is submitted that the objectives of a rescue may be wider than those of a bankruptcy procedure and consequently the role and voting rights of a secured creditor in such a procedure should also be viewed differently. As pointed out in Chapter One, the "ideal" rescue" procedure should enable a full rescue of the company with all the creditors being paid in full. If this is not possible it should facilitate the unsecured creditors receiving a greater dividend than would be possible in a winding up. Whether or not either of these objectives is achieved, it should encourage the preservation of the viable aspects of the company's business, provided that a floating charge holder does not receive less than it would have, had a Receiver been appointed, and the unsecured creditors do not receive less than they would have in a liquidation.

The method of dealing with creditors in the new Canadian Proposal procedure is not far removed from the prevailing system in schemes of arrangement to the extent that they allow for an arrangement with secured creditors. In a Canadian Proposal, secured creditors vote up to the full value of their claim but they vote together only so long as they have a commonality of interest in the particular class of secured claim in respect of which the proposal has been made. The advantage here is that where more than one secured creditor has an interest in a particular class of claim the view of a majority in number and two-thirds in value present[287] and voting prevails over the minority. In spite of having the right to vote, the secured creditors have no control over the success of the procedure, since this power is vested solely in the unsecured creditors.

In a CVA there is no question of classifying secured creditors. Each secured creditor's right to enforce his security is sacrosanct and a proposal which affects the right of a secured creditor to enforce his security cannot be approved without the agreement of the secured creditor concerned. The difference which is immediately apparent is the fact that because there is no system of classification, in a case where there are three or more secured creditors with identical interests in the same security it would be necessary to obtain a separate approval from each

287 Either personally or by proxy.

creditor so that that creditor may be bound by the CVA. Whilst this difference appears to be significant, except in the larger cases where there may be a large number of secured creditors with common interests, in the smaller insolvencies, at which the CVA procedure is pitched, it is likely that there will only be a few secured creditors whose interests are in any event likely to be disparate. In this procedure too, the secured creditors have no power to influence the outcome of the rescue.

The provisions of the Australian Voluntary Administration procedure are superficially perhaps the most radical since a secured creditor is entitled to vote in respect of the full amount of its debt rather than the unsecured balance and without any classification being made of the creditors according to the commonality of their interests. The procedure appears even more radical in the light of the simple majorities in number and value of those present and voting required for the approval of the administrator's proposals. In this procedure, secured creditors may influence the outcome of the rescue. This ostensibly simple procedure does not have a dramatic impact on a secured creditor's rights to enforce its security or the rights of a lessor or hirer in respect of its property. As in the case of a CVA such rights may be affected only if the creditor concerned has voted for the resolution. But the significant difference is that even where such a creditor has voted against the execution of a deed of company arrangement which has had the requisite majority support, it is possible to restrain that creditor by way of an application to court.

English Administration restricts secured creditors to the unsecured balance, if any, of their claims and does not provide for such creditors to agree to the variation of their rights. Should a variation be required then it would have to be procured throughout a CVA or a Scheme of Arrangement.

If the success or failure of the procedure rests solely in the hands of the unsecured creditors then, unless the procedure provides for such creditors to receive a better return than is possible in a winding up, they will have little motivation to approve a proposal which only ensures a liquidation dividend but provides for the preservation of the company's business. The preservation of all or part of a company's business is not always synonymous with the unsecured creditors receiving a better return than is possible in a winding up. Often unsecured creditors receive little or no dividend where the company's assets are subject to a floating charge but in such cases a Receiver may be able to save all or part of the company as a going concern. If the secured creditors, including floating charge holders, were able to influence the outcome of the vote then it may be possible to ensure that an arrangement is entered into which provides for preservation of the viable parts of the company's business.

In CVAs and Canadian Proposals, there is no express statement of the objective of the procedure and as such it could be argued that these procedures must be used to ensure a better return for the company's unsecured creditors than would be possible in a winding up. An English Administration on the other hand may be initiated specifically to achieve one or more of the purposes specified in s.8(3) IA 1986 [U.K.]. These purposes include under s.8(3)(a) "the survival of the company, and the whole or any part of its undertaking as a going concern" and under s.8(3)(d) "a more advantageous realisation of the company's assets than would be effected in a winding up." The wording of the section does not indicate that s.8(3)(d) must always be achieved in an English Administration. But, the creditors voting rights are such that the balance of power lies with the unsecured creditors who are able to veto an administrator's proposals unless they provide for the achievement of the purpose specified in s.8(3)(d) IA 1986 [U.K.]. It must be pointed out that the Cork Committee never intended that the English Administration procedure be used where a Receiver could be appointed.

The method of voting at the creditors meeting

On the issue of the method of voting, the new Canadian and particularly the Australian procedures acknowledge that provision should be made for more "creditor friendly" and technologically advanced methods of voting. The Canadian "voting letter" appears to address the problem of having to appoint a proxy for the purpose of voting. It is no doubt cheaper and is perhaps the most efficient system where there are a large number of creditors. It also obviates the need to appoint a proxy. The drawbacks are that it does not provide a mechanism for ascertaining the creditor's views on unanticipated matters which may arise at the meeting itself such as an amendment to the proposal.

The Australian system is more advanced since it provides for creditors to be "present" from a remote location by way of a telephonic link. As such, unanticipated matters which arise at the meeting may be dealt with by the creditors themselves. Voting which is carried on "the voices" obviates the need for telephonic voters to join in a show of hands.

So far there has been no report of any difficulties associated with the new voting systems. The systems do not make use of radical new technology, telephones having been around for a considerable period of time. What the adoption of the new voting systems demonstrates is a willingness on the part of the Canadian and Australian draughtsmen to look at new systems and to adapt to the changing needs of modern creditors.

Classification of creditors

Except in a receivership, the ideal result in a rescue would be a contractual arrangement between the company and its creditors which ensures both the continued survival of the company and a full repayment of the creditors. Lesser objectives may also be achieved by means of an agreement. Ever since the schemes of arrangement procedure was introduced in the 19th Century, a specified majority of creditors, usually three fourths, has been able to compel the minority to abide by their decision to accept a proposal by the debtor company. This prevents a sensible proposal for the payment of the company's debts which has the support of the majority from being scuppered by the dissentient majority. Equity demands, however, that a majority view may prevail over the minority only where there is a commonality of interests among the creditors. For this reason it has been and continues to be necessary to classify creditors for voting purposes. The classification process is not easy since it is in the interest of each creditor to try and establish that its interests are unique and shared by no other creditor, or by only a few so that it can either avoid having to toe the line taken by a majority in a large number of creditors or be able to have a significant influence if the numbers in its class is small.

Whilst classification has the advantage of ensuring an equitable treatment of like interests its recognised disadvantages are that it can lead to costly and time consuming litigation initiated by creditors who are dissatisfied with their classification. As the Cork Committee observed there does not seem to be a way round classification. An attempt has been made in the new procedures to dispense with classification, particularly where the unsecured creditors are concerned, by putting them all in one class. In CVAs this has not proved too successful where the unsecured creditors include those with unliquidated claims for damages. Where there is no classification system whereby all unliquidated claims may be classed together it is essential that a fair valuation be given since that is the only protection that such a creditor has against an arrangement which is disadvantageous being thrust upon him. The valuation process in CVAs which authorises a "minimum" valuation at the discretion of the chairman is, it is submitted, more likely to cause problems than a "just estimate of the value" which is what is required in an Australian Voluntary Administration.

The post approval procedure.

