Principles of Corporate Insolvency Law

Fourth Edition

Roy Goode

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PRINCIPLES OF CORPORATE INSOLVENCY LAW

by

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PRINCIPLES OF CORPORATE INSOLVENCY LAW

For Catherine to whom I owe so much

Preface

If reformers of our penal system were looking for new forms of non-custodial sentence they could do worse than introduce the penalty of six months' reading of UK insolvency legislation, enough to make the stoutest member of the criminal fraternity quail and repent of his evil ways. The phrase "United Kingdom" itself now needs some qualification in that we have a new concept, "British" (or, more shortly, "DisUK") insolvency law, following our adoption of the UNCITRAL Model Law on Cross-Border Insolvency. The Model Law is in many ways admirable. This cannot be said of our domestic legislation, which is badly drafted, bizarrely numbered—or rather, lettered—and organisationally incoherent. Perhaps Parliament and the Insolvency Rules Committee could be inspired by a verse from the Rubáiyát of Omar Khayyám:

Ah Love! could you and I with Him conspire
To grasp this sorry Scheme of Things entire,
Would not we shatter it to bits-and then
Re-mould it nearer to the Heart's Desire!

But it would take five years' hard work to do it properly! The experience of wrestling with the mass of legislation, case law and literature on corporate insolvency that has appeared during the six years following the appearance of the third edition of this work has left me in no doubt that it is high time I took my bow and left the stage to younger and more vigorous scholars. My plan is to essay a work of fiction. The more unkind of my Oxford colleagues remarked that he thought that was what I had been writing for years!

Yet I cannot deny that the subject is one of endless fascination involving the most intricate analyses of the general law of contract, unjust enrichment and, above all, property. It is this interrelationship with non-insolvency law that makes corporate insolvency such an intensely interesting object of study.

My aim, as in previous editions, is not to try to cover every situation or every rule but rather to lay down the fundamental concepts and principles underpinning the subject and set them in the context of practical problems, so that the reader—whether scholar, student or practitioner—is enabled to see the wood for the trees and to apply what he or she reads to new situations. It is very easy to get lost in the tangle of legislative rules, EU instruments and case law. But good advocates, like good scholars, know that what courts look for is lucid thinking and clear presentation, and that is what I have striven to provide in this book, very imperfectly, over the past two decades.

The major developments since the appearance of the third edition have necessitated a substantial rewriting of the entire work. The opening

chapter surveys the legislative scene, including (albeit briefly) the effects of the banking crisis and the new regimes governing bank insolvency under the Banking Act 2009. Two chapters have been split, so that there are now 16 chapters instead of 14. A complete chapter has been devoted to the anti-deprivation rule, on which the ruling of the Supreme Court is eagerly awaited.

A welcome development over the past 10 years has been the growth of empirical studies into corporate insolvency, enabling us to see how the law works in practice. From studies by leading insolvency scholars—Professors John Armour, Adrian Walters, Sandra Frisby and Audrey Hsu, to name but a few—we have learned the outcomes of different forms of insolvency proceeding and the success or failure of certain statutory regimes that had been thought to promote the rescue culture. Among other things, we now know that the small company moratorium appears to be a dead letter and that the assumption that a statutory moratorium is crucial to a successful restructuring or arrangement is far from axiomatic. I have drawn attention to several of these studies in different chapters. Prepack administrations ("pre-packs"), in which a prearranged sale of the insolvent company is concluded immediately after the appointment of an administrator, have also been the subject of empirical research and have given rise to intense debate and a measure of disquiet. The relevant aspects are examined in a revised chapter on administration. The chapter on restructuring and CVAs has been substantially expanded, as have the two chapters on the European Insolvency Regulation and international insolvency.

The enactment of the UNCITRAL Model Law has given rise to a good deal of litigation on the recognition and enforcement of foreign judgments, in decisions of the Privy Council and the House of Lords such as *HIH Casualty* and *Cambridge Gas* and of the Court of Appeal in *Rubin*, now on its way to the Supreme Court. Fascinating questions potentially arise as to what our courts should do when faced with conflicting decisions of, say, our own Supreme Court and New York courts if the latter were to seek recognition and enforcement of their decisions under the Model Law. Questions concerning the treatment of post-administration liabilities under pre-administration contracts have continued to exercise the courts and even now the textbook writers are not wholly agreed on the correct analysis. Pension liabilities, particularly those arising from contribution notices, have played an increasingly important role in corporate insolvency, as described in the chapter on administration, and the Court of Appeal is due to rule on this issue in the *Bloom* case. All these issues have been extensively addressed in this new edition.

