RETHINKING RECEIVERSHIP

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Abstract

A popular perception is that administrative receivers and their appointors hold 'too much' power in relation to troubled companies. Consideration of this issue is timely, because insolvency law is currently under review. We argue although the law's *formal* structure is imbalanced, this can nevertheless generate savings for parties by allowing a concentrated creditor who has invested in information-gathering about the debtor to conduct a private insolvency procedure. We suggest that this procedure is likely to be more efficient than one conducted by a state official, and that it facilitates debt-based governance, a matter of particular importance for small and medium-sized businesses.

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1. Introduction

A popular perception is that administrative receivers and their appointors hold 'too much' power in relation to troubled companies, and are able to look after their own interests to the detriment of other corporate stakeholders.[1] The proponents of this view would argue that the law should be reformed so as to 'redress the balance' by transferring power away from receivers and their appointors.[2] Consideration of the issue is timely, because insolvency law is once again under review, and a Bill is currently before Parliament. In this paper, we question the popular wisdom. Whilst English insolvency law certainly offers a very broad package of rights to an administrative receiver and his appointor, we argue that the current legal structure is justifiable in terms of its efficiency, and that wide-ranging reform is unwarranted.

Our argument is developed as follows. We begin by outlining the law relating to administrative receivership, showing how its formal structure is susceptible to the interpretation that it 'favours' the interests of the receiver's appointor—the holder of a debenture containing a floating charge. Once appointed, an administrative receiver acts as the agent of the company, and has power to incur trading liabilities on its behalf or to procure the breach of its contracts. The company's directors and other creditors have few rights to involvement in the decision-making process. Yet the administrative receiver's primary duties are owed to his appointing debenture-holder, rather than to the company. Furthermore, his appointment greatly restricts the operation of other, more collective insolvency procedures. The process of appointment is controlled by a party whose position is already protected by the priority which is afforded by a floating charge, yet in deciding whether or not to appoint, thechargee owes no duty to consider the impact of appointment on the interests of any other group.

We then develop an economic justification for the way in which the law is structured. It is now well understood that creditors can play a significant role in enhancing the performance of corporate managers. This role is particularly important for small and medium-sized enterprises (SMEs) which raise the majority of their outside finance in the form of debt. To do so effectively, creditors need to *monitor* the debtor's activities. The efficiency of monitoring can be greatly enhanced by *concentrating* a significant part of the firm's borrowing in the hands of one lender, which economises on the free-rider problems which creditors would otherwise encounter.

Creditors also need to be able to *co-operate* over decisions about the exercise of their rights—over questions such as whether a default should be followed either by enforcement or renegotiation, and if enforcement occurs, how the debtor firm's assets should then be deployed. Bargaining costs can make it difficult or impossible for creditors to reach a collective agreement over such decisions, an intuition that led to Jackson's famous model (1982) in which creditors of an insolvent firm face a prisoner's dilemma. This in turn suggests a role for insolvency law in modifying creditors' individual rights so as to achieve a superior collective solution. Under most countries' insolvency codes, a 'liquidation procedure' provides for control of the debtor firm's assets to pass to a state official who then sells them and distributes the proceeds to creditors. However, a liquidation procedure still requires that creditors be able to *co-ordinate* over whether renegotiation would be better than enforcement after a default. Some argue that the solution is for the state also to supply a 'reorganisation' procedure, which allows the debtor firm to continue trading whilst the creditors are encouraged to bargain to a compromise of their claims. Yet where creditors are *concentrated*, the costs of collective decision-making are much lower, and a renegotiation is likely to be achieved without any need for a reorganisation law.

Indeed, under these circumstances it may be efficient for a firm and its creditors to agree in advance to a procedure whereby decision-making about the deployment of assets *after* enforcement is delegated

to the concentrated lenders, rather than dealt with by a state official in a liquidation procedure. Decision-making about a firm's future is time-critical once it has become public knowledge that it is in default on its loan obligations. Concentrated lenders will, from their monitoring of the debtor, already have access to high-quality information about the debtor firm's business and will therefore be able to make these decisions better and faster than a state official drafted in from outside. In effect, the parties would have privatised the firm's insolvency procedure. By increasing the expected returns to the concentrated creditor following enforcement, the use of such a procedure also makes enforcement a more credible threat, enhancing the efficacy of the debt's disciplinary role.

However, achieving this result by a simple contractual agreement would be problematic. Every party which becomes a creditor of the debtor would need to be bound; or else it would be able to 'trump' the private procedure by petitioning for winding-up. Our claim is that administrative receivership can be understood as a legal response to these problems. The law allows the holder of an appropriate floating charge to appoint an insolvency practitioner who takes*control* of the entirety of the debtor firm's assets. Because the floating charge is a *proprietary* right, it binds all creditors of the debtor firm, making a 'private' insolvency procedure under which decision-making is conducted by a concentrated creditor a reality. The law thus allows parties to capture the benefits associated with such a procedure.