Only in Schemes and Canadian Proposals is it necessary to obtain the Court's approval for a proposal after it has been approved by the company's creditors, and in the case of a Scheme may be the members as well. Court involvement has long been considered one of the major delaying factors in a rescue procedure and one of the criticisms levelled at the Schemes of

Arrangement procedure. Hence it is surprising that the new Canadian Proposal procedure requires court approval in addition to approval by the creditors. In marked contrast in CVAs and Australian Voluntary Administration and English Administration the proposal is implemented immediately after the creditors' approval has been obtained, with only notice being given to the court.

In comparison with Schemes of Arrangement, in a Canadian Proposal the court is not required to examine the proposal from the standpoint of what an intelligent and honest man who is a member of the class concerned and acting in his own interest might reasonably approve. In a Canadian Proposal the circumstances in which the approval must or may be refused are described at some length indicating that in the absence of such circumstances the court has no choice but to approve the proposal.

With all the modern rescue regimes dispensing with court involvement the question may be asked why the Canadian draughtsmen decided to remain with Court approvals. The answer perhaps lies in the fact that the Canadian Proposal procedure, particularly under a Notice of Intention is, along with Australian Voluntary Administration, perhaps the easiest and cheapest procedure to initiate. It also has the most far reaching statutory moratorium which includes a stay on the enforcement of a floating charge by a debenture holder and runs until the terms of the approved proposal have been fully performed. It appears that court approval of a proposal which has been already approved by the creditor is an attempt to ensure that the rights of creditors are protected and that a proposal which does not conform with the law and commercial sense is not allowed to continue. What the procedure makes up in a speedy initiation with low cost is likely to be lost through the delays and expense of the court approval process. It may be argued that a quick initiation supported by an effective moratorium is more important than speed at the closing stage of the rescue and that the protection afforded by the court approval process may be said to justify the expense. The most apparent disadvantage in this system is that it does not protect the creditors from an inappropriate initiation and the total costs of the failed proposal will have to be deducted from any dividend payable to the unsecured creditors in the bankruptcy.

CHAPTER EIGHT

REFLECTIONS AND FINAL CONCLUSIONS

8.1. *AN "IDEAL" RESCUE PROCEDURE?*
8.2. *THE STATISTICS*
8.2.1. *Limitations of the English Statistics*
8.2.2. *Limitations of the Canadian Statistics*
8.2.3. *Limitations of the Australian Statistics*
8.2.4. *Conclusions that may be drawn from the available figures*
8.2.5. *The independent surveys*
8.3. *OVERALL COMPARISONS WITH SOME REFERENCE TO THE REVISED PROPOSALS RE CVAS*
8.3.1. *The Proposed New CVA Procedure and the Revised Proposals in outline*
8.3.2. *Making a proposal for a rescue v. Providing an opportunity for a rescue*
8.3.3. *Voluntary v. Hostile Initiation*
8.3.4. *A threshold requirement of viability?*
8.3.5. *The preparation of the proposal*
8.3.6. *The moratorium*
8.3.7. *Management of the company*
8.3.8. *Meetings of the creditors*
8.3.9. *Can the "ideal" rescue be achieved in the context of current procedures?*

AN "IDEAL" RESCUE PROCEDURE?

Is there an "ideal" rescue procedure which facilitates the achievement of all aspects of a "rescue" described in Chapter One? Such a procedure should enable a company in financial difficulties to achieve a complete recovery with all the creditors being paid in full. If it is not possible to pay all the creditors in full, it should enable a better recovery for the company's unsecured creditors than would be possible in a winding up. Whether or not either of these objectives is achieved, provided that any floating charge holder does not recover less than it would have had a Receiver been appointed, and unsecured creditors are not worse off than they would have been in a liquidation, the procedure should facilitate the preservation of viable businesses. In providing for the achievement of any of these aspects of the "ideal" rescue, the procedure should *not* provide a means for the company to liquidate "through the back door" thereby circumventing the powers vested in a liquidator to investigate the company's affairs, avoid certain transactions entered into by the company in a specified period leading up to its insolvency and to bring recovery and/or disqualification proceedings against delinquent directors.

By way of conclusion, it is therefore appropriate to reflect critically on the results of each chapter in the context of the professed objectives, if any, of each rescue regime, examining whether it deals with the various aspects of a rescue in the most efficient manner possible and whether or not any regime may benefit from the principles applied in and techniques used by one or more of the others in achieving the "ideal" status.

But first a look at the statistics.

THE STATISTICS

Original statistical data pertaining to each rescue regime was not gathered for the purpose of this thesis. The reason being that the financial and human resources required for such a task involving three jurisdictions and six procedures, two of which came into force only in 1993, were considerably beyond the writer's means. Nevertheless, it was proposed in the Abstract and Chapter One to examine the official figures published by the regulatory authorities in each jurisdiction.

Tables 1, 2 and 3 in Appendix I list the figures pertaining to the annual use of the various procedures in England and Canada since the year 1983 and in Australia since 1991. Since the figures were never gathered by the relevant regulators with a comparative analysis of foreign procedures in mind, they are of limited use in the comparative context. Even within the context of a particular jurisdiction, however, the figures are not without their limitations, which should be identified before they are considered any further.

Limitations of the English Statistics

The Insolvency Service, out of whose annual reports the corporate insolvency figures for England have been culled, notes that a single company may have been subject to more than one regime. It does not, however, specify the number of times this has occurred within a given year. For example, it is commonplace for a company in receivership to be placed in liquidation. In principle it is possible, although unlikely, for a single company to be subject to almost the whole gamut of the procedures: *i.e.* a company which has gone into receivership, may then go into an administration, which may lead to a CVA and eventually to liquidation. The Insolvency Service also notes that "compulsory liquidation" includes orders made against Partnerships since the Insolvent Partnerships Order 1986.[1] Enquiries from the DTI's Economics and Statistics department have revealed that "Receiverships," include appointments of Administrative Receivers and other receivers such as those appointed under the Law of Property Act 1925, and thus cover both straight forward debt recovery proceedings as well as proceedings under which a "rescue" may have been attempted.[2] It is also not clear whether an appointment to a group of companies

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1 SI 1986 No.2142, replaced by the Insolvent Partnerships Order 1994, SI 1994 No.2421.

2 *n.b.* The annual report make no such concession. *cf.* The figures gathered by the ASC where a (continued...)

counts as one or the multiple of the number of companies within the group.

Limitations of the Canadian Statistics

As regards the Canadian statistics, it should be noted that the figures pertaining to bankruptcy reflect the nature of the BIA [Can.]. Thus, in assessing business bankruptcies, no distinction has been drawn between Companies and unincorporated entities, such as sole proprietorships and partnerships. Whilst a distinction is drawn between businesses and consumers for the purpose of the bankruptcy figures, and notwithstanding the fact that there is a similar distinction in Part III, BIA [Can.], both classes are surveyed together for the purpose of determining the number of Proposals made. Until December 1992 receivership was regarded as a matter of "property and civil rights" and remained outside the BA [Can.] and there was no federal requirement for the notification of the appointment of receivers.[3] With the enactment of a few provisions governing the appointment of receivers in BIA [Can.] in the 1992 reforms, the Canadian Superintendent in Bankruptcy began publishing statistical data on the private appointment of Receivers under a debenture in 1994. Like in England there are no figures on the number of schemes of arrangement entered into between companies and their creditors. This is indeed surprising in the context of the Canadian Schemes under the CCAA [Can.] because that statute applies only in the event of bankruptcy and insolvency and comes within the umbrella of the Superintendent in Bankruptcy. Although there is no similar concession by the Canadian Superintendent in Bankruptcy, clearly some multiple use of the Canadian regimes must occur: for example where a Proposal is made by a bankrupt.