I have incurred debts to many people in the writing of this book. They are identified in a separate page of acknowledgments. To all of them I express my deep appreciation.

Finally, I owe a deep debt of gratitude to my long-suffering wife, Catherine, who has heard on countless occasions, and with growing

disbelief, of my complete retirement from law (at long last about to happen!) and has patiently and with good humour put up with the trials and tribulations of an author's spouse. I could not have written this, my final legal text, without her constant encouragement and support.

Roy Goode
Oxford
15 April 2011

Acknowledgments

AN EXPRESSION OF THANKS

Every author builds on the labours of his predecessors. Many other writers in this field, whether as scholars or as practising lawyers, have shed light on dark places. They are too numerous to mention individually here but throughout the book I have freely acknowledged my indebtedness to them.

Three Oxford colleagues, John Armour, Louise Gullifer and Jennifer Payne, have helped me in various ways, in particular through their own writings and by inviting me to have drafts of the different chapters distributed to the postgraduate students on the BLC/MJur corporate insolvency course and to participate in seminars in which questions and comments by the students helped me to sharpen my analysis of particular issues. Louise and Jennifer kindly gave me advance sight of their new book *Corporate Finance*, while Sandra Frisby did the same as regards her joint empirical research with Adrian Walters into the outcome of CVAs. Professor Jay Westbrook, of the University of Texas at Austin, from whose encyclopaedic knowledge of cross-border insolvency so many of us have learned so much, was kind enough to review what are now chapter 2, as regards the references to US literature, and chapter 16 on international insolvency, and to offer a number of helpful comments and criticisms. Other leading academics with whom I had fruitful exchanges were David Fox and Richard Nolan, both of Cambridge University. In addition I benefited from constructive criticisms made of the 3rd edition by Look Chan Ho of Freshfields Bruckhaus Deringer.

Anxious to ensure that I was up to date on practice and on the identification of key issues I had meetings with numerous practising corporate insolvency experts—lawyers, accountants, bankers and asset-based lenders—who gave me the benefit of their immense experience and were generous both with their time and with their expertise and the provision of specimen documents. The various meetings were kindly set up for me by Steven Brown, who himself has a considerable knowledge of insolvency affecting retailers and their leased premises.

The practising lawyers whom I consulted were: Jennifer Marshall of Allen & Overy; Adrian Cohen, Gabrielle Ruiz and Nicola Reader of Clifford Chance; Inga West of CMS Cameron McKenna; Nigel Barnett and Neil Griffiths of Denton Wilde Sapte; Andrew Watson of Hammonds LLP; Robert Elliott and Jo Windsor of Linklaters; and Sarah Paterson of Slaughter & May. To all of them I am indebted for their imvaluable comments on the state of the law and on current practice, particularly as regards concepts and strategies of financial and business restructuring, schemes of arrangement and the pros and cons of statutory moratoria.

Insolvency practitioners from leading accountancy firms with whom I had fruitful discussions were: Shay Bannon of BDO; Neville Kahn, Paul

Thompson and Marcus Rea of Deloittes; Alan Bloom, Ben Cairns and Steve Leinster of Ernst & Young; Richard Heis of KPMG; and Mike Jervis of PWC. With them I discussed, among other things, issues arising out of the move from relationship lending by banks to asset-based lending, debt fragmentation through distressed debt trading and bond issues; administration and CVAs, and the rise of the pre-pack. They too were generous with their time and knowledge and gave me fresh insights.

Members of both groups made thought-provoking comments on cross-border corporate insolvency, the impact of the EC Insolvency Regulation and the problems associated with identification and change of the debtor's centre of main interests.

Andrew McKnight of Salans was good enough to undertake the burdensome task of reading drafts of most of the chapters and making detailed comments which saved me from many errors, and I am very grateful to him. I have also derived great benefit from various discussions with Nick Segal, of Freshfields Bruckhaus Deringer, drawing on his long experience in corporate insolvency practice both in England and in New York.

The bankers whom I consulted were Kevin Booth and Malcolm Weir of Barclays Corporate and Duncan Parkes of Lloyds Banking Group. In very helpful discussions they told me about the approach of bankers to the handling of corporate insolvency problems, the focus on financial and management reconstruction with a view to maintaining relationships with their customers and the problems they encountered with the fragmentation of debt.