We distinguish our claim from much of the North American law-and-economics literature about security interests. A debtor firm is entitled to commence bankruptcy proceedings unilaterally in the US, and such commencement invokes an automatic stay of all secured creditors' enforcement remedies. Thus the focus in the US literature has been on the putative efficiency of priority to payment of returns from the sale of the debtor's assets. For reasons of space, we do not address the debate about the efficiency of priority to returns head-on in this paper, as we do not need to claim that priority to payment is efficient in order to make our claim about control. It would be conceptually

possible to 'unbundle' the package of proprietary rights comprised in the floating charge, and for firms to grant proprietary rights which carried only rights to control enforcement against the debtor's assets.

We then present data from twenty-six interviews that we conducted with professionals who are regularly involved in corporate insolvencies. Although our sample is neither random nor statistically significant, the interview data do provide a rich source of qualitative insights into the processes of decision-making in respect of troubled firms. We consider that these data are entirely consistent with our theoretical claims. Administrative receiverships tend to occur most frequently in the case of SMEs, which in turn tend to concentratetheir borrowing in the hands of banks. Consistently with the theoretical rationale for concentrating finance, banks actively engage in monitoring their customers, the intensity of monitoring being inversely correlated to the borrower's financial health. Where a firm is in financial difficulties, renegotiation will be conducted almost exclusively with the bank, and a receiver will be appointed if and only if such renegotiations are unsuccessful. This would usually be because either the bank has no confidence in the debtor's management, or because the debtor's business is fundamentally unsound.

Finally, we consider—in the light of our theory and evidence—two proposals for the reform of insolvency law. The rest of the paper sets out the substance of our argument as follows. Section two outlines the law relating to administrative receivership. Section three develops our theoretical framework. Section four then presents our empirical data, and in section five we discuss the merits of various possible reforms to the current law. Section six concludes.

2. An outline of the Law Relating to Administrative Receivership

2.1. The functional dominance of receivership in insolvency proceedings

Administrative receivership is one of four formal corporate insolvency procedures recognised by English law. In terms of the distribution of decision-making rights, it is the most important, for a party entitled to appoint an administrative receiver ('the debenture holder') may legally or effectively block the commencement of any of the other three. First, the creditors' meeting called to vote on a CVA may not approve any proposal that affects the right of a secured creditor of the company to enforce his security, except with his concurrence.[3] Second, whilst a liquidator may be appointed without the consent of secured creditors,[4] he may not take possession of assets under the control of a previously appointed receiver. Further, a liquidator is vulnerable to ceding possession of secured assets to a *subsequently* appointed receiver.[5] Third, the debenture holder is entitled to block altogether the appointment of an administrator. When a petition for an administration order is presented, notice of such must be given to any person entitled to appoint an administrative receiver,[6] who may then choose to make such an appointment, in which event the court must dismiss the petition.[7]

In light of its procedural significance, there are remarkably few restraints on the debenture-holder's ability to play this 'trump card'. Debentures may confer the right to appoint a receiver without any precondition of a demand for repayment being made of the debtor company. Even where such a demand is contractually required, the courts have ensured that it does not impede the appointment process. Thus, a demand will not be invalid purely because it overstates the amount due.[8] The appointor need not allow the company more time than is necessary to 'implement the mechanics of payment' before proceeding with an appointment, nor afford its directors the opportunity to seek alternative finance.[9] Moreover, an appointment may also be made with total single-mindedness. In deciding whether

to appoint, the debenture-holder need not give consideration to the interests of the company or its unsecured creditors.[10]

2.2. The chargeholder's expansive security

In order to appoint an *administrative receiver*, a debenture-holder must have a security interest over the whole or substantially the whole of the company's property, that security comprising a charge which, as created, was a *floating charge*.[11] This expansive form of security is capable of covering the entirety of the debtor company's assets. The original rationale for its use was that it permitted security to be taken over revolving and future assets, whilst allowing these to be used in the normal course of the debtor's business.[12] However, the priority accorded to the holder of a floating charge *per se* has been gradually eroded through the advent of various types of claim which override it. The result is that a floating charge now ranks behind the claims of lessees, retention of title claimants, trust claimants, fixed chargees, and preferential creditors.[13]

As fixed charges rank ahead of preferential creditors,[14] a predictable response has been to subject an increasing range of assets to fixed charges, most controversially in the case of book debts.[15] Yet the floating charge is by no means obsolete. Its most important role is now as part of a 'composite' or 'global' security package which enables the chargeholder to appoint an administrative receiver, and so to 'block' an administration order.[16] This is not to say that the floating charge *itself* must extend to 'substantially the whole of the company's property'. In *Re Croftbell Ltd*,[17] Vinelott J held that a 'lightweight floating charge', which was for the time being 'empty' of assets, was capable of falling within section 29(2) of the Insolvency Act 1986, so as to entitle its holder to appoint an administrative receiver.

