

WHAT LIQUIDATION DOES FOR SECURED CREDITORS, AND WHAT IT DOES FOR YOU

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A core objective of collective insolvency regimes is to preserve value in the insolvent estate. This value is then to be distributed in accordance with the appropriate statutory scheme. Value might be lost for any of a variety of reasons, including, in particular, (i) misuse of corporate assets by those with influence over the distressed company, and (ii) precipitate individualistic enforcement action by particular claimants, which dismembers the corporate estate and thus destroys synergetic values. The statutory liquidation regime attempts to counter this, in order not simply to benefit those with claims against the company, but also with a view to protecting the public at large from (among other things) abuse of the corporate form. It does so by (i) disabling certain types of dealings with the company's assets, (ii) arming the liquidator with investigative and recuperative tools, and (iii) empowering him to carry out synergy-preserving disposals of the company's property. While liquidation has long (though far from perfectly) performed all these essential functions, the virtual abolition of administrative receivership by the Enterprise Act 2002 had promised to energise the third of these in particular.

Unfortunately, however, the ability of the liquidation system to perform any of these functions is threatened by the lingering effects of a recent judgment of the House of Lords, and by some of the commentary this judgment has attracted. Their Lordships' decision has been used to contend that secured claimants 'stand outside' liquidation, in the sense that they are "not entitled to participate" in the winding-up process. It has further been contended that this remains true even though the actual effect of the judgment has been legislatively reversed. The extent to which these propositions, if true, undermine the core functions of liquidation may not have been fully appreciated by those seeking, even in the face of Parliamentary disapproval, to shore up their Lordships' decision.

This paper undertakes a fresh analysis of the liquidation process. On the basis of this analysis, it is argued that the proposition that secured claimants 'stand outside' liquidation in the relevant sense (i) is a product of a misunderstanding of the dual duality in the nature of liquidation proceedings, in that, in principle, they serve both public and private functions, and, they further the interests of both secured and unsecured creditors; (ii) overlooks, both, the ways in which secured creditors benefit from liquidation, and the ways in which unsecured creditors have a real interest in the proper administration of their debtor's encumbered assets; (iii) mistakes the secured creditor's *choice* in usually being able to gain immunity from the liquidation process, for a *compulsion* for it to stand exiled from this process; (iv) is incorrect as a matter of the history and practice of this institution; and (v) is rendered unsustainable by the statutory text. It is concluded that secured creditors have never 'stood outside' liquidation, and that this is *a fortiori* given that the judgment allegedly confirming their exile has been overturned by the Legislature.

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1. Introduction

How may the secured creditors of an insolvent company vindicate their claims? What are the proper functions of the statutory corporate liquidation regime? What is the status of the insolvent company's estate at the intersection of the laws governing property and insolvency? And how far-reaching may be the unintended damage caused by a decision of the highest court, even though Parliament has intervened to reverse its actual effect?

In *Buchler v Talbot* (*Leyland Daf*),¹ the House of Lords set out to answer the apparently obscure question of the correct priority as between themselves of, on the one hand, the expenses properly incurred by the liquidator of an insolvent company ('liquidation expenses'), and on the other, debt claims against the company secured by a floating charge ('floating charge claims'). The statutory context was section 175 of the Insolvency Act 1986 ('the Act'). This provides that the company's statutory preferential debts should be paid in priority to "all other debts", and should rank behind liquidation expenses. If "the assets" are insufficient to meet them, preferential claims should abate in equal proportions. And "so far as the assets of the company available for payment of general creditors" are insufficient to meet them, preferential claims should have priority over a floating charge claim with respect to "any property comprised in or subject to that charge".

For thirty-four years, ending with *Leyland Daf*, section 175 had been authoritatively interpreted according to the Court of Appeal's judgment in *Re Barleycorn Enterprises Ltd* ('the *Barleycorn* approach').² The *Barleycorn* approach had been based on three arguments (amongst others). There was, firstly, the principle of transitivity: the statute appeared to rank X (liquidation expenses) ahead of Y (preferential claims), and to place Y before Z (floating charge claims). It should necessarily follow that X ranked ahead of Z. Second, the statute said that preferential debts would begin to abate upon the exhaustion of "the assets". Given that preferential debts had priority over floating charge claims as well as unsecured ones, they could not abate at all unless *both* unencumbered assets *and* assets subject to a floating charge had been exhausted. It must follow that the statutory term "the assets" is a generic reference to both, the "assets... available for payment of general creditors", and also "any property comprised in or subject to" the floating charge. And third, the statute unambiguously intended to place liquidation expenses ahead of preferential claims. But this intention could be easily frustrated unless liquidation expenses also had priority over floating charge claims. If they did not, then the debtor and one of its creditors could overturn the statutory priorities as between liquidation expenses and preferential claims through the simple expedient of creating a floating charge over all of the company's property. Any interpretation that allowed parties through private contracting thus to undermine clear legislative intent was regarded as unacceptable.

The crucial decision for their Lordships in *Leyland Daf*, then, was whether assets subject to a floating charge are "assets of the company" for the purposes of section 175 of the Act. They replied that they are not.

Both the conclusion and the reasoning supporting it were the subject of extensive discussion and criticism.³ The central objection was that there is nothing in property law that places, at any point during the existence of the encumbrance, the beneficial ownership of floating charge assets (or indeed, of any

¹ [2004] UKHL 9. All self-standing references in square brackets below are references to the paragraphs of their Lordships' speeches in this judgment.

² [1970] Ch 465.

³ See Riz Mokal, "Liquidation Expenses and Floating Charges – The Separate Funds Fallacy" [2004] LMCLQ 387 (reprinted at (2005) 21(2) IL&P 46); Harry Rajak, "Liquidation Expenses Versus a Claim Secured by a Floating Charge" (2005) 18(7) Insolvency Intelligence 97; Gerard McCormack, "Lords Hoffmann and Millett and the Shaping of Credit and Insolvency Law" [2005] LMCLQ 491, 496-499; Look Chan Ho, "Reversing *Buchler v Talbot*: The Doctrinal Dimension" (2006) 21(3) BJIBFL 104; Look Chan Ho, "The Debenture Holder's Liability in Unjust Enrichment After *Spectrum*", in Joshua Getzler and Jennifer Payne (eds), *Company Charges: Spectrum and Beyond* (Oxford: OUP, 2006), 173 at 175-179; and Dominic Venton, "The Rightful Ranking of Liquidation Expenses – A Statutory Perspective" (2006) 22(6) IL&P 205.

encumbered property) in the secured claimant. The chargee certainly obtains a beneficial proprietary *interest* in the collateral, but the collateral itself remains “property of the [chargor] company”.⁴ The practical implications of the judgment that floating charge assets would no longer be available to service winding-up expenses were also highlighted, particularly by legal and accountancy practitioners.⁵ In view of these objections and after exhaustive consultation,⁶ the Government announced that it would seek the legislative reversal of *Leyland Daf*.⁷ This was brought about by section 1282 of the Companies Act 2006.⁸

In a paper written some months before the Government’s decision to seek statutory reversal but published some considerable time after the announcement of that decision, John Armour and Adrian Walters (‘A&W’) have sought to support the *Leyland Daf* judgment.⁹ They concede (though this might not be readily apparent on a cursory reading of their paper)¹⁰ the principle underlying the central objection to their Lordships’ reasoning, that neither the creation nor the crystallisation of a floating charge in itself removes beneficial ownership of encumbered property (‘the collateral’) to the chargee.¹¹ They claim, however, that this objection is simply beside the point, since their Lordships must be understood as having held that the chargee gains beneficial ownership of the collateral by virtue not of *property* but of *insolvency* law, and in particular, by virtue of the law governing corporate liquidation. When a chargee “enforces” his security subsequently to the commencement of the winding-up – and, it seems, even prior to enforcement,¹² and even in the absence of it,¹³ so long as the debtor is being wound up – the collateral is regarded as having been beneficially vested in the chargee from the time at which winding-up began, because, according to A&W, *that is what liquidation law dictates*.

So what might there be in the law of corporate liquidation which brings about this result? A&W suggest a variety of candidates. Perhaps the most fundamental of these is the proposition that secured creditors are “not...entitled to participate in the collective [liquidation] proceedings”.¹⁴ This allegedly follows from the very purposes of the liquidation regime, and also because the references in the statutory text to “the assets/property of the company” cover only free but not encumbered assets. A&W conclude that this (among other factors) supports their Lordships’ judgment that the reference in section 175 of the Act to “the company’s assets” does not include floating charge assets.

This paper undertakes a fresh analysis of the liquidation process. By way of essential background, Section 2 introduces and critiques the central elements of their Lordships’ reasoning in *Leyland Daf*. Section 3 briefly introduces the basic steps in A&W’s unorthodox attempt to rationalise the judgment. Crucially though equally briefly, Section 4 provides the normative framework within which the remaining analysis of the paper proceeds. It explains the two fallacies which, it is argued, undergird the proposition that secured creditors are “not entitled to participate” in, and should not be required to pay for, winding-

⁴ The detailed argument is to be found in Riz Mokal, “Liquidation Expenses and Floating Charges – The Separate Funds Fallacy” [2004] LMCLQ 387.

⁵ For an overview, see Lorinda Peasland, “Company Law Reform Bill: Views from the Profession Compiled by the ABRP General Technical Committee” (2006) 22(2) IL&P 88.

⁶ See e.g. the account of a seminar held on the subject by the Insolvency Service on 17 February 2005, at <http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/LeylandDAFseminar.doc>; and “Insolvency Service Consults on Reversal of ‘*Leyland Daf*’ in Company Law Reform Bill” (2006) 27(4) Comp Lawyer 119

⁷ The reasoned statement by Stephen Leinster, the Head of Policy at the Insolvency Service, is essential reading for anyone interested in the official policy on this area; see “Insolvency Service Response to FMLC Paper on Clause 868 of the Company Law Reform Bill – The Statutory Reversal of *Re Leyland DAF*”, reproduced at (2006) 22(2) IL&P 43.

⁸ Inserting a new section 176ZA in the Insolvency Act 1986 (‘IA’).

⁹ ‘Funding Liquidation: A Functional View’ (2006) 122 LQR 303.

¹⁰ Perhaps because of the discussion in AW, 302-303 (including fn. 44); their arguments on this issue are addressed in Mokal, “At the Intersection of Property and Insolvency: The Insolvent Company’s Encumbered Assets” (forthcoming, 2008).

¹¹ AW, 301 (particularly text to fns. 30-31), 305, and 309 (the two final paragraphs).

¹² AW, 309: “the statutory scheme goes further than merely waiting for enforcement to take place before deeming assets subject to security to be *pro tanto* outside” the “company’s assets”.

¹³ AW, 309: “insofar as they are subject to valid security, assets simply do not form part of” the “company’s assets”.

¹⁴ AW, 307.

up. Section 5 builds on its predecessor by highlighting what might be called the dual duality in the nature of the liquidation regime. This regime certainly aims to serve the private interests of those concerned with the insolvent company's undertaking, but it also plays an important public role by enforcing commercial morality. And while it certainly acts as a form of collective execution on behalf of the company's unsecured creditors, it also, unless impeded by secured creditors themselves, serves to realise encumbered assets and discharge secured liabilities. This last-mentioned function of liquidation proceedings seems increasingly to have been obscured from view in recent decades. Section 6 finds that the most vital of liquidation law provisions treat encumbered assets as the company's property. To read those provisions in any other way would severely undermine the core insolvency law objectives that the insolvent company's estate be preserved, the causes of its failure investigated, and any misapplied property recovered. This would harm the interests of unsecured *and* secured creditors, and in the bargain, would cripple the ability of insolvency law to perform the essential public function of reinforcing commercial morality. Section 7 consolidates the results and concludes that there is nothing in either the language of the statute governing liquidation or in the functions performed by liquidation proceedings that provides any support to *Leyland Daf*, or to the proposition that secured creditors 'stand outside' these proceedings. In fact, the position is quite to the contrary.

2. *Leyland Daf* and its Critics

There were three speeches in *Leyland Daf*, from three of the most distinguished judges to grace the House in a long time. Each carried the same three themes. And with respect, each was unsatisfactory.

2.1 Assets, Property, Funds

Firstly, their Lordships recast the statutory text. The familiar statutory concepts of "assets" and "property" were relegated, functioning as mere labels to be attached to conclusions reached without any apparent recourse to the legal principles that would usually have governed their use. Their Lordships adopted as their basic unit of analysis something they called the "fund".

The nub of their Lordships' reasoning was provided with characteristic crispness by Lord Millett: "Questions of priority arise only between interests which compete with each other for payment out of the same fund."¹⁵ The "real question" is therefore "whether the expenses of a winding up are payable out of charged assets at all."¹⁶ "If they are", Lord Millett conceded, then "there is no doubt that they are payable in priority to the claims of the charge holder". But if they are not, then "questions of priority do not arise."¹⁷ "The significance of the floating charge", his Lordship went on to explain, "is, not that it alters priorities for payment out of a single fund, but that it brings a second fund into existence with its own set of priorities."¹⁸

The "assets subject to the floating charge form a separate fund", agreed Lord Hoffmann, because they "belong beneficially to the [charge]-holder... The [debtor] company has only an equity of redemption; the right to retransfer of the assets when the debt secured by the floating charge has been paid off."¹⁹ Lord Nicholls was of the same view: "In distribution of *non-charged* assets of the company liquidation expenses rank ahead of the claims of preferential creditors", he held; but "unlike the non-charged assets, the *charged* assets belong to the debenture holders to the extent of the amounts secured."²⁰ It follows that there is "nothing inherently surprising in Parliament deciding that in future the proprietary interests of a debenture holder in his fund, that is, the charged assets, shall be eroded to the extent of the claims of preferential creditors without making any similar incursion in respect of liquidation expenses."²¹

¹⁵ At [81].

¹⁶ At [41].

¹⁷ At [41].

¹⁸ At [81].

¹⁹ At [29] and [30] (emphasis added).

²⁰ At [16] (original emphasis).

²¹ At [16].

The issue, to reiterate, was not one of priorities in “one fund” at all, since if it were, then there would be “no doubt” but that liquidation expenses enjoyed priority over floating charge claims. The issue was of “property” in two “separate funds” which “belonged”, respectively, to the company and the debenture holder, and each of which was governed by “its own set of priorities”. Liquidation claims, in short, were not “payable out of the charged assets at all”. All of this, held their Lordships, was clear from the late Victorian history of the statutory antecedents of section 175 of the Act.

Their Lordships’ critics were not persuaded. Since the governing statutory phrase “assets [of the company]” has not been given a specific statutory meaning, this meaning must *prima facie* be gathered from the general (property) law, subject to any countervailing reasons of principle or policy.²² As for the general law, the effect of a floating charge (and indeed, of a fixed charge, and even of a mortgage²³), is *never* to split the debtor company’s estate into two funds one of which is “owned” by or “belongs” to the charge holder. At all times during the existence of the charge or mortgage, the encumbered assets remain vested in, and therefore “assets of, the company”. Instead, the effect of a charge (or mortgage) is precisely to reorder the priorities for payment out of the charged assets in favour of the charge holder (or mortgagee). This remains true throughout the existence of the charge (or mortgage).

Turning to policy, however, there are important reasons for distinguishing between fixed and floating security. The existence of fixed security (charges and mortgages) decrease the chances of the debtor’s insolvency by (i) encouraging lending which would not have taken place in the absence of the priority afforded by the security, and (ii) allowing the secured creditor considerable control over the debtor, and thus reducing the expected variance of the projects to which the company’s business is committed. The reduction in the probability of the debtor’s insolvency increases the expected value of *all* the debt claims against the debtor, *unsecured* as well as secured. This provides justification for protecting the priority of claims secured by fixed charges or mortgages: the priority can be seen as a reward to the secured creditor for its control and its credit, both of which bring benefits *ex ante* (that is, at the time that the lending takes place) to the very parties (unsecured creditors) who would suffer a detriment *ex post* (that is, once the debtor is distressed) in being subordinated.²⁴ By contrast, floating security does not (with some very limited exceptions) encourage additional lending, nor does it allow the holder of a merely floating charge the ability effectively to control the debtor, nor, in turn, is it relied upon *ex ante* to gain priority by lenders in the overwhelming majority of transactions where the debtor ends up insolvent.²⁵

It follows that protecting the priority of claims secured by fixed charges or mortgages is justifiable, including against liquidation expenses, whereas there is little to justify *any* priority for claims covered by floating security. This is consistent with the law as it stood before their Lordships’ decision in *Leyland Daf*.²⁶

2.2 Statutory history

In *Leyland Daf*, their Lordships placed great emphasis on the Victorian genesis of what are now sections 115 and 175 of the Act. They pointed to provisions in the Companies Act 1883 and the Preferential Payments in Bankruptcy Act 1888, the combined effect of which was to prioritise the wage claims of certain of the bankrupt’s employees over the claims of other unsecured creditors. This statutory priority

²² See e.g. *Wisely v John Fulton (Plumbers) Ltd* [2000] 1 WLR 820 (HL), 823-824.