Limitations of the Australian Statistics

Detailed figures pertaining to Australian Insolvency came to be gathered centrally only since 1991 after the Australian Securities Commission (ASC) took over the Australia-wide regulation of all companies and securities legislation.[4] Hitherto, corporate affairs were regulated through a co-operative scheme involving the National Companies and Securities Commission (NCSC) and the regulatory body in each state. Figures pertaining to corporate insolvency and

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2(...continued)
distinction is drawn between Receivers, Receivers and Managers, Controllers and Managing Controllers.

3 See Ziegel, J., "The Privately Appointed Receiver and the Enforcement of Security Interests: Anomaly or Superior Solution?" in Ziegel, J., (Ed) *Current Developments in International and Comparative Corporate Insolvency Law*, Clarendon Press, Oxford, 1994, p.451 at p.457.

4 Pursuant to the Alice Springs Agreement between the Commonwealth and State Law Officers on 20 June 1990.

related procedures appear to have been gathered by the state regulatory authorities with only total figures under the single heading "Receivers, Liquidators and Managers appointed" being published annually by the NCSC. To what extent an uniform effort was made in all the states and territories is unclear, but the Harmer Commission pointed out that the statistics available at the time of its deliberations were "meagre".[5] Since the *Harmer Report* was published however great strides appear to have been made to improve the statistics available for analysis.[6] Table 3 of Appendix I lists the figures pertaining to the use of the various Australian procedures since the ASC took over the responsibility of gathering and publishing such data. These figures cover all the "External Administration" procedures under CL [Aust.] and, to this extent, are more comprehensive than the English and Canadian statistics. The main flaw in the Australian statistics is that the figures that pertain to schemes of arrangement cover both solvent and insolvent schemes.

Conclusions that may be drawn from the available figures

The majority of these annual figures, are only useful to the extent that they demonstrate the number of times the various regimes have been resorted to within a specified period. When read in the context of the other figures in a jurisdiction, this indicates the relative "popularity" of each procedure. On this basis it is clear that those which relate to Australian Voluntary Administration are indeed "healthy". In any event, in comparison to English Administrations and Company Voluntary Arrangements, Australian Voluntary Administrations appear to be enjoying a higher initiation rate. It is difficult to assess the Canadian position because as mentioned the figures appearing in the annual assessment by the Canadian Superintendent in Bankruptcy do not distinguish between Business and Consumer Proposals. Thus, although the overall figures for Canadian Proposals are up, one cannot say whether it is the consumers or the businesses that have benefitted most. If the ratio of business to consumer bankruptcies is anything to go by, it could be the consumers. It is encouraging to note that the ASC publishes its records of the number of voluntary administrations which culminate in deeds of company arrangement. There is however no evidence of the "quality" of the deeds, *i.e.* did they result in a better return to the creditors than was possible in a winding up, a saving of the company or its business and employment? At the other extreme, subject to the qualification mentioned above, it may be noted that the

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5 *Harmer Report*, paras.36-42 and 50.

6 Such statistics are not, however, available in the U.K. and, therefore, it has been necessary to turn to other sources.

Australian figures pertaining to schemes of arrangement show only those schemes which have been approved at the meetings, sanctioned by the court and had a scheme administrator appointed. It is not possible, therefore, to compare these figures with the other Australian figures. Nevertheless, on the whole, these Australian figures are an improvement on the official figures available in England and Canada since neither of these figures shed any light on the extent to which the non liquidation procedures have been successful by being able to achieve the objectives for which they were initiated in the first instance. The Canadian Superintendent in Bankruptcy does publish figures concerning the estates closed within a particular year together with the total dividend paid out. These figures are not, however, correlated with the number of procedures which were initiated during the same period. Thus, in the light of available official empirical evidence on the use of these rescue procedures in Australia, Canada and England, it is impossible to say with any certainty whether each rescue regime addresses and eventually achieves its desired objectives.

The independent surveys

In addition to the official statistics, the results of two surveys carried out by the associations of insolvency practitioners in England and Australia became available in 1994.[7] The interim results of a survey undertaken by Prof. Rajak were also published in 1994.[8] These surveys perhaps throw more light on the relative success or failure of the regimes under consideration than do the official figures.

OVERALL COMPARISONS INCLUDING CONSIDERATION OF THE REVISED PROPOSALS RE CVAS

In April 1995, the Insolvency Service published its *Revised Proposals for a New Company Voluntary Arrangement Procedure,* (hereafter the *"Revised Proposals"*) which were based on the responses received in respect of its first Consultative Document published in October 1993.[9] Since these *Revised Proposals* have not been treated in the preceding discussions it would be appropriate to consider them at this stage in the light of the comparative conclusions to be expressed concerning the current regimes.

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7 See The Society of Practitioners of Insolvency in *Company Insolvency in the United Kingdom: The Third SPI Survey*, London, 1994; and the Australian Society of CPAs Survey *The first Year of Voluntary Administration.*

8 Rajak, H., "The Challenges of Commercial Reorganization in Insolvency: Empirical Evidence From England" in Ziegel, J.S. (ed) *Current Developments in International and Comparative Corporate Insolvency Law* Clarendon Press, Oxford, 1994, p.191.

9 Insolvency Service, *Consultative Document,* October, 1993.

The *Revised Proposals* are restricted to CVAs and no mention is made of the "Proposed Additional Administration Procedure" set out in the first Consultative Document. Regarding CVAs, the *Revised Proposals* are largely based on the recommendations already made, but with more attention to detail.[10] The draughtsmen of the New CVA procedure appear to have been considerably influenced by the procedure leading to a Proposal under a Notice of Intention in Part III, BIA [Can.]. The new Voluntary Administration procedure under Part 5.3A of CL [Aust.] does not appear to have had a similar impact. The Canadian experience in the implementation of various aspects of the Proposal regime may throw some light on the manner in which the proposed new procedure may be expected to be received and applied in England.

The Proposed New CVA Procedure and the Revised Proposals in outline

For the purpose of initiating the proposed new procedure, the directors of a company will be required to approach an insolvency practitioner, who, if all goes well, will be the nominee in the CVA, and ask him to assess whether the company is suitable for a CVA. The nominee's assessment is to be based on information supplied by the directors. If the intended nominee forms the view that there is a reasonable prospect of a successful CVA and that a moratorium is necessary, then a moratorium can be obtained for the company by filing the following documents in court:

"(a) notice of the prospective CVA;
(b) the prospective nominee's consent to act;
(c) a statement by the directors that the information they have supplied to the nominee is correct and the company had not had an earlier moratorium which had expired or otherwise come to an end in the preceding 12 months;
(d) a statement by the nominee that in his opinion there is a reasonable prospect of a successful CVA and a creditors meeting should be called;
(e) a statement that no administrative receiver, liquidator, administrator or supervisor is in office; and
(f) a statement that adequate funding is available for the period of the moratorium."[11]

On these documents being filed a twenty eight day moratorium will come into force which will prevent any creditor from exercising any enforcement rights against the company and its property without the leave of court. It will also not be possible to wind up the company, voluntarily or compulsorily. The moratorium will not however, alter the rights that are stayed or interfere with the set off of mutual debts and credits on the date it comes into force. Secured

[10] Insolvency Service, *Consultative Document*, October, 1993.

[11] Insolvency Service, *Revised Proposals*, Ch.1, para.3.

creditors will be protected during the twenty eight day period by the prevention of the disposal of any property which is subject to a fixed or floating charge without the consent of the charge holder or the court. If such permission is granted the secured creditor affected acquires a right to proceed against proceeds generated by the sale and, in the event of a shortfall against open market sale value, against any property of the company.

Prior to the moratorium coming to an end, meetings of the company's creditors and shareholders must be held, on fourteen days notice, so that the proposal, as made or amended at the meeting, may be accepted or rejected. The meetings may also resolve to extend the 28 day moratorium period, with or without conditions, up to a maximum of two months. Both secured and unsecured creditors are entitled to vote for the full values of their claims and the majority required to pass any resolution at the meetings is "in excess of 75% in value of all creditors present or represented and entitled to vote.

