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At the Intersection of Property and Insolvency: The Insolvent Company's Encumbered Assets

Riz Mokal

AT THE INTERSECTION OF PROPERTY AND INSOLVENCY: THE INSOLVENT COMPANY'S ENCUMBERED ASSETS

Rizwaan Jameel Mokal[*]

When a company becomes subject to winding-up proceedings, it is widely thought to lose beneficial ownership of its property. The property is held, instead, on a 'statutory trust' to discharge the company's liabilities. The attribution of this 'proprietary' effect to the commencement of winding-up has, however, created significant confusion. Faring particularly poorly is our understanding of the status of those of the company's assets in which others held proprietary rights prior to this point, notably, assets the company's title to which is encumbered by security interests. The confusion takes many forms and infects several areas of analysis. First, the House of Lords has recently ruled that property subject to a floating charge is to be regarded, not as "the company's assets", but instead, as part of a 'fund' beneficially owned by the secured creditor "to the extent of the amount secured". Their Lordships' conclusion appears to be based on the proprietary nature of the floating charge as they understand it. Second, courts and commentators over the last several decades have asserted that encumbered assets do not fall in the statutory trust of the debtor company's property. This too appears to have been endorsed by the House of Lords decision mentioned above. Third and in what is put forward as a different explanation of their Lordships' ruling, it has been claimed that, at the point at which the company enters winding-up, the 'hindsight principle' of insolvency law causes beneficial ownership of encumbered assets to vest in the secured creditor. Fourth and finally, it has also been contended that the very notion of 'fund' as invoked by their Lordships supports the same conclusion.

This paper takes issue with each of these propositions. Firstly, it finds cause to highlight one of the many confusions surrounding insolvency law's (in)famous *pari passu* principle. A key reason for the problems that beset our understanding of the status of encumbered assets is the assumption that to distribute *pari passu* is to pay *each claimant* the same proportion of their debt as each other claimant. The argument here draws on long established case law and distinguished scholarship to point out that in fact, the principle requires merely that those classified by the general (pre-insolvency) law as being on par with each other be treated equally. This seemingly minor correction to our understanding of the requirement of *pari passu* distribution has far-reaching implications. Second, it is argued that the very nature of a security interest precludes the possibility that, at one and the same time, an asset would be beneficially owned by the secured creditor and yet be held by that creditor to secure the debtor's obligations. Third, the paper undertakes a fresh analysis of the origins and nature of the statutory trust to show that, on any reasonable view, assets subject to floating security fall in the statutory trust of the debtor's property, and further, that it is strongly arguable that the same is true of assets subject to fixed security. The fourth part of the argument demonstrates that, properly understood, insolvency law's hindsight principle simply cannot move the beneficial ownership of encumbered property to the secured creditor. Fifth and finally, certain elements of the theory of property law are analysed. The aim is to show that, on pain of the fallacy of equivocation, the relevant concept of 'fund' must be understood such that the encumbered and unencumbered assets of a company undergoing liquidation form one fund out of which both secured and unsecured claims are met in appropriate order of priority.

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1. Introduction

Dramatic things happen when a company becomes subject to winding-up proceedings. On a view widely[1] (though not universally[2]) accepted in the common law world, the commencement of its winding-up deprives the company of beneficial ownership of its property. (The position in Singapore is unclear,[3] but it is more likely than not that Singapore courts would also take the view that the onset of liquidation divests the company of beneficial ownership of its property.[4]) The company holds its assets thenceforth on a 'statutory trust' for the benefit of its creditors. The attribution of this 'proprietary' effect to the commencement of the winding-up has, however, created significant confusion about the status of assets which were already, prior to winding-up, subject to the proprietary rights of others. What are the legally causative factors behind the loss of beneficial ownership? And what happens to those of the company's assets in which, even prior to the commencement of its winding-up, others had held proprietary rights?

Over the last many decades, courts and commentators have asserted that the statutory trust does not extend to assets subject to security interests. This proposition has been reiterated, and it is submitted, the confusion of which it is a product was on display, in *Buchler v Talbot* ('*Leyland Daf*'),[5] a decision of the House of Lords. Their Lordships propounded the view that assets subject to a security interest fall into a 'fund' beneficially owned by the secured creditor to the extent of the secured liability. This decision has been extensively discussed and criticised,[6] and its actual effect has been legislatively reversed.[7] Nevertheless, two distinguished commentators, John Armour and Adrian

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[1] In *Commissioner of Taxation v Linter Textiles Australia Ltd (In Liquidation)* [2005] HCA 20, [184], Kirby J noted that the jurisdictions where this view is taken include England (*Ayerst v C & K (Construction) Ltd* [1976] AC 167); Ireland (*In re Frederick Inns Ltd (in liq)* [1994] 1 ILRM 387); New Zealand (*Shaw Savill and Albion Company Ltd v Commissioner of Inland Revenue* [1956] NZLR 211 at 232, 234); and Hong Kong (*Re Yaohan Hong Kong Corp Ltd* [2001] 1 HKLRD 363 at 370).

[2] See the majority opinion in *Commissioner of Taxation v Linter Textiles Australia Ltd (In Liquidation)* [2005] HCA 20 (Australia).

[3] See e.g. *Low GimHar v Low Gim Siah* [1992] 2 SLR 593 (Chan Sek Keong J) (appears to suggest that the company retains beneficial ownership); *Good Property Land Development Pte Ltd v Societe-Generale* [1996] 2 SLR 239 (CA) (beneficial ownership vests in liquidator); *Ng Wei TeckMichael v Oversea-Chinese Banking Corporartion* [1998] 2 SLR 1 (CA) (beneficial ownership vests in creditors); and *Kuok (Singapore) Ltd v Commissioner of Stamp Duties* [2003] 4 SLR 43 (Woo Bih Li J). This footnote draws on Eng Beng Lee, 'Insolvency Law' (2003) 4 *Singapore Academy of Law Annual Review of Singapore Cases* 263, 272; and on '*The Convenience Container'* [2007] 4 HKC 484.

[4] See Eng Beng Lee, 'Insolvency Law' (2003) 4 *Singapore Academy of Law Annual Review of Singapore Cases* 263, 272, citing *Ng Wei TeckMichael v Oversea-Chinese Banking Corporartion* [1998] 2 SLR 1. The Court of Appeal's finding in this case that as a matter of Singapore law, beneficial ownership of the company's property vests in creditors rather than being in suspense, is controversial; see e.g. Lee Eng Beng, 'Unregistered Creditor versus Unregistered Charge' (1998) 10 SALJ 241; Tan Cheng Han, 'Unregistered Charges and Unsecured Creditors' (1998) 114 LQR 565.

[5] [2004] UKHL 9. All self-standing references in square brackets below are references to the paragraphs of their Lordships' speeches in this judgment.

[6] See Riz Mokal, "Liquidation Expenses and Floating Charges – The Separate Funds Fallacy" [2004] LMCLQ 387 ('Mokal, "Separate Funds Fallacy"') (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; Dominic Venton, "The Rightful Ranking of Liquidation Expenses – A Statutory Perspective" (2006) 22(6) IL&P 205; and Riz Mokal, "What Liquidation Does for Secured Creditors, and What It Does for You" [2008] MLR (forthcoming).

[7] See Companies Act 2006, s. 1282, inserting a new section 176ZA in the Insolvency Act 1986 ('IA'); and the Insolvency (Amendment) Rules 2008.

Walters ('A&W'), have argued that the broader principles enunciated by their Lordships should be considered as having been touched neither by academic criticism nor by Parliamentary intervention.[8] Previous criticism of their Lordships' judgment had focused (though not exclusively) on property law, arguing that it is fundamentally inconsistent with the nature of a security interest to regard assets subject to it as being beneficially owned by the secured creditor. Attempting to sidestep this criticism, A&W turn from property to insolvency law itself. They argue that some interplay between the statutory trust of the insolvent company's property and the 'hindsight principle' of insolvency law helps to explain how, upon the commencement of the debtor's winding-up, beneficial ownership of encumbered assets comes to be vested in the secured creditor. They also suggest that there might be something in the very notion of a 'fund', as invoked by their Lordships, which supports the same conclusion.

This paper undertakes a fresh analysis of these complicated issues at the intersection of the laws governing property and insolvency. Section 2 summarises their Lordships' decision in *Leyland Daf* and respectfully argues that the neither its principles nor its conclusion are defensible as a matter of property law. Section 3 considers the origins and nature of the statutory trust said to apply to the property of the company in winding-up. It is argued that, to the extent to which such a trust exists at all, it must – contrary to repeated judicial pronouncements – cover the insolvent company's *encumbered* as well as unencumbered property. Section 4 turns to the hindsight principle, and shows that it could not possibly assist in the alleged conversion of the company's encumbered property into property beneficially owned by secured creditor. Section 5 draws on the theory of property law to examine the concept of 'fund'. It also unearths a misunderstanding of insolvency law's *pari passu* principle, a misunderstanding which appears to motivate the misleading search for an illusory 'separate fund' of encumbered assets. To highlight the untenability of *Leyland Daf* and its defence, two pairs of *genuinely* separate funds relevant to corporate insolvency are also considered. Section 6 is a brief conclusion.

2. *Leyland Daf*: Property, Priority, and Propriety

In *Leyland Daf*, their Lordships were called upon to determine the correct priority as between themselves of the expenses properly incurred by the liquidator of an insolvent company ('liquidation expenses'), and debt claims against the company secured by a floating charge ('floating charge claims').[9] The statutory context was section 175 of the Insolvency Act 1986 ('the UK Act').[10] 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".

The crucial question 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 UK Act. Overturning long-established Court of Appeal authority,[11] they replied that they are not.

[8] 'Funding Liquidation: A Functional View' (2006) 122 LQR 303 ('AW'). At least some of A&W's arguments would appear to have been endorsed by no less an authority than Roy Goode; *Principles of Corporate Insolvency Law* (London: Sweet & Maxwell, 2005, 3rd ed), 210. By contrast, several of the arguments in AW are rebutted in Mokal, "What Liquidation Does".

[9] While the wider consequences of their Lordships' judgment explored in this paper have significance for Singapore law, this particular question is not a live one. The Singapore Companies Act 1967 ('SCA'), ss. 328(1) and (5), read with s. 226 (1), expressly provide priority to liquidation expenses over floating charge claims.

[10] In general, most of the arguments made here apply in substance also in relation to IA, s. 115.

[11] *Re Barleycorn Enterprises Ltd* [1970] Ch 465.

2.1 The Fundamental Issue

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."[12] The "real question" is therefore "whether the expenses of a winding up are payable out of charged assets at all."[13] "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."[14] "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."[15]

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."[16] 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."[17] 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."[18]

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 UK Act.

2.2 The Property Law Response and the Charge/Mortgage Critique

With respect, neither the reasoning nor the conclusion are at all satisfactory.[19] Since the governing statutory phrase "assets [of the company]" has not been given a specific statutory meaning, this meaning must prima facia be gathered from the general (property) law, subject to any countervailing reasons of principle or policy.[20] As for the general law, the effect of a floating (and indeed, of a fixed) charge, and even of a mortgage, is *never* to split the debtor company's estate into two funds one of which is beneficially "owned" by or "belongs" to the charge holder. At all times during the existence of the charge or mortgage, the beneficial ownership of encumbered assets remains vested in, and the assets themselves therefore remain "assets of, the company". Instead, the effect of a charge is precisely to reorder the priorities for payment out of the charged assets in favour of the charge holder. This remains true throughout the existence of the charge.

[12] At [81].
[13] At [41].
[14] At [41].
[15] At [81].
[16] At [29] and [30] (emphasis added).
[17] At [16] (original emphasis).
[18] At [16].
[19] See e.g. Mokal, "Separate Funds Fallacy", and Mokal, "What Liquidation Does".
[20] See e.g. *Wisely v John Fulton (Plumbers) Ltd* [2000] 1 WLR 820 (HL), 823-824.

This point has apparently been misunderstood, so we should proceed with care. One of the critiques ('the charge/mortgage critique') of their Lordships' judgment in *Leyland Daf* had focused – "initially" and merely "as a pedagogical tool"[21] or "heuristic"[22] – on the distinction between charges and legal mortgages. The argument was that, at least in case of a legal mortgage, the legal title to the collateral is vested in the secured creditor, with the result that it is "at least possible to construct an argument in favour of their Lordships' [separate funds] analysis as applied to a mortgage".[23] But on no coherent understanding of a "mere charge"[24] could charged assets be considered part of a 'separate fund not owned by the chargor', since neither legal title nor beneficial ownership are transferred to the chargee:

> "While the creation of a *mortgage* just might conceivably remove the ownership of the mortgaged assets from the mortgagor's estate into a 'separate fund' (more accurately, the mortgagee's estate), this simply is not how a *charge* operate. The charge merely brings about a proprietary earmarking of the collateral for the prior payment of the charged debt, while leaving the collateral within the ownership of the chargor."[25]

It was then argued that even in relation to a mortgage, their Lordships' reasoning was untenable, since even a mortgage leaves beneficial ownership of the collateral in the mortgagor, and thus does not create a 'separate fund beneficially owned by the mortgagee'. A legal mortgage involves a transfer of legal title in the collateral from borrower to lender, but 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".[26]

In the result, to reiterate, beneficial ownership of the collateral remains in the mortgagor.