²³ A legal mortgage involves a transfer of legal title in the collateral from borrower to lender; however, at all times during the currency of the mortgage, the beneficial ownership in the collateral remains in the borrower. Equity “look[s] at substance and not at form. It insist[s] on seeing through the conveyancing device of the transfer of title involved in the creation of a mortgage, and recognise[s] the commercial reality of the transaction as a means of conferring security rather than ownership on the mortgagee”; Sir Gavin Lightman and Gabriel Moss (eds.), *The Law of Administrators and Receivers of Companies* (London, 2007, 4th ed), 279, citing *Casborne v Scarfe* (1783) 1 Atk. 603 (HL), 605; *Re Sir Thomas Spencer Wells* [1933] Ch 29 (CA), 52; *Quennell v Maltby* [1979] 1 WLR 318 (CA), 324; and *Ultraframe (UK) v Fielding* [2006] FSR 17 (ChD).

²⁴ The details of this argument and supporting empirical evidence can be found in Riz Mokal, *Corporate Insolvency Law – Theory and Application* (Oxford: OUP, 2005), Chapter 5.

²⁵ Details of this argument can be found in Mokal, *Corporate Insolvency Law*, Chapter 6.

²⁶ And this also provides justification for the law as it will exist once the new IA, s. 176ZA is brought into effect.

proved chimerical, however, since employee claims were still trumped by secured ones. To remedy this, section 2 of the Preferential Payments in Bankruptcy Amendment Act 1897 promoted employee claims over claims secured by a floating charge. And that, their Lordships maintained, was it. The 1897 Act did not have any further implications.

The primary problem with this argument is its violation of the principle of transitivity: it was, and remains, uncontroversial that liquidation expenses ranked ahead of statutory preferential claims,²⁷ so a necessary implication of section 2 of the 1897 Act would have been to confer upon liquidation expenses priority over floating charge claims as well. It is to meet this objection, as noted, that their Lordships introduced the notion that the creation or crystallisation of a floating charge removed floating charge assets from the debtor's company's ownership.²⁸

Even leaving aside the principle of transitivity, however, their Lordships' treatment of the statutory history is not free from difficulty. It remains important to understand why. Firstly, it failed to engage with much of the detailed and highly persuasive historical-doctrinal analysis in Chadwick LJ's judgment in the Court of Appeal, which demonstrated the correctness of the *Barleycorn* approach both as a matter of necessary implication of the 1897 Act and also in view of the commercial realities of ensuring compliance with the Parliamentary intent of prioritising statutory preferential claims.²⁹

But second and equally important, their Lordships' treatment of the statutory history did not deal with the implications of the principle of legislative adoption ('the *Barras* principle').³⁰ This principle holds that where a statutory term has received a judicial interpretation, and where Parliament subsequently employs the same term in the same context in successor legislation, then there is a presumption that Parliament has approved of and adopted the judicial gloss on the term. In the present context, this has clear implications. *Barleycorn* had been on the books for over thirty-four years by the time that *Leyland Daf* was decided. It was a well-established part of the law when Parliament legislated on insolvency matters in 1985/86, 1994, 2000, and 2002. And yet at no time was the statutory wording, as glossed by the Court of Appeal in *Barleycorn*, altered. This against the background that, as Lord Nicholls noted in *Leyland Daf* itself,

“More than once Parliament has intervened to correct perceived imbalance between the rights and interests of charge holders and the rights and interests of other persons.”³¹

So *Barleycorn* had stood for well over three decades, even though, as their Lordships were evidently aware, Parliament has been unusually active if it perceives there to be an imbalance regarding the interests of secured creditors and those of others. It must surely follow that *Barleycorn* had been approved by Parliament. Indeed, that it did so follow had been judicially confirmed some years back by no less distinguished a jurist than Millett J (as he then was) himself:

“Sections 115 and 175(2) of the Act of 1986 and the opening words of rule 4.218(1) of the Insolvency Rules 1986 re-enact, with only minor and inconsequential changes, sections 309, 319(5) and 319(6) of the Companies Act 1948 and the opening words of rule 195(1) of the Companies (Winding-Up) Rules 1949. Parliament must be taken to have re-enacted those provisions with full knowledge of the decision in *In re Barleycorn Enterprises Ltd.*...In my judgment, the word ‘assets’ where it appears without qualification, and even the phrase ‘the company's

²⁷ See e.g. at [16].

²⁸ As already noted, A&W agree that as a matter of property law, the floating charge does not and cannot have any such effect.

²⁹ [2002] EWCA Civ 228, [24]-[42].

³⁰ See *Barras v Aberdeen Steam Trawling and Fishing Co Ltd* [1933] AC 402, and also, e.g., *R v Chard* [1984] AC 279, and *Farrell v Alexander* [1977] AC 59. For a useful examination of several of the implications of the principle, see Dominic Venton, “The Rightful Ranking of Liquidation Expenses – A Statutory Perspective” (2006) 22(6) IL&P 205.

³¹ At [3]. His Lordship has been proved right once again; see Parliament's rapid response to *Leyland Daf* in the form of the new IA, s. 176ZA.

assets' in the present statutory provisions, must be given the meaning which they bore in those which they replace, and accordingly include the floating charge assets."³²

It is to be noted that the issue in the present context is not simply whether the Legislature, because of its failure to use a new phrase when enacting sections 115 and 175 of the 1986 Act, should be presumed to have adopted *Barleycorn*, strong though this factor is. There is no mere implication from Parliamentary inertia here. In fact, Parliament has unambiguously accepted the *Barleycorn* method as the correct approach to the funding of collective insolvency proceedings. In creating the new administration procedure in the 1986 Act, Parliament chose exactly that method for funding it that *Barleycorn* had laid down for liquidation. The costs and expenses of administration rank ahead of floating, but not fixed, charge claims,³³ just as, pursuant to *Barleycorn*, the costs and expenses of liquidation rank ahead of floating, but not fixed, charge claims. And when administration was recast in the Enterprise Act 2002, the same funding method was again approved.³⁴ This removes any shadow of a doubt from the matter: the 2002 legislation occurred very soon after the Court of Appeal's judgment in *Leyland Daf*,³⁵ which had not merely followed but warmly endorsed *Barleycorn*. Just as they were re-thinking major aspects of insolvency law, then, Parliament and its advisors would have had ample reminder of the *Barleycorn* position. The presumption of legislative adoption is not merely not rebutted in relation to *Barleycorn*, then; it would appear to have been strongly confirmed.³⁶

In *Leyland Daf*, most of these implications of the *Barras* principle were brought out at considerable length by Counsel for the liquidators,³⁷ and Counsel for the receivers attempted (though, it is submitted, unsuccessfully) to meet them.³⁸ So the matter was centrally at issue between the parties.³⁹ And its resolution was crucial, in particular, as a precondition to victory for the receivers. If it was indeed the case that *Parliament* ought to be treated as having approved of *Barleycorn*, then, regardless of *their Lordships'* views of the correctness of *Barleycorn*, the liquidators ought to have prevailed in their preferred interpretation of sections 115 and 175.⁴⁰ This interpretation of the statute could only be rejected if it could first be established that there had been no legislative adoption of *Barleycorn*.

At this point, recall that while there is certainly no duty upon courts to address each and every argument addressed to them by the parties, human rights law does require them to settle issues argued before them which are crucial to the dispute. As the English Court of Appeal has noted,

"The [European Court of Human Rights] will hold that article 6(1) [of the European Convention on Human Rights, which guarantees a fair trial] has been violated if a judgment leaves it unclear whether the court in question has addressed a contention advanced by a party that is fundamental to the resolution of the litigation".⁴¹

This is *a fortiori* where it is clear that a court has not in fact addressed some such contention.

³² *Re MC Bacon (No 2)* [1991] Ch 127, 135.

³³ IA, s. 19.

³⁴ IA, Sch. B1, paras 75 and 99.

³⁵ [2002] EWCA Civ 228, delivered on 22 February 2002.

³⁶ The reversal of *Leyland Daf* by the Companies Act 2006 strengthens even further the presumption that *Barleycorn* had been legislatively adopted at the time that their Lordships delivered themselves of their judgment.

³⁷ [2004] 2 AC 298, 302-303.

³⁸ [2004] 2 AC 298, 300-301.

³⁹ One way of making this point is to note that the report of *Leyland Daf* in the Appeal Cases Reports summarises the arguments by Counsel for the liquidators in ten paragraphs, three of which (30%) deal with the argument based on the *Barras* principle. And of the seven paragraphs summarising arguments for the receivers' Counsel, about two (29%) deal with this principle.

⁴⁰ After all, the question for their Lordships in *Leyland Daf* was a question of statutory construction, and Acts of Parliament "should be construed according to the intent of the Parliament which passed the Act", *per* Tindal LCJ in the *Sussex Peerage Case* (1844) 11 Cl & Fin 85, 143; 8 ER 1034, 1057, who described this as "the only rule for the construction of Acts". For a discussion of what the "intent of the Parliament" means in a context such as this, see Mokal, *Corporate Insolvency Law*, 10-20.

⁴¹ *English v Emery Ltd* [2002] EWCA Civ 605, [9], citing as examples *Torija v Spain* 19 EHRR 553 and *Hiro Balani v Spain* (1994) 19 EHRR 566.

What is more, there is a general common law duty upon courts to give reasons for their decisions:

“The duty is a function of due process, and therefore of justice. Its rationale has two principal aspects. The first is that fairness surely requires that the parties especially the losing party should be left in no doubt why they have won or lost. This is especially so since without reasons the losing party will not know...whether the court has misdirected itself, and thus whether he may have an available appeal on the substance of the case. The second is that a requirement to give reasons concentrates the mind; if it is fulfilled, the resulting decision is much more likely to be soundly based on the evidence than if it is not.”⁴²

Perhaps the most important justification for this duty is that compliance with it treats the litigants, not merely as objects to be coercively acted upon by another (in this case, the state), but rather, as rational agents themselves able in principle to comprehend and act by the normative determinants of their legal rights and obligations, and thus entitled to be informed of them.

So, how did their Lordships deal with the crucial argument based upon the *Barras* principle?

Despite the analytical indispensability of its resolution before the receivers might legitimately prevail, and despite its evident importance to the parties, their Lordships did not, in the course of deciding for the receivers, so much as advert to, let alone deal with, it. This can be understood in one of three ways. Firstly and at the very least, their Lordships left it unclear how they had addressed (or would address) the argument from legislative adoption. Or second, they did not merely leave this issue unclear, but in fact, did fail altogether to address it. Or third, they considered and rejected this argument *sub silentio*, without giving any reason. In *any* of these contingencies and on this point alone, it is difficult (to put it no higher) to defend the validity of *Leyland Daf*.

Their Lordships’ failure to deal with the argument from the *Barras* principle is of significant continuing importance, since it is this principle which explains why assets encumbered by *fixed* security are *not* covered by references in sections 115 and 175, etc, to “the company’s assets”.⁴³ Lord Millett in particular attempted a *reductio* of the liquidators’ position, suggesting that if the reference to “the company’s assets” in section 175 covered floating charge assets, then there was no reason why it should not also cover fixed charge assets.⁴⁴ But as already noted, Counsel for the liquidators had spent a third of his time answering precisely this question: Parliament had approved of the *Barleycorn* method for funding collective insolvency proceedings, administration as well as liquidation. It had endorsed, in other words, the decision of the Court of Appeal in that case that only floating, but not fixed, charge claims should be subordinated to liquidation (and administration) expenses. Lord Millett had been provided with a response to his challenge (a response that he himself had endorsed while deciding *MC Bacon (No 2)* some years ago), had chosen not to mention it at all in his speech, but then presented the challenge in his speech as if it had not and could not be met. No wonder their Lordships’ critics were puzzled.⁴⁵

⁴² *Flannery v Halifax Estate Agencies Ltd* [2000] 1 WLR 377, 381-382.

⁴³ This question is sometimes framed in a profoundly misleading way, as asking why assets subject to *floating* security *should* fall within the ambit of IA, ss. 115 and 175. As we will see below, however, insolvency legislation more or less consistently treats assets encumbered by *all* types of security interest (floating and fixed charges and mortgages) as “the company’s property”; and as noted, property law takes the same position. So the question is not whether floating charge assets are covered by the references to the company’s assets in IA, ss. 115 and 175. Of course they are. The real question is the one in the text here. And it is to answer this question that we must turn to the interpretive history of these provisions, including, in particular, Parliament’s approval of the *Barleycorn* approach.

⁴⁴ At [73].

⁴⁵ A&W have imitated their Lordships on this point, having omitted to address the argument based on the *Barras* principle despite its explicitly having been drawn to *their* attention by way of challenge to their Lordships’ conclusions. What is more, they go on to repeat – thrice – Lord Millett’s already puzzling attempt at a *reductio*, rhetorically asking why only floating but not fixed charge claims should be subordinated to liquidation expenses; AW, 299, 305 and 311, fn. 97. Even if the argument from legislative adoption is a bad one, it could only be shown to be so by being met.

2.3 Functions of the corporate liquidation regime

Their Lordships appear to have assumed that the sole purpose of liquidation proceedings (or at least, the purpose so dominant as to overwhelm any other) was to realise and distribute the insolvent company's unencumbered assets to its general creditors.⁴⁶ By virtue of holding proprietary rights in collateral (indeed, as their Lordships put it, by being "owners" of these assets to the extent of the secured debt), secured creditors have no interest in liquidation proceedings.⁴⁷ The implication, it appears, is that there is no reason why debenture-holders should be asked to pay for such proceedings.

The question whether the dominant – or even, sole – purpose of liquidation proceedings is to benefit unsecured creditors is of course central to our discussion, and is considered in detail below. Here, we should set the scene by noting that liquidation has a vital 'public' role which, in principle, may supersede those of its functions which directly benefit the company's creditors (including unsecured ones).⁴⁸ A properly conducted winding-up reinforces commercial morality, and does so in the public interest.⁴⁹ The liquidator must make a report to the official receiver or Secretary of State as to any offences in relation to the company of which any officer of the company appears to be guilty.⁵⁰ This report forms the basis for a consideration of whether a prosecution is merited. This role is unique to the liquidator; no other office-holder is obligated to perform it. In compulsory liquidations, the official receiver is required to investigate the company's affairs and the reasons for its failure, and if appropriate, to report to the court winding up the company.⁵¹ Again, if the report discloses the commission of a criminal offence, the court will order the report to be referred to the Secretary of State, who will consider bringing a prosecution.⁵² In carrying out investigations and/or drawing up reports, liquidators and official receivers (in common with other insolvency office-holders) have statutory powers to require any person connected with the company to submit to an examination and/or to produce documents.⁵³ The costs of investigations and preparation of these reports are recoverable as liquidation expenses. What is more, a liquidator (in common with other office-holders) is obligated, if it appears to him that a director or former director might be unfit to be concerned with the management of a company, to bring this to the attention of the Secretary of State.⁵⁴ This might lead to the director's disqualification. Again, the liquidator's investigative and reporting costs qualify as liquidation expenses.

Only seven months before the decision in *Leyland Daf*, Lord Millett had this to say about the functions of the winding-up regime:⁵⁵

"I reject the unspoken assumption that the functions of a liquidator are limited to the administration of the insolvent estate. This is only one aspect of an insolvency proceeding; the investigation of the causes of the company's failure and the conduct of those concerned in its management are another. Furthermore such an investigation is not undertaken as an end in itself, but in the wider public interest with a view to enabling the authorities to take appropriate action against those who are found to be guilty of misconduct in relation to the company. If the investigation yields information material to the Secretary of State's decision to bring or continue disqualification proceedings, it must be reported."

⁴⁶ See e.g. at [51].

⁴⁷ See e.g. at [31].

⁴⁸ An illuminating treatment, on which this part of the discussion draws, is Andrew Keay, "Insolvency Law: A Matter of Public Interest?" (2000) 51 NILQ 509, 511-515.

⁴⁹ See e.g. IA, s. 143(2); Cork Report, para 119; *In re London and Globe Finance Corp'n Ltd* [1903] 1 Ch 728, 734-735; *In re John Tweddle & Co Ltd* [1910] 2 KB 697, 707; *Re Thellusson* [1919] 2 KB 735, 764; *In re Paget, Ex p Official Receiver* [1927] 2 Ch 85, 87-88 and 92; *Bishopsgate Investment Management Ltd v Maxwell* [1993] Ch 1, 31; *Gamlestaden Fastigheter AB v Baltic Partners Ltd* [2007] UKPC 26, [2007] BCC 272, [32].

⁵⁰ IA, s. 218.

⁵¹ IA, s. 132.

⁵² IA, s. 218.

⁵³ IA, ss. 133 and 236-237.

⁵⁴ Company Directors Disqualification Act 1986, s. 7(3).

⁵⁵ *In Re Pantmaenog Timber Co Ltd* [2004] 1 AC 158, 177, [64]; see also at [75], [77].