During the moratorium, the directors of the company remain in control and continue to manage its affairs. Their activities are, however, subject to supervision by the nominee. Additional regulation of the directors' activities takes the form of the threat of criminal sanctions and civil penalties and the creditors and shareholder's right to make an application to court for relief. If at any stage during the moratorium the nominee forms the opinion that a CVA is not a viable proposition, he must withdraw his consent to act. This will bring the procedure to an end.[12]

An aspect of the *Revised Proposals* which impinges more upon the rights of floating charge holders than on the CVA procedure is that which requires such charge holders to give the company five working days notice prior to appointing an administrative receiver. This does not apply where the company concerned has had the benefit of a moratorium in twelve months preceding the appointment.

From the standpoint of the British banking and lending community, this is perhaps the

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12 The *Revised Proposals* expressly state that the proposed new procedure will be available *in addition* to the existing CVA procedure. If this is indeed the case the result will be that there will be two CVA procedures contained in Part I of IA 1986 [U.K.]. Whilst no reasons are given, one may be that the proposed new procedure does not lend itself to an initiation during the course of an English Administration or a liquidation and that, therefore, it is necessary to ensure that the existing procedure remains on the statute book. The Society of Practitioners of Insolvency (SPI) in their response to the *Revised Proposals* take the view among others, that it is certain that the law governing the two regimes will develop on divergent lines. See the Society of Practitioners of Insolvency, *Response of the Society of Practitioners of Insolvency to the Insolvency Service Consultative Document Dated April 1995,* July 1995, pp.1-3. It is submitted that this is a possibility rather than a certainty.

most controversial proposal to emanate from the Consultative Document.[13] While there is no express admission to this effect in the *Revised Proposals* this recommendation appears to be based upon s.244(1) BIA [Can.]. In considering this proposal, it should be borne in mind that the Colter Committee's views on Receivership which were the catalyst of s.244(1) BIA [Can.] were not necessarily on all fours with the views of the Cork Committee. The Colter Committee saw receivership as a hinderance to achieving a better return for the unsecured creditors of the company.[14]

Making a proposal for a rescue v. Providing an opportunity for a rescue

It has been established that the procedures examined during the course of this thesis may be classified in different ways depending on the manner in which certain important aspects of the "rescue" are addressed. One classification which endures more than the others throughout almost every level of the discussion is that which divides the procedures into those which involve the making of a "proposal for a rescue on initiation" and those which simply provide an "opportunity for a rescue on initiation".

In Chapter One it was shown that there were a number of "rescue" regimes which were available under the English Bankruptcy Acts in force during the early days of the registered joint stock company. The common characteristic amongst the majority of these regimes was that they involved the making of a proposal for the reorganization of the insolvent's debts on initiation. The proposal so made had to be accepted by a specified majority of the insolvent's creditors for its implementation. Once accepted, the approved proposal became statutorily binding on the creditors who had voted against the proposal. This technique of reorganizing an insolvent person's debts by means of a statutorily binding arrangement was then applied to the reorganization of the affairs of the pioneering railway companies which became insolvent in the middle of the 19th Century. Only in 1870 was this method of debt reorganization made available to English companies incorporated by registration under the CA 1862 [U.K.]. In time it was adopted by the legislatures in the Australian and Canadian Colonies. Since then, for almost a hundred years in England, Australia and Canada, procedures which involved the making of a proposal for a rescue on initiation remained the only statutory means of achieving a corporate

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13 Insolvency Service, *Revised Proposals* 1995, para.10, p.11. See also Milman, D., "Rescuing Corporate Rescues" (1993) *14 Company Lawyer* 82.

14 See Ziegel, J., "The Privately Appointed Receiver and the Enforcement of Security Interests: Anomaly or Superior Solution" in Ziegel, J., (Ed) *Current Developments in International and Comparative Corporate Insolvency Law*, Clarendon Press, Oxford, 1994, p.451 at 462.

rescue until the adoption of the Official Management procedure in Australia. This procedure did not require the making of a proposal at the initiation stage but merely provided for the "opportunity" for a rescue to be achieved. This alternative method of achieving a rescue involved the control over and management of the company being placed in the hands of an independent person with the hope that the rescue would be achieved through a more efficient management of the company's affairs. Consequently, this procedure may also be referred to as a "change in management" regime. Around this time the rescue potential of private Receivership and Managership, which involved a change in management, also appears to have been exploited. When insolvency law became the subject of reform in these three jurisdictions and a number of new regimes were created, the distinction between making a proposal for a rescue on initiation and merely providing an opportunity for a rescue at that stage was maintained. The reformers, however did not hesitate to borrow features from both systems. Thus, some of the post reform regimes provided an "opportunity" to make a "proposal" for a rescue.

The modern procedures involving the making of a "proposal for a rescue on initiation" are Schemes of Arrangement, CVAs and Canadian Proposals.[15] Those regimes which provide an "opportunity for a rescue on initiation" are Canadian Proposals under a Notice of Intention, English Administration, Australian Voluntary Administration and Receiverships. With the exception of Receivership, the "opportunity for a rescue on initiation" regimes would, if successful, usually culminate in a proposal being made to and approved by the creditors.[16] Other than in a Canadian Proposal under a Notice of Intention, the "opportunity" based regimes also involve "management" of the company being taken over by an independent person.

The modern trend in all three jurisdictions appears to be moving away from preparing a proposal for a rescue on initiation towards providing an opportunity for a rescue on initiation. Under the *Revised Proposals*, since one of the documents filed by the nominee gives notice of a "prospective" CVA, the proposed new regime *appears* to be one which provides an "opportunity

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15 *n.b.* There have been instances where Canadian Courts have made orders commencing the procedure leading to a scheme of arrangement under the CCAA [Can.] without a proposal being formulated. This shows a willingness on the part of the Canadian Courts, to take a purposive view of the law in keeping with contemporary views on rescue laws.

16 The English administrative receiver is required to prepare a report covering the disposal and proposed disposal of the company's property and the carrying on and proposed carrying on of the company's business. See s.48 IA 1986 [U.K.]. It shows that IA 1986 [U.K.] expects the administrative receiver to carry out his functions in a methodical and planned manner. Nevertheless, the administrative receiver is not required to obtain the debenture holder's or any other creditor's approval before implementing his plans.

for a rescue on initiation". Whether the draughtsman of the proposal will be able enjoy the luxury of the 28 day moratorium to perform this task is less certain and in reality the procedure may require the formulation of some form of a proposal before initiation. (See below.)

Voluntary v. Hostile Initiation

All the procedures excluding Receivership statutorily provide for voluntarily initiation. But, even a Receiver may be appointed at the invitation of the company to the charge holder. A speedy and successful initiation and rescue of a company would ordinarily require a good knowledge of the state of the company's finances and affairs. Such an understanding would be more easily obtained where the initiation is voluntary as opposed to hostile. The proposed new CVA procedure will be more of a voluntary procedure than the existing procedure for the reason that only the directors will have the right to approach the nominee.

A threshold requirement of viability?

Unlike the Harmer Commission, the Tassé, Cork, and Colter Committees expressed the view that a rescue procedure should be available to a company only where all or part of its business is viable. Such a threshold requirement of viability of the company's *business* is not, however, expressly required in any of the current regimes. In the Administration Order Procedure it is only necessary to satisfy the court that the making of an order would be likely to achieve any one or more of the purposes for whose achievement the order may be made. Since the these purposes cover more than the complete rehabilitation of a company or its business, what must be established is whether the achievement of these objectives is viable. In a Canadian Proposal under a Notice of Intention, the trustee is required to review the company's cash flow statement for its reasonableness only after the procedure has been initiated. In contrast, under the *Revised Proposals* for the new CVA procedure, it appears that a threshold requirement of a "viable" business or part of a business will have to be established[17] Companies whose businesses, in whole or in part, are not viable and which are bound to fail are to be filtered out by an "independent assessment" carried out by the proposed nominee.