Finally, I had lively discussions with Steven Chait and Dennis Levine of Burdale, a leading player in the asset-based lending market in the UK and the US. They explained the move from receivables financing to comprehensive asset-based lending and the differences in philosophy between traditional bank lending and asset-based finance, the latter involving a much more intensive valuation of assets. As Dennis Levine explained, "banks lend on the probability of default, asset-based lenders on the probability of loss."

I am also grateful to the publishers, Sweet & Maxwell, for all their work on the production side. In particular I would like to thank the senior publishing editor, Suzanna Wong; the production controller, Kathryn Harrison; the House editor, Ed Meadows; the typesetter, Laurie Burgess of LBJ Typesetting; the copy-editor, Sophie Rosinke; the tabler, Jane Belford; and the indexer, Andrew Prideaux. All of them have put in a great deal of effort to bring this work to publication.

My biggest debt, however, is to Kristin van Zwieten, an Oxford DPhil student who, sadly for us, is about to leave Oxford to take up a law post at Trinity Hall, Cambridge. She undertook responsibility for researching the huge volume of legislation, case law and literature, selecting and summarising the most important cases and articles and, at a later stage, reading the manuscript and the proofs. Her grasp of complex issues, her ability to set these out succinctly and her meticulous proof-reading were of the highest order, and I do not know what I would have done without her help, for which I am truly grateful.

Preface to the Third Edition

Astonishingly, eight years have now passed since the publication of the second edition of this work, and encouraged by the cordial reception given to it by the practising profession I decided to defer performance of my vow to give up law to write one last edition. After that the mantle will pass to a younger and more energetic scholar who I hope will find the subject as absorbing as I have done over the past 25 years.

Part of the fascination of corporate insolvency lies in the fact that it is inseparable from the general law of property and obligations. Since the starting position of insolvency law is respect for pre-insolvency entitlements, the subject cannot be understood without a good grasp of the general law, particularly the law relating to property, trusts, equity and security interests; and in all of these fields the law is in a state of flux. Thus in insolvency cases the courts are periodically exercised by that most fundamental of questions: what is property?

This has been a period of intensive legislative and judicial activity. The Insolvency Act 2000 was swiftly followed by the Enterprise Act 2000, which largely abolished new administrative receiverships, replacing them with administration, in respect of which both the principal Insolvency Act and the Insolvency Rules were entirely recast. The Act also introduced provisions requiring a prescribed part of floating charge assets to be surrendered for the benefit of ordinary unsecured creditors. These provisions are not free from ambiguity and it remains to be seen how they will be interpreted. A new section 1A of the Insolvency Act enables directors of a small eligible company to obtain a moratorium, but the process, set out in a new Schedule A1 of some 45 paragraphs, is so tortuous that it is hard to see why insolvency practitioners would want to make use of it.

To read the amended Insolvency Act 1986 it no longer suffices to be a lawyer; it is necessary to become a physical geographer in order to find one's way around provisions which are randomly dispersed among the body of the Act, the bizarrely numbered Schedules A1 and B1 and the Insolvency Rules, with seemingly no logic in the distribution nor any conception that it might be useful if all the provisions dealing with the same subject were brought together in clearly stated requirements. So if one reads paragraph 23 of Schedule B1 dealing with restrictions on the power of directors or the company to appoint an administrator there is neither an explicit statement nor the slightest hint of any requirement that the company must be unable or likely to become unable to pay its debts. Indeed, there is no provision anywhere in the Act that says this is a condition of such an appointment. It comes in by inference as a matter to be included in the statutory declaration under paragraph 27(2). And those who enjoy finding their way round mazes might give Hampton Court a miss and try their hands at tracking down the

meaning of "hire-purchase agreement" in paragraph 43(3). All that is required is perseverance and a passion for concentric circles.

Many other important legislative changes have taken place or are impending. They include the settlement finality Directive and the financial collateral Directive, providing significant immunities from insolvency law for market and exchange contracts; the EC Insolvency Regulation, replacing in almost identical form the ill-fated European Insolvency Convention, which had foundered on the twin rocks of John Major's refusal of cooperation with Europe because of the row over British beef and a desire not to prejudice the UK's sovereignty over Gibraltar; and the UNCITRAL Model Law on Cross-Border Insolvency, which it is planned to bring into force in the UK on April Fool's day 2006.