In the same case, Lord Walker (also on the panel in *Leyland Daf*), hammered home the fact that it is not simply that the investigative and reporting powers of the liquidator do not benefit the company's creditors alone. In fact, "it may be contrary to the financial interests of the creditors and shareholders for these procedures to be invoked;"⁵⁶ other things being equal, every penny spent on investigating the conduct of those connected with the now-insolvent company is a penny not available for distribution amongst the company's investors.⁵⁷

By providing opportunities for the investigation of the causes of a company's failure and the conduct of those involved in its activities, a properly conducted liquidation may deter misbehaviour and thus reinforce commercial morality. This brings benefits, in particular, to those who participate most frequently in commercial life. Institutional lenders (such as those whose interests were represented by the receivers in *Leyland Daf*) participate most frequently in commercial life, and in addition, are the most frequent beneficiaries of security interests. It follows that they should be required, *qua* secured creditors, to pay towards liquidation proceedings. Not so to require them would be to allow them to free-ride at the expense of everyone else interested in the company's undertaking, by receiving the benefits to the value of their security arising from improved debtor behaviour without sharing the burden of paying for those behavioural changes.

There are, however, good policy reasons why claims secured by *fixed* charges (and mortgages) should not be subordinated to any other claims (as explained in section 2.1 above). No such reasons support the non-subordination of *floating* charge claims, and in any case, Parliament had approved of *Barleycorn*, which (as explained in section 2.2 above) made available floating but not fixed charge assets for the payment of liquidation expenses. It follows that *Leyland Daf* was wrongly decided. It follows also that the new section 176ZA of the Act, reversing this decision, is entirely justified.

3. A Radical New Attempt to Rationalise *Leyland Daf*

So much for the decision itself and its critics. A&W claim that when their Lordships speak of assets subject to a floating charge forming a 'fund' separate from the one composed of unencumbered assets, their comments should be understood, not as applying from the point at which the charge is created or when it crystallises,⁵⁸ but instead, as restricted to the position *once the debtor company is in winding-up* (and, it seems, also when it is the subject of a winding-up application). This makes the second 'fund' a creature not of property law but of insolvency law itself.

Here are the main steps in A&W's reasoning:⁵⁹ The meaning of the statutory phrase the "assets of the company" must be understood in the context in which the phrase is used.⁶⁰ The context is of course that of liquidation, which "is a collective enforcement mechanism for the [sole] benefit of unsecured creditors."⁶¹ Therefore, the "assets of the company" include nothing other than "all legally

⁵⁶ [2004] 1 AC 158, 181, [79].

⁵⁷ In some instances where an action might be available to the liquidator against a director of the company, a balance might have to be struck between the interests of pre-liquidation creditors who would benefit from any recoveries from such an action, and the company's post-liquidation creditors whose interests lie in arriving at a compromise with the director; see *Whitehouse v Wilson* [2006] EWCA Civ 1688, [51]-[56] (Chadwick LJ) and [75]-[84] (Lindsay J). To the extent that the two learned judges in *Whitehouse* differ as to the degree to which the direct financial interests of the company's creditors might be subordinated to the liquidator's duty to investigate and report on misconduct, it is respectfully submitted that Lindsay J's views are to be preferred, for the forceful reasons given by his Lordship, and for the reason in the text here. To accept that the liquidator of an insolvent company might legitimately expend *any* of the company's resources on carrying out investigations or preparing a report even though the company's creditors would not benefit financially therefrom is necessarily to accept that the liquidator's public functions may legitimately trump those he performs in order to further the direct financial interests of creditors.

⁵⁸ AW, 305. Remember that crystallisation may happen, not merely upon the initiation of the debtor's liquidation, but upon the materialisation of any contractually specified contingency.

⁵⁹ Footnotes omitted.

⁶⁰ AW, 305.

⁶¹ AW, 305.

protected entitlements which the liquidator is capable of alienating for value for the benefit of the unsecured creditors.”⁶² This is what constitutes the “liquidator’s fund”, and the “assets of the company” in the relevant sense are identical with this “fund”.⁶³ By contrast, secured creditors “stand ‘outside’ [the liquidation] process”,⁶⁴ and “insofar as they are subject to a valid security, assets simply do not form part of the liquidator’s fund”,⁶⁵ and therefore, of “the company’s assets”.⁶⁶

This attempted rationalisation of *Leyland Daf* goes against the natural reading of that judgment, on which it is the *creation of the floating charge*,⁶⁷ or at most, its *crystallisation*,⁶⁸ which gives rise to the separate ‘fund’ belonging beneficially to the chargee. A&W, by contrast, attribute the creation of this ‘fund’, and the vesting in the chargee of the beneficial ownership in the collateral, to the *commencement of the chargor’s winding-up*. They insist that this proposition flows from “entirely orthodox” premises.⁶⁹ In fairness, however, and while the proposition itself might yet be true, there is no doubt but that it is entirely radical, and that it has never before been asserted in either case law or commentary.⁷⁰ Indeed, this proposition does not even have any discernable support in the text of their Lordships’ speeches, a fact A&W themselves notice, and which they seek to explain away on the basis that their Lordships “presumably considered it to be so fundamental as not to require elaboration”.⁷¹ But put aside “elaboration”; that is a long way away. The *barest statement* of this alleged aspect of the *Leyland Daf* judgment by any of their Lordships would have benefited not merely your present interlocutor, but also leading Counsel for the liquidators in *Leyland Daf*,⁷² the High Court,⁷³ the Court of Appeal,⁷⁴ and each of the other commentators on the decision. None of them appears to have been aware – even after the *Leyland Daf* judgment, let

⁶² AW, 307.

⁶³ AW, 309. While A&W put the phrase “liquidator’s fund” within quotation marks here, its source is unclear: it appears neither itself nor in any cognate form either in the legislation or in any of the speeches in *Leyland Daf*. A&W themselves employ it half a dozen times (at 305 (twice), 309 (thrice), and 323), treating it as identical with (the way in which they understand) “assets of the company”, “property of the company”, “unsecured creditors’ assets”, or in short, identical with the value of the company’s unencumbered estate.

⁶⁴ AW, 306.

⁶⁵ It is right to note that this particular proposition appears to be supported by high judicial authority (though this is not mentioned by A&W). In *Roberts Petroleum Ltd v Bernard Kenny Ltd* [1983] 2 AC 192, 208, Lord Brightman said (though in passing, without mentioning any supporting argument or authority, and *obiter*) that the “assets which the liquidator is able to collect and distribute are...necessarily those which are free from a charge.” The validity of this dictum should be assessed in the light of the discussion to follow.

⁶⁶ AW, 307.

⁶⁷ See e.g. at [18]; and see e.g. *NW Robbie & Co Ltd v Witney Warehouse* [1963] 1 WLR 1324.

⁶⁸ See e.g. at [29], where Lord Hoffmann refers to crystallisation of the charge as forming the “separate fund”; and see also, e.g., *George Barker Transport Ltd v Eynon* [1974] 1 WLR 462.

⁶⁹ AW, 301; see also at 305.

⁷⁰ The closest that this author has been able to get to finding any support at all for this proposition is the comment by Sachs LJ in *In re Barleycorn* [1970] Ch 465, 475-476, that “in those days [referring in particular to *In re David Lloyd & Co.* (1877) 6 ChD 339, 343 and 345] judgments on points such as those in issue before this court today were given upon the basis that when a winding-up order took effect the assets of the company changed to being assets of the debenture holders and could not be touched”. In fact, however, even this dictum provides no support at all to AW’s view, since (i) Sachs LJ was “in full agreement with all that [had] fallen” from Lord Denning, who referred (at 473, added emphasis) to the same Victorian case-law to state that “In those days it was held that, when there was a debenture which gave the creditor a floating charge over the property of the company, then, *as soon as the charge crystallised* on a winding up, the property did not belong to the company but to the debenture holder”; the context makes it clear that what was crucial was the reference to crystallisation, winding-up being merely one of a potentially unlimited range of contingencies in which a floating charge might crystallise; and (ii) the dicta in *In re David Lloyd* on which Sachs LJ relied unambiguously provide that winding-up would not interfere with the *pre-existing* proprietary rights of debenture-holders; winding-up did not in itself *confer* any rights that the debenture-holder had not previously possessed. *In re David Lloyd* is further discussed below.

⁷¹ AW, 305.

⁷² See the submission summarised and dealt with by the court in *Ultraframe (UK) Ltd v Gary Fielding* [2005] EWHC 1638 (Ch), at [1397]-[1399] and [1401]-[1405].

⁷³ See Counsel’s submissions as to the conflict between *Leyland Daf* and *Re MC Bacon* [1990] BCLC 324, and the court’s response in *Hill (as trustee in bankruptcy of Nurkowski) v Spread Trustee Company Limited* [2005] EWHC 336 (Ch). Compare A&W’s treatment of this issue at AW, 310.

⁷⁴ *Hill v Spread Trustee Co Ltd* [2006] EWCA Civ 542, [138]; again, compare AW, 310.

alone before it – that it is the commencement of the winding-up (rather than, say, the creation or crystallisation of a floating charge) which removes assets subject to a floating charge into a “separate fund beneficially owned” by the chargee. Indeed, this alleged premise (or is it implication?) of *Leyland Daf* does not appear to have been clear even to Lord Hoffmann. Less than ten months before delivering his judgment in this case, his Lordship held that winding-up leaves creditors’ debts “untouched”; does not either create new “substantive rights” or destroy old ones; but instead, merely effects the way in which these rights can be enforced.⁷⁵ So how could the commencement of winding-up transform creditors holding security into beneficial owners of the collateral?

Even leaving all this aside, this proposition is confusing. Consider its implications for a company undergoing administrative receivership. On A&W’s view, the encumbered assets remain “the company’s property/assets” when the receiver is appointed and when he takes control of them, so long as the company does not enter winding-up. When they are sold by the receiver, their proceeds become the company’s property.⁷⁶ This is true under the general law and also (as shown below) as a matter of the statutory language. The proceeds only cease being “the company’s property/assets”, in fact, when they (or some of them) are appropriated to repayment of the secured debt. In principle, this *pro tanto*, both, discharges the secured liability and simultaneously extinguishes the security interest. By strange contrast, however, if the company also enters *winding-up* at any point during this process, then simultaneously with the commencement of the winding-up, secured assets cease being “the company’s property/assets” and become beneficially owned by the debenture-holder. If all of the company’s assets are encumbered to their full value (as is often the case), then winding-up results in the company no longer retaining any of its assets/property at all. This premature transfer of beneficial ownership of the encumbered assets to the debenture holder, which does not happen in receivership itself – a process meant predominantly to further the debenture-holder’s interests – is, rather strangely, brought about by the commencement of a process meant (on A&W’s own testimony) to deal with all of the company’s affairs and all of its property. But why? What analytical or practical advantage is served by this move? After all, a receiver may deal with “the company’s property” in recouping his own costs, paying preferential creditors, discharging the secured liability, and then handing any residue over to the company (or its liquidator). So why can liquidation not manage, in a similar way, to deal with the various claims on (what continue to be) the assets of the company?

We can only hope to solve this puzzle by disentangling the multiple confusions that have in recent decades beset our understanding of the nature of liquidation proceedings. The next Section begins the process of identifying and disentangling those confusions.

4. The Dual Duality in the Nature of the Liquidation Regime

What are liquidation proceedings for? The answer is: to fulfil a variety of objectives, any of which may be marginalised or ignored, let alone denied, only at the cost of serious misunderstanding.

Take A&W’s account of these proceedings. As they conceive of it, liquidation is a remarkable institution. Liquidation, it appears, is an “execution” against “all” of the company’s assets for the benefit of “all” of the company’s creditors,⁷⁷ but at the same time, is a process “essentially”⁷⁸ or “primarily”⁷⁹ for the benefit of “unsecured” creditors. Or is it “purely”⁸⁰ for their benefit, or for their benefit “alone”?⁸¹ (And by the way, should “unsecured creditors” in fact read “general creditors”,⁸² the latter usually, though not necessarily, understood to exclude unsecured creditors statutorily elevated to a preferential position?⁸³) But if it is, then how can it also sometimes bring benefits to a debenture-holder?⁸⁴ And if the

⁷⁵ *Wight v Eckhardt Marine GmbH* [2003] UKPC 37, [27].

⁷⁶ *Foskett v McKeown* [2001] 1 AC 102, 127.

⁷⁷ AW, 311.

⁷⁸ AW, 313.

⁷⁹ AW, 324.

⁸⁰ AW, 311.

⁸¹ AW, 321.

⁸² AW, 299 (and also 305), citing *Leyland Daf*, [28] (and also [51]).

⁸³ For the general/preferential creditor distinction, see e.g. *In re Barleycorn* [1970] Ch 465, 472.

winding-up process may indeed sometimes serve the interests of a debenture-holder, then how is it that the latter has “no interest”⁸⁵ in that process? And simultaneously with being “purely” for the benefit of unsecured creditors “alone”, how can liquidation proceedings also “undeniably” involve “some public aspects”⁸⁶? How can they be for the benefit of “all those dealing with companies”,⁸⁷ indeed, of “the general public”⁸⁸?

The well-known problem with a set of mutually inconsistent statements is that, necessarily, the set is internally incoherent, and that at least some of those statements must be false. Implicit in their Lordships’ speeches in *Leyland Daf* but right at the heart of A&W’s argument is confusion about two distinct sets of issues, one relating to the dual public/private functions of liquidation, and the other to the role played by liquidation as regards secured and unsecured creditors.

4.1 Two New Fallacies to Defend an Old One

Let us begin by reminding ourselves of the self-evident distinctions between right and obligation, and between choice and compulsion. We must also understand the rather puzzling phenomenon that will be referred to here as the *choice/compulsion fallacy*, which may be defined, quite simply, as the outcome of a confusion between the proposition that agent A has a choice to do *y* as an alternative to doing *x*, with the proposition that A is under a compulsion or obligation to do *y* to the exclusion of *x*. It seems mysterious why anyone would suffer this fallacy, but it might perhaps arise where it is observed that it is, in most (perhaps even all) circumstances, more rational or prudent or convenient for A to do *y* than *x*. Suppose I may drive to and from work on one of two routes, one twice as long as the other. Under most circumstances, I would of course choose the shorter route. Someone who observed me taking that route day after day after day might well conclude that I was under some compulsion to do so. But of course that would be a fallacy. I would remain free to take the longer route, and might one day choose to do so, for example, in order to avoid congestion on the shorter route, or to pick up a friend I had arranged to meet along the longer route, or to give myself more time to think, or to enjoy the scenery, or simply for the sake of change.

To develop this point, take another set of examples. Suppose that your society, having provided for all its citizens a reasonable national health service, a publicly funded school education system, and a network of roads, insists that the values of political and civic equality require that all citizens be on par in having no less, but no more, than equal and reasonable access to these services. In these circumstances, it might well be entirely justified in doing so, for example, by prohibiting private markets in any of these services. Suppose, however, that for some appropriate reasons that appeal to it, your society decides instead, while continuing to require you to pay taxes towards maintaining the health service, publicly funded education system and road network, also to grant you the privilege, if you are able and willing, of taking out private health insurance, sending your children to fee-paying schools, and opting out of the use of the collective road network in favour of exclusive toll-funded routes. The fact that you had been accorded these additional choices would not, of course, imply that you had been shut out of the publicly funded facilities, even though a child educated at a fee-paying school, an illness tended to at a private hospital and a journey taken on a toll road would not, of course, be educated, tended to or travelled on the publicly funded system. To assert otherwise would be to commit the choice/compulsion fallacy.

And it would only compound this fallacy to assert that, in addition to enjoying the exercise of these choices, you could now refuse to pay those elements of your taxes that went towards supporting the collective facilities of which you had opted out. Being allowed to opt out of the requirement to use those facilities in common and on par with fellow citizens, in favour of health or education or travel regimes that afforded greater than average autonomy, choice, or speed, would *already* be a privilege. So it would hardly behove you to demand, simply on the basis that you had exercised one privilege, that you were

⁸⁴ AW, 322.

⁸⁵ AW, 311.

⁸⁶ AW, 314.

⁸⁷ AW, 314

⁸⁸ AW, 313.

therefore somehow *owed* or *entitled to* the additional privilege of opting out also of the requirement, along with fellow citizens, of paying your fair share towards the maintenance of the public services. Simply put, the fallacy that *privilege in itself legitimates further privilege*⁸⁹ would, in this context, be founded upon ignoring your continuing obligation to pay for the public services. You would remain thus obligated because you would continue to benefit from their existence: Your publicly-supported friends, workmates, and relatives would be well-educated, healthy, and on time, and the public services would continue to provide you with a sort of insurance scheme, should you find yourself one day unable or unwilling to ‘go private’. But you would remain obligated to pay for those public services also, quite simply, because a citizen of a civilised society must bear their fair share of the costs of a reasonable public provision of the sorts of services at issue.

4.2 The Fallacies Deployed: Not Paying for the Public Functions of Liquidation Proceedings

Now consider an instance of the choice/compulsion fallacy, which, for good measure, is then used as a premise in committing the fallacy that privilege in itself legitimates further privilege. In most (but as explained in the next Section, not all) circumstances prior to the coming into force of the Enterprise Act 2002, a creditor holding security over some of a distressed company’s property would, instead of participating in the collective proceedings to wind up the debtor’s affairs, have been allowed, considered it in its interests, and thus would have chosen, to appoint some form of receiver, notably, a receiver and manager or administrative receiver. It would not follow, of course, that it was either obliged or obligated to do so, nor that it was frozen out of the liquidation proceedings, nor that those proceedings did not operate in its interests. Any assertion to the contrary would be the product of the choice/compulsion fallacy. Nor would it follow from the brute fact that debenture-holders enjoyed the extraordinary privilege of choosing to opt out of the collective liquidation regime that they should enjoy the further and even more startling privilege of not being required to contribute towards liquidation expenses, and in particular, for the role played by the regime in the enforcement of commercial morality which brings benefits to “all those dealing with companies”, indeed, to “the general public”.⁹⁰ To insist otherwise would be to commit the fallacy that privilege in itself legitimates further privilege.