The statement which the *Revised Proposals* expect the proposed nominee to prepare, appear to proceed on slightly different lines. The nominee must determine whether a CVA is a viable proposition and a moratorium is appropriate in the particular circumstances of the company and file a statement with the court to that effect that "in his opinion there is a reasonable prospect of a *successful* CVA" (italics added). This "independent assessment" and "statement" looks

[17] Insolvency Service, *Revised Proposals*, 1995, para.1.2, p.7.

suspiciously like the rule 2.2 report in the Administration Order procedure[18] which the Insolvency Service was so keen to dispense with in its first Consultative Document.[19] The proposed nominee's statement however, goes further than the r.2.2 report. Whilst he is required to decide whether the new CVA procedure is appropriate in the circumstances in which the company is placed, he must, according to the statement which he is required to file, take a reasoned view of the outcome of the meetings of the creditors and the shareholders. Although, the *Revised Proposals* explain that the "nominee does not need to undertake an investigation in order to determine whether CVA is suitable, there is nevertheless an obligation placed upon him to base his decision on "any negotiations he considers appropriate with the company's bankers, major creditors and suppliers and the availability of funding."[20] It is clear that the nominee will not be able to determine whether there is a reasonable prospect of a successful CVA purely on the information supplied to him by the directors.[21] Such a decision would have to be based on the nominee's own opinion, formed during his initial assessment, of the manner in which the creditors may be expected to vote.

There appears to be a significant difference between the purpose for which his assessment is carried out, as expressed in the *Revised Proposals*, and the content of the statement which may be filed by the nominee. The former is concerned with restricting the procedure to companies with wholly or partially "viable" businesses. The latter with the likelihood of the procedure's success. If both are read together, the statement would relate to the prospects of a successful CVA where the company's business is wholly or partially viable. It has been noted that "viability" of the whole or part of a business is not necessarily synonymous with an increased return to the unsecured creditors. A CVA which provides for the viable parts of a company to

18 The r.2.2 report is to the effect that the appointment of an administrator for the company is expedient.

19 "[T]he demand for a report is usually seen as a distinct handicap, imposing lengthy obligations on the company and the IP and indeed the Court." (at para.5.2) The Insolvency Service observed that "There is not in most cases considered to be a significant difference between the cost of preparing a Rule 2.2 report and that of preparing a proposal to the creditors" (at para.5.3). Thus the DTI proposed that "[T]here should be a modified procedure which would provide for the appointment of a administrator and for a moratorium without the necessity of a lengthy court application and a formal independent report. (known as the Rule 2.2 report)." (at para 6.1) - Insolvency Service *Consultative Document* October 1993.

20 Insolvency Service *Revised Proposals* 1995, para.3, p.7.

21 The directors will be required to make a statement that any such information is true and will face penalties for providing false and misleading information. Insolvency Service *Revised Proposals* 1995, para.4, p.9.

be saved may yet fail to achieve the relevant majority if there is no increased return to the creditors.

It may be recalled that a Canadian Trustee under a Notice of Intention only reviews the company's cash flow statement for its reasonableness. Based on information furnished to him by the company, he forms a view whether or not the company may be reasonably expected to continue in business for the duration of the rescue. Although he is also intimately involved in the preparation of the proposal which is filed, he is not required to venture to form an opinion on the manner in which the creditors may be expected to vote at the meeting of the creditors. Indeed there have been cases where a secured creditor holding sufficient votes to veto a proposal has sought successfully to prevent a proposal under a Notice of Intention being filed.[22] By asking the proposed nominee to determine whether the prospective CVA will be *successful*, it appears that the Insolvency Service wishes to guard against such an eventuality.

It is also possible that the proposed nominee will be unlikely to be able to form a view on the success of the proposed CVA without it being in an advanced stage of preparation with its more important terms worked out. If a successful CVA does not materialise at the end of the procedure, and the creditors lose more than they would have, had the company gone straight into liquidation, could any one of the affected creditors, perhaps even the holder of any floating charge over the company, sue the nominee if it can be established that there was no reasonable prospect of the successful CVA at the time the nominee made his decision? Alternatively, if the nominee decides that there is no reasonable prospect of a successful CVA without consulting the creditors, could one of the shareholders sue him for unreasonably refusing to consent to act as the nominee and thereby denying the company the opportunity to enter into a CVA? It should be borne in mind that in a large number of cases, if not the greater majority, the proposed nominee will be required to act within a five day period.[23] Thus, although the procedure has the appearance of being in the category of regimes which provide an opportunity for a rescue on initiation, in practice, it will bear strong resemblance to the regimes which involve the making of a proposal at that stage.

The proposed nominee's costs in making the assessment

If the nominee determines that the company does not have a wholly or partly viable

22 See *Re Cumberland Trading Inc.*, (1994) 23 C.B.R. (3d) 225, the dictum of Farley J.

23 On the basis that the holder of a floating charge has given the company notice of its intention to enforce the charge.

business and a viable proposal could not be made the procedure appears to come to an end. No moratorium comes into effect and the company would presumably enter a terminal insolvency regime such as a receivership or a winding up. The *Revised Proposals* make no provision for the nominee's costs in making an "independent assessment" to be payable in preference to other creditors in the administrative receivership or the winding up. Obviously, no prudent insolvency practitioner would wish to run the risk of recovering his costs in such a manner and it is to be expected that the nominee will demand that his or her costs be paid in advance before the nominee makes his assessment.

The preparation of the proposal

Except in a Receivership,[24] a rescue, if any, is achieved through the implementation of a proposal which is made to and approved by the company's creditors, and in some cases its members as well. The proposal may be prepared by the directors of the company or by an independent insolvency practitioner. If the identity of the person charged with the responsibility of preparing the proposal is considered, the level of acceptance of the two categories of procedure, vary between the three jurisdictions. In Canada the only statutory means of achieving a "rescue" is through a proposal prepared by the directors. Australia gives greater emphasis to a proposal prepared by an independent person who takes over the management of the company. England appears to stand firmly between the two by having four statutory rescue regimes divided equally between each method. In practice, however, the balance in England has so far been tipped in favour of proposals prepared and rescues carried out by an independent person.

Limitations of a proposal based on the identity of its author

Whether prepared by the directors or an independent person, provided it is viable, a proposal is clearly a legitimate means of achieving some if not all aspects of the "ideal rescue". In the context of insolvent companies, the question that arises is whether the proposal prepared by one of these categories of person is better suited to achieving a "rescue" than the other with the least risk of leaving unsecured creditors worse off than in a liquidation. In other words, is a "viable" proposal more likely to be made by the directors or an independent person?