The courts, too, have been hard at work, with a cornucopia of cases covering everything from disclaimer of waste licences to voidable transactions, from wrongful trading and the disqualification of directors to the provision of assistance to foreign courts and the extent of jurisdiction over oversea companies, and from receivership and administration to a company voluntary arrangement for the Dean and Chapter of Bradford Cathedral—the first ecclesiastical feat of its kind and, sad to say, the last as a perceived loophole in the system was closed. The Insolvency Regulation has also attracted its fair share of case law, mainly focused on the identification of the debtor company's centre of main interests (COMI) but also addressing difficult issues relating to the time when proceedings are deemed to have been opened and the effect of a change of the COMI before the hearing of a winding-up petition.

As an indication of the speed of development, the decision of Peter Smith J. in *Krasner v McMath* on the insolvency super-priority of protective awards and claims for payment in lieu of notice was handed down on July 25, 2005 only to be overruled by the Court of Appeal in *Re Ferrotech* on August 9! Through the good offices of Ruth Pedley, of CMS Cameron McKenna, I was just in time to include a reference to both of these unreported cases.

All these developments, coupled with a range of new ideas, have necessitated a substantial amount of rewriting. The treatment of assets comprising the company's property has been substantially expanded; the chapter on administration has been completely rewritten and considerably enlarged; the analysis of vulnerable transactions has been refined in the light of major decisions of the House of Lords and lower courts. There is a new chapter on the Insolvency Regulation, which deals with the applicable law, jurisdiction, recognition and enforcement in relation to intra-Community insolvencies and raises complex issues as to determination of the applicable law and its relationship to the *lex concursus*. A number of these have not yet come before English courts but I have sought wherever possible to offer an analysis which combines reasonable textual interpretation with an approach that leads to a sensible outcome. The concluding chapter, on international insolvency, has been substantially rewritten to reflect modern theories of jurisdiction and to provide a treatment of the UNCITRAL Model Law.

With all this legislative and judicial activity going on, I find myself increasingly in sympathy with Baron Bramwell who, on being told that the line he was proposing to take in a case was at complete variance with one of his own earlier decisions replied: "The matter does not appear to me now as it appears to have appeared to me then."

In writing this, my final edition, I have received valuable assistance both from the writings of other scholars, here and abroad, and more directly from a number of people whom I consulted. They are identified in a separate page of acknowledgments. To all of them I am greatly indebted. I should like to say in conclusion, as so often in the past, that this new edition could not have been written without the constant support of my wife Catherine, who has shown extraordinary tolerance towards this obsessive author and made no protest when almost every living room in our small house was taken up with manuscript, proofs, books and other writing paraphernalia.

Roy Goode
Oxford
August 12, 2005.

Preface to the Second Edition

In the first edition of this book I sought to lay out the fundamental principles of corporate insolvency law and to demonstrate that it is not simply a collection of rules but possesses a structure and concepts a knowledge of which is essential to a true understanding of the subject. So much has happened over the past seven years, and so many new ideas have surfaced, that this new edition is almost a new book. I have rewritten and reorganised most of the original text, and substantially expanded both the general theoretical treatment and the analysis of particular issues and statutory provisions.

There are four entirely new chapters. The first, dealing with the philosophical foundations of corporate insolvency law, examines the different perceptions of the role of corporate insolvency law and the interests which it is designed to protect. There is a new chapter on the winding-up process which focuses on the principles governing entitlement to a winding-up order: *locus standi*, the existence of grounds for winding-up and a material interest in the order being made. The third new chapter briefly examines the complex but extremely important subject of set-off and netting. Decisions of the House of Lords and Court of Appeal have radically changed the perception of rights of set-off on insolvency. Also dealt with are arrangements for the pre-insolvency netting of obligations by novations, close-outs and payment netting. The fourth new chapter gives a brief treatment of some of the key issues arising in cross-border insolvency and the various steps taken by legislation, conventions and judicial cooperation to bring about orderly cross-border reorganisations and arrangements.