A&W assert repeatedly – though, as we have seen, they also contradict equally freely – the propositions that “liquidation is a collective enforcement mechanism for the benefit of unsecured creditors”,⁹¹ and that secured creditors “stand ‘outside’ this process” and do not benefit from it.⁹² This is wrong. In fact, the unambiguous words of the legislation render it uncontroversial that a winding-up order “operates in favour of *all* the creditors and of all contributories of the company”.⁹³ And the liquidator is required to ensure that “the assets of the company are got in, realised and distributed to the company’s creditors”.⁹⁴ The legislation qualifies “the assets of the company” no more than it qualifies “the company’s creditors”, so that in order artificially to exclude from the former assets subject to a charge, one would have to rewrite the latter so as to exclude any creditor holding any such charge.⁹⁵ That secured liabilities are *not* ‘outside’ winding-up should be further clear from the fact that the company’s members are required in the company’s winding-up to contribute towards discharging *all* of its “debts and liabilities”,⁹⁶ and that their contributions would often be charged or mortgaged.⁹⁷

⁸⁹ A fallacy inspired, perhaps, by a misreading of Matthew 25:29: “For to everyone who has, more will be given”?

⁹⁰ The ‘public’ functions of liquidation are considered in section 2.3 above.

⁹¹ AW, 305, and also 296, 299, 311, 313, 321 and 324.

⁹² AW, 305, 295 and 299.

⁹³ IA, s. 130(4) (emphasis added). It should go without saying that the legislature is quite capable of drawing – and when it considers it appropriate to do so, does draw – distinctions amongst different classes of creditor. The language here, by contrast, is entirely general.

⁹⁴ IA, s. 143(1).

⁹⁵ See also *Judd v Brown* (2000) P&CR 491 (CA), 497, *per* Robert Walker LJ: “creditors’ in section 335A(2)(a) of the Insolvency Act means (as elsewhere in the Act unless the contrary appears) both secured and unsecured creditors”.

⁹⁶ IA, s. 74; see also s. 76. It cannot be seriously argued that secured liabilities are excluded from the ambit of these provisions.

⁹⁷ See e.g. *Re Pyle Works Ltd* (1890) LR 44 Ch D 534.

What is more, if winding-up were “purely”⁹⁸ for the benefit of unsecured creditors or for their benefit “alone”,⁹⁹ then it would be unavailable in cases where no assets were likely to be distributed to such creditors. In fact, however, the court is explicitly precluded from refusing to make a winding-up order “on the ground only that the company’s assets have been mortgaged to an amount equal to or in excess of those assets, or that the company has no assets.”¹⁰⁰ And how could liquidation “essentially”¹⁰¹ or “primarily”¹⁰² be for the benefit of “general” creditors,¹⁰³ when nothing is distributed to general creditors (the vast bulk of unsecured creditors) in about three-quarters of all liquidations,¹⁰⁴ and when there are nil returns in a quarter of such proceedings even to preferential creditors (a tiny minority of unsecured creditors)?¹⁰⁵ To the extent to which it is possible to answer (metaphysical?) questions about the “essential” nature of liquidation, surely such proceedings are “primarily” about whatever happens in the vast majority of them where no assets go to general creditors at all. And that “essential” nature must have at least *some* connection with whatever happens in a quarter of liquidation proceedings where not even preferential creditors obtain anything.

5. The Treatment in Liquidation of Encumbered Assets and Secured Claims

Keeping in mind the foregoing observations, we may now examine the role played by liquidation proceedings in the treatment of the insolvent company’s encumbered assets and the discharge of its secured liabilities.

5.1 Voting, Proving and Interests in Winding-Up

Let us begin by clearing some ground. In asserting that secured creditors are not “entitled to participate in the collective [liquidation] proceedings”, A&W cite provisions which allow the secured creditor to prove in the winding-up to the extent to which it is undersecured or if it chooses to surrender its security, but not otherwise.¹⁰⁶ They also point out that secured creditors are not usually entitled to vote on the selection of the liquidator,¹⁰⁷ nor do they usually have a voice in whether liquidation ought to be initiated.¹⁰⁸

This argument proves too much.¹⁰⁹ There is no statutory mechanism for secured or preferential creditors to prove in receivership, any more than there is for secured ones to prove in liquidation.¹¹⁰ If

⁹⁸ AW, 311.

⁹⁹ AW, 321.

¹⁰⁰ IA, s. 125(1); “there is no doubt that the court has jurisdiction to make a winding-up order in circumstances in which the company has no assets and where the only purpose of the order would be to enable an investigation to take place into the company’s affairs”, *per* Chadwick J, as he then was, in *Bell Group Finance (Pty) Ltd (in liq) v Bell Group (UK) Holdings Ltd* [1996] B.C.C. 505, 512, applying (among others) *Re Crigglestone Coal Co Ltd* [1906] 2 Ch 327 (CA).

¹⁰¹ AW, 313.

¹⁰² AW, 324.

¹⁰³ AW, 299 (and also 305), citing *Leyland Daf*, [28] (and also [51]).

¹⁰⁴ ABRP, 8th Survey, 4.

¹⁰⁵ ABRP, 9th Survey, 18. As to the proportions of the debts owed by insolvent companies to different types of creditor, it has been estimated on the basis of pre-Enterprise Act data that preferential claims make up a little over 1% of these debts whereas general unsecured creditors hold over 70%; Mokal, *Corporate Insolvency Law*, 128-9.

¹⁰⁶ IR, r. 12.3. They also cite r. 4.88, which provides simply that a secured creditor may prove in liquidation to the extent to which it is undersecured (that is, the value of its claim exceeds the value of its security), and that it may prove for the whole amount if it chooses to surrender its security. A secured creditor might choose the latter option when, for example, it would be prohibitively expensive to realise the secured asset, perhaps for the sort of reason already mentioned in the text. In any case, none of this shows that the secured creditor is frozen out of liquidation proceedings *qua* secured creditor. The secured creditor may rely upon the liquidator dealing with its collateral in the way described in the text to follow, and thus has no *need* to prove in the liquidation to the extent to which its debt is covered by the value of the collateral.

¹⁰⁷ See AW, 306.

¹⁰⁸ Compare AW, 306, text to fn. 62.

¹⁰⁹ Compare AW, 305 and 311, fn. 97.

valid, therefore, A&W's argument also demonstrates that neither secured creditors nor preferential ones are "entitled to participate" in administrative receivership. But of course this is a *reductio*: A&W sport the belief that administrative receivership "functions for the exclusive benefit of the debenture-holder".¹¹¹ (A&W's latter statement should not be taken literally, since the receiver unquestionably owes duties to benefit preferential creditors,¹¹² and must also protect certain interests of subsequent encumbrancers and the company itself.¹¹³)

Similarly, preferential creditors have no say in whether to initiate receivership, and no influence on the identity of the receiver. It does not follow that receivership cannot accommodate their interests or that the receiver does not owe duties to them. *Mutatis mutandis* for liquidation and secured creditors.

Let us return for a moment to the requirement for secured creditors to sell or value their security and to prove only for the remainder. A&W appear to have overlooked the antecedents of this rule. In the first half of the nineteenth century, when the winding-up of companies was beginning to occupy more of the courts' attention, there were two rules governing proof by mortgagees.¹¹⁴ The *equity rule* – applicable in the Chancery courts, for example, in the distribution of the insolvent estates of deceased persons – was that the mortgagee, so long as he did not receive more than twenty shillings in the pound, could prove for the full amount of his loan, without giving any credit for the value of the collateral.¹¹⁵ By contrast, the *bankruptcy rule*, applicable in the Bankruptcy Court,¹¹⁶ was that the collateral was to be realised or valued, with the mortgagee being able to prove only for any balance.¹¹⁷

Against this background and left to their own devices, the courts entrusted with the winding-up of companies applied the equity rule to proofs by mortgagees in winding-up.¹¹⁸ For anyone who assumed that the ability to prove in a particular set of proceedings is an indication of the degree to which the creditor in question may participate in those proceedings, it would follow that mortgagees were, at the very least, as fully entitled to participate in winding-up as were unsecured creditors.

The position as to proofs was altered by section 10 of the Supreme Court of Judicature Act 1875.¹¹⁹ Thenceforth, the bankruptcy rule applied to a mortgagee intending to submit a proof in his

¹¹⁰ See also IR, rr. 3.9(5) and 3.11(6) (secured creditor not entitled to participate or vote in creditors' meeting called by administrative receiver).

¹¹¹ AW, 314.

¹¹² See e.g. IA, s. 40.

¹¹³ Perhaps the most frequently cited authority on this point is *Downsview Nominees Ltd v First City Corp Ltd* [1993] AC 295.

¹¹⁴ The classic case in which the existence of these divergent practices was first noticed is *Mason v Bogg* (1837) 2 Mylne and Craig 443, 40 ER 709 (Cottenham LC).

¹¹⁵ This rule was confirmed, albeit tangentially, by the House of Lords in *Attorney-General v Cox* [1850] 3 House of Lords Cases 240, 10 ER 93.

¹¹⁶ And attributed to the practices of "a Court having a peculiar jurisdiction, established for administering the property of traders unable to meet their engagements, which property that Court found it proper and right to distribute in a particular manner, different from the mode in which it would have been dealt with in the Court of Chancery"; *In re Barned's Banking Company; Kellock's Case* (1867-68) LR 3 Ch App 769, 777. The bankruptcy rule was however applied to the administration of the joint and separate estates of partners in *Lodge v Prichard* (1863) 1 DJ & S 610, 46 ER 242.

¹¹⁷ The best statement of the different rationales, and the reasons for equity's preference for the first of these rules is provided by Sir Page Wood in *Kellock's Case: In re Barned's Banking Company* (1867-68) LR 3 Ch App 769, 776.

¹¹⁸ This was confirmed by the Court of Appeal in *In re Barned's Banking Company* (1867-68) LR 3 Ch App 769.

¹¹⁹ This provided that: "in the administration by the Court of the assets of any person who may die after the commencement of this Act, and whose estate may prove to be insufficient for the payment in full of his debts and liabilities, and in the winding up of any company under the Companies Acts, 1862 and 1867, whose assets may prove to be insufficient for the payment of its debts and liabilities and the costs of winding up, the same rules shall prevail and be observed as to the respective rights of secured and unsecured creditors, and as to the debts and liabilities provable, and as to the valuation of annuities and future and contingent liabilities respectively, as may be in force under the Law of Bankruptcy with respect to the estates of persons adjudged bankrupt; and of persons who in any such case would be entitled to prove for and receive dividends out of the estate of any such deceased person, or out of the assets of any such company, may come in under a decree or order for the administration of such estate, or

debtor's winding-up. The position then became as it is today: a secured creditor may only prove for that portion of his debt, if any, which exceeds the value of the collateral. What section 10 of the 1875 Act was never intended to do, and what it could do neither explicitly nor by necessary implication, was to 'exclude' mortgagees from winding-up proceedings in some deeper or wider way. That simply was not its purpose, nor has any such effect ever been attributed to it.¹²⁰ Indeed, much of the case law on the place of secured claims in winding-up, discussed below, postdates the 1875 Act.

It follows that while secured creditors were required, if intending to prove in the liquidation, to realise or value their security and to put in only for the balance, section 10 of the 1875 Act did not push them out of the winding-up proceedings, nor did it withdraw from the company's encumbered assets the attention of its liquidator.

In further support of their contention that secured creditors 'stand outside' winding-up, A&W assert that the liquidator's "fiduciary duties to act in the 'interests of the liquidation' promote the maximisation of realisations for [unsecured creditors alone]."¹²¹ However, *In re Adam Eyton Ltd*,¹²² the main authority they cite, makes clear that the "interests of the liquidation" extend to "all those who are interested in the company being liquidated".¹²³ Note that, *contra* A&W, this is not restricted to unsecured creditors, nor even to those interested in "the company's assets", whether or not understood to include the company's encumbered property. So for example and as discussed in Section 5.2, if, prior to being wound up, the company held assets as trustee, then the beneficiaries under that trust would also be "interested in the company being liquidated", and so the liquidator's duties would also include dealing with those trust assets.¹²⁴ Further and as discussed in Section 5.5, the very duties that the liquidator owes in respect of the company's *unsecured* liabilities compel him to deal with encumbered assets. The requirement to deal with encumbered assets and to discharge secured liabilities is thus thoroughly intertwined with the liquidator's other functions. Furthermore, *Adam Eyton* held that the yardstick for judging the liquidator's conduct is "the real, substantial, honest interests of the liquidation, and...the purpose for which the liquidator is appointed."¹²⁵ But surely all of this is not limited simply to maximising the realisations of unsecured creditors. If it were, it would follow that in the 25% of liquidations in which nothing would be distributed to unsecured creditors, the liquidation would not have any "interests" at all, and/or that the liquidator's duty was vacuous. And it would surely be wrong to suggest that there were no "liquidation interests" in relation to the public functions that, as A&W must and do concede, the liquidator is bound to perform. It must be part of the "real, substantial, honest" process of winding up the affairs of a company that those affairs be investigated, in the interests of the broader public as well as of those with a direct financial stake in the company's undertaking.

5.2 The Liquidator's Role

So much for the ground-clearing. In reflecting upon the position of secured creditors, we should consider the role of the liquidator. A&W maintain that the liquidator is simply the "manager of the fund of free assets (which ensures to the benefit of unsecured creditors)",¹²⁶ and that "assets subject to a charge are...not part of the 'fund' available for distribution by the liquidator."¹²⁷

There are several problems with this statement. Recall first that winding-up is an occasion for concluding *all* of the company's affairs. For a company which, prior to the initiation of its winding up,

under the winding up of such company, and make such claims against the same as they may respectively be entitled to by virtue of this Act."

¹²⁰ The case law on s. 10 of the 1875 Act is authoritatively reviewed by the Court of Appeal in *Re Jessel Securities Ltd* [1983] BCLC 1.

¹²¹ AW, 306.

¹²² (1887) LR 36 ChD 299 (CA), cited and relied upon in *Quickson (South & West) Ltd v Katz* [2004] EWHC 2443 (Ch) at [168]; these are two judgments mentioned by A&W on this point.

¹²³ (1887) LR 36 ChD 299, 304 (Cotton LJ).

¹²⁴ See e.g. *Polly Peck International plc (in administration) v Henry* [1999] 1 BCLC 407.

¹²⁵ (1887) LR 36 ChD 299, 306 (Bowen LJ).

¹²⁶ AW, 322.

¹²⁷ AW, 305.

held assets not beneficially but on trust for another, this would usually require the liquidator to deal in an appropriate way with those assets,¹²⁸ even though it is clear that they do not fall to be distributed to any of the company's creditors, secured or otherwise, and therefore, clear *a fortiori* that they do not fall within any statutory trust to be administered by the liquidator for the benefit of creditors, unsecured or not. If required to deal with trust assets, the liquidator would of course be remunerated, from the assets of the company as trustee if appropriate,¹²⁹ or otherwise from trust assets.¹³⁰

A similar pattern holds, *a fortiori*, for all assets that belong beneficially to the company at the point of commencement of its winding-up, whether or not they are subject to a security interest. The liquidator is required, upon assuming office, to take custody or control of "all the property and things in action to which the company is or appears to be entitled".¹³¹ A&W concede that this injunction applies also to assets subject to a security interest.¹³²

On any credible interpretation of the statute, then, the liquidator is required to gather in *all* of the company's assets – whether or not they are subject to a security interest – and to distribute the proceeds thereof amongst *all* of the company's creditors in the order explicitly or implicitly provided by the statute.

5.3 How Secured Creditors Participate in the Winding-up Process

As noted, A&W maintain that:

"Secured creditors stand 'outside' [the winding-up] process, not being entitled to participate in the collective proceedings, but instead being permitted to enforce their security."¹³³

It is quite true that a debenture-holder might, prior to the coming into force of the Enterprise Act, have *chosen* to appoint an administrative receiver, in which case the collateral would be realized within receivership. But the debenture-holder was not *compelled* to initiate receivership, nor was it true then – any more than it is today, after the virtual abolition of administrative receivership – that they were not "entitled to participate" in the winding-up. As the following discussion demonstrates, to assert otherwise is to succumb to the choice/compulsion fallacy.

Firstly, it has long been recognised as perfectly proper – indeed, often sensible – for the debenture-holder not to opt out of winding-up proceedings, but instead to participate in them *without giving up the benefit of their security*. This might be done for reasons of cost-effectiveness,¹³⁴ for example, or

¹²⁸ *Re Berkeley Applegate Ltd (No 2)* (1988) 4 BCC 279; *Polly Peck International plc (in administration) v Henry* [1999] 1 BCLC 407; the case concerned an administration, but at 413, the court made it clear that the position is the same for liquidation.