Once a company is insolvent, it is now recognised that its shareholders cease to have any interest in its assets. The assets are held by the company not for its own benefit but the benefit of the company's creditors. The shareholders' interest in the assets would, at most, be limited to

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24 See ftn.16, *supra*.

a right to redeem the assets by paying off the company's debts.[25] Thus, unless it is possible to engineer a complete turn around of the company's fortunes resulting in a return to solvency (*i.e.* the "pure rescue" described in Chapter One), the shareholders, would not benefit by any proposal prepared by the directors. The directors would also be in a similar position, except to the extent that they may benefit in the short term by continuing to receive payment of salary and other emoluments for the duration of the rescue.[26] In these circumstances what interest do the shareholders and the directors have in trying to achieve the best recovery possible for the creditors out of the company's insufficient assets? There is a risk that the directors may prefer to make a Proposal directed at a complete turn around even when the company's assets do not merit such action.[27]

The procedures leading to a CVA and a Canadian Proposal, with and without a Notice of Intention, attempt to avoid such result. The CVA requires a nominee to examine the Proposal and to file a report in court stating whether he is of the view that a meeting of the creditors should be summoned to consider the proposal. In Canada, under a Notice of Intention, the trustee is required to advise on and assist in the preparation of the Proposal. The trustee also has to monitor the company's affairs and notify the Official Receiver of any material adverse change in the company's cash-flow. This duty applies whether or not Notice of Intention to make a Proposal has been given. Such supervision and monitoring in a CVA and a Canadian Proposal *without a Notice of Intention* do not protect the creditors against the cost incurred in preparing an inappropriate proposal. They only serve as an early warning that the procedure which has been made is not viable and should be abandoned.

The alternative to the director made proposals are those that have been prepared by an independent insolvency practitioner. English Administration and Australian Voluntary Administration both provide for an administrator to examine the affairs of the company and to formulate proposals to be voted on by the creditors. The independent status of the administrator should, in theory, ensure that the creditors' interests are maintained as paramount in a proposal

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25 Where the company is not yet insolvent, the shareholders and directors may have a greater interest in its affairs but the shareholders' interest is relative to the likelihood of insolvency.

26 The directors would be particularly interested in initiating a rescue where they remain in control, where the company is protected by a moratorium. The risk of abuse in this manner has been recognised by the Insolvency Service in its *Consultative Document*, October, 1993, at para.2.4.

27 It is possible that in initiating the rescue the directors are only concerned in ensuring that they do not expose themselves to any personal liability to contribute to the company's assets in the event of a liquidation.

which is prepared in respect of a company which is insolvent. If the administrator takes the view that a "rescue" would result in the creditors being worse off than in a liquidation, no proposal would be prepared and the procedure would be brought to an end immediately. A common feature in both these regimes is that the administrator is given the power to take into his possession and control the business property and affairs of the company. There is consequently, no risk of the directors misusing the assets during the moratorium.

The question that remains to be answered is whether the "administrator" made proposal is likely to be cheaper and provide greater protection to the creditors than the proposal made by the directors? The independence of the insolvency practitioner may guarantee, at least in principle, that the creditors will not have to suffer the expense of an inappropriate proposal being made. But as the administrators in both regimes are required to be professional insolvency practitioners, this type of procedure will not be without its expenses. The creditors will only be able to avert the risk of an unsatisfactory proposal at the cost of having an independent person examine the company's affairs. It may be argued that a proposal prepared by the directors would almost invariably have required professional assistance. The cost of obtaining such assistance, may, to some extent at least, be off set against the costs of an independent insolvency practitioner examining the company's affairs for the purpose of deciding on the most appropriate course of action. If the management of the company's affairs is also placed in the hands of the independent person, that cost would also have to be added to the cost of preparing the proposal.

An attempt at a more cost effective method of ensuring an appropriate proposal appears to be the Canadian Proposal *under a Notice of Intention* where the *trustee's* costs are kept to the minimum by involving him only in a supervisory and auxiliary role. The cost of preparing a proposal would be avoided if the trustee refused to certify as reasonable the cash-flow statement prepared by the directors, since this would mean that the company is unable to continue in business for the duration of the proposal. As there is a mandatory requirement that the trustee should assist in the preparation of the proposal there is also some assurance that the proposal that is prepared will be fair and reasonable. Having the trustee involved in a mere auxiliary capacity, may not necessarily result in a reduction in the cost of preparing the proposal. If the company employs its own financial and legal advisers, the total cost of the proposal may be more than if prepared solely by the trustee.

The *Revised Proposals* for the New CVA procedure do not impose any obligation upon the nominee to take responsibility for the preparation of the proposal and in the event of no such provision being made it will be the directors who will have to perform this task. If the proposal is prepared during the moratorium period, they would be subject to the nominee's supervision. Since the nominee is required to determine that there is a reasonable prospect of a successful CVA, once his statement has been filed, in the majority of cases, there should be no reason for a non-viable proposal to be made. As pointed out earlier, however, it is unlikely that the proposed nominee will be able to discharge his pre-initiation duties without the proposal for the CVA being at an advanced stage of preparation. The *Revised Proposals*, nevertheless provide for the nominee, during the 28 day moratorium before the proposal is filed, to come to the conclusion that "a CVA is no longer a viable proposition.[28]

Despite these checks against the preparation and balances, there is no guarantee that even if a viable proposal is prepared by the directors or an appointed person, that it will receive the approval of the creditors. For example, there have been instances where proposals were made by Canadian Companies which were terminated by secured creditors before they were voted upon on the grounds that the proposals had no likelihood of success.[29]

The moratorium

The moratorium, which was the most significant feature pressed for and incorporated into legislation during the reform process in the '80s, appears to have now established itself as an integral part of modern rescue regimes. If the current proposals for a new CVA procedure are adopted it will be a part of all post-reform rescue regimes. There is also near uniformity in the nature of the moratoria in the modern rescues. Secured creditors who hitherto managed to stand outside bankruptcy and insolvency procedures have now been made to participate in a limited manner in a collective procedure.

There is also a consensus that the moratorium should not be absolute and that creditors and various categories of persons affected by it should be able to challenge the moratorium if it appears that their position is being prejudiced or that the company/directors are abusing the procedure and the protection of the moratorium.

The moratorium that comes into force under the proposed new CVA procedure is almost identical to the stay which is imposed by s.11(3) IA 1986 [U.K.]. The notable difference is that the nominee, unlike the English Administrator, has no authority to give leave to a person affected by stay to act as if it did not apply.

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28 Insolvency Service *Revised Proposals* 1995, para.32, p19.

29 See *Re Cumberland Trading Inc.,* (1994) 23 C.B.R. (3d) 225; *Re Triangle Drugs Inc.* (1993) 16 C.B.R. (3d) 1; *cf. Re N.T.W. Management Group Ltd.,* (1993) 19 C.B.R. (3d) 162 (Ont.Bktcy.) See also the discussion at p.239 *supra.*

While the proposed new CVA procedure in England appears to be modelled on the Canadian Proposal under a Notice of Intention, there is nonetheless a crucial difference. The Canadian procedure begins with the filing of the Notice of Intention which triggers the moratorium. The trustee has no statutory role to play until the company's cash flow statement is furnished to him. In the new CVA procedure the Nominee appears to be statutorily involved at a much earlier stage, making a statement that "in his opinion there is a reasonable prospect of a successful CVA and a creditors' meeting should be called". But it is only after such a statement is made by the English nominee that the moratorium takes effect. The absence of a moratorium during this stage of the proposed new CVA procedure has important consequences for a floating charge holder and the company. A floating charge holder may be affected since it cannot appoint an administrative receiver without giving five working days notice to the company. The *Revised Proposals* expressly recognise that other creditors will not be affected in a similar manner. It argues that since the floating charge holder's notice to the company will not be advertised, creditors and others should not be in a position to take undue advantage, and that most creditors will not be in a position to act precipitately without taking some other form of action to attach the company's assets.[30] During this period the company will also be restrained from disposing of assets other than in the ordinary course of business. This means that ordinary payments out of the company's current accounts will not be affected. If the current accounts are held with the floating charge holder any attempts to delay payments until the five day notice period elapses is likely to arouse suspicion. The company's consultation with the proposed nominee during these five days will have to be shrouded in secrecy for at risk are the company's contractual arrangements which may be terminated and the viability of its business affected. Whether the lack of a moratorium will drive up the costs of initiating the procedure remains to be seen.