In attempting to rationalise *Leyland Daf*, A&W concede that whatever defence there might be of the judgment does not lie in the law of property itself.[27] (They go on to insist, as we see below, that the judgment must be regarded as a creature of the peculiarities of the law governing corporate

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[21] Mokal, "Separate Funds Fallacy", 389.
[22] Ibid., 395.
[23] Ibid., 389; see also 390-391.
[24] Ibid., 390 (the term "mere charge" appears twice on this page, once in a citation of another author) and 395 (appears once). A&W (at AW, 302, original emphasis) begin their response to the argument in the text by asserting that the charge/mortgage critique is based on the erroneous assumption that "the use of the term 'charge' necessarily connotes the distinguishing characteristics of a *mere* charge". They then use an entire page of the *Law Quarterly Review* to expound an argument which concludes, impeccably, that a mortgage may sometimes be referred to as an 'equitable charge by way of mortgage'. Three points by way of response: (i) A sympathetic reader might take the repeatedly qualified references to charges in Mokal, 'Separate Funds Fallacy' as indicating a sensitivity to the possibility of a charge which was not a "mere" charge. (ii) That characterisation issues were not entirely alien to your interlocutor might also have been detected from Stephen Atherton QC and Mokal, 'Charges over Chattels – Issues in the Fixed/Floating Jurisprudence' [2005] *Company Lawyer* 10, published some months after Mokal, 'Separate Funds Fallacy'. (iii) Perhaps most importantly and as shown in the text here, it makes no difference whatsoever to the argument whether the 'charge' in question is correctly characterised as a mere charge or an equitable mortgage.
[25] Mokal, "Separate Funds Fallacy", 391.
[26] 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).
[27] AW, 301 (particularly text to fns. 30-31), 305, and 309 (the two final paragraphs).

liquidation.) For reasons which are not entirely clear, however, A&W nevertheless take issue with the charge/mortgage critique. They claim that the modern standard debenture routinely grants the 'chargee'

> "all the remedies available to a mortgagee", with the result that, "in substance [the standard debenture] creates an equitable mortgage rather than a mere charge".[28]

It follows, A&W argue, that

> "in the vast majority of cases, the answer to [the charge/mortgage critique] is simply that most debentures are drafted so as to create charges by way of equitable mortgage, both fixed and floating."[29]

It is not easy to know what to make of this argument. Recall that the charge/mortgage critique was based on the observation that since a charge does not involve the transfer of even legal title to the secured creditor – though a legal mortgage does – that it is inconceivable that the existence of a charge could remove the collateral into a 'separate fund' not owned by the debtor. A&W "answer" that given the standard remedies of a chargee, he is likely to be characterised as holding, not a mere charge, but an equitable mortgage instead. But this is wholly irrelevant, whether or not it is true. An equitable mortgage no more makes the mortgagee the *legal* title-holder to the collateral than does the equitable charge. Nor, it should be said, is an equitable mortgagee any more the *beneficial* owner of the collateral than is the equitable chargee.[30] It follows that the charge/mortgage critique may be reformulated as the charge-or-equitable-mortgage/legal-mortgage critique without losing any force (though its label would then be considerably less elegant). The existence of an equitable mortgage does not remove the collateral into a 'separate fund' owned legally (or beneficially) by the mortgagee any more than does the existence of an equitable charge.

Further, and again for reasons which remain obscure, A&W insist that:

> "In contrast to the distinction between fixed and floating security, there has been no statutory imperative to distinguish between charges *stricto sensu* and mortgages of personal property. Rather, the relevant legislation has tended to bundle them together."[31]

However, the main UK statutory instrument governing insolvency creates an imperative to distinguish between mortgages and (mere) *floating* charges in a manner that is highly relevant in the present context. Where a liquidator (who is not an official receiver) realises assets subject to a security interest, the calculation of his remuneration depends on whether the security interest in question was

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[28] AW, 303 (fns. omitted).

[29] Ibid.

[30] To simplify, an equitable mortgage of a legal estate replicates *in equity* (to the extent possible) the rights that would be held at law by the legal mortgagee, but it does not confer on the mortgagee *legal* title to the collateral. And since the legal mortgagee of a legal estate is not its beneficial owner (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]), nor is the equitable mortgagee. An equitable mortgage of an equitable interest transfers to the mortgagee the equitable interest, subject to the mortgagor's equity of redemption. See the useful discussion in the England and Wales Law Commission's *Land Mortgages* (Report) [1991] EWLC 204 (01 January 1991), paras 2.8 – 2.11. Again, the mortgagee has neither legal nor beneficial ownership.

[31] AW, 302, citing as examples Companies Act 1985, s. 396(4) and Law of Property Act 1925, s. 205(1)(xvi).

a fixed charge or mortgage,[32] or whether it was a floating charge.[33] A&W refer to this provision elsewhere in their piece,[34] but may have overlooked its implications for this part of their argument.

2.3 The Relevance of the Distinction between Fixed and Floating Security

None of this is to suggest that there are no relevant differences between fixed and floating security. But these differences lie primarily in 'policy', and derivately from that, in doctrinal history. The existence of fixed security (charges and mortgages) decreases 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, *un*secured 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.[35] 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.[36]

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*.[37]

3. The Statutory Trust

Two propositions – let us label them P_1 and P_2 – are of interest here. First and as discussed in some detail below, it has long been the position in English law that the assets of a company in winding-up are held on a 'statutory trust' for distribution to its creditors (P_1). And second and for not quite so long, it has been asserted that the *encumbered* assets of the company in winding-up do not fall in the statutory trust (P_2). Perhaps most clearly, Lord Brightman – speaking for a unanimous House of Lords – stated in *Roberts Petroleum Ltd v Bernard Kenny Ltd*:[38]

> "An order for the compulsory winding up of a company, or a resolution of the company in general meeting for voluntary winding up, in each case brings into operation a statutory scheme for dealing with the assets of the company…The statutory duty of the liquidator in each case is to collect the assets of the company and to apply them in discharge of its

[32] IR, r. 4.127B(2).Note that mortgages are classified together with fixed charges in such a way in this rule that no space appears to have been left for a "floating" mortgage; cf. AW, 303, text to fn. 39. It is submitted that in any case, any 'floating' mortgage would fall to be classified alongside of a floating charge for all (or virtually all) the purposes of the insolvency legislation, just as (fixed) mortgages are put together with fixed charges; the reasons for this are explained in Mokal, *Corporate Insolvency*, chapters 5 and 6.

[33] IR, r. 4.127B(3).

[34] AW, 300, fn. 22.

[35] 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.

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

[37] And this also provides justification for the new IA, s. 176ZA.

[38] [1983] 2 WLR 192, 208.

> liabilities. For this purpose, unsecured creditors, unless preferred or deferred, rank equally and share *pari passu*…The assets which the liquidator is able to collect and distribute are however necessarily those which are free from a charge."

And for the Court of Appeal in *Re Oasis Merchandising Services Ltd*, Peter Gibson LJ observed:[39]

> "A secured creditor and his security fall outside the statutory trust to the extent that the creditor relies on his security."

The objective of the argument in this Section is to analyse the foundations of P_1 so as to cast doubt on the validity of P_2, notwithstanding the latter's distinguished pedigree. It is the present author's view that there are good arguments for rejecting P_1 – that is, for rejecting the claim that the assets of a company in winding-up are held on a statutory trust[40] – but that these are not decisive, and that there are also very good arguments (some considered below) going in the other direction.[41] This, when coupled with English law's long-standing commitment to P_1, suggests that as a matter of English law, P_1 may be regarded as sound. By contrast, P_2 – while frequently asserted – is entirely undefended, and upon scrutiny, is either false or must be heavily qualified. The position taken here, then, is that if the unencumbered assets of a company in winding-up are held on a statutory trust, then so are its encumbered assets.

3.1 The Origins of the Statutory Trust

Let us begin by looking at the decision of the House of Lords in *Ayerst (Inspector of Taxes) v C & K (Construction) Ltd* ('*Ayerst*'),[42] which most authoritatively confirms in English law the existence of the statutory trust.

The notion that the property of a company in winding-up falls into a statutory trust derives by analogy and implication from the fact that the property of an individual bankrupt explicitly falls into a statutory trust. The trustee in bankruptcy of an individual is vested with legal but not beneficial title to the bankrupt's property. That is, he holds it on trust. Neither the bankrupt nor his trustee may use this property for their own purposes; instead, the property must be used pursuant to the statutory scheme of distribution. Imported into the *corporate* context, the argument (to be explained in more detail below) is that the restrictions on the insolvent company's use of its assets mirror those to which the bankrupt is subject, and correspondingly, that the functions of a liquidator are similar to those of the trustee in bankruptcy.[43] It follows that it is appropriate to employ the terminology of 'statutory trust' in case of the former by analogy with that of the latter. The primary (and only relevant) difference between the two cases is that while title to the individual bankrupt's property vests in his trustee in bankruptcy, the title to the company's property remains in the company.[44] Any

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[39] [1998] Ch 170, 181. See also *Leyland Daf*, [28]-[30].

[40] See e.g. the view of the majority of their Honours in *Commissioner of Taxation v Linter Textiles Australia* [2005] HCA 20, particularly [21]-[55], and [127]-[130].

[41] See e.g. Kirby J's strong cautionary observations in *Commissioner of Taxation v Linter Textiles Australia* [2005] HCA 20, [218]-[247].

[42] [1976] AC 167.

[43] *Ayerst* [1976] AC 167, 177. The analogy stretches to the position of the administrator of the estate of a deceased person, but the details of this will not be considered here.

[44] Indeed, this distinction was at the heart of the appeal to the House of Lords in *Ayerst* [1976] AC 167; see at 178: "The argument advanced for the appellant company is that it makes all the difference that, upon the winding up of a company, the company does not cease to be the legal owner of its property as does a person who…is adjudicated bankrupt…" This contention was rejected by Lord Diplock, at 179: "I do not see how it can make any relevant difference that the legal ownership remains in the person in whom the full ownership was previously vested instead of being transferred to a new legal owner."

other difference between the two would have to follow from this one, or from the very nature of the insolvent entity.[45]

In the case of an individual bankrupt, then, the statute refers to that which is held on statutory trust – *viz.*, the property the legal but not beneficial title to which is vested in the trustee – as the 'bankrupt's estate'.[46] And section 283(5) of the UK Act removes any doubt but that property subject to a security interest falls within the bankrupt's estate, while remaining subject, of course, to that security interest.[47] For example, in relation to land of registered title – which would frequently be subject to (fixed) legal (and perhaps equitable) charges – title vests in the trustee without any need for registration,[48] though the trustee may, if he considers it appropriate, have himself registered as proprietor.[49] Being vested with legal title but bound to use the land and its proceeds only in accordance with the statutory scheme, the trustee holds that land on trust. There would appear to be no principled reason why the position should be any different in relation to a *company's* fixed charge assets. Indeed, the company's position is more straightforward. There is no requirement in the corporate context for anything equivalent to section 283(5) of the UK Act, which exists to ensure that the trustee's title would be no better than the title of the bankrupt. The company in winding-up simply retains the legal title it always had. Therefore, if the individual bankrupt's fixed charge property falls within the statutory trust, so must the fixed charge property of a company in winding-up. And while individuals cannot create floating charges, the position regarding the company's floating charge assets must be *a fortiori* its fixed charge ones.

3.2 The Nature of the Statutory Trust

The nature of the statutory trust rewards detailed attention. Speaking for a unanimous House of Lords in *Ayerst*, Lord Diplock propounded two propositions (marked here as ST_1 and ST_2) as the basis for his conclusion that the property of a company in winding-up, while legally vested in it, becomes subject to a statutory trust:

> "All that was intended to be conveyed by the use of the expression 'trust property' and 'trust' in [previous judicial pronouncements on the nature of the statutory trust, and in particular, *In re Oriental Inland Steam Co.*[50]] was that the effect of the statute was to give to the property of a company in liquidation that essential characteristic which distinguished trust property from other property, viz., that [ST_1] it could not be used or disposed of by the legal owner for his own benefit, but [ST_2] must be used or disposed of for the benefit of other persons."[51]

The proposition ST_1 is key. That the company in winding-up may no longer use or dispose of its property for its own benefit was regarded by Lord Diplock as resulting in the loss on its part of beneficial ownership of its assets, and explains why his Lordship considered it appropriate to use the term 'trust' in relation to such assets:

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[45] For example, the statute excludes from the individual bankrupt's estate (without any parellels in the corporate context) the bankrupt's tools of trade and certain items essential for satisfying the bankrupt's basic domestic needs; see IA, s. 283(2); cf. Singapore's Bankruptcy Act 1995 ('SBA'), s. 78.
[46] IA, s. 306; cf. SBA, ss. 76 and 78.
[47] IA, s. 283(5) (emphasis added): "property comprised in a bankrupt's estate is so comprised subject to the rights of any person other than the bankrupt (*whether as a secured creditor of the bankrupt* or otherwise) in relation thereto". Cf. SBA, s. 76(3).
[48] Land Registration Act 2002, s. 27(5)(a).
[49] Land Registration Rules 2002, r. 168(1).
[50] (1874) 9 Ch App 557.
[51] [1976] AC 167, 180. There are several other dicta to similar effect; see particularly the dicta from *In re Oriental Inland Steam Co.* (1874) 9 Ch App 557, 559-560, approvingly cited at [1976] AC 167, 179-180.