2.3. The receiver's 'agency of convenience'

An administrative receiver is statutorily deemed to be the company's agent, unless and until the company goes into liquidation.[18] According

to established canons of agency law, the agent, having power to affect his principal's legal position, is subjected to concomitant duties in order to address the principal's consequent vulnerability. Most notably, an agent owes his principal a fiduciary duty of loyalty, and also a duty of care (Reynolds, 1996: para 1-001). The nature and incidents of an administrative receiver's agency, however, are markedly distinct, to the point of being unique. The agency can aptly be described as one of *convenience*.[19]

2.3.1. Duties of the receiver

The agent's fiduciary duty of loyalty is central to the legal notion of agency, yet it is of a somewhat attenuated nature where the agent in question is a receiver (Frisby, 1999). Far from being compelled to act in the company's best interests, a receiver may, and indeed must, sacrifice those interests where the well-being of the debenture-holder demands.[20] Contrary to accepted tenets of agency law, a receiver owes his corporate 'principal' no duty of obedience,[21] nor any duty to provide information as to the conduct of its affairs.[22] This surprising conclusion is reached by reference to the contractual framework which spawns the agency relationship between company and receiver.[23] The result is that, although appointed as agent of the company, a receiver's duty is to exercise his powers *bona fide* in the interests of the *debenture-holder*, rather than those of his nominal 'principal'.[24]

Until very recently, it was thought that a receiver's duty of care to the company was limited to a requirement that he take reasonable steps to obtain a proper price on the exercise his power of sale.[25] The law appears, however, to have been altered by the Court of Appeal in *Medforth v Blake & Ors*,[26] the revised position being that a receiver owes an *equitable* duty of skill and care to the debtor company, should he decide to continue trading,[27] insofar as this does not conflict with his fiduciary duty to act in the interests of the debenture-holder. This development clearly imposes an obligation to act carefully in the administration of the secured assets, and most notably in the

management of the company's business, a responsibility which, arguably, did not exist prior to *Medforth*. Nonetheless, it is manifest from the judgment of Scott V-C in that case that this duty does not compromise the receiver's cardinal commitment to the welfare of his appointor (Frisby, 2000).

2.3.2. Powers of the receiver

The receiver is given wide-ranging powers to manage the company's business, to commit it to new contracts, and to take control of and sell its assets.[28] The receiver's status as agent also grants him immunity from personal liability for business rates unpaid during the currency of the receivership.[29] Furthermore, the rule propounded in *Said v Butt*,[30] whereby an agent cannot be liable in tort for inducing a breach of his principal's contract, has been held to apply to receivers.[31] Hence a receiver may cause the company to breach its pre-appointment contracts in order to further the interests of the debenture-holder,[32] leaving the counterparty with a remedy in damages for breach of contract against *the company* (Oditah, 1992: 562-569).[33] Being unsecured and against an insolvent enterprise, the latter is likely to prove worthless.

As agent, a receiver would not in normal circumstances be personally liable on the contracts he procures his principal to enter.[34] Exceptionally, a receiver is made so liable under section 44(1)(b) of the Insolvency Act 1986, in relation to both commercial and employment contracts. However, even this *prima facie* disadvantage is watered down in two significant respects. First, it appears that a receiver may 'contract out' of personal liability. This is expressly envisaged as regards contracts he enters into,[35] and has been held to be legitimate in relation to those contracts of employment he adopts.[36] Second, a receiver is entitled to an indemnity out of the company's assets in relation to such liability,[37] which is payable ahead of the claims of his appointor,[38] and so, by definition, ahead of the company's unsecured creditors.[39] A receiver's personal liability is therefore largely cosmetic. So long as he is confident that there are

sufficient assets to support his indemnity claim, he will be able to contract on behalf of the company without risk to himself.

2.4. The disenfranchisement of other stakeholders

In comparison to administration and liquidation, third parties are afforded remarkably little input into the receivership process.[40] The company, acting through the board of directors, is unable to govern its receiver's actions,[41] and so displaced from decision-making authority in relation to the use of its property.[42] Junior creditors emerge as similarly remote from the receiver's deliberations. The Cork Committee expressly adverted to this 'complaint', and responded by propounding statutory provisions, later incorporated into the Insolvency Act 1986, designed to create 'a relationship of accountability between the receiver and the unsecured creditors' (Insolvency Law Review Committee, 1982: para 481).[43] A closer examination of these initiatives suggests that in practical terms they do little to generate meaningful participation rights. Consider, for example, the requirement that there be a creditors' committee.[44] Its function is to *assist* the administrative receiver in discharging his functions, but has no power to *direct* how he shall carry out his functions.[45] This is in stark contrast to the powers enjoyed by a liquidation committee (Grier, 1991: 184), and a meeting of creditors in administration.[46] Given the overall tenor of the Cork Report and its preoccupation with the facilitation of corporate rescue, this appears anomalous. Arguably, the Committee envisaged a co-operative regime whereby creditors and office holders would be afforded the opportunity to negotiate towards a mutually satisfactory outcome, and there is no reason to suspect that this ethos was not intended to apply equally to administrative receivership. By excluding receivership creditors from participation in the course of the receivership, it seems that the decision whether to attempt a rescue is placed entirely in the hands of the receiver. One might have expected this critical issue at least to be subject to consultation, but the current regime does little to encourage this.