Management of the company

After the initiation of a rescue procedure, the management of the company may remain in the hands of the directors, with or without supervision, or be placed in the hands of an independent person.

A common characteristic among the procedures in which the plan is prepared by the directors is that, throughout their duration, (*i.e.* until the plan is accepted or rejected by the creditors) the directors usually remain in control of the companies affairs. It may be argued in favour of these "debtor in possession" regimes that the persons most familiar with the company's

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30 Insolvency Service *Revised Proposals* 1995, para.16, p.13.

affairs would be better placed to run the company efficiently with the least wastage and diminution of assets than an outsider, however competent, who may be unfamiliar with the customs and practice of the business in which the company is engaged. Whilst this may hold true in the case of a company whose directors and/or managers are not themselves responsible for the company's insolvency, where they are, the creditors are more likely to be worse off if they remained in place. The risk is exacerbated if the creditors' hands are stayed by a moratorium.

The procedure leading to a Canadian Proposal, both with and without a Notice of Intention, seek to address the risk to which the creditors are exposed by involving the trustee in monitoring and actively investigating the affairs of the company. The proposed new CVA procedure follows the example of the Canadian procedure and the nominee under the CVA will be obliged to supervise the company during the procedure. The *Revised Proposals* refrain from prescribing a common level of supervision on the grounds that this will vary from case to case and be determined by the circumstances.[31] Nevertheless it prescribes a base level of *supervision* which requires only the scrutiny of weekly management accounts by the nominee. Based on this supervision, the nominee will have the power to withdraw his consent to act as nominee if he takes the view that a successful CVA will be unlikely. If he does so the moratorium comes to an end.[32]

Where there is a "change in management", as the description implies, the directors lose their power to control the company's affairs and are effectively replaced by an independent person who, in all the regimes today, is an insolvency practitioner. In such procedures there is no risk of the directors misusing the company's assets.

The administrator appointed in an English Administration and an Australian Voluntary Administration have the power to carry on the company's business for the duration of the procedure in a manner similar to a Receiver under a floating charge. One of the differences between the Receiver and both types of administrator is that the former may, subject to the liabilities to which he may be exposing himself, continue to manage the company until the result desired by him is achieved or has been proved to be incapable of achievement. In contrast, the English and Australian administrators are, in the first instance, able to carry on the company's business only until their proposals have been formulated and voted upon by the creditors. The administrator is limited by having to manage the business in accordance with the directions given

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31 Insolvency Service *Revised Proposals* 1995, para.26.1, p.17.

32 *n.b.* No provision is made for the procedure to move smoothly into another insolvency procedure.

by court. The continuation of the company's business thereafter depends on the outcome of the meeting. In principle the creditors may approve a proposal under which the administrator[33] continues to manage the company's affairs.

Although English Administration and Australian Voluntary Administration have to some extent been modelled on Receivership, they essentially centre around proposals prepared by an independent person as opposed to the directors. The questions to be answered are whether the cost of placing a professional in charge of the management of a company is viable where it is clear that he has very little time, unlike in a Receivership to effect a rescue through the managerial process?

In the case of an English Administrator, since the period within which the administrator must formulate his proposal is limited, in the absence of adequate resources and an extension of the three month period within which he must prepare his proposal, an English Administrator would have little opportunity to utilise the various special powers conferred upon him for the purpose of swelling the assets within his control in the administration.

Meetings of the creditors

The success of a corporate rescue based upon a proposal is dependant upon its approval by creditors entitled to vote for that purpose at a meeting of the creditors. The ability of a proposal based rescue regime to achieve all aspects of the "ideal rescue" is affected by the identity of the creditors who are enfranchised and the extent to which their votes are taken in to account in determining whether the proposal has been approved. Where only the company's unsecured creditors' votes are taken into account even if all or part of the company's business may be viable, unless the proposal provides for unsecured creditors to receive a better pay out than they would have received in a liquidation, such creditors have no real incentive to vote for its approval.

In CVAs, and English Administration only votes in respect of unsecured claims are taken into account in determining whether the proposal has been approved or not. In a Canadian Proposal, whilst secured creditors are able to vote the debtor company is deemed to have made an assignment in bankruptcy if the unsecured creditors reject the proposal. Only in an Australian Voluntary Administration, and Schemes of Arrangement are secured and unsecured creditors able to vote. For this reason, even if there is a good possibility that all or part of a company's business may be preserved, there is a risk that a proposal in a CVA, English Administration or

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33 The Deed Administrator in Australia.

Canadian Proposal may be rejected.

The *Revised Proposals* provide for the secured creditors of a company to vote for the full amount of their claims observing that "If the secured creditor is persuaded that a CVA offers the best solution, then it should have no reason not to vote in favour of the proposal".[34] The primary purpose of enfranchising the secured creditor appears to be to give it a say on any possible extension to the moratorium which is a achieved by the agreement of the creditors. Depending on the extent of the secured creditors' claims it may be possible to obtain approval for a proposal which, although it does not provide for a better return to the company's unsecured creditors, nevertheless ensures the preservation of the viable parts of its business. The views of secured creditors also matter in an Australian Voluntary Administration.

Can the "ideal" rescue be achieved in the context of current procedures?

Rather than being an "ideal" procedure, each of the current procedures available in Australia, Canada and England may be more successful in achieving certain *aspects* of the "ideal" rescue" procedure. The question that arises is whether any of them, nevertheless, facilitate the achievement of all aspects of the "ideal" procedure? If not, as all three jurisdictions have more than one type of "rescue" procedure on the statute books, subject always to the overriding considerations of cost, is it possible, to achieve, or attempt to achieve, by the judicious combination of procedures, the most appropriate aspect of the "ideal" rescue procedure?

The "proposal" based procedures are best used to accomplish a complete reversal of the company's financial affairs or to provide a better return to the unsecured creditors than would be possible in a winding up. If the proposal is made by the directors it is possible that it may be biased in favour of preserving the company as a going concern. From the unsecured creditors' point of view, a businesses would be more likely to be saved through a statutorily binding arrangement only if a better return, than would be available in a liquidation, is forthcoming.

In an English Administration, which requires the administrator's proposal to be approved by the company's unsecured creditors, there is nevertheless a slim prospect of the business being saved even if the proposal is rejected by the creditors. This is because the rejection of the proposal does not automatically bring the English Administration to an end. The English Administrator continues in office until the court makes an order discharging the administration. The extent to which he may continue to manage the company is unclear, but, in principle, the English Administration procedure may yet be successful in preserving a business after the

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34 Insolvency Service *Revised Proposals* 1995, para.21. p.15.

proposal has been rejected. As the statutory position is not entirely clear, an application to court would be necessary and there will be a cost attached to achieving this ideal. An Australian Voluntary Administration may also be successful in achieving such a result since the views of secured creditors are taken into account when the Australian Administrator's proposals are considered. If the secured creditors vote for a deed of company arrangement to be executed, the Deed Administrator may yet be able to manage the company towards preserving the company's business.

Whilst acting as a debt-recovery procedure for the benefit of a single creditor, Receivership may be more successful at saving businesses because there is no necessity to provide for a better return to the unsecured creditors than would be possible in a winding up. Indeed a business may be saved through a Receivership even though the unsecured creditors receive nothing. As a Receiver is not obliged to ensure that the unsecured creditors receive any payment, in principle the floating charge should give way to a procedure which attempts at the very least to procure a better return for the unsecured creditors. If so the floating charge holder should be adequately protected so that its position is not detrimentally affected thereby. The current law in England and Australia does not encourage the pursuit of a better return for a company's unsecured creditors in this manner, because the floating charge holder is able to prevent the initiation of a "proposal" based rescue. Both English Administration and Australian Voluntary Administration may be avoided or curtailed in favour of Receivership.