> "Retention of the legal ownership does not prevent a full owner from divesting himself of the beneficial ownership of the property by declaring that he holds it in trust for other persons. I see no reason why it should be otherwise when an event occurs which by virtue of a statute leaves him with the legal ownership of property but deprives him of all possibility of enjoying the fruits of it or disposing of it for his own benefit."[52]

It should be noticed that the company's statutorily-induced inability to employ or dispose of any of its assets for its own benefit possesses, and possesses strongly, an important property-like feature: They have effect *in rem* and *erga omnes*. We can understand this point by contrasting the case of a company which has bound itself by contract not to use its assets for any purpose not permitted by the contract: The general effect there would be merely *in personam*, and if any of the company's assets were to be alienated or otherwise dealt with in breach of contract, the contractual counterparty would normally be restricted only to a claim in damages. Not so with assets of a company in winding-up: No recipient of any of those assets may keep them in a manner not authorised (expressly or by implication) by statute.

We could stop here and conclude that there was indeed a strong analogy between 'ordinary' trust property and the property of a company in winding-up.

According to Lord Diplock in *Ayerst*, however, the existence of a 'trust' is further confirmed by the fact that:

> "The company itself as a legal person, distinct from its members, can never be entitled to any part of the proceeds. Upon completion of the winding up, it is dissolved."[53]

It is unclear what this adds to the foregoing analysis. Arguably, this feature of (most but not all) liquidations confirms that the company has lost beneficial interest in the property, and indicates that it has done so irrevocably.

Now, this 'trust' is 'statutory' since it is statute which deprives the company in winding-up of the right to use its property for its own purposes. The proposition ST_2 provides the second, and closely related, reason which makes this modifier appropriate: what happens to the company's property is to be determined by reference to the statutory scheme of distribution:

> "All powers of dealing with the company's assets, including the power to carry on its business so far as may be necessary for its beneficial winding up, are exercisable by the liquidator for the benefit of those persons only who are entitled to share in the proceeds of realisation of the assets under the statutory scheme."[54]

Third and unrelated to our present concerns, the 'trust' is 'statutory' because it "does not bear all the indicia which characterise a trust as it was recognised by the Court of Chancery apart from statute".[55]

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52 [1976] AC 167, 179.
53 [1976] AC 167, 177.
54 [1976] AC 167, 177.
55 [1976] AC 167, 178. In particular (ibid, 180 and 178), (1) while the liquidator has the power and duty to manage the company's property (and thus is in the position ordinarily occupied, in relation to trust property, by the trustee), that the liquidator does not (whereas a trustee does) have the legal title to the property, which remains vested in the company itself; (2) whereas the trustee owes fiduciary obligations to the beneficiaries of the trust, the liquidator does not owe the same sort of obligations to either individual creditors or members; (3) the requisite certainty of subject-matter may be lacking as at the point at which the statutory trust comes into existence; and (4) so might the certainty of objects, which depends, among other things, on which of the company's (unsecured) creditors choose to lodge a proof.

3.3 The Statute behind the Trust

It would be useful to consider the current version of the very provisions which Lord Diplock in *Ayerst* considered as giving rise to the statutory trust.[56] It will be seen that each of them appears to hold with equal force in relation to the company's encumbered assets:[57]

(1) "The custody and control of all the property and choses in action of the company are transferred from those persons who were entitled under the memorandum and articles to manage its affairs on its behalf, to a liquidator charged with the statutory duty of dealing with the company's assets in accordance with the statutory scheme":

Section 144 of the UK Act (cf. section 269 of the SCA) requires the liquidator to assume possession and control of encumbered as well as unencumbered assets;[58]

(2) "Any disposition of the property of the company otherwise than by the liquidator is void":

Section 127 of the UK Act (cf. section 259 of the SCA) avoids the disposition of the company's encumbered as well as unencumbered assets;[59] and

(3) "The statutory duty of the liquidator is to collect the assets of the company and to apply them in discharge of its liabilities…If there is any surplus he must distribute it among the members of the company in accordance with their respective rights under the memorandum and articles of association…All powers of dealing with the company's assets, including the power to carry on its business so far as may be necessary for its beneficial winding up, are exercisable by the liquidator for the benefit of those persons only who are entitled to share in the proceeds of realisation of the assets under the statutory scheme":

Section 143 of the UK Act (cf. sections 272, 300, and 305 of the SCA) requires the liquidator, unless impeded by the appointment of a receiver, to collect the company's encumbered assets as well as its unencumbered ones, and to distribute the proceeds according to the statutory scheme.[60]

3.4 Assets of No Value to Unsecured Creditors

Next, we should clear up a confusion. A&W maintain that assets not of value to unsecured creditors do not fall in the statutory trust.

> "The 'assets' of the company falling into the statutory trust comprise all [but only those] legally protected entitlements which the liquidator is capable of alienating for value for the benefit of the unsecured creditors [and thus excluding encumbered assets, at least to the value of the secured liability]."[61]

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[56] [1976] AC 167, 177.
[57] For a contextual discussion of several of these provisions, see Mokal, "What Liquidation Does".
[58] As, e.g., A&W accept, at AW, 300, fn. 22
[59] See, e.g., *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). Section 127 of the UK Act is discussed in detail in Mokal, "What Liquidation Does".
[60] See for example *Re Pyle Works Ltd* (1890) LR 44 Ch D 534; *In re Central Sugar Factories of Brazil* [1894] 1 Ch 369; and *In re Potters Oils Ltd* [1986] 1 WLR 201; and the discussion of this in Mokal, "What Liquidation Does".
[61] AW, 307. The insertion within square brackets reflects what A&W say immediately following the quotation in the text: "Yet, where an asset to which the company is entitled in some way is subject to a proprietary claim

A&W cite the Court of Appeal's judgment in *Re Celtic Extraction Ltd*[62] as authority. It is submitted, however, that in fact, the reasoning of the Court, and indeed, the very existence of the judgment, repudiate their claim. The Court of Appeal's primary focus was to examine the nature of waste management licences, and in this context, it was concerned to answer the very specific question as to "the salient features which are likely to be found if there is to be conferred on an exemption from some wider statutory prohibition the status of property".[63] The great specificity of this focus might suggest that the Court's reasoning would not illuminate the broader issues with which A&W are concerned. But to conclude thus would be a mistake. In fact, in the discussion leading up to its conclusions on this narrow point and in the very pages cited by A&W, the Court approvingly considered no fewer than three more general authoritative dicta to the effect that the property which falls into the insolvent debtor's bankruptcy estate, and which must thus be dealt with by the debtor's trustee in bankruptcy, need not have any value.[64] Each of these dicta would appear to hold on their own terms in respect of secured assets.[65] And in general, as for the trustee, so for the liquidator: the insolvent company's estate in liquidation must also include all of its property, whether or not alienable for value by its liquidator.

This in itself is significant enough, but the point is clearer still. Notice that *Re Celtic Extraction* is a decision on section 178 of the UK Act (cf. section 332 of the SCA), which confers on the liquidator the power to disclaim "onerous property", that is, "any unprofitable contract", "any other property of the company which is unsaleable or not readily saleable", or property that "may give rise to a liability to pay money or perform any other onerous act". It is only because such assets *do* fall into the statutory trust of the property of the company in winding-up, and only because the liquidator *is* duty-bound appropriately to deal with them, that statute confers on him the power to "disclaim" it, that is, "to determine, as from the date of the disclaimer, the rights, interests and liabilities of the company in or in respect of the property disclaimed". But for the disclaimer, the rights and interest in the property would remain vested in the company, and failure on the liquidator's part appropriately to deal with the associated liabilities might constitute a breach of his duty.

The point is simply this: If only those things fell into the statutory trust which were capable of being alienated by the liquidator for value and for the benefit of unsecured creditors, then Parliament would not have put itself to the trouble of conferring on him this power of disclaimer.

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that binds the liquidator and which is subsequently enforced, then by symmetry with the treatment of contingent liabilities, the hindsight principle implies that the 'asset of the company' is treated as never having been more than the company's net entitlement, after the proprietary claimant has taken that to which he is entitled." A&W's invocation of what they call the 'hindsight principle' is considered below.

[62] [2001] Ch 475, 486-489.

[63] Ibid, 489.

[64] Particularly clear on this point is *De Rothschild v Bell* [2000] QB 33 (CA), 48-49 ("First, and crucially, the issue ... is whether the interest or right is, in juristic terms, 'property.' If the right is, in its legal nature, property, it only falls outside the bankrupt's estate by some specific exclusion. That in practical terms the 'property' when held by a bankrupt may be of no value to the creditors is nothing to the point. The issue is of the general nature of the right…and not of its value in particular circumstances."). See also *Hollinshead v Hazleton* [1916] 1 AC 428 (HL), 440 (on the definition contained in the Irish Bankrupt and Insolvent Act 1857: "These words could scarcely be wider. They cover everything received which the bankrupt can retain and employ for his own use and benefit [prior to the initiation of bankruptcy proceedings]."); *Hollinshead v Hazleton* [1916] 1 AC 428, 436 (referring to a well established "principle of public policy, which has found expression in the provisions of the Bankruptcy Codes of ... England ... as estimable and as conducive to the welfare of the community as any. It is this, that in bankruptcy the entire property of the bankrupt, of whatever kind or nature it may be, whether alienable or inalienable, subject to be taken in execution, legal or equitable, or not so subject, shall, with the exception of some compassionate allowances for his maintenance, be appropriated and made available for the payment of his creditors.")

[65] Independently but to the same effect, see *Judd v Brown* (2000) 79 P&CR 491, 497.

Indeed – and this takes us to the next step in our argument – section 179 of the UK Act (cf. section 332(7) of the SCA) makes it explicit that the disclaimer power is meant to apply to the encumbered property of the company in winding-up. This removes any doubt: encumbered assets form part of the 'fund' with which, in some appropriate way, the liquidator is duty-bound to deal.

3.5 Encumbered Assets and the Statutory Trust

By this stage, it should be obvious that there is simply no basis for the assertion that property subject to a charge does not fall within the statutory trust (that is, for P_2). As to ST_1, it is of course indisputable that despite retaining legal title to them,[66] the company in winding-up is no more entitled to use or dispose of assets subject to a charge (fixed or floating) for its own purposes than it is unencumbered assets.[67] Further and to the extent to which this is relevant, it is also clear that in most cases, the company itself will never again be entitled to any part of these assets. It follows that from the point at which it enters winding-up, the company is no longer the beneficial owner of charged assets. Therefore, such assets are henceforth held on a 'trust'.

Second and as to ST_2, it is equally clear that the purposes for which such assets must be used is dictated by statute. This is expressly so in relation to assets subject to a floating charge and impliedly so in relation to fixed charge assets.

Consider, first, floating charge assets: when their Lordships delivered the judgment in *Leyland Daf*, such assets were obviously subject to the statutory distribution scheme, being required first to be made available (among other things) for the payment of statutory preferential creditors, only then to the floating charge holder, and then to other creditors in the order stipulated by statute.[68] Subsequently and as a result of the changes made by the Enterprise Act 2002 (which were obviously in their Lordships' notice, not least because of the efforts of Counsel for the liquidators),[69] part of the proceeds of floating charge assets constitute a statutory 'special reserve fund' for the benefit of unsecured creditors.[70] Since floating charge assets must fall within the statutory trust, then, A&W must be wrong in their defence of *Leyland Daf*.

Turning, second, to fixed charge assets, Parliament has chosen not to provide special priority rules for the chargee, as it no doubt could have, and as it has done for floating charge holders. Statute does, however, require the liquidator, unless and until hindered by a receiver, to take custody of fixed charge assets (as of assets subject to a floating charge).[71] It assumes that the liquidator would realise these assets, this assumption is substantiated by very extensive case law,[72] and the Rules provide separate formulae for fixing his remuneration when he realises, respectively, fixed and floating charge assets.[73] The Rules also explicitly assume that the liquidator would pay off the secured claim from "the realisation of the assets of the company" – which, again *contra* A&W,[74] must here mean assets subject to the security – and that the remainder of such realisation would be distributed according to

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[66] As noted by A&W themselves, at AW, 309.
[67] This remains true whether or not the charge is duly perfected by registration, otherwise enforceable (for example, not in breach of IA, ss. 239 and 245; cf. SCA, ss. 329 and 330), and whether or not there is sufficient value in the rest of the company's estate to discharge the secured liability.
[68] IA, ss. 115 and 175; cf. SCA, ss. 300 and 328.
[69] See Mokal, "What Liquidation Does".
[70] IA, s. 176A.
[71] IA, s. 144 (cf. SCA, s. 269). As noted above, A&W concede this point and the one made next; AW, 300, including fns. 22.
[72] Discussed in Mokal, "What Liquidation Does".
[73] IR, r. 4.127B; paragraph (2) of this rule deals with assets subject to a fixed charge and paragraph (3) with those subject to a floating charge.
[74] See e.g. AW, 301.

other elements in the statutory scheme.[75] In the liquidator's hands, then, property subject to a fixed charge is as much "assets of the company" as is property subject to a floating charge, and indeed, as is unencumbered property. And it is as much held on the statutory trust, being legally (or if appropriate, equitably) vested in the company but unavailable for its own purposes, and dedicated instead to the uses expressly provided or implicitly contemplated by the statute.