¹²⁹ See e.g. *Polly Peck International plc (in administration) v Henry* [1999] 1 BCLC 407, 413.

¹³⁰ *Re Berkeley Applegate Ltd (No 2)* (1988) 4 BCC 279, etc. The liquidator is, however, precluded from acting on behalf of trust beneficiaries if doing so would cause a conflict between the duties he would then owe to the trust beneficiaries and those he owes to the company's creditors, and in the appropriate case, contributories; see e.g. *Mettoy Pension Trustees Ltd v Evans* [1990] 1 W.L.R. 1587, 1616-1617.

¹³¹ IA, s. 144(1); see also *Re Regent's Canal* (1875) 3 ChD 411, 427; *Re Berkeley Applegate (Investment Consultants) Ltd* [1989] Ch 32, 50-53; *Leyland Daf*, [19], [31], and [63].

¹³² AW, 300.

¹³³ AW, 306 (footnotes considered in the text below).

¹³⁴ For an example, see *In re Marine Mansions Company* (1867) LR 4 Eq 601, 611, *per* Page Wood VC, which involved "a mortgagee who, not wishing to put the estate to the expense of a separate suit, [did] not file a bill, but [took] the simple and proper course of coming in under the winding-up to have his rights decided by summons in Chambers." In this case, which involved a fixed (not floating) security (see e.g. the importance of the debenture-holders' consent in relation to dealings with the collateral, at 609), it was held that the liquidator's costs of realising the mortgaged assets took priority over the secured debt (this was not disputed by the debenture-holder), which in turn took priority over the general costs of winding-up. Notably, the Vice-Chancellor spoke of all of the realisations of the company's property as constituting one "fund", and determined the appropriate priorities as amongst the mortgagee, the holder of a "vendor's lien" over some of the property, and the liquidator. And as Lord Millett noted in *Leyland Daf* itself, issue of priority arise only in respect of interests which compete in relation to one 'fund'.

even, on the basis that the machinery of the winding-up is more suited to the realisation of the encumbered assets than would be a receivership.¹³⁵

Second, it has long been recognised – though the choice/compulsion fallacy might occasionally have obscured this from view – that secured creditors may look to the winding-up for payment. Particularly illuminating in this regard is *In re Mayfair Property Company*.¹³⁶ The context here was section 5 of the Companies Act 1879, pursuant to which the company had rendered part of its share capital incapable of being called up “except in the event of and for the purposes of the company being wound up”. Affirming the first instance judgment, a unanimous Court of Appeal held that this part of the share capital could not be mortgaged by the company while solvent. Notice that it would have been easy for the courts, in reaching their conclusion, to say that the payment of secured claims could not be a “purpose of the winding-up”; indeed, the Court of Appeal was expressly invited to do so by Counsel for the liquidator.¹³⁷ But none of the judges took this position.¹³⁸ Instead, the basis of their decision was that a purpose of the Companies Act 1879 was to set up a fund utterly beyond the company’s control; this fund could therefore not be mortgaged by the company, and was available only to the company’s liquidator for the purposes of the winding-up.¹³⁹ And decisively, Vaughan Williams LJ expressly stated in the Court of Appeal¹⁴⁰ that “the payment of secured creditors is a purpose of the winding-up”.¹⁴¹

For a modern analogue, consider the decision of no less a jurist than Hoffmann J (as he then was) in *In re Potters Oils Ltd*.¹⁴² Here, the company’s liquidator had asked the court – in terms which make the choice/compulsion distinction particularly pertinent – to disallow the remuneration and disbursements of the receiver appointed by a debenture-holder:¹⁴³

“The liquidator says that the appointment of the receiver was unnecessary because he, the liquidator, was doing all that could be done to protect the interests of [the debenture-holder] and the appointment of the receiver only caused duplication of effort and unnecessary expense.”

This argument pointedly assumes that the secured creditor was entitled to participate in the winding-up, and that the liquidator was empowered to look after its interests. As if to prove this point, the collateral in this case had been realised by the liquidator. This had been done with the consent of the receiver,¹⁴⁴ and in the latter’s absence, could undoubtedly have been done with the consent directly of the debenture-holder.¹⁴⁵ At no stage had there been any doubt, subject to establishing the debenture’s validity, that the mortgagee’s priority would – and would have to – be respected by the liquidator in the distribution of the proceeds.¹⁴⁶ So the secured creditor participated in the winding-up in a manner appropriate to its position.

¹³⁵ See e.g. the authoritative discussion in *In re Joshua Stubbs Ltd* [1891] 1 Ch 475 (CA), particularly at 482-483; and *Bartlett v Northumberland Avenue Hotel Co* 51 LT (NS) 611, 612; for another example of a case in which only the liquidator but not (at least without significant difficulty) the receiver could have collected the encumbered assets, see *Re Pyle Works Ltd* (1890) LR 44 Ch D 534 (CA).

¹³⁶ [1896] 2 Ch 28.

¹³⁷ [1896] 2 Ch 28, 34: “The mortgagees of the company and their rights are outside the liquidation: *In re David Lloyd & Co* (1877) 6 Ch D 339; and although the debenture-holders may receive their debts through the machinery of the winding-up, the payment of such debts is in no sense one of the purposes of the winding-up.”

¹³⁸ Both courts relied (*inter alia*) on *Re Pyle Works Ltd* (1890) LR 44 Ch D 534 (CA), where the Court of Appeal ordered the liquidator to collect in encumbered assets and use their proceeds to pay off secured claims; see below.

¹³⁹ See e.g. [1896] 2 Ch 28, 36, 40 and 42.

¹⁴⁰ Apparently accepting the argument by Counsel for the debenture-holder that “the payment of the debts of the company secured by the debentures is as much ‘one of the purposes of the company being wound up’ as the payment of its other debts is”; [1896] 2 Ch 28, 33.

¹⁴¹ [1896] 2 Ch 28, 42.

¹⁴² [1986] 1 WLR 201.

¹⁴³ [1986] 1 WLR 201, 205.

¹⁴⁴ [1986] 1 WLR 201, 205.

¹⁴⁵ After all, once the liquidation has started, the receiver may only exercise the debenture-holder’s proprietary rights in the collateral, and what may be done by him as the debenture-holder’s agent can, save in the most exceptional circumstances, be done by the debenture-holder as principal. For an example, see *Re Norman Holding Company Ltd* [1991] 1 WLR 10.

¹⁴⁶ See e.g. the terms of the liquidator’s letter to the receiver at [1986] 1 WLR 201, 205.

It had standing to, and did, make its interests known to the liquidator. And the liquidator was entitled to, and did, deal with the encumbered assets, though of course not in any way inconsistent with the secured creditor's proprietary rights. And while Hoffmann J refused to disallow the receiver's remuneration etc., he did not so much as hint that it had been improper – or even worthy of remark – for the liquidator to claim to protect the secured creditor's interests, or to realise the encumbered assets.

Perhaps the point should be hammered home. Hoffmann J did not respond to the liquidator's argument (excerpted above) by pointing to the debenture-holder's alleged *compulsion* to 'stand outside' winding-up. He did not announce, resoundingly, that since 'secured creditors are not entitled to participate in the collective proceedings', that the debenture-holder's interests could not possibly be protected by the liquidator. Instead, his Lordship based his decision on the debenture-holder's *choice*. He held that a debenture-holder may, if contractually entitled to do so, make an out-of-court appointment of a receiver without paying any regard to the company's interests, and that, in any case on the facts, the liquidator had placed himself in a position of conflict with the debenture-holder by questioning the validity of the debenture and the value of the collateral (considered independently of the company's unencumbered property).¹⁴⁷

5.4 When Secured Creditors *Must* Participate in Winding-up

There is a common misunderstanding that a debenture-holder may obtain immunity from having to participate in the collective liquidation process 'as of right'.¹⁴⁸ This is an oversimplification, dangerously confusing in this context, of the true position.¹⁴⁹ Consider three situations, roughly ordered in terms of the degree of court assistance required by the debenture holder: (1) the debenture-holder has no contractual right to appoint a receiver, so that the court must be requested to appoint one; (2) the debenture-holder asks the court for an order of sale or foreclosure; and (3) the debenture-holder has the contractual right privately (that is, without court assistance) to appoint a receiver:

First, then: where an official liquidator was already in place, there was a rule of practice that the court would refuse to appoint another person as receiver; instead, the *liquidator* would be empowered also to act in this capacity.¹⁵⁰ The objective was presumably to maximise the value of the company's property by allowing the liquidator, acting *qua* receiver, to release the encumbered assets from the security interest, while simultaneously protecting the debenture-holder's position, and avoiding the duplication of costs.¹⁵¹ Even more strongly, an already-appointed receiver might be discharged in favour of the liquidator, for similar reasons.¹⁵² This rule of practice was displaced only in cases where the facts made it proper to do so, for example, where the liquidator might be required to dispute the validity of the debenture, or where the nature of the encumbered assets was such that some part of their value could only be captured by a private receiver with experience in the relevant markets, rather than by the liquidator (who would often be

¹⁴⁷ [1986] 1 WLR 201, 205-206.

¹⁴⁸ See e.g. AW, 308.

¹⁴⁹ See also *Re Exchange Securities & Commodities Ltd* [1983] BCLC 186 (ChD) (claimants with an arguable case of being beneficiaries under a trust rather than mere creditors refused leave to commence independent actions against the company in winding-up, on the basis that they could assert their claims, as claims under trusts, within the winding-up itself).

¹⁵⁰ For an early example, see *Perry v Oriental Hotels Co* (1869-70) LR 5 Ch App 420; a flavour of the reasoning may be gained at 423, *per* Giffard LJ: "[The liquidator] has already been in communication with the persons abroad, is in constant communication with them, and very great additional expense would be occasioned if I were to introduce a third person as receiver, because, of course, that receiver would be entitled to his own set of expenses." For the modern position, see IA, s. 32.

¹⁵¹ A joint appointment could, however, create confusion and expense when either the liquidator was not sufficiently clear as to the capacity in which he performed a particular action, or if one of the insolvent company's counterparties for some reason wished to seek the comfort of a court order; see *In re Oriental Hotels Company* (1871) LR 12 Eq 126, 133-134. But this type of problem appears very much to have been an exception rather than the rule; see the following text and the authorities cited in the next footnote.

¹⁵² See e.g. the discussion in *In re Joshua Stubbs Ltd* [1890] 1 Ch 475 (CA) and *British Linen Company v South American and Mexican Company* [1894] 1 Ch 108. It was, however, improper for a court to remove the receiver without having appointed the liquidator in his place or otherwise having protected the mortgagee's position; see *Strong v Carlyle Press* [1893] 1 Ch 268.

the official receiver).¹⁵³ This indicates once again that in the appropriate case, the encumbered assets would be realised and the secured liabilities discharged *within* the winding-up.

Second: where a mortgagee asked the court winding-up the mortgagor company for leave to proceed with the sale of the collateral or with foreclosure, the court would grant that leave. This much is well-known, and *In re David Lloyd & Co*¹⁵⁴ is routinely cited as authority.¹⁵⁵ What appears to have been overlooked is the *qualification* to this ruling, which is that leave would be given to the mortgagee if but only if he could not obtain identical protection *within the winding-up*.¹⁵⁶ On the facts, it was crucial that the liquidators in this case appeared to have been casting doubt on the validity of the mortgage or the exercise of the mortgagee's rights, and were thus not offering protection to the mortgagee within the winding-up.¹⁵⁷ This appears to have been crucial to the three judges on the panel. Jessel MR said this:

“Now, as a rule, a mortgagee has a right to realize his security, and of course, as incidental to that, a right to bring an action for foreclosure. Those who say that he should be restrained from bringing or proceeding with such an action must either shew some special ground for restraining him, or must say, ‘We can offer the mortgagee all he is entitled to, foreclosure or sale, as the case may be, at once, *without any proceeding in the [mortgagee’s] action*.’¹⁵⁸ That, of course, would be a reason for refusing leave to proceed with an action if commenced, or for not giving leave to commence a threatened action. But, short of that, it appears to me that the Court ought not under the 87th section of the [Companies Act 1862, the partial predecessor to section 130(2) of the 1986 Act] to interfere with the rights of a mortgagee.”¹⁵⁹

James LJ (the first, incomplete portion of whose judgment in this case is endlessly cited) was “entirely of the same opinion”, observing:

“I am of the opinion that the [mortgagee’s] action ought to proceed, unless, indeed, the whole thing being under the control of the Court, the Court is able to say, We, on behalf of the company being wound up, will without further litigation of any kind give you all which you are entitled to have. The Court may say on behalf of the company, We accede to your terms, and will give you your right at once”.¹⁶⁰

Two implications are significant. Firstly, the mortgagee *could* certainly stand “entirely outside the company”, *could* choose to opt out of being “*quasi parties to the winding-up proceedings*”,¹⁶¹ but only if, *on the facts of the particular case*, his rights would not be protected within the winding-up. Second, following from that, and once again: it was entirely proper, if circumstances permitted, for the encumbered assets to be realised within the liquidation, and for their proceeds to be applied towards the discharge of the secured liability. A proposition of real significance to be derived from *David Lloyd* is that the ‘liquidator owes no higher duty to the mere creditors than he does to other claimants on the funds in his hands’.¹⁶²

Third and finally: where the debenture-holder had a contractual right privately to appoint a receiver, the courts appear to have taken a more ‘hands-off’ approach, apparently on the basis that the

¹⁵³ See e.g. *British Linen Company v South American and Mexican Company* [1894] 1 Ch 108, where only certain securities of the sort described in the text were put under the receiver’s control, the remaining encumbered assets being left to be dealt with by the liquidator.

¹⁵⁴ (1877) LR 6 Ch D 339.

¹⁵⁵ See e.g. AW, 306 and 308.

¹⁵⁶ The direct authority for this is *In re St Cuthbert Lead Smelting Co* (1866) 35 Beav 384, 55 ER 944.

¹⁵⁷ (1877) LR 6 Ch D 339, 346, *per* Cotton LJ.

¹⁵⁸ That is, without putting the mortgagee to proof as to the validity or enforceability of their mortgage.

¹⁵⁹ (1877) LR 6 Ch D 339, 343-344 (emphasis added).

¹⁶⁰ (1877) LR 6 Ch D 339, 344 and 345; see also at 346 (Cotton LJ). To similar effect, see e.g. *In Re Wanzer Ltd* [1891] 1 Ch 305, 314 (emphasis added): “...I am reminded of the cases in which a mortgagee is allowed, pretty much as a matter of course, *if the relief he asks for is not conceded*, to commence proceedings after the winding-up, or after the winding-up to continue proceedings commenced before, for the purpose of realizing his security.”

¹⁶¹ (1877) LR 6 Ch D 339, 344-345 (James LJ).

¹⁶² *Re Lineas Navieras SAM* [1995] BCC 666, *per* Mervyn Davies J.

debenture-holder had bargained for the right to determine the identity of the receiver, and that the court did not have the jurisdiction to interfere with this right.¹⁶³ But it should be obvious, once again, that the debenture-holder has a choice to appoint a receiver and to opt out of the winding-up; there is no obligation on it to do so, nor is it exiled from the winding-up.

In any case where the secured creditor chooses or is required to participate in the winding-up, the liquidator would simply realise the charged assets and distribute the proceeds according to the statutory (including the proprietary) scheme of priorities. For these functions, the legislation explicitly provides for him to be remunerated from the proceeds of sale of the realised assets,¹⁶⁴ as A&W also concede.¹⁶⁵

5.5 Encumbered Assets, Unsecured Liabilities, and the Liquidator's Duties

It is instructive to think through the liquidator's handling of the company's encumbered property. The liquidator stands in no better position than the company itself in relation to assets subject to security, and so could not simply act as if the proceeds of their sale could be distributed in a manner identical to those of assets not subject to security. At the same time, however, he could not simply ignore the assets subject to security, because to do so would violate any number of his obligations, including the duty to take control of all of the company's property, and even, the duty to realize *encumbered* property in order to discharge (*inter alia*) the company's *unsecured* liabilities.¹⁶⁶

There are three possibilities, in each of which the liquidator must deal with encumbered assets as a way of complying with his obligation to discharge the company's unsecured liabilities.

Firstly, if the value of the assets subject to the security, net of realisation costs, is worth more than the value of the secured debt, then the liquidator must realise it in order to maximize the recoveries of unsecured creditors. He would use the proceeds to discharge the secured debt and distribute the surplus amongst unsecured creditors.

Second, if the value of the assets subject to the security, net of realisation costs, is less than the value of the secured debt, the liquidator must nevertheless realise it (on the assumption that the secured creditor does not wish, or is unable, to do so himself) and use the proceeds to discharge *pro tanto* the secured debt, so as to maximise the value of the remaining estate for the benefit of unsecured creditors (who would not then have to compete against the full claim of the secured creditors).

In either of these situations, it would almost invariably be in the secured creditor's interests to participate in the sale by releasing its encumbrance, subject, of course, to protection for its priority in the proceeds of sale. This would maximise those proceeds, which would rarely (if ever) be contrary to the secured creditor's genuine interests.