In preparing this new edition I owe a particular debt of gratitude to my friend and colleague Dan Prentice, with whom I share a postgraduate course on corporate insolvency law and whose meticulous reading of the typescript and detailed comments saved me from a number of errors. I am also indebted to my friend Nick Segal, of Allen & Overy, who performed a like service and who has been so generous in imparting the fruits of his long experience. The students themselves have provided a rich harvest of ideas which I have sought to capture before they were lost to an ever-fading memory. I should also like to express my thanks to the Society of Practitioners of Insolvency and its form President, Gordon Stewart, for kindly supplying me with copies of the Society's annual surveys and other material; to the Department of Trade and Industry for statistical information and copies of annual reports on companies; to Jane Whitfield, one of my postgraduate students at Oxford, for her very effective research assistance over the Long Vacation in searches in legal literature on insolvency; and to Sweet and Maxwell for piloting through this new edition so smoothly. Finally, a word of gratitude to that long line of corporate debtors without whom this book could never have been written.

This new edition is dedicated to my wife Catherine. For nearly 33 years, despite all the pressures of her own demanding work, she has given me unstinting encouragement and support and has borne with good humour and grace the rigours of marriage to an absent-minded academic who at certain critical points in the process of authorship has engulfed our small home with law reports, textbooks and manuscripts. My debt to her is immeasurable.

St. John's College,
Oxford,
July 9, 1997.

Roy Goode

Preface to the First Edition

Corporate insolvency law is a subject of peculiar fascination; one, indeed, of which universities in this country are in the course of acquiring practical experience! Part of its intellectual interest lies in its close relationship to company law and to law relating to security interests in personal property, which come together in that most brilliant of equity's creations, the floating charge. But for the scholar it possesses the additional attraction of encompassing a wide range of complex, not to say controversial, policy issues which are only now beginning to receive in this country the attention the deserve.

This book had its origins in my Commercial Law Lectures 1989, a set of five lectures on corporate insolvency law delivered at the Centre for Commercial Law Studies, Queen Mary College, in January and February 1989. In addition to substantially revising and expanding these I have added four more topics, resulting in a work of nine chapters and 219 pages of text.

My principal objective in this book, as in others in the same series, has been to concentrate on fundamentals: to stand back from the minutiae of the statutory provisions governing the insolvency of companies and to identify the concepts and principles of corporate insolvency law, showing how these both implement and modify the general law relating to property and obligations. This is an unusual approach but I make no apology for it, because I firmly believe that corporate insolvency law cannot be adequately comprehended without a grasp of the basic principles of property and contract law and of equitable obligation. Also central to corporate insolvency law is the principle of *pari passu* distribution, which can itself be understood only if one has a clear perception of the concept of *value* and of what constitutes an unjust enrichment of a particular creditor or other party at the expense of the general body of creditors. In concentrating on fundamental principles I have sought to provide for insolvency practitioners, academic lawyers and students in this country and in other parts of the Commonwealth a framework of the kind that Professor Thomas H. Jackson of Harvard University has furnished for American practitioners and scholars in his outstanding work *The Logic and Limits of Bankruptcy Law* published in 1986.

But this book is not concerned solely with general principle; it also examines the provisions of the Insolvency Act 1986 and related legislation and case law with what I hope is sufficient analytical rigour and detail to be of assistance in the resolution of everyday problems confronting the insolvency practitioner, and to provide a reliable guide to those intending to move into this field. Particular attention has been devoted to three topics: vulnerable transactions (transactions at an undervalue, preferences, etc.), which will continue to play a prominent role in corporate insolvency; receivership and the new administration order procedure; and improper trading, with particular reference to wrongful trading and the duties and liabilities of directors.

The current legislation is still very young, so that we are all feeling our way and it will be many years before certain key problems are fully worked out by the courts and by writers in the field.

I should like to express my particular indebtedness to John Gibson of Price Waterhouse for his invaluable assistance in providing information and in commenting in detail on the manuscript; to Nick Segal of Allen and Overy for a like service and for a number of helpful ideas; to Neil Cooper of Robson Rhodes for material supplied; to Mark Homan, also of Price Waterhouse, for supplying me with a copy of his admirable survey on the administration order procedure to which I have made numerous references in the text; and to my brother-in-law Philip Rueff, a member of the Bar, for bringing to my attention some cases in the criminal law which I would otherwise have overlooked. Finally, I should like to express once again my thanks to Sweet & Maxwell, for guiding this new creation safely to publication, replete with tables and index.

The law is stated on the basis of information available to me at November 24, 1989.

St. John's College
Oxford,
January 1990.

Roy Goode