That the encumbered assets of a company in winding-up fall in the statutory trust of its property is also supported by *In re Central Sugar Factories of Brazil*,[76] one of the cases cited to their Lordships in *Ayerst*.[77] Pursuant to certain mortgage debentures, the entire undertaking, property and assets of the company in winding-up were encumbered to in excess of their full value. The mortgagees had decided to stand on their security, choosing to participate in the winding-up and allowing the liquidator to realise the encumbered assets, most of which were located in Brazil.[78] The liquidators agreed to sell (what the court repeatedly described as) the company's assets to B_1, and this agreement was sanctioned by the court. Some money was paid under the agreement but a significant sum was left outstanding. The liquidators then received an offer from B_2 to buy out the company's interest under the sale agreement with B_1. They agreed, and this was again approved by the court. It was then discovered that F, one of the company's trade creditors, had obtained a judgment in Brazil in respect of his claim, and had proceeded to levy execution on the company's Brazilian assets. This was a serious hurdle to the completion of the agreement with B_2. Acting to all purposes in the interests of the debenture-holders, the company's liquidators therefore asked the English court to order F, without prejudice to any right he might have by virtue of his judgment, to withdraw his claim to the assets. North J agreed, reasoning thus:[79]

> "I must grant an injunction. I do so upon the authority of *In re Oriental Inland Steam Company* [the main authority later relied upon the Lord Diplock in *Ayerst*], where the matter is put in this way, that the assets of the company are held upon a trust, as it were, for the persons entitled to them…That is the principle applied there, and it seems to me to apply here in the same way…The Court restrains creditors from proceeding against the property of the company which is being wound up, regardless of whether they consent or not, or whether they are bound by proof or not. It stops all proceedings against the assets of the company; and those are the assets which we have to deal with in this case."

The same conclusion is reinforced by noticing that a solvent company may mortgage (and *a fortiori*, charge) its uncalled share capital,[80] and that, in winding-up, the company's liquidator may make calls to gather in this capital.[81] It is clear that once in the liquidator's hands, this category of the company's assets, mortgaged or not, must be applied according to the statutory (including the proprietary) scheme. An excellent illustration is provided by *Re Pyle Works Ltd*, where Cotton LJ stated that mortgaged assets were "property of the company", fell into the "common fund" of the company's assets, and so must be got in by the company's liquidator so as to be applied according to

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75 IR, r. 4.127A. This rule is fruitfully juxtaposed with Lord Millett's remark in *Leyland Daf*, [41]: "the real question is whether the expenses of a winding up are payable out of charged assets at all. If they are, there is no doubt that they are payable in priority to the claims of the charge holder." This rule leaves no doubt but that the expenses of the winding up are indeed to be paid out of the assets of the company, including charged assets.

76 [1894] 1 Ch 369.

77 [1976] AC 167, 173.

78 For an analysis of the secured creditor's option to stand on its security in this way, see Mokal, "What Liquidation Does".

79 [1894] 1 Ch 369, 372-372.

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

81 IA, ss. 150, 160(1)(d), and 165(4)(b), and IR, r. 4.202. Cf. SCA, ss. 280 and 281(2), and also s. 288(d).

the statutory (including the proprietary) scheme.[82] The way in which proprietary priorities are worked into the statutory scheme is illuminated by the orders claimed by the successful mortgagees in this case.[83] *Re Pyle Works Ltd* is long-established Court of Appeal authority, then, that assets subject even to a mortgage (and *a fortiori*, to a charge) fall within the statutory trust to be administered by the liquidator at the behest of (among others) secured creditors. It is therefore quite curious that *Re Pyle Works* is cited by A&W as authority that secured assets, "up to the value of the assets or the debt secured, whichever is the smaller[,] are treated *pro tanto* as never having fallen into the statutory trust".[84]

3.6 Does It Matter Which Insolvency Office-holder Deals with Trust Assets?

A&W appear to believe that only that part of the company's estate which is under the *liquidator's* control is held on statutory trust:

> "insofar as they are subject to valid security, assets simply do not form part of the liquidator's fund. Of course, legal title to the entirety of the charged assets will remain with the company until the moment they are sold or foreclosed upon. Yet…insofar as they are subject to the secured creditor's rights, they form a separate fund from that which the liquidator is required to administer.
>
> Returning briefly to *Buchler*, we can see that the 'liquidator's fund' is merely shorthand for the ultimate pecuniary value of *the 'company assets' falling into the statutory trust, which…does not include charged assets*."[85]

We have already considered the validity of much of this argument. But it is illuminating to consider the status of assets under the control of an *administrative receiver*. Do they cease to be, or do they never become, subject to the statutory trust?

The answer is clear. The assets subject to a charge (fixed or floating) which are duly seized by a receiver (a) remain legally vested in the company; but, (b) are no longer available for the company's own use or disposal; (c) to the extent that this is relevant, will, in most cases, never again fall within the entitlement of the company if the company becomes subject to winding-up proceedings which overlap with receivership (as is usually the case, and was the case in *Leyland Daf*); (d) in the case of floating charge assets, must first be used to pay preferential claims (and now, also to create the special reserve fund[86]), as explicitly provided for by the statutory scheme of distribution, and in the case of fixed charge assets, are implicitly left by that scheme for first distribution to the chargee; and (e) for a company which becomes subject to winding-up proceedings overlapping with receivership, must then be distributed according to the terms of the statutory scheme.

It follows that at least for companies which become subject to overlapping receivership and winding-up proceedings (in general, regardless of the order in which these proceedings are initiated), charged assets seized by the receiver are and remain part of the statutory trust. It matters not whether the statutory scheme is administered by the liquidator or the administrative receiver. What matters is

[82] (1890) LR 44 Ch D 534, 575-578.
[83] (1890) LR 44 Ch D 534, 538-539.
[84] AW, 308. It should be acknowledged that it is easy to misread the Court of Appeal's reference to a "statutory fund" at the disposal of the liquidator as a reference to the statutory trust. As explained below, however, the 'statutory fund' in question is distinct from the statutory trust of the company's property: assets constituting the former fall within, but do not exhaust the contents of, the latter.
[85] AW, 309 (emphasis added). A&W's reader should be aware that the source of the term "the liquidator's fund" is obscure. It does not, contrary to appearances, derive from any of the speeches in *Leyland Daf*.
[86] IA, s. 176A.

that the property in question remains vested in the company, and that it is administered not beneficially for the company but instead in accordance with the statutory scheme. The matter is *a fortiori* when the person responsible for administering it is a statutory office-holder, be it a liquidator or administrative receiver.[87]

4. The Hindsight Principle

It is a principle of insolvency law ('the retroactivity principle') that the assets of a company in winding-up are regarded as having been collected, and their proceeds distributed according to the statutory scheme, instantaneously, as at the point at which the company goes into winding-up.[88] This creates two issues, which are dealt with using two different techniques.

Firstly, keep in mind that in fact, of course, it will take time for the liquidator to determine the identity and quantum of the company's assets and to assume custody and control of them; to invite, receive, and if necessary, adjudicate, proofs from creditors; to dispose of the company's assets; and eventually, to distribute their proceeds pursuant to the statutory scheme. What is more, it would often be inappropriate to ignore the effect upon the company's assets and liabilities of events that happen between the time that the company goes into winding-up, and the time at which the liquidator in fact takes accounts as between the company and its creditors. So 'the hindsight principle' requires, quite simply, that in taking the account, regard must be had to events which have occurred since the initiation of the winding-up.[89] Traditionally, the principle appears only to have been applied to the insolvent company's liabilities.[90] So for example, if a person had a claim as against the insolvent company when it entered winding-up but no longer has this claim by the time the accounts are taken, then the quantum of the company's liabilities must be taken to exclude the erstwhile claim. It is submitted that the hindsight principle should apply in determining the value of the company's *assets* as well, for the same sorts of reasons that it applies in ascertaining its liabilities. For example, if one of the company's buildings has burnt down as between the initiation of winding-up and the time at which the liquidator ascertains what is available for distribution according to the statutory scheme, then the value of the company's assets for the purposes of distribution must surely be taken to exclude the value of the building.[91] In any case, remember that the retroactivity principle still holds, so that the company's liabilities (minus, now, the one owed to the erstwhile creditor) are taken to

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[87] This is consistent with the maxim that equity will not allow a trust to fail for want of a trustee, which implies, in this context, that the identity of the trustee is not usually relevant to the validity and nature of the trust and its associated obligations; see e.g. *Mallott v Wilson* [1903] 2 Ch 494. Indeed, the assets of a company, whether or not encumbered by a charge, would remain subject to the statutory trust even if they were to come under the custody and control of the reader, aware, having read the foregoing discussion, of their status as such.

[88] See e.g. *In re Humber Ironworks and Shipbuilding Co* (1869) LR 4 Ch App 643, 646- 647; *In re Dynamics Corporation of America* [1976] 1 W.L.R. 757, 762; *MS Fashions Ltd v Bank of Credit and Commerce International SA* [1993] Ch. 425, 432-433.

[89] See e.g. *Stein v Blake* [1996] AC 243, 252, and *MS Fashions Ltd v Bank of Credit and Commerce International SA* [1993] Ch. 425, 432-433.

[90] Indeed, in *In re T&N Limited* [2005] EWHC 2870 (Ch), [90], David Richards J appears to suggest that the hindsight principle *only* applies in determining the quantum of the insolvent company's liabilities, and not to determining the value of its assets. And all of the cases cited by AW, 306, fns. 68 and 69 explain/deploy the hindsight principle in relation to liabilities only. (Incidentally, the reader should note the reference to *Re Northern Counties of England Fire Insurance Co*, one of the cases cited at AW, 306, fn. 69. The correct citation is (1881) LR 17 Ch D 337.)

[91] Compare the facts of *In re Northern Counties of England Fire Insurance Co* (1881) LR 17 Ch D 337, where the building insured with a company in winding-up burnt down before accounts had been taken by the insurance company's liquidator. The insured was allowed to prove for the full loss. Suppose that at the time of the fire, the insured itself had been a company in winding-up, and that the actual value £x of the building was different from the recovery £y it made under the insurance policy. It would surely be reasonable to substitute y for x in determining the value of the insured's estate.

have been satisfied by the realisation of its assets (excluding, now, the value of the building) as at the date of the initiation of winding-up. Indeed, it is because the retroactivity principle applies that the law needs to qualify its effect through the hindsight principle.

Secondly, if an unmaterialised contingency still affects one of the company's liabilities as at the date at which accounts must in fact be taken, then statute provides for an estimated value to be placed on it ('the contingency valuation principle').[92] And again by virtue of the retroactivity principle, the liability is regarded as having borne that value as at the commencement of winding-up.

4.1 The Hindsight Principle and a Separate 'Fund'

Against this background, we should consider a central argument offered by A&W:

> "where an asset to which the company is entitled in some way is subject to a proprietary claim that binds the liquidator and which is subsequently enforced, then by symmetry with the treatment of contingent liabilities, the hindsight principle implies that the 'asset of the company' is treated [for example, for the purposes of section 175 of the UK Act] as never having been more than the company's net entitlement, after the proprietary claimant has taken that to which he is entitled."[93]

In assessing the validity of this assertion, we should notice two things. First, and as explained elsewhere,[94] the alleged distinction between secured assets and 'assets of the company' is comprehensively repudiated by the general law; by the broader statutory scheme for dealing with the insolvent company's estate; and also by the historical development of this phrase in the particular context of section 175.

Second and independently, it is submitted that A&W's assertion is question-begging, or as they themselves might put it, it is "a *petitio principii*".[95] The clue lies in the final part of the quotation above: the hindsight principle provides (even on A&W's own rendition) simply that the company's assets include whatever is left "after the proprietary claimant has taken *that to which he is entitled*." In relation to assets subject to a floating charge, then, we must determine the chargee's entitlements, *before* we can determine what falls outside of the "company's assets" by virtue of the hindsight principle. And the chargee's entitlements depend, in turn, on the correct interpretation of (among others) section 175.

The problem, then, is the following: A&W invoke the hindsight principle as an aid in interpreting section 175, and more specifically, as a way of ascertaining whether or not floating charge claims are subordinate to liquidation expenses. But their invocation of the principle requires

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[92] IR, r. 4.86(1). This, indeed, is the value for which the creditor in question may prove; IR, r. 4.86(2).