Third and finally, if the costs of realising the secured assets are prohibitive (for example, because the asset in question is polluted land whose clean-up costs exceed its value), the liquidator still must take appropriate steps in relation to it, for example, by disclaiming it as onerous property. Any doubt on this front is removed by section 178 of the Act, which confers upon the liquidator the power to disclaim "any... property of the company", including – as the explicit reference to the company's mortgaged *leasehold* property in section 179 demonstrates – any of its encumbered assets. This in itself shows that prior to and but for the disclaimer, the assets are the company's property, and that the liquidator is obligated to deal with them in the discharge of his duties.

5.6 The Choices Available to the Secured Creditor

¹⁶³ The leading authority for this proposition is *In Re Henry Pound, Son, & Hutchins* (1889) LR 42 Ch D 402.

¹⁶⁴ IR, r. 4.127B.

¹⁶⁵ AW, 300, fn. 22.

¹⁶⁶ *Contra* AW, 306.

A&W appear to think that the secured creditor of a company in winding-up has only three choices. It may:¹⁶⁷ (i) surrender its security and prove in the liquidation for the full amount;¹⁶⁸ (ii) enforce its security (if a mortgage) through foreclosure;¹⁶⁹ (iii) enforce its security through receivership and/or sale, and prove for any unpaid balance.¹⁷⁰ In fact and as demonstrated above, there is a fourth and particularly convenient option: the secured creditor may simply (iv) ‘stand on its security’, allowing or requiring the liquidator to realise the company’s property and use the proceeds of the collateral to discharge the secured liability in accordance with the statutory scheme.¹⁷¹

This final point is so fundamental as to require further elaboration. In general, the liquidator takes the company’s property as he finds it, whether this property be subject to security interests, easements, restrictive covenants, profits, or options (or even rights of pre-emption). The legislation governing liquidation does not provide to such parties all of the protections that it makes available to the company’s unsecured creditors, since the former but not the latter benefit from their standing under (*inter alia*) the general law of property.¹⁷² So none of the parties holding any of these proprietary rights is able directly to influence the identity of the liquidator, for example, or to ‘prove’ in some way in the liquidation, or to have a decisive – or, more often, any – say in whether liquidation ought to be initiated. Yet the liquidator is bound to uphold the company’s obligations in respect of all such persons, and all of them may participate in the liquidation process as and when appropriate, for example, when the liquidator proposes to realise land subject to an option, or in a way that *prima facie* would violate a restrictive covenant. Or indeed, when the liquidator considers whether to realise charged or mortgaged property and how to distribute the proceeds

The Court of Appeal’s judgment in *Re Pyle Works Ltd*¹⁷³ provides an excellent illustration of this point. At the behest of certain of its mortgagees, the Court ordered the debtor company’s liquidator to determine the priorities *inter se* of the mortgagees, realise the collateral, and apply it first for the discharge of the secured liabilities. It is illuminating to gain a flavour of the sorts of orders successfully sought from the Court. One mortgagee, for example, asked the Court to direct the liquidator that:

“an account...be taken of what was due on such mortgages: that, if necessary, an inquiry...be directed as to the priorities of persons claiming to have charges over such uncalled capital: that the liquidator...be directed to give effect to and satisfy such mortgages, and for that purpose to enforce and recover payment of the uncalled capital then remaining unpaid [the mortgaged assets], and out of the moneys to be received by him in respect of the said uncalled capital to pay and satisfy – and, if necessary, according to their respective priorities – the amounts which might be found due for principal, interest, and costs under such mortgages.”¹⁷⁴

Re Pyle Works Ltd is a leading illustration of the way in which the liquidation process serves (unless hindered by receivership) the direct financial interests of secured creditors, and of how the liquidator is obligated (unless impeded by a receiver) to deal with secured assets. And yet, quite curiously, A&W cite it¹⁷⁵ in support of an argument which concludes¹⁷⁶ that:

¹⁶⁷ AW, 306, including fn. 60; and 309.

¹⁶⁸ IR, r. 4.88(2).

¹⁶⁹ This rather refines A&W’s analysis; they do not consider this possibility explicitly.

¹⁷⁰ IR, r. 4.88(1) deals with proof in these circumstances.

¹⁷¹ See e.g. *Re Norman Holding Company Ltd* [1991] 1 WLR 10.

¹⁷² It is for this reason that, as Robert Walker LJ noted in the analogous bankruptcy context in *Judd v Brown* (2000) 79 P & CR 491 (CA), 497 (added emphasis), “in the nature of things it is *generally* the interests of the unsecured creditors to which the trustee in bankruptcy will pay *special* attention.” The same holds for the liquidator. Compare the point in the text with (i) the special issues raised by leases, which are explicitly dealt with in the statute, and (ii) the special treatment for secured creditors provided for in administration.

¹⁷³ (1890) LR 44 Ch D 534.

¹⁷⁴ (1890) LR 44 Ch D 534, 538-539.

¹⁷⁵ AW, 308.

¹⁷⁶ AW, 309.

“insofar as they are subject to valid security, assets simply do not form part of the liquidator’s fund...they form a separate fund from that which the liquidator is required to administer”.

Let the reader be judge.

We may now respond to A&W’s claim that secured creditors ‘stand outside’ winding-up, in the sense of “not being entitled to participate” in those proceedings. The response is not new. In fact, it was given a hundred and twelve years before the publication of A&W’s paper. At first instance in *British Linen Company v South American and Mexican Company*,¹⁷⁷ Counsel for the debenture-holders had argued¹⁷⁸ that “mortgagees are to be treated as persons outside the liquidation”. Vaughan Williams J, who was later said by the Court of Appeal to have “proceeded upon right principles from first to last”,¹⁷⁹ corrected him in a way precisely on all fours with the argument in this Section:

“Instead of saying that debenture-holders are ‘outside the liquidation’, you should say that the Court will not allow their rights to be prejudiced by the liquidation.”¹⁸⁰

Understanding the significance of this distinction could have prevented a lot of misunderstanding and confusion.

6. Statutory Text

There might be a temptation at this point to minimise the reach or significance of the foregoing arguments. Even if liquidation plays some role in the furtherance of the secured creditor’s interests, perhaps this is only marginal, or exists only in relation to rather exotic collateral, like calls on the company’s contributories? Notice that even this would be sufficient to rebut the suggestion that secured creditors are “not entitled to participate” in the winding-up. In fact, however, the protection of the interests of secured creditors lies at the heart of the winding-up regime, and such protection is available as a matter of course in all liquidations. This point is again best understood by considering another of A&W’s arguments to the contrary.

Does the Act governing winding-up depart from the general property law position so as to begin to treat encumbered assets as not “the company’s property” but the property of the chargee instead? So suggest A&W. The alleged second ‘fund’ consisting of encumbered assets now owned by the chargee might spring into existence when the debtor company becomes subject to a winding-up application (call the point in time at which such an application is made T_1), or alternatively, only when a winding-up order is made (call this time T_2). In either case, other references in the insolvency legislation to ‘assets of the company’ should “demonstrably”¹⁸¹ exclude assets subject to a floating charge. As we will see, A&W appear to take the maximalist position that from T_1 onwards, assets of the company do not include assets subject to a floating charge. We must ask if that is right.

6.1 Debtor Subject to a Winding-Up Application

When a company is in winding-up, then pursuant to section 127 of the Act and unless the court orders otherwise, “dispositions” of “the company’s property” made after the commencement of the winding-up application (that is, after T_1) are void. Referring to an Australian authority which suggests that section 127 would not catch dealings by a secured creditor with property subject to its security interest,¹⁸² A&W state as follows:

¹⁷⁷ [1894] 1 Ch 108.

¹⁷⁸ Wrongly citing *Strong v Carlyle Press* [1893] 1 Ch 268; the true basis of that decision is mentioned in a previous footnote.

¹⁷⁹ [1894] 1 Ch 108, 126 (Lindley LJ). Vaughan Williams J was partially reversed on the facts on the basis of new evidence.

¹⁸⁰ [1894] 1 Ch 108, 112.

¹⁸¹ AW, 303, fn. 44.

¹⁸² *Re Margart Pty Ltd* [1985] BCLC 314.

That “the ‘assets of the company’ and ‘assets subject to security’ should be thought of as two distinct ‘funds’...is consistent with the position that the enforcement of a charge does not constitute a disposition of the company’s property under s. 127 of the Insolvency Act 1986.”¹⁸³

Now remember that for section 127 to apply, there must be a “disposition”, and this must be of “the company’s property”. In the statement just quoted, A&W correctly note that the enforcement of a security interest is not caught by section 127, but they do not say clearly whether they think this is (i) because *encumbered assets* are not “the company’s property”, or, (ii) because *the enforcement of security interests* is not a “disposition”. Be that as it may, we can be confident that they must be committed to the first of these propositions, quite regardless of their position on the second. Recall that in discussing section 127, A&W are attempting to explain why references to the company’s assets/property in sections 115 and 175 do not include references to assets subject to a security interest. So if they are to gain any traction for this broader argument from invoking the authorities on section 127, they must assert that there is no magic in the term “disposition” (a term not occurring in sections 115 or 175), and that the work is done by the phrase “the company’s property”. They must argue, that is, not (or not merely) that enforcement of security is not a “disposition”, but that the property against which security is enforced is not “the company’s property”. From the context, it is clear that they are indeed committed to the latter position.¹⁸⁴

But are they right? Here are six mutually reinforcing reasons for thinking that they are not.

First and quite simply, their position is inconsistent with direct English authority which treats property subject to equitable¹⁸⁵ and legal¹⁸⁶ charges as “the company’s property” for the purposes of section 127.

Second, the statutory text which confers upon the court the power to make a winding-up order – and which, in addition to being virtually adjacent to section 127 within the body of the Act, applies to the time between T₁ and T₂, just as section 127 does – explicitly refers to assets subject to a mortgage (and therefore, *a fortiori*, to assets subject to a charge) as assets of the company.¹⁸⁷ It follows that the phrase “the company’s property” in section 127 excludes assets subject to a security interest only if there is something special about *this* section which distinguishes it from the provisions preceding (and as we see below in relation to section 130 of the Act, following) it in the statutory corpus.

Third, however, no such reason is available.¹⁸⁸ As noted, A&W cannot even assert unambiguously (though their broader argument nevertheless commits them to the assertion) that the reason why enforcement of a charge is not caught by section 127 is because encumbered assets are not “the company’s property”. And the authorities on which they rely are best understood as providing that the secured creditor’s proper dealings with the collateral do not constitute a “disposition” of the company’s property for the purposes of section 127.¹⁸⁹ Section 127 is perhaps best conceptualised as

¹⁸³ AW, 301. To similar effect, see AW, 308-309, text to fn. 81.

¹⁸⁴ At AW, 301, see the text to fns. 25-28; and at AW, 308-309, see the text to fns. 80-82 and also the two sentences to which fn. 84 is appended.

¹⁸⁵ *Mond v Hammond Suddards (No 1)* [1996] 2 BCLC 470, impliedly approved by the Court of Appeal in *Mond v Hammond Suddards (No 2)* [2000] Ch. 40, 50.

¹⁸⁶ See e.g. *Re Norman Holding Company Ltd* [1991] 1 WLR 10 (notice the sale ordered by Warren J, the proceeds being regarded as subject to the same security as the land disposed of), and *Re Tramway Building and Construction Co Ltd* [1988] 1 Ch 293.

¹⁸⁷ IA, s. 125(1).

¹⁸⁸ As the discussion of IA, s. 130(2) and other provisions of this Act in the next two sub-sections will make clear, the fact that IA, ss. 125(1) and 127 bite prior and subsequent to the making of the winding-up order, respectively, provides no such reason. Even after the order has been made, the statute continues to refer to and treat encumbered assets as the *company’s* property.

¹⁸⁹ Even apart from the points made in the text, these authorities do not exactly help anyone attempting a defence of *Leyland Daf*, since they both, as part of their operative reasoning, refer to encumbered assets as (i) assets of the debtor company, and as (ii) constituting *one fund out of which both secured and unsecured debts may be paid in the appropriate priorities*. See *Re Margart Pty Ltd* [1985] BCLC 314, 320 (quoting from the majority judgment in the High Court of

depriving the company of the legal power to divest itself of its own property,¹⁹⁰ and in addition, also precluding the removal by any other means of any asset from the company's estate by anyone who does not have an enforceable proprietary right in it. The rationale is to preserve the company's estate intact and to subject any dealings with any of its property to the consent of the very court entrusted with holding the balance amongst those with pre-existing interests in its undertaking, and between them and everyone else. Where, however, an asset is removed from the company's estate not by the company (and thus not motivated by any improper considerations on the company's part), and only by someone whose rights in that asset would have been respected by the very court that would subsequently wind up the company, then the removal is not violative of the policy of the provision. For this reason, then, there is no "disposition" when a chargee 'enforces' his charge in the company's assets.¹⁹¹

Notice that only this view is consistent with the operation of an after-acquired property clause in a security or other instrument executed by the company. When a company which is the subject of an outstanding winding-up application acquires an asset, section 127 does not render void the falling of this asset into the ambit of such a clause.¹⁹² Remember that it is only *when*, and *because*, the asset becomes the company's property that it is caught by the after-acquired property clause. It would therefore strain the statutory language to breaking point to insist that when the asset becomes subject to the security interest precisely by virtue of becoming the company's property, that this event is not caught by section 127 because the asset is not "the company's property"¹⁹³ The better view is that section 127 does not apply because the falling of the asset into the ambit of the security agreement is not a "disposition" for the purposes of the statute, on the basis that the beneficiary of the after-acquired property clause has a pre-existing enforceable right to the asset. The company now subject to the winding-up application is not required to do anything, and thus, not required to do anything which it can no longer do because of section 127. But if this is the correct understanding of "disposition", then there is no need to do violence to the statutory phrase "the company's property". The secured creditor's dealings with the collateral are not caught by this section simply because the secured creditor has a pre-existing right to it. There is an exact parallel with the exercise, while a company is the subject of a pending winding-up application, of a pre-existing option to acquire the company's land. There can be no sensible argument but that the land was "the company's property" before the exercise of the option. The reason why the exercise would not be avoided by section 127¹⁹⁴ is that the exercise of the option does not involve any "disposition".

Australia in *FCT v Barnes* (1975) 133 CLR 483, 492). The same passage is approved and followed in *Re French's Wine Bar Ltd* (1987) 3 BCC 173, 177. Compare *Leyland Daf*, e.g. [81]: "The significance of the floating charge is, not that it alters priorities for payment out of a single fund, but that it brings a second fund into existence with its own set of priorities."

¹⁹⁰ The company's property may thenceforth be dealt with only with the permission of the court, or by the liquidator exercising statutory powers.

¹⁹¹ Perfectly consistently with this and with other aspects of English law as discussed in the text here, the ratio of *Re Margart Pty Ltd* [1985] BCLC 314, the authority relied upon by AW, is simply as follows (at 320): "I do not think that there is a disposal of property of the company when there is a dealing by someone who is really someone other than the company and who has the right to say how it is to be dealt with". The question, in other words, is what constitutes a 'disposal', and the answer must be understood as centring on the issue of who it is who is dealing with the company's property, and whether they have a right enforceable in insolvency proceedings to engage in such dealings. The same passage is cited and followed by Vinelott J in *Re French's Wine Bar Ltd* (1987) 3 BCC 173, 177; this case is cited by A&W at AW, 308-309, fn. 81.

¹⁹² Roy Goode, *Legal Problems of Credit and Security* (3rd ed), para 2-14.

¹⁹³ This point probably does not hold in those sub-set of cases where, as a matter of fact, it is only because the debtor company has contracted to grant a security interest in the assets in question that it obtains the money necessary to acquire those assets. Here, all that the company obtains in the assets is a title encumbered by the security interest; see *Abbey National Building Society v Cann* [1991] 1 AC 56, read together with the Court of Appeal's judgment in *Whale v Viasystems Technograph Ltd* [2002] EWCA Civ 480. It would appear to follow, though the matter is not free of doubt, that no 'property of the company' is disposed of in a way which might be caught, even potentially, by IA, s. 127. Be that as it may, after-acquired property clauses hold even in relation to those transactions which are outside of the scope of the decision in *Abbey National v Cann* (that is, where the relevant assets are not acquired using the funds provided by the security holder), and in relation to these cases, the point made in the text here applies without qualification.

¹⁹⁴ *Re Margart Pty Ltd* [1985] BCLC 314, read together with *Re French's Wine Bar Ltd* (1987) 3 BCC 173.

Fourth, a sale of the collateral on behalf of a mortgagee pursuant to section 101(1)(i) of the Law of Property Act 1925, read together with section 104(1) of this Act, “enables the mortgagee to confer on a purchaser the *mortgagor’s* interest in the thing in question, free from the mortgage and from any other derivative interest to which the mortgage takes priority”.¹⁹⁵ To the extent to which such a sale is not rendered void by section 127 of the Act, therefore, this simply could not be because the mortgagor does not deal with “the company’s property”. Once again, then, the correct view must be that the sale, while unquestionably of the company’s property, does not involve a “disposition”.