English insolvency law, laid out barely in this fashion, appears to favour the interests of the debenture-holder above those of other creditors. We hope to show, over the course of this paper, that this formal imbalance is justifiable in terms of its ability to enhance efficiency.

3. Rethinking Receivership

3.1. Debt and corporate governance

Much current work on corporate governance is derived from the so-called 'agency costs' view of the firm's financial structure (Jensen and Meckling, 1976; Easterbrook and Fischel, 1991; Shleifer and Vishny, 1997; *cf.* Blair, 1995). This emphasises the costs generated by information asymmetry and contractual incompleteness, and suggests that parties' attempts to economise on these factors determine—at least in part—the way in which firms are structured (Jensen and Meckling, 1976: 308-310). Managers are thought to serve their own interests, rather than those of investors, because of the difficulties of specifying, observing and verifying the appropriate actions for them to take, and the circumstances under which they are to be taken. Hence a variety of techniques are employed to reduce these costs—incentive pay schemes and hostile take-overs being two of the best known (eg Easterbrook and Fischel, 1991: 162-211; Cheffins, 1997: 678-698). Debt can, however, act as a means of incentivising managers to promote the interests of outside investors, because it imposes a hard constraint (Jensen and Meckling, 1976: 333-343; Jensen, 1986; Wruck, 1990; Easterbrook, 1991). The key feature of debt which allows it to function in this way is that it involves a contingent allocation of property rights (Hart, 1995: 95-125). Should the firm fail to meet fixed payments, its assets may be seized by creditors.[47] The removal of assets from managers' hands will terminate any continuing benefits which they derive from control. In turn, this gives managers strong incentives to avoid conduct which will reduce the firm's expected returns, since this will increase the likelihood of failing to meet fixed payments.

The use of debt also brings costs. Perhaps the best known of these are the costs of insolvency, or 'financial distress' as it is referred to in the corporate finance literature.[48] A firm without debt would not incur such costs.[49] Less obviously, the use of debt gives shareholders perverse incentives in making investment and financing decisions (Jensen and Meckling, 1976: 333-343; Myers, 1977; Barnea *et al*, 1985: 33-38). Put simply: because shareholders have limited liability, they do not bear the entire downside if the firm fails. And because creditors (debt investors) have fixed maximum claims, shareholders have no limit to the 'upside' which they may retain if the firm's projects succeed. This can give shareholders an incentive to 'gamble' with the assets and to pursue high-risk projects which maximise *shareholders'* expected returns, rather than those projects which maximise the firm's expected value as a whole. These costs may be reduced by giving some measure of control over the firm's activities to creditors (Smith and Warner, 1979a). Yet such control is not cost-free either, because creditors' return structure will bias *their* preferences—this time towards projects which maximise *creditors'* returns, rather than those which maximise firm value as a whole. The combination of costs generated by these perverse investment incentives are referred to by Jensen and Meckling (1976) as the 'agency costs of debt', and sometimes by others as 'financial agency costs' (eg Triantis, 1994: 2158).

The 'agency costs' theory suggests, therefore, that a firm's financial structure involves a trade-off: the costs of outside equity (managerial agency costs) versus the costs of debt (financial agency costs plus insolvency costs), and that firms will arrange their affairs so as to optimise this at the minimum level. The majority of SMEs are owner-managed (Cosh and Hughes, 1998a: 10). This makes the agency costs of outside equity unusually high. There is no possibility of a 'disciplinary' hostile takeover where management own a majority shareholding. And it may be difficult for managers to commit to incentive contracts which align their interests with those of minority shareholders, when these may be subject to subsequent renegotiation by the board of directors. Rational investors would discount the rights

associated with such a shareholding. Thus debt finance will seem relatively more attractive to such firms. This is consistent with the pattern that UK SMEs are financed largely with debt (Cosh and Hughes, 1994: 50-53; Freedman and Godwin, 1994: 258-262; Cosh and Hughes, 1998b: 72-75). In this context, the costs and limitations of debt finance become a matter of particular concern.

3.2. Monitoring, default and renegotiation

Assume for now that a firm's creditors are able to act always as a cohesive group. The efficiency of debt as a governance mechanism is highly sensitive to the way in which 'default' is defined, because this stipulates the circumstances under which the creditors' contingent property rights become operative. Broadly speaking, there are at least three types of event which will give rise to a default under a loan contract. First, and most important, there is what we shall here refer to as a 'trigger'. This is the occurrence of some event which suggests that the debtor is not going to repay the debt. The most basic trigger is a failure to make a scheduled repayment. Where this happens generally, the debtor is 'financially distressed' in the parlance of financial economists, or 'cashflow insolvent' in the parlance of lawyers.[50] However, loan contracts often contain covenants by the debtor to maintain specified financial ratios, which can act as 'early warning' triggers—the ratios being set such that a breach of the provisions indicates that the firm is likely to become unable to pay debts in the future (see Citron, 1992: 327; Day and Taylor, 1995: 398; 1996a: 203-204).[51] Alternatively, the loan contract can be structured such that it is repayable 'on demand', with an informal arrangement between the parties as to what circumstances will trigger a demand.