[93] AW, 307 (footnote omitted).

[94] See Mokal, "What Liquidation Does".

[95] See AW, 305, fn. 56. One reason why a well-known English term for a fallacy might be spurned in favour of an obfuscatory Latin tag was drawn to your interlocutor's attention by Nigel Warburton, who refers (not altogether approvingly) in his web-log (at http://nigelwarburton.typepad.com/virtualphilosopher/2007/01/an_offensive_cr.html) to Madsen Pirie's recommendation, in *How to Win Every Argument: The Use and Abuse of Logic* (London: Continuum, 2006), x, that: "It is well worth the…trouble to learn the Latin tags [for fallacies] wherever possible. When an opponent is accused of perpetrating something with a Latin name it sounds as if he is suffering from a rare tropical disease. It has the added effect of making the accuser seem both erudite and authoritative." Warburton's disapproving tone notwithstanding, who could possibly disagree?

that the correct answer to this question be settled upon independently of, and prior to, the application of the hindsight principle.[96] Hence the begging of the question.

Consider next the following argument:

> "When a chargee enforces, the proceeds of sale of the charged assets become their property, up to the value of the assets or the debt secured, whichever is the smaller. By a symmetric application of the hindsight principle, these assets are treated pro tanto as never having fallen into the statutory trust."[97]

Here, A&W give the impression that it somehow matters that the secured creditor has property rights in the collateral as at the commencement of winding-up. Upon reflection, however, it is clear that this does not matter at all. The event which counts is when the chargee "enforces", with the result that the proceeds of sale "become their property". What A&W appear to have in mind is the appropriation of the proceeds of the collateral to repayment of the secured loan. It is only then, and then alone, that the proceeds 'become the chargee's property'. And only then, and not an instant sooner, do they cease to be the debtor company's property. A&W insist, however, that by virtue of the hindsight principle (coupled, presumably, with that of retroactivity), this is deemed to happen in such a way that, *for the purposes of section 175*, the proceeds of the collateral are *never* the "company's assets".

It is difficult to see how this argument could be valid, since if it were, it would prove too much. It could be used to show, for example, that the statutory trust never contains anything for distribution to any creditors. Consider the following, which has a structure identical to that of A&W's argument:

> When an unsecured creditor C is paid a dividend by the liquidator, the money comprised in the payment becomes C's property. By an application of the hindsight principle, this money is treated *pro tanto* as never having fallen into the statutory trust.

Since the same argument could be made on behalf of each claimant to whom a dividend is paid and in relation to all of the company's property available for this purpose, it would follow that the statutory trust never contains anything for distribution to creditors. And a trust cannot exist unless there are assets to be held on trust. This is the *reductio* of A&W's argument.

4.2 Distinguishing Hindsight from Mere Fiction

A&W's 'hindsight' argument must be flawed if it leads to problematic conclusions of the sort described above. Indeed, it is submitted that the flaw is not hard to spot. It is one thing to say that though I in fact sold my car to you at time T_2, that the sale should instead be deemed to have occurred at an earlier time T_1 ('hindsight + retroactivity'). This would not commit us to the quite different proposition that since the car was sold to you at T_2, that it should be deemed never to have belonged to me at all (mere fiction). Indeed, the hindsight + retroactivity statement is inconsistent with the merely fictional one: whether at T_1 or T_2, I could only have sold the car to you if it were mine to sell in the first place.

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[96] Proof that hindsight is not always twenty/twenty?

[97] AW, 307. In support, A&W cite Goode, *Principles of Corporate Insolvency Law* (3rd edn, 2005), 140-153, which is about three-quarters of Goode's entire discussion on the "Delineation of the Property of the Company". Your interlocutor searched diligently but fruitlessly for anything in these pages which might provide support to this assertion.

In exactly the same way, it is one thing to say that the property of a company is deemed to have been distributed as at the moment of commencement of its winding-up. This is entirely different from, and inconsistent with, saying that the property is deemed never to have been the company's at all. The hindsight principle, read together with the retroactivity principle, provides simply that instead of having taken place at time T_2, say, the distribution of certain of the company's assets to a particular creditor C should be deemed to have occurred at time T_1. It provides no license at all for the phantasmagorical assertion that the assets eventually distributed to C should be deemed never to have belonged to the company. This holds with equal force whether or not the assets started off being subject to a charge.

Consider a variation on this theme. *Un*encumbered assets are distributed pursuant to (*inter alia*) section 175 of the UK Act. But they are deemed to have been distributed as at the commencement of the winding-up (T_1). It follows that section 175 applies in relation to assets deemed to have been distributed as at T_1. But of course *floating charge* assets are also distributed pursuant to the same statutory provision, and are also deemed to have been distributed as at T_1. So if unencumbered assets remain the "company's assets" for the purposes of section 175 despite (what A&W call) the 'hindsight principle', then so must floating charge assets. The only way the 'hindsight principle' could have made floating charge assets something other than the "company's assets" for section 175 would have been if these assets had been deemed to have been distributed at T_0 (that is, at some point in time *prior to* the commencement of winding-up), whereas section 175 had only applied at T_1. But if the 'hindsight principle' had had that effect in relation to *floating charge* assets, then there is no reason to suppose that it would not have an identical effect on *unencumbered* property. There is, after all, nothing at all in the 'hindsight principle' itself (certainly nothing identified by A&W themselves) which causes it to apply differentially to encumbered and 'free' assets respectively. So not only would floating charge assets have ceased to be "the company's" by the time that section 175 applied at T_1, so would 'free' assets. Hence the emptiness of the statutory trust, and hence, again, the *reductio* of A&W's position.

4.3 Winding-up Does Not Turn Another's Assets into the Company's, But Nor Does it Turn the Company's Assets Into Another's

A&W purport to support their position by citing the Court of Appeal's judgment in *Re Carl Hirth*.[98] At time T_1, Mr Hirth, who hitherto had been in business as a sole trader, engaged in a fraudulent conveyance of his business to a company set up by him, with a view to putting assets beyond the reach of his creditors. At time T_2, a bankruptcy petition was presented against him. At T_3, the transferee company went into liquidation. At T_4, Hirth was declared bankrupt. Since the transfer of the business constituted an act of bankruptcy, Hirth's bankruptcy was deemed to have commenced at the date at which this act occurred, that is, at T_1. Thus, the transfer was, once impeached by Hirth's trustee in bankruptcy, retroactively avoided, with title to the assets vested in the trustee *as at* T_1. Hirth's trustee in bankruptcy disputed with the company's liquidator the right to distribute the assets in the respective insolvency proceedings. In a passage quoted by A&W, Rigby LJ observed:

> "What is meant by 'the property of the company'? The property which *apparently* is vested in the company at the time of the commencement of the winding-up, or the property which ultimately turns out to be the property of the company? I venture to think that the latter must be the proper construction. When the time for division has arrived you must find out if you can, and in the best way you can, what is the property of the company, and divide that, and that only."[99]

[98] [1899] 1 QB 612; see AW, 308.
[99] [1899] 1 QB 612, 624, *per* Rigby LJ (emphasis added).

Recall that A&W provide this quotation in support of their view that assets subject to a security interest enforced when the debtor is in winding-up do not fall into the statutory trust and should, by application of the hindsight principle, not be treated as assets of the company at all.[100]

With respect, *Carl Hirth* provides no support for A&W's argument, since it deals with an entirely different point altogether. We should note three elements in the Court's analysis. First, the hindsight principle as such had no role to play in the Court's reasoning.[101] A variant of the *retroactivity* principle – namely, that the onset of bankruptcy, and thus the title of the trustee in bankruptcy, 'related back' to the relevant act of bankruptcy – *did* play a crucial role. But this 'relation back' principle applied in *Hirth's* bankruptcy, and not in the *company's* winding-up.[102] What is more, the only (rough) analogue to the 'relation back' principle in the corporate context is the rule that the commencement of a winding-up relates back to the date of the winding-up application.[103] This obviously has no relevance to anything at issue in *Leyland Daf*. Therefore, no principle applicable in the company's winding-up as such removed from the company's estate, in any sense or for any purpose, assets which would otherwise have remained vested in the company. This alone indicates that this judgment provides no support to A&W.

Secondly, the Court of Appeal agreed with the first instance judge that had the recipient company *not* been in winding-up, there would have been no question but that the trustee could recover the property, on the basis that the conveyance was, retroactively, avoided *ab initio*.[104] But for the winding-up, the assets were part of *Hirth's* (bankruptcy) estate. By contrast, A&W's argument appears to assume – correctly – that in the absence of winding-up, beneficial ownership of the collateral would remain in the *chargor*.[105] The structure of A&W's argument, then, is the *inverse* of the Court's reasoning.

The third step in the Court's analysis was crucial, and was the one at which the Court of Appeal overruled the first instance decision. The question was whether it made a difference to the analysis thus far that the recipient company *had* gone into winding-up between the time of the bankruptcy petition and the time at which the bankruptcy order was made. Rigby LJ opened his judgment thus:

> "…I need only deal with that part of the case where we differ from [the judge at first instance]. I understand him to have held that the mere commencement of a winding-up is an absolute bar to the recovery of the *property which was the property of the bankrupt*, and which by reason of an act of bankruptcy has been, *on the face of it*, transferred to the company…"[106]

The Court responded in the negative. Having explained that the property in question had become retrospectively vested in Hirth's trustee as at a time pre-dating the commencement of the company's liquidation, and that it was (in the passage quoted by A&W) therefore not available to the company's liquidator, Rigby LJ concluded:

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[100] AW, text to fn. 75 on 307, and text between fns. 79 and 80 on 308.
[101] Any more than it did in *Leyland Daf* itself, of course.
[102] This is particularly clear from Wright J's judgment at first instance. At [1899] 1 QB 612, 616, the judge dealt thus with the crucial argument made on behalf of the trustee: "I am unable to see how, by an order made *in exercise of bankruptcy jurisdiction*, I can wholly avoid the transfer of property to a company now that the company is in liquidation." As the following text explains, this was precisely the point on which the first instance judge was overruled by the Court of Appeal.
[103] See generally IA, s. 129, and also s. 86; cf. SCA, ss. 255 and 291(6).
[104] [1899] 1 QB 612, 622.
[105] We should add that this would be the case unless and until the proceeds of the collateral are appropriated to repayment of the secured loan (or unless they are effectively placed beyond the ambit of the security).
[106] Ibid., 624 (added emphasis).

> "I do not think that anything that has been done here *converts this property into the property of the company*. [The] passing of this extraordinary resolution to wind up was no bar whatever to proceedings for setting aside the conveyance and recovering the property".[107]

Here, then, is the crux of the issue: A&W are quite right that the property in question was not the "property of the company". But they are wrong to assert that this was because the commencement of the company's winding-up and the resulting application of the hindsight principle rendered assets previously "the property of the company" no longer its own. To the contrary, the issue the Court was called upon to decide was whether the initiation of the winding-up should somehow allow the company's liquidator to retain, for the benefit of its creditors, property that *had not belonged to the company outside of winding-up*.[108] The Court answered that it did not.

Perhaps the point ought to be hammered home: The question was not whether the onset of winding-up caused assets which were "property of the company" until that time to lose that status and so become unavailable to the company's (unsecured) creditors. The question was whether assets which would *not* be "property of the company" *in the absence* of winding-up had somehow obtained this status (had been "converted into" property of the company) *because* of the winding-up and should *thus be* made available to the company's creditors (unsecured, or indeed, holding an appropriately worded security). The Court of Appeal replied in the negative. The assets only "appeared" to be vested in the company, as Rigby LJ put it; only "on the face of it" had they been transferred to it. In legal fact and because of the retrospective avoidance, they never left the bankrupt's estate; they remained "property of the bankrupt".

It follows once again that nothing in the company's winding-up – certainly not the hindsight principle – causes encumbered assets to cease being "the company's property". Understanding *Carl Hirth* merely reinforces this conclusion.

5. 'Fund'

It seems, then, that we are still owed an explanation of the notion of 'fund' in the sense in which the encumbered assets of a company in winding-up allegedly constitute a 'fund' separate from that which consists of its unencumbered property. In this regard, A&W cite *Re Pyle Works Ltd*.[109] One cannot help but be struck by the profusion of the term 'fund' in both the arguments and the judgments (at first instance and in the Court of Appeal) in this case.[110] It should be noted, however, that this term was given at least three different meanings – and naturally, therefore – was liable to confuse. A&W provide a lengthy quotation from Cotton LJ's judgment, but do not mention what was at issue in the case, nor what was in fact ordered by the Court of Appeal. With respect, it is not possible to overstate the damage done by these omissions to any attempt to understand the Court's reasoning.[111] We must repair this damage and then ask whether *Re Pyle Works* does, indeed, somehow support *Leyland Daf*.[112]

5.1 Understanding *Re Pyle Works*: Encumbered Assets are Assets of the Company

107 Ibid., 624-625 (added emphasis).
108 Compare, e.g., *Chase Manhattan Bank NA v Israel-British Bank (London) Ltd* [1979] 3 All ER 1025, 1033-1034.
109 (1890) LR 44 Ch D 534.
110 The term appears no fewer than thirty times.
111 Cf. Goode, *Principles of Corporate Insolvency Law* (London: Sweet & Maxwell, 2005, 3rd ed), 210.
112 What follows should be read in conjunction with the discussions of *Re Pyle Works* above.