Fifth, A&W themselves provide a good reason for rejecting their own position when they point out that if the company’s secured assets are in its liquidator’s control (call the time at which the liquidator takes control T_3), the secured creditor can obtain an order “as of right” for the delivery up of those assets.¹⁹⁶ This is discussed below. In any case, however, if the secured creditor has this right to gain possession of the secured assets at T_3 ,¹⁹⁷ then it must have had this right at time T_2 as well. Consider the alternatives, that the right arose *only when* the liquidator gained custody and control of the collateral, or going further back, *only when* the winding-up order was made. Each of these suggestions would be indefensible, attributing to these events a legal effect they neither do nor could possess. After all, the general position is the following:

“Just as the advent of liquidation does not deplete a chargee’s pre-liquidation proprietary rights, it surely cannot be the occasion for their enhancement... The secured creditor should fare no better under insolvency law than under the general law”.¹⁹⁸

This consideration can only be strengthened when we recall that, under the general (that is, pre-insolvency) law, the secured creditor certainly has the right (again, subject to fulfilment of any relevant pre-conditions) to take possession of the collateral before T_1 (that is, just before the time at which the winding-up application is made).¹⁹⁹ But of course, no one denies that as a matter of English law, encumbered (charged or mortgaged) assets are the ‘property of the chargor company’.²⁰⁰ It follows that just as property subject to a security interest may be seized by the secured creditor before the making of the winding-up application even though it is property of the company, and just as the secured creditor has the right to the property of the company subject to the security when this property is in the liquidator’s

¹⁹⁵ Alison Clarke and Paul Kohler, *Property Law: Commentary and Materials* (Cambridge: Cambridge University Press, 2005), 397 (original emphasis); and see e.g. *Lord Waring v London & Manchester Assurance Co Ltd* [1935] Ch 311.

¹⁹⁶ AW, 308.

¹⁹⁷ Of course subject to the fulfilment of the relevant conditions, particularly those laid down in the debenture.

¹⁹⁸ AW, 321, including fn. 150. As a normative (though not descriptive) matter, it should be noted that there are in fact very good reasons for restricting the pre-insolvency right of the secured creditor to take possession of the collateral, that is, to gain immunity from having to participate in the collective liquidation regime. Where the collateral is more valuable when left with unencumbered assets as part of a functioning business unit, allowing the secured creditor unilaterally to remove the collateral is destructive of this synergetic value. This issue is addressed in the Conclusion, below. A sensible alternative is the one ordered by Malins VC in *Re David Lloyd & Co* (1877) 6 Ch D 339, 340-341 (overturned in the Court of Appeal): “Now in exercising this discretion [under what is now section 130(2) of the Act to allow the secured creditor to enforce his security against the property of a company in winding-up], I must see whether I cannot protect [the mortgagee] and protect the [mortgagor] company at the same time. If I can effectually protect [the mortgagee], and also give the company the chance of getting something out of the property, I think it is my duty to do so. If [the mortgagee] be, as I take him to be, a *bonâ fide* vendor, he is entitled to have his purchase-money, and he must have it if possible. Therefore, if I allow the colliery [the collateral] to be disposed of in the winding-up, I can effectually protect [the mortgagee] by giving him leave to bid. If the colliery shall eventually be worth £40,000, then it will pay [the mortgagee] his £ 30,000, and there will be £10,000 for the shareholders. If, on the other hand, the colliery produces only £20,000, and I give [the mortgagee] liberty to bid, then he will get this property back for £20,000, and stand a creditor against the company for the balance of £10,000. Therefore I think everything will be done that [the mortgagee] can properly desire if I allow him to go in and bid in the winding-up, and give him the benefit of having the property realized there.”

¹⁹⁹ If a solvent company defaults on a secured obligation, the secured obligee uncontroversially has the right to seize the collateral so as to recoup what it is owed. This right does not arise only when the company becomes subject to a winding-up application, or only when the court orders winding-up.

²⁰⁰ See e.g. *Fairclough v Marshall* (1878) 4 Ex D 37 (CA); *Re Wells* [1933] Ch 29 (CA); *Quennell v Maltby* [1979] 1 WLR 318, 324 (CA); *Ultraframe (UK) v Fielding* [2005] EWHC 1638, [1401] – [1405], etc.

control, so the secured creditor has the right to that property while the winding-up application is pending (and also, after the order has been made but before the company's property, including its secured assets, have come under the liquidator's control).²⁰¹ At none of these stages is it either necessary or possible to exclude the collateral from the ambit of the statutory references to "the company's property/assets".

Sixth and finally, suppose that the company the subject of the winding-up application were to attempt to dispose of some of its encumbered property to someone *other than the secured creditor*. It would be an odd, inconvenient and unnecessary interpretation of section 127 to assert (in the face of each of the arguments set out above) that since the collateral was not "the company's property", the section did not avoid this disposition and thus did not confer on the court jurisdiction to order that the property be re-vested in the company, or perhaps, vested in the secured creditor. It would also be inconsistent with the interpretation of section 127 provided above, that this provision removes from the company the power to divest itself of its own assets. The attempted transfer of the collateral by the company to someone other than the secured creditor is, on this view, beyond the company's powers. And in fact, that section 127 does catch such a disposition is supported by authority which treats assets subject to a security interest as "the company's property".²⁰²

6.2 Debtor in Winding-Up

A&W maintain, as we have noted, that references in the insolvency legislation to 'property of the company' relate solely to unencumbered assets.²⁰³ But then, what about the provision whose relevant effect they summarise thus:

"Whilst secured creditors are formally stayed from enforcing their claims in liquidation by s. 130(2) of [the Act], they are given leave to proceed as of right"²⁰⁴

Subject to the discussion in the previous Section about "as of right" in this context, this statement is true. However, section 130(2) prohibits, unless with the court's leave, any action or proceeding "against the company or *its property*". It would appear to follow that secured creditors, *qua* secured creditors, enforce their claims in liquidation against the *company's* property, thus belying A&W's assertion.

The reader may be confident that it is indeed the reference to "[the company's] property" in

²⁰¹ See e.g. *Sowman v David Samuel Trust Ltd* [1978] 1 WLR 22 (emphasis added): The onset of winding-up "does not in the least affect [the receiver's] powers to hold and dispose of *the company's property* comprised in the debenture, including his power to use the company's name for that purpose, for such powers are given by the disposition of the company's property which [the company] made (in equity) by the debenture itself. That disposition is binding on the company and those claiming through it, *as well in liquidation as before liquidation*". In other words, the disposition that matters happens when the debenture is executed, and it is *that* disposition which continues to bind the company, *before* liquidation (i.e. when there is no 'statutory trust' of the company's property) as much as in it, up to and including the point at which the security interest is enforced. There is therefore no "disposition" upon enforcement to be caught by s. 127. (In reading this judgment, it is important not to be confused by the court's later comment that "the rights and powers given by the debenture are themselves property, but not property of the company, and if they are not extinguished by the fact of winding-up, their enforcement or exercise is not within the scope of s [127] at all." With respect, while this statement is perfectly accurate, it looks at the enforcement of the security from the wrong end, from the point of view of whether the *debenture-holder* has property rights in the collateral. The answer to this question is of course yes (the secured creditor has property rights in the collateral, just as the owner of the dominant tenement has the property rights constituting an easement in the servient tenement, or the owner of a profit has property rights in the land on which the profit is to be exercised, etc.), but this is beside the point. The real question is whether the *company* itself also has property rights in the collateral such that the enforcement of the security would constitute a "disposition of the company's property". Keeping in mind that more than one person may have property rights in one and the same asset, this later question is not answered by pointing out that the debenture-holder has property in the collateral.)

²⁰² For example, *Re Tramway Building and Construction Co Ltd* [1988] 1 Ch 293, *Re Norman Holding Company Ltd* [1991] 1 WLR 10, and *Mond v Hammond Suddards (No 1)* [1996] 2 BCLC 470 (read together with *Mond v Hammond Suddards (No 2)* [2000] Ch. 40, 50), all clearly support this position.

²⁰³ AW, 301.

²⁰⁴ AW, 308 (footnote omitted).

section 130(2) that obligates the secured creditor to proceed pursuant to this section. Firstly, the debenture-holder need not proceed *against the company* at all if (unusually) he needs to, and does, ask that the company's liquidator be ordered to hand over possession. Authority suggests that the custody and control of the property of the company in winding-up rests not in the company but in its liquidator, over whom the company has no control.²⁰⁵ Or suppose that the encumbered assets against which the secured creditor wishes to proceed are in the possession neither of the company nor (as yet) its liquidator but of a third party. It follows that in asking the court for leave to seize property subject to his security, the secured creditor is proceeding for the purposes of s. 130(2) not against the *company*, but against the *company's property*.

Second, if and to the extent that secured creditors must, in seeking possession of the encumbered assets, invoke section 130(2) at all as opposed to the general discretion of the court,²⁰⁶ it must be because of the presence of the words "or its [that is, the company's] property" in this provision. In the absence of these words, the provision would not catch the debenture-holder's proceedings in relation to the encumbered assets. Section 87 of the Companies Act 1862 was substantially in the same terms as the present section 130(2) of the Act, except that it did not contain any reference to "the company's property". It was held that section 87 of the 1862 Act had no relevance to an application by a mortgagee to allow a receiver appointed by it to take over possession of the collateral from the company's liquidator.²⁰⁷

Thirdly, there are considerations relating to the internal consistency of the statutory text. To avoid redundancy within section 130(2), there must be situations in which it is possible for the purposes of this provision to proceed (i.e. to commence or proceed with an action or proceeding) against "the company's assets" without *ipso facto* also proceeding against "the company".²⁰⁸ If this is indeed true, then there are two possibilities:

- (1) Can an *unsecured* creditor proceed against the "company's property" without *ipso facto* also proceeding against the company? Suppose that it can, and that in such a situation, it seeks to proceed against an asset subject to a security interest.²⁰⁹ Consider the suggestion that a court would allow it to do so, on the basis that this asset was not "the company's property" at all for the purposes of section 130(2), at least to the value of the previously secured loan. This suggestion would be untenable, being (among other things) quite inconsistent with a central policy of this provision, which is to negate efforts by individual creditors to improve their position compared to other creditors.
- (2) Consider now the situation where a *secured* creditor seeks to proceed against the "company's property" without at the same time proceeding against "the company". In this case, the only property against which a secured creditor is entitled to proceed *qua* secured creditor is the property subject to his security. It follows that a secured creditor must seek leave pursuant to section 130(2) because (among other things) the ambit of the statutory reference to the "company's property" includes assets subject to a security interest.²¹⁰

²⁰⁵ *Ayerst (Inspector of Taxes) v C & K (Construction) Ltd* [1976] AC 167, 181.

²⁰⁶ Since an official liquidator is an officer of the court, a secured creditor must, quite independently of IA, s. 130(2), seek the court's permission before seizing assets in the liquidator's control; *In Re Henry Pound, Son, & Hutchins* (1889) LR 42 ChD 402.

²⁰⁷ *In Re Henry Pound, Son, & Hutchins* (1889) LR 42 ChD 402, 420.

²⁰⁸ One situation where this is arguably so is where the company's encumbered assets are within the possession or control, not of the company or its liquidator, but of a third party; see e.g. *Re Lineas Navieras SAM* [1995] BCC 666 (ChD) (particularly the final paragraph of the judgment).

²⁰⁹ For example, a hitherto unsecured creditor has obtained a charging order over encumbered property and now seeks to enforce it.

²¹⁰ See e.g. the alternative ground for Arden J's decision in *Re Lineas Navieras SAM* [1995] BCC 666. For the sake of completeness, consider now the possibility that, contrary to the position taken in the text, s. 130(2) does contain redundancy, in that any action or proceeding against the "company's property" is also, for that reason alone, an action or proceedings against "the company". In that case, s. 130(2) provides no support at all to the assertion that, in general, when the statutory text refers to the assets/property of a company in liquidation, that its language is

6.3 The Statutory Text More Generally

So far, then, references to “the company’s property/assets” in the insolvency legislation appear to cover encumbered assets, including those subject to a floating charge. What about the statute more generally, however? Perhaps, wonders the reader, the examples considered above are anomalous exceptions to A&W’s position? Perhaps they are a careless slip, or few, of the Parliamentary draughtsman’s pen?

A&W certainly appear to reinforce this impression. Consider, for example, their rendition of section 436 of the Act. This provision defines “property” inclusively and expansively so as to cover (among other things) “every description of interest, whether present or future or vested or contingent, arising out of, or incidental to, property”. This is certainly wide enough to cover property subject to a charge or mortgage, so that it would appear to follow that references in the Act to “property” or “assets” “of the company” should be read as including assets subject to such a security interest. A&W, however, interpose the words “meaning the free assets” between “company property” on the one hand and the enormously inclusive definition in fact provided by section 436 on the other.²¹¹ They thus exclude from the statutory definition, ostensibly by simple fiat, the company’s charged or mortgaged assets.

Such free rewriting of the legislation *must*, one might think, be justified by reference to the language of the rest of the statute, which must, accordingly, reserve (or all but reserve) the phrase “assets/property of the company” for assets not subject to a charge.

In apparent confirmation, A&W state that:

“...other provisions in the insolvency legislation [that is, in addition to section 175] that refer to the ‘assets of the company’ or ‘the property of the company’ appear to relate solely to the free assets.”²¹²

Give the context in which this statement is made, here is its natural reading: A&W contend that since all – or at least, virtually all – other statutory references to “the assets/property of the company” appear to cover only “free” but not encumbered assets, this should suggest, or at least create the presumption, that similar references in, say, section 175, also exclude encumbered assets. One way of understanding this point is in terms of an allocation of the burden of argument in discussions about section 175. If all or virtually all of the references to “the company’s property/assets” in other parts of the legislation relate solely to “free” assets, then the burden must be on someone who denies that the same holds in relation to section 175. By contrast, if all or virtually all references to “the company’s property/assets” include encumbered as well as unencumbered property, then the burden of arguing for a different position in relation to section 175 shifts to anyone seeking to defend *Leyland Daf*. A&W would of course be committed to the former position.

In fact, it turns out that there are several dozen references in the Act itself to “assets/property of the company”,²¹³ and all or virtually all of these include within their ambit the company’s encumbered assets. It would be impractical to mention all of them. But some examples would be instructive in demonstrating that the entire scheme of the insolvency legislation does and must treat encumbered assets as the debtor company’s property. We may group these provisions in terms of their function, as (i) those dealing with the preservation and recuperation of the company’s property and the investigation of its affairs, and (ii) those ensuring the unity of the estate of an insolvent company which is undergoing multiple insolvency procedures.

based on a rejection of the general legal principle that an asset subject to a security interest remains the debtor’s property.

²¹¹ AW, 324, fn. 163.

²¹² AW, 301, referring to IR, r. 4.181. This provision is discussed in Mokal, ‘At the Intersection of Property and Insolvency Law: The Insolvent Company’s Encumbered Assets’ (forthcoming, 2008).

²¹³ For the avoidance of doubt, the term “the property of the company” has the same meaning as “assets of the company”; *Webb v Whiffin* (1871-72) LR 5 HL 711, 724.

6.4 Preservation, Investigation, and Recuperation

A&W contend that the insolvency legislation simply “deems” encumbered assets to be outside the ambit of the property of a company in winding-up, on the basis of (what they say is) “the common-sense assumption that any creditor with valid security will, on the liquidation of his debtor, proceed to enforce it.”²¹⁴ In fact, however, when a company becomes distressed, those in control of it and/or of its property have perverse incentives to use its undertaking and assets in a way which benefits them but harms others with genuine claims against but less influence over the company.²¹⁵ In the face of such foreseeable and likely misbehaviour, it would have been silly, rather than “common-sense”, for the law to “deem” anything of the kind suggested by A&W. The insolvency legislation is concerned, after all, with winding up *the insolvent company, its affairs, and its assets*. For it to “deem” certain assets to be “outwith” this company’s property would be substantially²¹⁶ tantamount to the law washing its hands of the care of that property, and to “deem” the preservation and proper application of those assets to be someone else’s problem. This demonstrates the self-defeating nature of the assumption that A&W attribute to the law: the more that insolvency law *assumed* or *treated* encumbered assets as already, as at the commencement of the winding-up, having been applied towards discharging the secured liability, the less likely such assets would in fact be to *be* so applied.

In fact, insolvency law continues to treat encumbered assets as very much part of the distressed company’s estate, and seeks to ensure their proper application just as it seeks to ensure the proper application of any other portion of the company’s property. We have already considered two important mechanisms for preserving the estate of the distressed company in the interests of all of its claimants as a group, namely, the avoidance of dispositions of the property of a company in winding-up (section 127) and the restrictions on proceedings against a company in winding-up or its property without the leave of the court (section 130). Both these provisions refer to and treat encumbered assets exactly according to their legal status, that is, as the debtor company’s property. And both of them thus make it more likely that the company’s encumbered assets would in fact be used in discharge of its secured liabilities.