In Canada, the position is different, as the floating charge holder must give notice to the company ten days before the charge is enforced, giving the company an opportunity to make a proposal to its creditors. The fact that the proposal must be prepared by the directors may limit its scope to preserving the company as a going concern. As, the procedure leading to a proposal under a Notice of Intention does not necessarily enable the achievement of all the aspects of the "ideal" rescue, it is important to ascertain early whether a viable proposal may be made by the company. If the proposal is not viable it is important to be able to pursue the other aspects of the "ideal" rescue. An opportunity to do so arises if the trustee does not consider the company's cash-flow statement to be reasonable. In this event, the debtor is immediately considered to have made an assignment in bankruptcy and the trustee in bankruptcy may pursue such aspects of the "ideal" rescue as remain.[35] Alternatively, the floating charge holder may appoint a Receiver. The Receiver will not, however, enjoy the same extensive moratorium which applied during the

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35 See the discussion at p.306 *supra*.

procedure under the Notice of Intention. Although the trustee in bankruptcy has the power to carry on the business of the company he only enjoys a limited moratorium compared with the trustee under a Notice of Intention. As pointed out above, the making of a viable proposal is no guarantee of its acceptance. It is therefore, possible that it may be refused by the creditors in which event the company is placed in the position of having made an assignment. Where there is no floating charge, the prospects of achieving the other aspects of the "ideal" rescue are reduced.

If all aspects of the *Revised Proposals* of the Insolvency Service are enacted, there appears to be a possibility of achieving more aspects of the "ideal" rescue, than is currently possible in England, since there will be a stay on the floating charge holder's right to appoint a Receiver. If the procedure fails and a proposal is not made, the moratorium would come to an end. The holder of the floating charge would then have the opportunity to appoint a receiver thereby putting in place a procedure which enables the preservation of viable businesses. If there is no floating charge, although the revised proposals do not provide for the company to proceed automatically into liquidation there is every likelihood that it will. In such circumstances, if viable parts of a company's business are to be preserved, the English liquidators will have to seek the courts permission to carry on the company's business in a limited manner.

APPENDIX I
TABLE 1
CORPORATE INSOLVENCY PROCEEDINGS - ENGLAND AND WALES: 1983 - 1994

TYPE OF PROCEEDING	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Compulsory Liquidations	4,807	5,260	5,761	5,204	4,116	3,667	4,020	5,977	8,368	9,734	8,361	6,597
Creditors Voluntary Liquidations	8,599	8,461	9,137	9,201	7,323	5,760	6,436	9,074	13,459	14,691	12,464	10,131
TOTAL LIQUIDATIONS	13,406	13,721	14,896	14,405	11,439	9,427	10,456	15,051	21,827	24,425	20,825	16,728
Receiverships	2,828	2,116	1,944	1,905	1,265	1,094	1,706	4,318	7,515	8,324	5,362	3,877
Administration					131	198	135	211	206	179	112	159
Company Voluntary Arrangements					21	47	43	58	137	76	134	264
TOTAL OTHER PROCEEDINGS	2,828	2,116	1,944	1,905	1,417	1,339	1,884	4,787	7,858	8,579	5,608	4,300
TOTAL OF ALL PROCEEDINGS	16,234	15,837	16,840	16,310	12,856	10,766	12,340	19,838	29,685	33,004	26,433	21,028

n.b. - Figures do not include Schemes of Arrangement entered into under the CA 1985 [U.K.].
- Some companies were subject to more than one proceeding. Compulsory liquidations also include some orders made against partnerships under the Insolvent Partnerships Order, 1986.
- Grey shaded area indicates that the procedure was not available.

Source - Department of Trade and Industry, *Insolvency, General Annual Report,* (Presented by the Insolvency Service), HMSO, 1987, 1989, 1994.

TABLE 2
CANADIAN BANKRUPTCY STATISTICS 1983 - 1993

TYPE OF PROCEEDING	1983	1984	1985	1986	1987	1988	1989	1990	1991	1992	1993	1994
Business Bankruptcies	10,210	9,578	8,663	8,502	7,659	8,031	8,664	11,642	13,496	14,317	12,527	N/D
Consumer bankruptcies	26,882	22,022	19,752	21,756	24,384	25,817	29,202	42,782	62,277	61,822	54,456	N/D
TOTAL BANKRUPTCIES	37,092	31,600	28,415	30,258	32,042	33,848	37,866	54,424	75,773	76,139	66,983	N/D
Proposals	470	389	402	543	633	585	570	855	1,239	1,133	2,314	N/D
Private Receiverships	N/D	N/D	N/D	N/D	N/D	N/D	N/D	N/D	N/D	N/D	1,562	N/D
TOTAL NON BANKRUPTCY PROCEEDINGS	470	389	402	543	633	585	570	855	1,239	1,133	3,876	N/D
TOTAL OF ALL PROCEEDINGS	37,562	31,989	28,817	30,801	32,675	34,433	38,436	55,279	77,012	77,272	70,859	N/D

n.b. - Figures do not include Schemes of Arrangement entered into under the CCAA [Can.]
- Data on Receiverships published only since 1994.

DEFINITIONS:
Consumer Bankruptcy - A bankruptcy where an individual has not incurred liabilities as a result of a business venture or where the liabilities attributable thereto consists of less than 50% of the total liabilities owed.
Business Bankruptcy - A bankruptcy which is mainly attributed to liabilities incurred while carrying on a business. It is not restricted to limited companies and includes proprietorships and partnerships as well.
Proposal - Includes both Consumer and Business Proposals under BA [Can.]. Does not include Schemes under CCAA [Can.].
N/D - No data

SOURCE:Consumer and Corporate Affairs (The Superintendent of Bankruptcy), *Insolvency Bulletin*, Minister of Supply and Services: (1984) Vol.4, No.2; (1985) Vol.5, No.2; (1986) Vol.6 No.3, (1987) Vol 7, No.2; (1988) Vol.8, No.1; (1989) Vol.9, No.2; (1990) Vol.10, No.4; (1991) Vol.11, No.4; (1992), Vol.12 No.3; (1993) Vol.13, No.1; (1994) Vol.14, No.1.

TABLE 3

CORPORATE INSOLVENCY PROCEEDINGS AUSTRALIA: 1991 - 1994

TYPE OF PROCEEDING	1991	1992	1993	1994	To July 1995
Court Liquidations	3,421	4,406	2,744	1,216	408
Creditors Voluntary Liquidations	1,013	814	740	406	241
TOTAL LIQUIDATIONS	4,434	5,220	3,484	1,622	649
Receiverships	1,024	970	1,075	949	423
Receiver	133	148	81	81	35
Receiver & Manager	1,071	822	692	448	221
Controller	0	0	294	420	165
Managing Controller	0	0	8	9	2
Voluntary Administration			From June 307	916	845
(Deeds of Company Arrangements)			(124)	(466)	(451)
Schemes of Arrangement (Approved)	41	27	27	36	23
Official Management	14	9	2	Repealed	
TOTAL OTHER PROCEEDINGS	1,079	1,006	1,411	1,901	1,291
TOTAL OF ALL PROCEEDINGS	5,513	6,226	4,895	3,523	1,940

n.b. - Some companies were subject to more than one proceeding.
- Grey area indicates that the procedure was not or is no longer available.

Source: Australian Securities Commission. (My sincere thanks to Mr.Ron Harmer, Partner, Blake Dawson Waldron (Solicitors), Melbourne, Australia, and Ms.Janet O'Conner, Media Liaison, Corporate Relations Unit of the ASC.)

APPENDIX II

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