The issue (said to be squarely before a court for the first time) was whether a company, while solvent, could mortgage its uncalled share capital, so that the amounts provided in response to calls made in the winding-up would be caught by the mortgage. To simplify somewhat, two arguments had been presented to the Court of Appeal why such mortgages should not be effective.

First, it was said, the right to make calls in the winding-up was what we would now label an office-holder action.[113] It was said to be a right vested exclusively in the liquidator rather than in the company, and it was a right to constitute a "statutory fund" for the benefit of the company's creditors as a whole and not any particular class of creditor preferred by the company itself. It would follow that the company itself could never have dealt with it, for example, by mortgaging it. The Court quite correctly rejected this submission: the shareholders' liability pursuant to the calls was not a new one arising only by statute, but was the pre-existing one deriving from their original bargain with the company.[114] It followed that the uncalled share capital of the company was part, not of the statutory fund (whose existence was nevertheless affirmed),[115] but of the "common fund" with which the company itself could have dealt while solvent, and which was available to the liquidator to meet all of the company's liabilities, in accordance with (*inter alia*) any priorities created by the company itself while solvent. The right to make calls in the winding-up was simply (though in a somewhat modified form) the right to add to this common fund.

The second argument for the assertion that a company could not mortgage its uncalled share capital in such a way as to bind its liquidator was based on sections 98 and 133 of the Companies Act 1862 ('the 1862 Act').[116] In a passage only part of which is quoted by A&W (the portions they omit are italicised), Cotton LJ dealt with it thus:[117]

> "*the question is whether the Act contains any necessary implication preventing the company or the directors from effectually mortgaging that part of their property.*
>
> *Now, what is the argument upon that point? It is said that this part of the capital of the company that is to say, calls made by the liquidator--ought to be applied in payment of all the unpaid creditors equally, and for that proposition reliance is placed upon sects. 98 and 133.* But then the question arises, what are to be considered 'assets' or 'property' of the company? *In my opinion the 'assets' or 'property' of the company which are referred to in those sections must mean that portion of the capital which the directors have not actually dealt with before the winding-up commenced. That portion of the capital, being the property of the company, must be got in by the liquidator; but* if the legal estate, so to speak, is outstanding in a mortgagee, then the only portion of that property which the liquidator can look upon as a fund in the winding-up for payment of the debts of the creditors will be the equity of redemption, or, in other words, that portion of the property remaining after the satisfaction of all the obligations which the directors have properly thrown upon this part of the

[113] Akin to the right to challenge transactions for being at an undervalue or for being impermissibly preferential (pursuant to IA, ss. 238 and 239 respectively; cf. SCA, ss. 331 and 329), or the right to being a wrongful trading claim (pursuant to IA, s. 214).
[114] See e.g. at (1890) LR 44 Ch D 534, 584.
[115] Ibid, 584 and 586-587.
[116] Section 98, roughly equivalent to IA, s. 148(1) (cf. SCA, s. 280(1)), provided: "As soon as may be after making an order for winding up the company, the Court shall settle a list of contributories, with power to rectify the register of members in all cases where such rectification is required in pursuance of this Act, and shall cause the assets of the company to be collected, and applied in discharge of its liabilities." Section 113, roughly equivalent to IA, s. 107 (cf. SCA, s. 300), provides that "The property of the company shall be applied in satisfaction of its liabilities *pari passu*, and, subject thereto, shall, unless it be otherwise provided by the regulations of the company, be distributed amongst the members according to their rights and interests in the company."
[117] (1890) LR 44 Ch D 534, 577-578.

> property of the company. Therefore, in my opinion, although the assets of the company must, *under sects. 98 and 133*, be applied by the liquidator in payment *pari passu* of all the creditors then unpaid, yet property which is in mortgage is not, in my opinion, 'assets' of the company in the sense in which that is to be done, namely, free assets, assets which can be dealt with by the company in payment of their debts without regard to those who have a mortgage on this portion of the property of the company."

A&W claim that this supports the view that:

> "the starting point for the analysis is not that the secured creditor is, at any point prior to enforcement, the 'owner' of the property, but rather that because he enforces, its *value* is deemed *pro tanto* to be outwith the 'assets of the company' [for the purposes of provisions like section 175 of the UK Act]…To recapitulate: insofar as they are subject to valid security, assets simply do not form part of the liquidator's fund."[118]

In fact, it is submitted that the Court's judgment condemns this assertion. Firstly, what do A&W imagine to be "the liquidator's fund"? Is it that property (or since they emphasise this term, is it that "*value*") which the liquidator is required to administer in the discharge of his functions? If so, then A&W's position is inconsistent with the actual decision in *Re Pyle Works*: the liquidator was bound at the behest of certain mortgagees – indeed, he was so ordered by the Court – to make calls and then to apply the proceeds (that is, the assets/property/*value*) first according to the mortgagees' priorities *inter se* (which he was also ordered to ascertain) and then amongst the general creditors.[119] "The liquidator's fund" certainly, therefore, included mortgaged (and presumably, charged) assets.

Second and related to this, if A&W were right that the (value of the) collateral is not part of the "assets of the company", then section 98 of the 1862 Act (section 148(1) of the UK Act; cf. section 280(1) of the SCA) would not have empowered the Court – and on its behalf, its officer the liquidator – to make calls to collect the company's *mortgaged* share capital at all. After all, the statutory provision only addresses "assets of the company". Again, then, *Re Pyle Works* demonstrates that these "assets" manifestly include the company's encumbered property.

Thirdly, Cotton LJ's point in the quoted passage was simply that for the purposes of payment *pari passu*, the *liquidator* could no more ignore the mortgages created by the company's directors than could the *company itself* while still solvent. In the course of discharging his functions, the liquidator is no freer to ignore the proprietary interests held by the debenture-holder in "the company's assets" than is the company itself. Precisely this point is made in the second substantive judgment in *Re Pyle Works* by Lindley LJ (agreeing with Cotton LJ) without using the term 'fund' at all,[120] and indeed, by Stirling J at first instance.[121]

Fourth and by way of context, A&W's understanding of the statutory phrase "the company's assets/property" is not apposite to most of those occasions on which this phrase appears in the insolvency legislation. Think, for example, of provisions dealing with receivership;[122] those empowering the court to make a winding-up order even if most or all of the company's assets are

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118 AW, 308-309.

119 In that light, see AW, 309, a couple of paragraphs after citing *Re Pyle Works*: "…insofar as [assets] are subject to the secured creditor's rights, they form a separate fund from that which the liquidator is required to administer".

120 (1890) LR 44 Ch D 534, 585.

121 Ibid, 556-557.

122 See e.g. IA, ss. 29, 30, 35, 37(4)(b), 39, 42(2), 43, 45(3)(b), 48(1)(b), and 48(4), and in relation to Scotland, ss. 51, 55, 56, 57, 58, 60, 61, 67, and 70. See also IA, ss. 72 (cross-border operation of receivership provisions) and 248 (definition of 'secured creditor'). Cf. SCA, ss. 217, 218, 219, 221, 222, 223, 224, 225, and 227).

subject to security interests;[123] those restricting dealings with assets when the company is the subject of a winding-up application or order;[124] and those providing for the examination, and if appropriate, liability, of company officers who may have knowledge of or have misapplied the company's assets.[125] In none of these instances could it be appropriate to regard either secured assets *or their value* as not being fully caught by statutory references to 'the company's property/assets'. This is self-evident in relation to provisions defining and providing substance to the status, rights and obligations of secured creditors and receivers. But the point holds generally: Imagine an unsecured creditor asking the court to allow it to proceed pursuant to section 130(2) of the UK Act against secured assets on the basis that they were not "the company's property" up to the value of the secured liability![126] Or a corporate officer challenged under section 212 of the UK Act responding that while he admitted liability for wrongfully retaining "property of the company", that his liability should be no more than the value of the company's equity of redemption in the retained assets, on the basis that nothing more was caught by the statute! Or someone refusing to respond to requests for information pursuant to section 236 of the UK Act on the basis that the asset in his possession was fully encumbered and was thus not "property of the company"!

5.2 The *Pari Passu* Myth…Again

It is difficult not to feel weary as we embark – again[127] – on an explication of insolvency law's *pari passu* standard. But explicate it we must. It is essential to distinguish three principles, each of which has been given this label with varying degrees of accuracy, and correspondingly, varying degrees of confusion.

Firstly, there is the *pari passu* principle properly so called ('the *pari passu* principle').[128] This principle requires insolvency law to take claimants "exactly as it finds them",[129] such that the distribution of assets within an insolvency forum is based on the *pre-insolvency form* of claims. So for example, all those holding claims classified under pre-insolvency law as 'unsecured' ought to be repaid the same proportion of their claims as all others similarly placed. On this understanding of the *pari passu* principle, the existence of insolvency set-off and preferential claims (among others) constitutes exceptions to this principle.[130] More soon on the *pari passu* principle properly so called.

Secondly, sometimes the term '*pari passu*' is also confusingly used to refer to *pro rata* distribution within the various classes of claimant established by *insolvency law itself* ('the principle of

[123] IA, s. 125(1); cf. SCA, s. 257(1).
[124] See e.g. IA, ss. 127 and 130(2) (cf. SCA, s. 259, and the somewhat differently worded s. 299(2)), discussed in Mokal, "What Liquidation Does".
[125] See e.g. IA, ss. 212 and 236; cf. SCA, ss. 341, and 285 and 286.
[126] For a discussion of this provisions, see Mokal, "What Liquidation Does". Cf. SCA, s. 299(2), which does not include a reference specifically to the "company's property".
[127] See Mokal, "Priority as Pathology: The *Pari Passu* Myth" (2001) 60(3) Cambridge LJ 581. A significant literature now explores the actual contours of the much-misunderstood *pari passu* principle, and which seeks to highlight the confusions surrounding it. For some recent contributions, see e.g. Jay L. Westbrook, "Avoidance of Pre-Bankruptcy Transactions in Multinational Bankruptcy Cases" (2007) 42 Texas International LJ 899, particularly at 901; Anthony Duggan and Thomas Telfer, "Canadian Preference Law Reform" (2007) 42 Texas International LJ 661, particularly at 665-667; Mokal, "Contractarianism, Contractualism, and the Law of Corporate Insolvency" [2007] Sing J Legal Stud 51, 85-90; Tracey E. Chan, "The *Pari Passu* Principle in Judicial Management" [2006] Sing J Legal Stud 213; Mokal and L.C. Ho, "The *Pari Passu* Principle in English Ancillary Proceedings" (2005) 21 IL&P 207; and Mokal, *Corporate Insolvency Law*, Chapter 4, including the references to L.C. Ho's work at 101, fn. 62.
[128] In the UK, enshrined, *e.g.*, in IA, s. 107, and IR, r. 4.181(1).
[129] See *e.g. Re Smith, Knight & Co, ex p Ashbury* (1868) L.R. 5 Eq. 223 at 226, discussed below.
[130] For example, this, with subtle variations, is the understanding espoused in *McGrath v Riddell* [2008] UKHL 21, by Lord Hoffmann at [2], [22], and [32]; and by Lord Scott at [49] and [62].

ratable distribution within classes').[131] It should be clear why it would be extremely confusing to describe this too as *pari passu* distribution: the ratable treatment of preferential claims *inter se* constitutes the *application* of this principle, whereas the very existence of preferential claims constitutes an *exception* to the *pari passu* principle, properly understood in the first sense described above. It would be paradoxical – indeed, self-contradictory – to say that the treatment of preferential claims is an application of, and yet the very existence of such claims is an exception to, one and the same *pari passu* principle.[132]

Thirdly, confusion is compounded when the term '*pari passu*' is used to describe not just one or both of the above situations, but also to refer to the automatic stay, or more broadly, to the collectivity of formal insolvency forum itself ('the collectivity principle').[133] While the two principles described in the previous two paragraphs are *distributive* (specifying how the value in the insolvent estate is to be allocated amongst various claimants), the collectivity principle does not mandate distribution of any sort. It is in fact about the *conservation* of the insolvent estate, striking down attempts to bypass the collective insolvency regime. The collectivity principle is perfectly compatible with *any* manner of distribution within a collective insolvency forum, be it *pari passu*, or ratable distribution within classes set up by insolvency law itself, or indeed any other distributive formula.

Against this background, we may examine the fifth, final, and most important aspect of *Re Pyle Works*. The argument there that the mortgagees ought not to be granted priority in the distribution of the proceeds of the calls to be made by the liquidator was based on one of a myriad common misunderstandings as to the nature of the *pari passu* principle.[134] The relevant misunderstanding about this principle may be expressed thus ('the *pari passu* argument'):

> Section 113 of the 1865 Act (section 107 of the UK Act; cf. section 300 of the SCA) requires that "the property of the company" be distributed *pari passu* (or rateably, or equally, which in this context mean exactly the same thing). This means that *each creditor* must receive the same proportionate amount of their claim from those assets. But the courts [including the Court of Appeal in *Re Pyle Works*] do not allow encumbered assets to be distributed in this way; instead, priority is accorded to creditors holding security. It follows that secured assets are not "the property of the company", at least to the value of the secured debt.[135]

On *any* understanding of the *pari passu* principle, this argument is fallacious.