Second, there are what might be termed 'negative' covenants—promises by the debtor not to take particular actions (Day and Taylor, 1995: 394-395; 1996b: 322-323). These are commonly rationalised as being written so as to constrain the perverse incentives which debt will engender in borrowers, and are likely to prohibit actions which an opportunistic debtor might take in order to transfer wealth to himself

from creditors (Smith and Warner, 1979a). As we have seen, debt can affect managers' incentives in both positive and negative ways, giving an incentive to work harder and avoid the excessive consumption of perquisites, but at the same time distorting investment incentives towards high-risk, high-payoff projects. Tighter 'trigger' provisions can be understood as responding to the first effect, and negative covenants to the second.

Obviously, the efficacy of debt as a governance mechanism will also depend on the information available to creditors about the debtor's financial position and actions. Covenants are of limited value if a breach is not detected in time. One means of enhancing the creditors' information is to stipulate that the debtor must provide regular financial information—management accounts and such like—and that failure to do so will itself constitute an event of default (Day and Taylor, 1996b: 323). However, it is likely that it will also be necessary for the creditor to *monitor* the debtor—to try to observe its actions and to analyse the financial information available—in order to detect defaults as and when they occur.

The implications of a default—or an imminent default—will depend on the circumstances. It is possible, however, to make one or two general observations. In the case of a breach of 'trigger' provisions, much will depend on the underlying state of the firm's business. Firms which have fundamentally unprofitable businesses—which are 'economically distressed'—will sooner or later become unable to pay their debts. If this is the case, the creditors will want to minimise their losses by enforcing and closing the firm down as soon as possible, then selling its assets on a break-up basis. This is also socially efficient, as the firm's assets are not being put to their best use in its current line of business (eg White, 1989).

However, firms which are not economically distressed may also become unable to pay their existing debts. If this is the case, then it is socially efficient for the firm to remain in business—and this will maximise the returns to creditors. Creditors of such a firm may

achieve this outcome either by enforcing and seeking to sell the firm's assets as a going concern, or by *renegotiating* with the debtor. If debt is being used as a governance mechanism, we would expect creditor' choice to depend on their assessment of managers' role in the events leading up to the default. The tighter the provisions are drawn, the greater will be the incentive effect of the debt, but paradoxically, also, the greater the likelihood of a default resulting from 'bad luck.'[52] Provided that the creditors can distinguish between these causes, there are good reasons for thinking that renegotiation is preferable to enforcement where management are not 'at fault'.

First, there may be failures in markets for the assets of firms in default. On the one hand, potential buyers may be liquidity-constrained.[53] On the other hand, there are likely to be significant adverse selection problems (Webb, 1991). The greater the vendor creditor's knowledge of the firm, the more likely that there will be an information asymmetry between it and potential purchasers of the assets. A potential purchaser will discount the price it is willing to pay for the assets to reflect its uncertainty about their value. For vendors with 'good' firms to sell, the best price offered may not be as much as they consider the firm's assets to be worth, and they may find that renegotiation—in effect a 'sale' of the firm's assets to themselves and the existing equity holders—will be privately optimal.

Second, enforcement against managers of viable businesses which are not 'at fault' will not have any disciplinary effect. Rather, it will serve only to impose harsh consequences on managers arbitrarily,[54] creating an additional and unnecessary source of risk.[55] This could have *adverse* effects on their motivation, perhaps leading to risk-averse decision making (White, 1996), or an undersupply of effort generated by 'a fatalistic sense that effort might be wasted in a futile cause.' (Triantis, 1997). Hence where the debtor firm defaults, but is not economically distressed, and the default is not due to managerial failure, the possibility of appropriate renegotiation can enhance managerial incentives *ex ante*. Such a renegotiation may involve creditors 'waiving' a default in return for a reduction in the

outstanding repayments demanded from the debtor. Thus if failure to make the fixed payments is the result of 'bad luck',renegotiation may be *ex post* value-maximising for the creditor in either case. If the owner-manager has underperformed, however, a going-concern sale may be necessary to remove them. Figure 1 summarises these factors in the form of a decision tree.

3.3. Multiple creditors and collective action problems

If we relax the assumption that creditors are able to act as a cohesive group, we see that collective action problems are likely to intrude on their information-gathering and decision-making functions. First, consider the creditors' information. For each creditor, the marginal benefit from an investment in information about a particular decision (e.g. whether or not to renegotiate) will only be a commensurate fraction of its 'true' value. The amount at stake for each creditor will only be a fraction of the total value which could be preserved or destroyed by a particular decision. Hence individual creditors will be rationally underinformed (see Easterbrook and Fischel, 1991: 66-67). Furthermore, each creditor may seek to free-ride on the monitoring activity of others, with the result that there is collective underinvestment in monitoring (Levmore, 1982: 53-54).