The same holds in the case of a company undergoing either type of voluntary liquidation where no liquidator has (yet) been appointed: the directors of such a company lose virtually all their powers to operate it except with the court’s leave. What they do retain, however, is power “to do all such other things as may be necessary for the protection of the company’s assets” (section 114). The selective disabling of directors’ powers is clearly meant to prevent them causing the company sub-optimally to rid itself of some of its assets, while leaving them with the ability to preserve value in the company’s estate, for example, by committing the company to a contract with a firm providing security for the company’s inventory and other assets, or by authorising the payment of an insurance premium. It cannot seriously be contended that a court would rule them to have exceeded their powers under this provision if the company’s inventory or insured assets are encumbered, on the basis that such assets were not “the company’s assets” for the purposes of this section.

Along similar lines, section 208 of the Act makes it an offence for any officer of a company in any type of winding-up not fully to disclose to the liquidator “all the company’s property”, or not to disclose the circumstances in which any such property might have been disposed of out of the ordinary course of the company’s business, or to prevent the production of any document relating to the “company’s property”, or to attempt to account for “any part of the company’s property” by fictitious losses or expense (section 208). To read the many references to “the company’s property” here as excluding its encumbered assets would seriously undermine, both, the efficacy of liquidation as a process for unearthing and remedying impropriety, and consequently, the interests of secured creditors.

²¹⁴ AW, 309 (footnotes omitted). Discussion of whether it is always “common-sense” for secured creditors to “enforce” their security, rather than, say, simply ‘standing on’ it, is in Sections 5.3 and 5.6 above.

²¹⁵ For detailed discussion, see e.g. Mokal, *Corporate Insolvency Law*, chapters 2, 3, 6, 8 and 9.

²¹⁶ Though, as we have seen in relation to the assets held on trust by the company prior to its winding-up, not entirely.

Further, in the case of any company in (*inter alia*) winding-up, its officers, insolvency office-holders, promoters, and employees, etc., are obligated to provide information to the liquidator about the company and “its...property” (section 235). Similarly, the liquidator may ask the court to order any corporate officer, or anyone suspected of having in his possession “any property of the company”, or anyone capable of giving information about the “property of the company” to submit an affidavit concerning his dealings with the company, and to produce any documents in his possession concerning “any property of the company” (section 236). The court has significant enforcement powers in relation to these obligations. If, as a result of any information uncovered by virtue of any of the afore-mentioned provisions, it appears to the court that any person has possession of “any property of the company”, that person may be ordered to deliver “the whole or any part of the property” to the liquidator, and may also, if appropriate, be examined on oath (section 237).

Notice two things about sections 235 to 237. Firstly, the powers enshrined therein are exercisable by administrative receivers as well as liquidators, and the former would of course be interested in inquiring about and recovering encumbered property. So the legislation *uses the same words* to refer to, both, the company’s encumbered *and* free assets, in both liquidation *and* receivership. And second and as discussed in the previous Section, it would often be sensible for a secured creditor simply to ‘stand on his security’ in the winding-up, letting the liquidator investigate the whereabouts of and recover the collateral. These provisions thus allow liquidation to be an effective vehicle for the pursuit of the secured creditor’s interests. This last point is underlined by the liquidator’s power to ask the court to order anyone in possession or control of “any property...to which the company appears to be entitled”²¹⁷ to deliver or convey such property to the liquidator (section 234). In the face of such a demand from the liquidator, it is unthinkable that a third party would be able to retain encumbered assets on the basis that they were not the company’s property. Another way in which liquidation directly serves the financial interests of the secured creditor is the court’s or liquidator’s ability to collect “the company’s assets”, including by making calls on its contributories (sections 148 to 150), and it is clear that some or all of the proceeds of calls may be mortgaged or charged.²¹⁸

Any doubt that the company’s property in winding-up includes its encumbered assets is removed by two other provisions. First, section 212 of the Act provides that an administrative receiver may, at the instigation of the liquidator or any creditor (presumably including a secured creditor), be found liable for misapplying or retaining “any property of the company”. It would be quite astonishing if it turned out that neither the liquidator nor a creditor (including a creditor holding a crystallised floating charge over the assets in question) were thus empowered to bring an action concerning property subject to a floating charge misappropriated by the receiver subsequent to the initiation of the winding-up. And second, section 215(2) of the Act empowers the court, when making a declaration in relation to the fraudulent or wrongful trading provisions (sections 213 and 214 respectively), to provide for the liability of the person against whom the declaration has been issued to be a charge “on any mortgage or charge or any interest in a mortgage or charge on *assets of the company* held by or vested in him”.

6.5 The Unity of the Company’s Estate in Liquidation and Receivership: Only One ‘Fund’

One of the oddest things about their Lordships’ decision in *Leyland Daf* was its insistence that “unsecured creditors have no interest in the administrative receivership”.²¹⁹ With respect: of course they do. Where the debtor is insolvent and undergoing both receivership and liquidation, each penny spent in its receivership – on the expenses of these proceedings or on discharging the secured liability – is a penny not available for the benefit of its junior creditors. Even (indeed, particularly) when unsecured creditors will receive nothing on their claims, therefore, they have a real interest in ensuring that their debtor’s affairs have been thoroughly investigated and its assets properly applied. Junior creditors need assurance, that is, that the loss they have suffered is not due to impropriety. In recognition of this real interest that unsecured creditors have in (*inter alia*) the administration of their debtor’s encumbered assets, the

²¹⁷ A&W accept that a similar phrase in s. 144 encompasses encumbered assets; see at 300, fn. 22.

²¹⁸ *Re Pyle Works Ltd* (1890) LR 44 Ch D 534.

²¹⁹ At [31].

legislation goes to some pains to ensure that information about such assets is fully available within the winding-up.

For example, where the liquidator in a members' voluntary winding-up considers that the company is insolvent, he must prepare, to be laid before a creditors' meeting, a statement of the company's affairs, which must include particulars of the company's assets and creditors, including what securities are held by its secured creditors (section 95). Similarly, those connected with a company in compulsory winding-up may be required to produce a statement of the company's affairs, which would have to include particulars of the company's assets and creditors and the details of any securities held by the latter (section 131). And the final accounts to be prepared at the conclusion of either type of winding-up must detail how "the company's property" has been disposed of (sections 94 and 106). As a matter of practice, these accounts *always* cover disposals of encumbered assets, and there is no doubt upon the proper construction of the governing provisions that this is precisely what the law demands.

It is even more striking to consider the essential unity of the encumbered and free parts of the company's estate from the direction of receivership itself. First and most broadly, the Act defines a "secured creditor" as "a creditor of the company who holds in respect of his debt a security over property of the company" (section 248).²²⁰ This provision applies indifferently to a company in receivership or liquidation. Second, a receiver or manager is defined to include a receiver or manager (as appropriate) of a part only of the "property of a company" or of income arising from that property (section 29). A receiver may be appointed after as well as prior to the commencement of the company's winding-up.²²¹ Third, a body corporate and an undischarged bankrupt are precluded from acting as receiver of "the property of the company" (sections 30 and 31). Again, this preclusion presumably holds after as well as before the initiation of winding-up, especially since, as noted, the appointment of a receiver may be made even though winding-up has already commenced. Fourth, a receiver or manager of "the property of a company" may apply to court for directions (section 35), presumably, after as well as before the initiation of winding-up. Fifth, the liquidator has power to apply to the court to fix the remuneration of a person "who...has been appointed receiver or manager of the company's property" (section 36). Sixth, where a receiver or manager or administrative receiver vacates office, his remuneration and expenses are to be "charged on and paid out of any property of the company which is in his custody or under his control at that time in priority to any charge or other security held by the person by or on whose behalf he was appointed" (sections 37 and 45). The most frequent reason for the receiver leaving office would be that he was about to transfer control of the company's property to the liquidator. Seventh, when a receiver or manager "of the property of the company" is in office, every company document issued by him, the company, or the liquidator must contain a statement to this effect; if it does not, then the responsible office holder, including (if appropriate) the liquidator, may be liable to a fine (section 39). Similarly, where the company is being wound up, any document issued by the liquidator or receiver or manager of "the company's property" must contain a statement to this effect (section 188). Eighth, the receiver may apply to the court for an order for "the disposal (with or without other assets) of any relevant property which is subject to a security" when this would be likely to promote "a more advantageous realisation of *the company's assets* than would otherwise be effected". The court might authorise the disposal "of the property as if it were not subject to the security" (section 43). This would obviously apply even though only "the company's assets" subject to the security in question (but no free assets) would be better realised by the receiver than, say, the liquidator. And ninth, in Schedule 1 to the Act, which specifies the presumptive powers of the administrative receiver, "references to *the property of the company* are to the property of which he is or, but for the appointment of some other person as the receiver of part of the company's property, would be the receiver or manager" (section 42). Comment would be superfluous.

Turning once again explicitly to the fact that unsecured creditors have a real interest in the administration of their debtor's encumbered property, this is recognised by the law governing receivership as much as that regulating liquidation. First, any receiver or manager "of a company's property" has a duty to deliver accounts of receipts and payments to Companies House (section 38), and this duty is

²²⁰ This is subject to any contrary indication in the context. Neither IA, s. 175 nor any of the provisions mentioned in the text here provide any such contrary indication.

²²¹ *In re Northern Garage Ltd* [1946] Ch 188, 191-192.

enforceable at the behest of the company's liquidator, among others (section 41). And second, an administrative receiver must, within three months of his appointment, prepare and send to relevant interested parties, including, if appropriate, a liquidator, a report about, among other things, disposal or proposed disposal by him of "any property of the company" (section 48). This would usually be the encumbered property of the company being wound up.

The provisions governing receivership in Scotland employ language identical in all relevant respects,²²² as does the section providing for cross-border operation of the receivership provisions.²²³ The same position is replicated by the language of the Insolvency Rules 1986.²²⁴

The dozens of provisions mentioned above were in force at the time of their Lordships' decision in *Leyland Daf*. But the Act by then also contained two additional sections introduced by the Enterprise Act 2002 but not in force at the relevant time, to at least one of which their Lordships appear to have been directed. Firstly, "where a floating charge relates to property of a company", the statute sets up for the benefit of unsecured creditors a 'special reserve fund' of part of the proceeds of realisation of floating charge assets. The text of this provision does not distinguish between companies in liquidation, provisional liquidation, administration or receivership. And second, the prohibition on the appointment of an administrative receiver refers to the holder of a qualifying floating charge "in respect of a company's property".²²⁵

For completeness, we should note that just as the statutory phrases "assets/property of the company" do not distinguish between assets subject to or free of security, they equally do not distinguish between assets of a company within or outside of winding-up. This is already clear in relation to receivership, which might be conducted alongside, or prior to the initiation, of winding-up. The same holds of the situation where the directors of a company propose a voluntary arrangement with the benefit of a moratorium,²²⁶ and where the company goes into administration.²²⁷

So whether the company is in winding-up, receivership, or both, the company's property includes all of its encumbered assets. This is a matter not simply of (property law) 'form' but of (insolvency law) substance: each of the company's unsecured creditors has a real interest in ensuring the due and proper administration of encumbered assets, since *all* of the company's estate forms *one fund*' out of which both secured and unsecured claimants will be paid, according to their statutory (including proprietary) priority and the value in that 'fund'.

7. Conclusion

It is time to consolidate our understanding of four broad issues. The first issue pertains to their Lordships' judgment in *Leyland Daf*. They held that the encumbered assets of a company form a 'fund' separate from that consisting of the company's 'free' assets, and that the former "fund" is beneficially owned by the encumbrancer. With respect, this is untrue as a matter of property law. For debtor D, who owed £10 to creditor C, to vest beneficial ownership of an asset worth £10 in C in right of the debt would not be to create a security interest; it would be to discharge the indebtedness altogether. To understand security at all is to understand that the secured creditor is not beneficial owner of the collateral. The collateral or its proceeds of sale become beneficially owned by C only when appropriated to repayment of the loan, but in principle at the same time, both the indebtedness and the security are also extinguished. So at no time is an asset *both* encumbered property *and* beneficially owned by the creditor. Their Lordships also held that the legislative history of provisions like sections 115 and 175

²²² See IA, ss. 51, 55, 56, 57, 58, 60, 61, 67 and 70, etc. IA, ss. section 122 and 221(7) explicitly provide for a way in which the winding-up order may protect the interests of the floating charge holder.

²²³ IA, s. 72(1).

²²⁴ See e.g. r. 3.31(1), and r. 4.127A (which allows the court to fix the liquidator remuneration "from the realisation of the assets of the company... but after deducting any sums paid to secured creditors in respect of their securities").

²²⁵ IA, s. 72A(1) (see also s. 72A(2) in relation to Scotland).

²²⁶ IA, Sch. A1 (inserted by the Insolvency Act 2000), paras 13, 20(1)(a) and 20(4).

²²⁷ IA, Sch. B1 (inserted by the Enterprise Act 2002), paras 14, 35, 36, 37, 41(3), 59(1), 70, 96, 97, etc.

shows that they do not include within their ambit assets subject to a floating charge. However, legislative history did not grind to a halt in 1970 with the Court of Appeal's decision in *In re Barleycorn*. Unsurprisingly, history continued, Parliament re-enacted the provisions exactly as glossed by the Court of Appeal, and what is more, extended the same method of funding to the newly-created administration regime. It follows that the words in the 1986 Act mean exactly what the Court of Appeal in *In re Barleycorn* said they meant.

The second issue concerns the functions of liquidation. Their Lordships implied, and A&W expound at length, the thesis that secured creditors 'stand outside' the winding-up of their debtor. It is unclear whether their Lordships would in fact endorse A&W's view that to 'stand outside' the winding-up in this sense is to be "not entitled to participate" in it. What seems clearer is that both sets of views are based on the premise that winding-up only deals with 'free' assets, and that it does so only in the interests of unsecured creditors. With respect, this is wrong. Winding-up deals with *all* of the company's affairs and assets, including property held by the company only as trustee, and *a fortiori*, assets beneficially owned by the company but subject to security interests. Far from being exiled from these proceedings, secured creditors are allowed fully to participate in them, and in normal circumstances, are assured the benefit of the liquidator's efforts. In the absence of good reason, therefore, they must pay their fair share of the costs of liquidation proceedings. What is more, the law of liquidation preserves all of the company's property, including the collateral, and empowers the liquidator to investigate the whereabouts of and recover any misappropriated property. And not only do secured creditors have an interest in liquidation proceedings, but unsecured creditors have a crucial interest in the handling of their debtor's encumbered property. This interest is recognised by the requirements upon both liquidators and receivers to preserve and provide information about disposals of the collateral. Nor are the liquidator's investigative powers meant only to protect those with direct financial interests in the company's undertaking. Such powers also serve the crucial public role of discouraging (*inter alia*) the abuse of the corporate form.

Third and following from the first two points, it should now be obvious why there is no question but that the references in sections 115 and 175 of the Act to the company's assets cover assets subject to floating security. This is true as a matter of both property and insolvency law.²²⁸ In fact, the real challenge lies in understanding why assets subject to *fixed* security ought to be *excluded* from the distributive ambit of these statutory provisions, since by virtue of both property and (the rest of) insolvency law, such assets are equally covered. The answer is found, as a matter of policy, in the functional differences in the nature of fixed and floating security, and as a matter of doctrine, in the interpretive history of these provisions. Fixed security is priority-based, and it is legitimate to protect this priority, including against liquidation expenses. Floating security, by contrast, is overwhelmingly priority-independent, and thus deserves little or no protection as against liquidation expenses.²²⁹ And this is precisely the effect of the Court of Appeal's *Barleycorn* decision, and precisely the position that Parliament has approved ever since.²³⁰

The fourth and final issue focuses on the wider importance of understanding the proper place in liquidation proceedings of encumbered assets and secured claims. The advantage to secured creditors of the liquidator being able to deal with encumbered assets is clear: the secured creditor is assured a convenient method for the realisation of the collateral.²³¹ It is important to remember, however, that for the collateral to be dealt with within the winding-up is beneficial to *all* those interested in the company's undertaking. If some or all of the assets of the company in winding-up, including its encumbered assets, are more valuable if kept together as a productive unit than if disposed of piecemeal, then this value can be preserved for the benefit of *all* claimants through a sale by the liquidator. Such sales benefit creditors, but they also benefit employees, who may not lose their jobs if a functioning business is preserved as such. And the fact that essentially viable businesses are allowed to survive rather than being decimated through piecemeal sales of their constituent units is also good for the economy as a whole.

²²⁸ See Sections 2.1 and 5 and 6, above, respectively.

²²⁹ See Section 2.1, above.

²³⁰ See Section 2.2, above.

²³¹ This is subject to the liquidator's obligation, in the interests of all creditors as a group, to challenge the validity or enforceability of the security, if it appears to him appropriate to do so.

Prior to the virtual abrogation of administrative receivership by the Enterprise Act 2002, liquidation was able to achieve this type of synergy-preserving ‘going concern’ sales of the distressed company’s property in about 10% of cases.²³² After receivership’s demise, this proportion could be expected to increase. This depends, however, on the ability of secured creditors to stand on their security, and on the ability of liquidators to deal with encumbered property. A&W’s assertion that secured creditors are “not entitled to participate” in winding-up, and that encumbered assets fall outside the “liquidator’s fund” is, if true, extremely harmful to this process. Thankfully, it is not true.

²³² R3 – Association of Business Recovery Professionals, *Corporate Insolvency in the UK: 12th Survey* (5 July 2004), 30 including Figure 24.