What sense of '*passi passu*' is at play here? Since the argument focuses on distribution, the collectivity principle may be set aside as irrelevant. In any case, collectivity was not at issue on the facts of *Re Pyle Works*. Nor is the principle of ratable distribution within classes of any relevance: the argument makes no explicit or implicit reference to claimant classes as defined by insolvency law itself. Therefore, let us focus on *pari passu* properly so called.

The fallacy in the *pari passu* argument lies in the assumption that, in this context, to distribute *pari passu* is to distribute proportionately amongst *all* creditors. In fact and as noted above, the accurate formulation of the *pari passu* principle is that, in the distribution of value from an insolvent estate, *likes* must be treated alike. That is to say, creditors placed by the general (non-insolvency) law

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[131] This principle is exemplified by IA, s. 175(2)(a). Cf. *McGrath v Riddell* [2008] UKHL 21, [73] and [81] (Lord Neuberger).
[132] Cf. *McGrath v Riddell* [2008] UKHL 21, [67] (Lord Neuberger).
[133] This is to be found in, e.g., IA, s. 130(2).
[134] The misunderstanding is reflected in several of the dicta rehearsed by the two courts in *Re Pyle Works*.
[135] Compare AW, 301, referring to IR, r. 4.181, which is exactly to the same effect as IA, s. 107.

on par with each other must (at least prima facie) be treated as equals by insolvency law. This point is perhaps most perspicuously made by Fidelis Oditah:[136]

> "the [*pari passu*] principle does not explain the obvious truth that insolvency law largely respects rights acquired prior to insolvency. If the principle means anything it only affirms the self-evident truth that equals are to be treated equally. However, the more important determination of those who are equals is seldom determined by insolvency law…It is a fundamental, albeit shallow, principle of insolvency law that all unsecured creditors standing in positions of relative equality at the onset of insolvent liquidation must…be treated equally."

Note the crucial implication: since creditors holding security interests are not 'like' unsecured creditors under the general law, the *pari passu* principle does *not* require them to be treated like unsecured creditors.

That this is the correct understanding of the statutory references to *pari passu* or ratable or equal distribution has proved surprisingly difficult to grasp, but it is hardly a new discovery. As early as 1758, Lord Mansfield was pointing out – in *Worsley v Demattos*, a decision based on the doctrine of ostensible ownership – that it was one of the purposes of bankruptcy law to ensure an

> "equal distribution among creditors who equally gave a general personal credit to the bankrupt…The policy of the bankrupt law…is to level all creditors, who have not actually recovered satisfaction, or got hold of a pledge which the bankrupt could not defeat."[137]

The references to equal distribution in bankruptcy law have never required *every* creditor to be paid proportionately. All (but only) those giving a "general personal credit" are to be "levelled". This includes those who hold a security interest rendered defective by some principle or policy of bankruptcy law (as in *Worsley* itself). But this "levelling" does not affect those with an unimpeachable security interest, that is, those whose claim rests in something more than merely "a general personal credit".

Some eighty years hence, and this lesson appeared in need of repetition, this time in the context of a creditors' suit for the administration of the estate of an intestate. In *Mason v Bogg*,[138] the question was whether a specialty creditor could prove for the full amount of her claim, without giving credit for the value of the assets over which she held certain security interests. Counsel for the administrator of the intestate's estate argued that she should not be allowed to do so, on the basis that:

> "The decree of this Court is in the nature of a judgment for all creditors."

Lord Cottenham LC retorted:

> "Not for the purposes of altering the securities of the creditors. It is a judgment *according to their legal rights*."[139]

The decree made in this case by the Court of Equity for an account of the intestate's debts and for the due administration of his estate was indeed a judgment equally for all of the deceased's creditors.

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136 'Assets and the Treatment of Claims in Insolvency' (1992) 108 LQR 459, 463-464 (footnote omitted).
137 1 Burr 467, 477 and 483; 97 ER 407, 412 and 416.
138 (1837) 2 MY & OR 443; 40 ER 709.
139 (1837) 2 MY & OR 443, 449; 40 ER 709, 711 (added emphasis).

But this judgment did not deprive them of their pre-existing rights; instead, it acknowledged and would give effect to those rights.[140] The same holds, it is submitted, for a winding-up order.

A similar point was made by Lord Romilly MR in *In re Smith, Knight, & Co ex parte Ashbury*.[141] A distressed company executed a deed of inspectorship, pursuant to which most of its creditors (call them Deed Creditors) were paid two shillings on the pound. The company was then put in winding-up, and certain of its creditors who had not received any payment by virtue of the inspectorship deed asked the court to order the liquidator to pay them the same two shillings on the pound before Deed Creditors should receive anything more. His Lordship refused, stating:[142]

> "The Act of Parliament unquestionably says, that everybody shall be paid *pari passu*, but that means everybody after the winding-up has commenced. It does not mean that the Court shall look into past transactions, and equalise all the creditors by making good to those who have not received anything a sum of money equal to that which other creditors have received. It takes them exactly as it finds them, and divides the assets amongst the creditors, paying them their dividend on their debts as they then exist."

This interpretation of the *pari passu* principle holds also for secured claims. It is not that encumbered assets are not to be regarded as the company's property. Rather, (unimpeachably) secured creditors are not to be regarded as on par with unsecured creditors, and therefore, the *pari passu* principle does not require them to be "equalised" with each other. The liquidator must distribute *pari passu*, but he can only do so consistently with the pre-existing rights of the claimants, and thus, by respecting the hierarchy of (*inter alia* and subject to statutory qualifications) secured over unsecured claims.

Let us conclude on this point with the hope that the Court of Appeal's reasoning in *Pyle Works* is now clear. The term 'fund' (which, as noted, Lindley LJ did not employ in making the very point made by Cotton LJ in the passage partially cited by A&W) did not perform any explanatory role in the Court's judgment. It is uncontroversial that the solvent company cannot ignore the mortgagee's rights in the relevant assets outside of winding-up even though there is no separate 'fund' of those assets. The Court of Appeal in *Pyle Works* concluded simply that nothing in the relevant part of the statute indicated that the liquidator could ignore the mortgage and distribute the mortgaged assets indiscriminately amongst secured and unsecured creditors. No separate 'fund' need be dreamt up to ensure this to be so.

5.3 Property Law Theory, and What the Separate 'Fund' is Not

In purporting to explain the use of the concept of 'fund' by their Lordships in *Leyland Daf*, A&W invoke Richard Nolan's discussion of property in a fund in English law.[143] On Nolan's view, however, a necessary (though not sufficient) pre-condition for the existence of a 'fund' (which Nolan accepts is not a term of art) is that more than one person come to hold proprietary rights in one and the same asset:

> "To say that someone has property in a fund means simply that one person, the fund-beneficiary, has immediate proprietary rights in identifiable assets held by another person, the fund-holder, but that those rights are inherently subject to, and limited by, the superior

[140] See also *In re Oriental Inland Steam Company ex p Scinde Railway Company* (1873-74) LR 9 Ch 557, 560-561, indicating that encumbered property of a company in winding-up would be held on statutory trust but subject to the encumbrancer's rights.
[141] (1867-68) LR 5 Eq 223.
[142] Ibid, 226.
[143] Nolan, "Property in a Fund" (2004) 110 LQR 108.

> right of the fund-holder to manage and alienate the assets free of the fund-beneficiary's rights. In other words, the fund-beneficiary's prima facie rights of property in fund assets are moulded and limited ab initio by the fund-holder's powers of management and alienation."[144]

It cannot be doubted that on this view, the *creation* of a security interest, such as a floating charge, also creates *one fund*, with the chargor's (the fund-holder's) proprietary rights in the collateral being limited by the chargee's (the fund-beneficiary's) proprietary rights:

> "The floating charge is a charge over a fund of assets, in the sense that the chargee has an immediate security interest in identified assets owned by the chargor, which is nevertheless subject to, and restricted by, the superior but limited power of the chargor (as owner) to manage and alienate those assets free of the chargee's interest."[145]

It cannot be doubted, either, that on this view, were the beneficial ownership of certain assets to vest in an erstwhile chargee C, that those assets would no longer be part of any 'fund'. C's ownership of those assets would no longer constitute "property in a fund", since there would no longer be any other person whose proprietary rights "moulded and limited" those of C. We would then simply have property in those assets, and there would be no analytical advantage, and potential for confusion only, in describing the situation as property in a 'fund' containing those assets. This is *a fortiori* of any talk of 'two funds', when all we have is different assets beneficially owned by different people.

Against this background, it cannot be doubted, finally, that whatever the merits of Nolan's understanding of 'property in a fund', it is not their Lordships' understanding of the separate 'fund' constituted by encumbered assets. Nor are the two understandings consistent, for the reasons just mentioned. For *a* fund to exist at all, it is crucial, on Nolan's view, that the property rights in certain assets be held at one and the same time by different persons; by contrast, it is crucial to their Lordships' reasoning and conclusion in *Leyland Daf* that assets subject to a charge be in a 'fund' beneficially owned by the chargee, with the chargor enjoying no rights in it at all.

A&W's treatment of this point is most curious. As noted, they start off by claiming to endorse Nolan's notion of a fund as an aid to understanding *Leyland Daf*.[146] By the time they have explained the use of this term in *Leyland Daf*, however, they would appear to have repudiated Nolan's understanding. In Nolan's terms, the creation of a floating charge over a company's assets creates *one* fund in which chargor and chargee *both* hold property rights. A&W assert, instead, that the sort of 'fund' their Lordships must have had in mind could not possibly come into existence at the point at which a floating charge is created.[147] And in the situation in which, according to their Lordships, *two* funds would exist (in the one case, beneficially owned by the chargee; and in the other case, held by the debtor for distribution according to the statutory scheme), Nolan would hold that there is no property in a fund at all. It follows that the sort of 'fund' their Lordships had in mind is inexplicable on Nolan's understanding of the law. A&W's attempt to press the latter in defence of the former serves merely to highlight the mutual incompatibility of these two notions of 'fund'.

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144 Ibid, 108.
145 Ibid, 117.
146 AW, 304, text to fns. 45-48.
147 This comes across most clearly in their discussion of *Re MC Bacon (No 1)* [1990] BCC 78, 92, at AW, 310, and particularly text to fns. 89-92.

And while we are at it, certain of the conceptual problems with *Leyland Daf* may fruitfully be unearthed by considering A&W's invocation, in support of this judgment, of the work of two other authors.

First, they remind us of Tony Honoré's classic analysis of ownership in the "full liberal sense".[148] While A&W talk about Honoré's treatment of the "entitlements that together comprise 'ownership'",[149] what Honoré in fact analyses are what he calls the "incidents" of ownership. The difference is significant in this context, since several of these incidents are more like burdens than entitlements. Importantly, one of these is the "liability to execution": it is a mark of ownership that it is the owner's property, rather than anyone else's, which is liable to being taken by the owner's creditors in satisfaction of the owner's obligations.[150] The implication in this context is obvious: for a company in liquidation, the reason why the appropriation by the chargee of the proceeds of sale of the collateral to the secured liability extinguishes the *company's* secured liabilities marks out the company, rather than the chargee, as the beneficial owner, until appropriation, of the collateral. As we have noticed above, this directly contradicts their Lordships' position in *Leyland Daf* that the chargee, *qua* chargee, is the beneficial owner of the encumbered assets.

There is, finally, Bernard Rudden's important discussion of things as things and things as wealth.[151] Against their Lordships in *Leyland Daf*, it had been complained that the existence of a charge does not confer on the chargee beneficial ownership of the collateral. All that the chargee has, until the point at which the proceeds of the collateral's sale are appropriated to the secured liability, is a property right in the collateral. In that respect, therefore, a chargee is no different from anyone else holding proprietary rights in the company's assets, for example, the holder of a restrictive covenant, profit, option, or easement. It is no more sensible to assert that assets subject to a charge fall into a separate fund not beneficially owned by the chargor as to hold the same regarding land subject to, say, an easement. Therefore, if the company's assets subject to an easement are not outwith the ambit of sections 115 and 175, then nor are assets subject to security.[152]

In attempting to rebut this point, A&W invoke what they (appear to) suggest is Rudden's "distinction between 'use-value' and 'wealth-value'",[153] and assert that:

> "The term 'fund' is not…an appropriate term to describe every partition of proprietary rights in relation to an asset. The ordinary meaning of the word is 'a stock or sum of money, esp. one set apart for a particular purpose'.[154] It follows that it is ordinarily used as an ellipsis in relation to partitions that are understood in terms of a sum of money – typically, the sum A expects to receive on sale of the underlying assets – as opposed to the enjoyment to be had from the assets' use. A corollary of A's lack of interest in the assets for their own sake is that B will typically be permitted, to a greater or lesser degree, to substitute the underlying assets…However, the word 'fund' is not apt to describe every situation where ownership entitlements are partitioned between more than one party. An easement, for example, is not *usually* taken for the wealth-value it represents in relation to the underlying asset, as opposed to the enjoyment of the use-value it permits."[155]

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[148] Honoré, "Ownership", in Guest (ed), *Oxford Essays in Jurisprudence* (1961), 107.
[149] AW, 304, fn. 46.
[150] Honoré, "Ownership", 123. This is endorsed by Bernard Rudden, "Things as Things and Things as Wealth" (1994) 14 OJLS 81, 82; see below.
[151] Rudden, "Things as Things and Things as Wealth" (1994) 14 OJLS 81.
[152] See Mokal, "Separate Funds Fallacy".
[153] AW, 304, fn. 50. In fact, as we see below, Rudden explicitly rejects one of these terms and never employs the other.
[154] Citing the Oxford English Dictionary (2nd ed, 1989), ('OED') www.oed.com. See the text to follow.
[155] AW, 304, including fn. 52 (fn. 51 omitted; emphasis added).