Second, where creditors have individual (albeit contingent) property rights in the firm's assets, the accuracy of post-default decision-making will be further reduced by bargaining problems. A basic debt agreement gives each creditor individual rights to enforce against the debtor in the case of default. Thus in order to secure a collective renegotiation, or a decision to sell the firm as a going concern, it is necessary for all creditors to be in agreement about the preferred course of action. Creditors then have incentives to seek to extract side-payments from the others in return for their co-operation (Roe, 1987). Similarly, no creditor has an incentive to 'forgive' any of his claim in a renegotiation if he thinks that other creditors will do so anyway—rather, he has an incentive to 'free-ride' on the costs incurred by the others (Roe, 1987; Gertner and Scharfstein, 1991). If

these problems are sufficiently severe as to create a barrier to co-operative action, then as Jackson (1982) famously pointed out, the creditors face a 'prisoner's dilemma'. Default can then precipitate a 'race to collect' and the inefficient dismemberment of firms.

3.4. Reducing the costs of multiple creditors

The structure of creditors' rights can be modified in a variety of ways so as to reduce the costs of multiple creditors. One of thebest-known is a collective insolvency procedure. Jackson famously argued that the 'prisoner's dilemma' faced by creditors of a financially distressed firm provided a rationale for state-imposed collectivisation of creditors' interests upon corporate insolvency (Jackson, 1982). We can state, at a fairly abstract level, how this might happen. When a firm becomes financially distressed, the law provides creditors with the ability to unilaterally commence a 'liquidation procedure'.[56] This *collectivises* the property rights of individual creditors and provides for a state official to take charge of and sell the debtor firm's assets, then distributing the proceeds amongst creditors.[57] The availability of an appropriately-structured liquidation procedure can thus reduce the costs of inter-creditor collective action problems after default.

The existence of a 'liquidation procedure' in the shadows also assists creditors in renegotiating debt agreements where this is appropriate, by altering the structure of the 'game' which they play from a 'prisoner's dilemma' to one of co-ordination. However, it does not *solve* the difficulties which creditors face, and for this reason some argue that a 'reorganisation procedure' should also be supplied, which will coerce creditors towards a compromise.[58] Such a procedure runs the risk that it may result in decisional inaccuracy running in the opposite direction. Inefficient firms may continue in business, and poor managers may remain in post (eg Franks and Torous, 1992). Furthermore, neither a liquidation procedure nor a reorganisation procedure do anything to ameliorate collective action problems associated with information-gathering beforehand.

A more comprehensive solution is for the debtor firm to choose *not* to have multiple creditors, thereby eliminating entirely the associated costs. In reality, it would be highly inconvenient to have only one creditor, as this would oblige the debtor to pay for all services, supplies, wages and taxes in advance. However, it is perfectly feasible to have only one *main* creditor, and to restrict liabilities incurred other than in the ordinary course of business. Under such an arrangement, the 'main' creditor will bear primary responsibility for monitoring the debtor's behaviour, and for deciding whether or not to renegotiate following a default (see Hudson, 1995). So long as the main creditor is willing to provide the firm with finance to cover payments due under its operating credit facilities, it will be able to continue to pay its debts as they fall due.[59] Yet if it is not, the firm will be unable to avoid insolvency (unless another creditor can be persuaded to step into the breach). This can achieve considerable savings. First, the 'main' creditor's concentration means that it has appropriate incentives to invest in monitoring the debtor to determine whether or not a default has occurred. Second, renegotiation will be greatly facilitated, as it need only be done with one creditor, which because of its concentrated position, will have appropriate incentives to invest in gathering information about whether renegotiation is warranted.

In the corporate finance literature, the proposition that savings in monitoring and the costs of default can be obtained through creditor concentration is well-established (see eg Diamond, 1984),[60] and empirical research shows that the role of 'main creditor' is generally played by banks (see eg Hoshi *et al*, 1990). Where the debtor's financing requirements are very large, the absolute level of risk which a single bank performing the role of 'main creditor' would have to bear makes such an arrangement expensive, and the role may be shared between multiple banks. These are, nevertheless, far more concentrated in their information-gathering and renegotiation activities than, for example, bondholders.

Although concentrated investors may be able to generate considerable savings, they can also bring costs. Concentrating debt leads to an

increased risk of 'reverse agency costs'.[61] The main creditor's control may inhibit the debtor's investment decisions, such that valuable projects are shunned in favour of lower risk alternatives (Triantis and Daniels, 1995: 1090-1103). Such a seemingly one-sided relationship may, however, be tolerable where the creditor has significant reputational capital, and may be inevitable where the manager does not (Diamond, 1991). Put another way, a creditor which lends to many firms has an interest in developing a reputation for not expropriating debtors, and for investing in high-quality monitoring (see eg Chemmanur and Fulghieri, 1994). (Moreover, if it lends to many firms then it is also likely to be able to achieve significant economies of scale in its monitoring technology). If expropriation were publicised, benefits foregone in the form of repeated interactions with the pool of would-be borrowers would be likely to outweigh any gains from expropriation in a single case.

Thus we see two alternative techniques for reducing the costs of multiple creditors: legal modification of creditors' property rights, or private ordering to increase creditor concentration (seeHege, 1999). It seems that where creditors are highly concentrated, a reorganisation law may not be necessary. An unanswered question, so far, is whether concentrated creditors—i.e. banks—can make a 'state-supplied' insolvency law entirely unnecessary. In a similar vein, a number of scholars have questioned the need for a state-supplied insolvency procedure. They have suggested that firms could instead offer creditors 'insolvency contracts' which would stipulate collective decision-making procedures that would be more efficient—either generally, or for a particular firm—than the unitary state-sponsored procedure (Rasmussen, 1992; Schwartz, 1997a). For example, in the context of the bank-firm relationship which is prevalent in SME finance, it might be thought that it would be efficient to allow the post-default decisions to be taken by the bank itself. However, the problem with contracting for such a procedure is that the debtor firm cannot credibly commit itself not to borrow from creditors which are not parties to the contract (Adler, 1993; 1994). It is our claim that English insolvency law allows a firm to do precisely that by granting

a debenture to a bank which would allow the appointment of an administrative receiver.

3.5. A concentrated creditor governance theory of receivership

A grant of secured credit—of which the charges held by the debenture-holder in our typical cases are examples—gives the creditor two basic types of right; first, a right to *control* the collateral should the debtor default, and second a right to be paid out of the *returns* from the sale of the asset in *priority* to unsecured creditors. Analytically, these are *contingent property* rights, in the sense that they cannot be altered, once granted, without the debenture-holder's consent, but they only take effect if the debtor defaults. The extent to which parties can use such contingent property rights to divide up post-default rights to a debtor firm is a matter of policy for the legal system. English law not only permits the grant of such rights over the entire firm, but also allows them to be enforced—through receivership—so as to trump other insolvency proceedings. Thus receivership has the ability to function as a sort of 'privatised' insolvency regime, and a firm is able to 'opt in' to this regime by granting an appropriate package of charges to a concentrated creditor. We should be clear that it is not *necessary* for a legal system to offer parties the ability to allocate rights in this way. For example, floating charges were not recognised at all at common law in many US jurisdictions, where they were subsequently introduced by statute.[62] Similarly, the US Federal Bankruptcy Code denies secured creditors any individual rights of control after the commencement of corporate bankruptcy proceedings.[63]

Our principal claim is that giving *control* over the post-default decision-making process to the debenture-holder can generate efficiencies. As we have seen, a bank (or other concentrated creditor) is likely to be the 'whistle-blower' on the company's financial distress. In order to make a decision whether or not to put the company into formal proceedings, it will be necessary for the bank to have made a decision that renegotiation is inappropriate, and why that

is so. As 'main creditor', it will have the best information about the debtor's business, and whether it should be sold as a going concern or on a break-up basis. The rights of control accorded to the debenture-holder mean that junior creditors are stayed from enforcing their claims against the firm's assets during receivership, thereby preventing any 'race to collect' (Picker, 1992; Buckley, 1994). This allows the receiver to deploy the firm's assets in themanner which the bank considers will be best. Enforcement in this fashion is likely to be better-informed and quicker than if it were conducted by a state official. Furthermore, by increasing the expected returns to the bank following enforcement, it makes this a less costly strategy for the bank, hence increasing the effectiveness of debt as a disciplinary mechanism for underperforming managers.

Seen in this light, administrative receivership is a vehicle for facilitating the efficient disposal of assets by a concentrated creditor, following a decision by that creditor to enforce. This perspective helps to explain a number of features of the law. Perhaps the most obvious is the fact that the ability to 'block' an administration order is granted only to a party whose debenture entitles them to appoint a receiver over the whole, or substantially the whole, of the company's assets. This suggests that the appointor of an administrative receiver will be a concentrated lender of the sort we have been discussing.[64] It is, of course, possible for a company to grant extensive security in respect of a debt that forms only a small part of its total borrowing. Our theory would predict that lending arrangements of this sort are unlikely to be common in practice, because parties could reduce their overall expected costs if the firm structured its borrowing so as to exploit the governance and enforcement efficiencies which concentrated lender control can bring.

Second, the receiver's agency. If the business is to be sold as a going concern, it must continue to trade. This means that new, post-receivership contracts must be negotiated. Were the receiver to enter into contracts as principal, he would be personally and exclusively liable on them. Were he to act as agent for his appointor, the latter

would be in a similar position. As the law stands, whilst receivers are personally liable on post-receivership contracts, except to the extent that the contract provides otherwise,[65] their agency status ensures that *the company* continues as principal, and that the appointor is a stranger to the contract.[66] Were the concentrated creditor not distanced from potential liability in this fashion, there would be a strong disincentive to continued trading, thus restricting the outcomes which could realistically be achieved. If receivership is used to remove underperforming managers from viable businesses, then it may be the case that the business' value can be enhanced by rapid extrication from unfavourable contracts entered into by the old management. The receiver's immunity from actions in tort for procuring a breach of contract where the contract in question is with the company, which allows him to 'breach' pre-receivership contracts and to consign the counterparty to an empty damages remedy, facilitates such extrication.