Firstly, the "usually" in the final sentence is helpful. Even accepting everything else A&W say here, it follows that, in some *un*usual circumstances, easements *are* taken for their "wealth-value", which, let us guess,[156] is the situation in which the holder of the dominant tenement (the insolvent company's neighbour) would be indifferent between having the benefit of the easement on the one hand, and on the other, having a sum of money instead of the easement. This would usually be true, for example, of easements like those to store coal,[157] park cars,[158] or install an advertising board on the company's land,[159] each of which would usually be of a quantifiable value to its holder. It follows, on A&W's view, that if the company's land is burdened by some such easement, then it *does* create a separate fund not falling within the ambit of sections 115 and 175! The same holds if the company's neighbours hold other "wealth-value" rights, like a profit to take fruits or fish from the company's land, a restrictive covenant precluding the company from running a competing business, or an option to acquire a part of this land in order to expand their own (that is, the neighbour's) commercial activities. To accept this 'defence' of *Leyland Daf*, then, would be to reduce their Lordships' conclusion to absurdity: it would be preposterous to suggest that if subject to any such right, the company's land would be outside the ambit of the statutory references to "the company's property/assets". It is telling that A&W have nothing to say about the status of assets subject to such rights.

Secondly – and even assuming that we can make some sense of what "use-value" means to A&W[160] – there is a fatal problem with their suggestion. Within fairly robust parameters, it is doubtful that many *things* are ever held for their "use-value". It should, in principle, almost always be possible to plot any individual's indifference curve as between any given thing and money (i.e. a claim to more of most other things). It follows that A&W's exception swallows their rule: easements, profits, and restrictive covenants, etc., are *always* (within robust limits, as noted) taken for their "wealth-value", as much as are security interests. It follows in turn that the *reductio* spelt out above holds in relation to all such proprietary rights.

The third and final observation relates to an issue which is less important but amusing nevertheless. A&W are rather mischievous in attributing an "ordinary" use to the term 'fund'. They cite the OED, but choose the *fourth* sense of the term provided there. The emphasis there on money – which, as we have seen, A&W appear to equate with "wealth-value" and contrast with "use-value" – allows them to attempt to explain why the existence of an easement does not remove, into the equivalent of a 'separate fund beneficially owned by the charge rather than the chargor', the servient tenement owned by the now-insolvent company. Precisely because this notion of 'fund' emphasises "wealth-value", however, it is inapposite as applied to security interests. The reason is obvious (though subject always to the doubts raised above about the notion of "use-value"). The chargee might be interested solely in the "wealth-value" of the collateral, but the *chargor* would often wish to "enjoy the use-value" of the collateral. This certainly holds of assets usually subjected to fixed but

[156] Rudden never uses the term "wealth-value"; and indeed, referring to the distinction between "use value" and "exchange value" drawn by some textbooks, he is at pains to explain that "neither of these two terms seems quite to express the points" he is making; (1994) 14 OJLS 81, 93. Also, see the point made in the following paragraph in the text.
[157] See e.g. *Wright v Macadam* [1949] 2 KB 744 (CA).
[158] *London & Blenheim Estates Ltd v Ladbroke Retail Parks Ltd* [1992] 1 WLR 1278.
[159] *Moody v Steggles* (1879) 12 Ch D 261.
[160] Since A&W contrast this notion with "wealth-value", let us assume that something is held for its "use-value" when no sum of money would induce the holder to forego of that thing. But in truth, the reader is left to decipher what "use-value" really means. Rudden, lumbered by A&W with this concept despite explicitly having disclaimed it, is not keen to help: "Use is not hard to understand, but use value is very problematic"; (1994) 14 OJLS 81, 93.

frequently also floating security, such as land, plant, intellectual property, and goodwill.[161] This holds also of assets usually subjected solely to floating charges, like raw materials or stock in trade that would be consumed or used up entirely in the process of manufacture. An understanding of 'fund' which captured only the chargee's "wealth-value" attitude to the collateral would usually be deficient for that reason alone, since it would leave out of account the "use-value" focus of the chargor. Given this obvious deficiency, it is intriguing to note that A&W did not prefer the OED's *third* sense of 'fund', *viz.*, "source of supply; a permanent stock that can be drawn upon".[162] The advantage of this definition in the present context would have been that it would conceive of the collateral as a source of supply of "use-value" to be enjoyed by the chargor, and a permanent[163] stock of "wealth-value" to be drawn upon (or held in reserve) by the chargee. For the same reason, however, *this* notion of fund cannot rule out assets subject to "use-value" rights like easements.

It follows that on no coherent understanding of 'fund' does this term, both, adequately explain the position of assets subject to security interests, and yet exclude from its ambit assets subject to other proprietary rights, like easements, profits or restrictive covenants.

5.4 Separate Funds

We should tie things up by considering two pairs of *truly separate* funds. First, recall our discussion of *Re Pyle Works*. The Court of Appeal there confirmed the existence of two funds: (i) the *common fund* of the company's property, with which the company itself while solvent may deal, including by charging or mortgaging any part of it; and (ii) the *statutory fund* consisting of the proceeds of office-holder actions properly so called, a fund which only comes into existence upon the commencement of winding-up, and which exists solely for the purposes of winding-up, including, most notably, to benefit creditors exclusively pursuant to the statutory scheme. According to A&W, by concluding that encumbered and unencumbered assets of the company fall in different 'funds', their Lordships in *Leyland Daf* somehow merged office-holder recoveries with the company's 'ordinary' unencumbered assets.[164] But this is difficult to understand. Assume for a moment that their Lordships had been correct in their conclusion. It would have followed only that what the Court of Appeal in *Re Pyle Works* had taken to be the "common fund"[165] was in fact an impermissible conceptual amalgam of two separate funds. It certainly would not have followed from that that what the Court in *Re Pyle Works* called the "statutory fund" – that is, assets not capable of being dealt with by the company itself while solvent – did not in fact have separate existence. 'Ordinary' unencumbered assets are of course at the disposal of the company while solvent, and therefore, simply could not fall in the same category ('fund') as assets utterly beyond the reach of the solvent company. If *Leyland Daf* were correct, then, we would have *three* 'funds'… at least! Talk about the separate funds fallacy![166]

Second, take A&W's suggestion that:

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[161] For an example of 'fixed' assets held to be subject to floating security, see *National Provincial Bank of England Ltd v United Electric Theatres Ltd* [1916] 1 Ch 132.
[162] Interestingly, the Dictionary's fifth sense for 'fund', now declared obsolete, is a "portion of revenue set apart as a security for specified payments".
[163] Of course within the limits set by the nature and duration of the rights in question.
[164] AW, 321-325; A&W claim that in order to do so, their Lordships "impliedly" overruled the Court of Appeal's decision *Re Oasis Merchandising Services Ltd* [1998] Ch 170 without so much as mentioning it. In fact and as explained below, A&W's view requires us to assume that their Lordships silently overruled *two* Court of Appeal authorities, not just one.
[165] (1890) LR 44 Ch D 534, 575-576, interpreting the House of Lords' decision in *Webb v Whiffin* (1871-72) LR 5 HL 711.
[166] Compare AW, 323, fn. 161.

> "…the 'assets of the company' and 'assets subject to security' should be thought of as two distinct 'funds', *each of which [bears] its own expenses* [in being administered in liquidation and receivership respectively]."[167]

> "…in administrative receivership, which functions for the exclusive benefit of the debenture-holder, the expenses are borne solely out of the debentureholder's fund."[168]

This proposition goes to the very heart of *Leyland Daf*, and it is difficult to see how it could possibly be true. For an insolvent company, each penny spent on servicing receivership expenses (from charged assets or otherwise) is a penny not available to meet the company's unsecured claims. After all, the company's secured liabilities *define*, by exclusion, the company's 'free' assets. So any claim, such as that for receivership expenses, which takes priority over or otherwise inflates the company's secured liabilities,[169] also – by that fact alone – cuts into the company's 'free' assets. What is more, something similar holds if no receiver is appointed and the liquidator is required to administer the encumbered assets.[170] This is simply another way of saying that the costs of administering encumbered assets (expenses of receivership or of the liquidator, as appropriate) *compete against* and *enjoy priority over* the company's unsecured liabilities. And it cannot be repeated often enough in this context that, as Lord Millett rightly observed, "Questions of priority arise only between interests which compete with each other for payment out of the same fund."[171]

Contrast this with the position of a true separate fund. Suppose that a solvent company owns property in its own right, which it uses for its business purposes, and that it also holds other assets as trustee. Now suppose that the company goes into winding-up. In a perfectly sensible way, we do now have *two funds*, one constituted by the assets beneficially owned by the company at the point at which it entered winding-up, and the other consisting of trust property, only legal but not beneficial title to which was vested in the company when winding-up started. And we do, though only now, have the situation where the costs of administering each fund are borne by that fund alone.[172] Whether those administering the trust fund (even if it is the company's liquidator) spend £1 or £1m in the course of discharging their duties *qua* trustee makes no difference to the amount available for distribution to the company's creditors.[173] This demonstrates the hollowness of the assertion that (merely) encumbered and 'free' assets fall in separate funds, and that each bears its own costs.

6. Conclusion

Property law provides that assets subject to a charge or mortgage remain beneficially owned by the debtor, unless and until appropriated to repayment of the secured loan. Does insolvency law disagree? Does it rend encumbered assets from the debtor's 'free' property – perhaps by virtue of the

[167] AW, 301 (emphasis added), summarising Lord Hoffmann's conclusion in *Leyland Daf*.
[168] AW, 314 (footnote omitted).
[169] See e.g. IA, s. 45(3); SCA, s. 219.
[170] See e.g. IR, r. 4.127B, and for a discussion, see Mokal, "What Liquidation Does".
[171] At [81].
[172] We assume here that the trust instrument does not preclude the person administering the trust from charging to the trust fund the proper expenses of doing so. Compare, e.g. *Re Berkeley Applegate Ltd (No 2)* (1988) 4 BCC 279, with *Polly Peck International plc (in administration) v Henry* [1999] 1 BCLC 407.
[173] A pension fund for the company's employees would usually include the company as one of its subsidiary beneficiaries, so that, should the fund be in a surplus, the costs of administering it would matter to the amount available to the company's creditors. But this is not an exception to the point made in the text: the difference to the creditors' recoveries arises, not because the company's liquidator must administer the trust fund, but because the company is a beneficiary of the trust.

hindsight principle – into a 'fund' separate from that constituted by the statutory trust of 'free' property? This paper answers these questions in the negative.

Firstly, it has been argued that if the assets of a company in winding-up are held on a statutory trust, then the trust must extend to encumbered as well as unencumbered property. The trust is said to arise because of the loss, upon the commencement of winding-up, of the company's ability to control, benefit from, or dispose of the property vested in it. But the company loses control, benefit and disposal of encumbered property to at least the same extent that it loses control, benefit and disposal of 'free' assets. This is supported by early authority on the statutory trust, which treats mortgaged assets as falling in the trust. Secondly, the retroactivity principle fixes upon the instant of commencement of winding-up as the point in time at which all of the company's assets are deemed to have been collected and distributed, while the hindsight principle qualifies this by taking into account events occurring after the commencement. In short, these principles 'move' to a uniform time T_1 events which would in fact have occurred at later times T_2, T_3, and so on. What these principles do *not* do is to *negate* facts altogether. That is, they do not, for the purposes of provisions like section 115 and 175 of the UK Act, deem assets which were the company's as never having been "the company's property" at all. Third and importantly, the statutory provisions providing for a *pari passu*/equal/ratable distribution of "the property of the company" require nothing less than respect for the proprietary priorities of claims secured by duly created and perfected security interests. Fourth, no coherent notion of 'fund' enables the encumbered assets of a company in winding-up to be conceptually segregated from the company's 'free' assets. Fifth and finally, to consider the position of those interested in one or other of two *truly* separate funds leaves little room for doubt: in relation to the encumbered property of a company in winding-up, the separate funds fallacy is properly named.