Third, the structure of the administrative receiver's duties is also explicable. The primary duty to the appointor ensures that it is the concentrated creditor's wishes which are implemented in the enforcement procedure. The creditor cannot exercise control directly for fear of incurring liability as the receiver's principal,[67] or as a shadow director.[68] The receiver's status as agent of the company coupled with a primary duty to the bank ensures that the concentrated creditor retains control but without associated liability. Were the receiver to owe broader duties, conforming with them would increase the costs of decision-making considerably.

Our claim is principally about the benefits of allowing the holder of a floating charge to exercise *control* over a debtor firm which is in default. As such, we distinguish it from much of the (extensive) law-and-economics literature that has debated the putative efficiency of secured credit.[69] This literature has principally originated in the US, where secured creditors are denied control rights in corporate insolvency.[70] As such, it has tended to focus on the other principal right accorded to secured creditors: that to priority of payment out of the returns from sale of the collateral. The benefits of control, and

particularly its relationship with insolvency, have received relatively little attention.[71]

The efficiency of granting priority to secured creditors has of course been hotly debated, with the literature offering both 'benign' and 'malignant' views. The most promising theory that priority is *efficient* seems to be that it may generate savings by reducing the costs to creditors of policing negative covenants. It 'automatically enforces' promises by the debtor not to sell secured assets to third parties (Smith and Warner, 1979b), or to raise subsequent finance which ranks ahead of, or pari passu with, the creditor (Schwartz, 1989, 1997b; Triantis, 1992), which in each case might be used to raise finance for high-risk investments.[72]

The best-known claim that priority to returns may be *inefficient* is that it may allow firms and secured creditors to transfer wealth away from unsecured creditors who do not 'adjust' to the reduced returns which, *ceteris paribus*, they can expect to receive on insolvency after a grant of security (Scott, 1977; LoPucki, 1994; Hudson, 1995; Bebchuk and Fried, 1996; Finch, 1999). This can lead to inefficient distortions in firm's financing decisions (Bebchuk and Fried, 1996), and to 'subsidies' being granted to firms by their creditors, thus reducing the discipline of competitive product markets (Hudson, 1995). The only way to distinguish the two claims seems to be an investigation of the extent to which the opportunities for expropriation of unsecured creditors exist. A detailed examination of this and other issues relating to the efficiency of *generally* according priority to secured creditors is beyond the scope of this paper.[73] However, our claim about the benefits of according rights of *control* to a concentrated creditor does not depend on the 'priority question' being resolved one way or the other. It is conceptually possible to imagine a legal system in which a 'floating charge' offers its holder *only* control rights and no benefits in terms of priority.

Assuming for now, without deciding the question, that priority is justifiable generally in efficiency terms, the interplay between this

right and the efficiency of concentrated creditor control becomes germane to our enquiry. Priority to returns may *encourage* creditor concentration, by—all other things being equal—reducing the overall level of risk which is borne by the secured creditor. This may encourage a creditor which is secured to lend more to a debtor firm than it would otherwise do, in turn increasing its level of concentration. However, this must be offset against the fact that having priority will also—all other things being equal—give the secured creditor a *dis*incentive to monitor the debtor (see Jackson and Kronman, 1979: 1149-1161; Finch, 1999: 650). This may mean that the debenture holder's decision about whether or not to 'blow the whistle' on the debtor is left too long. These two effects cut in different directions, and it is impossible to offer an *a priori* conclusion as to which is more significant.

A more compelling difficulty with priority to returns is that it may distort the debenture-holder's preferences when it comes to deciding whether or not to continue. It is likely to give it an incentive to behave in a somewhat risk-averse fashion, as regards the decision whether the firm is worth more as a going concern or as a collection of assets, and as respects the influence which they exert over management in ongoing decision-making (Benveniste, 1986; Aghion *et al*, 1995). A numerical example may help to illustrate the issue. Assume that the firm is worth £30,000 for certain if sold on a break-up basis, and either £20,000 or £60,000 (with equal probability) if it continues to trade. It is efficient for the business to continue operating, because its expected value as such is greater (i.e. £40,000). Assume further that the bank is owed £25,000, which ranks senior to other debt. From the point of view of the bank if asked to waive a default, or a receiver (acting in a bank's interests) asked to decide whether or not to continue trading, the figures suggest that their incentives will be skewed in favour of closure and sale on a break-up basis. Consider that on this approach, the bank's expected return is £25,000 with certainty, whereas if the firm continues in business, the bank has a 50% chance of losing £5,000, but cannot be paid more than £25,000 under any circumstances.

Of course, where the debenture-holder is 'under-secured'—i.e. its security does not cover the debt outstanding—it will indeed be the residual claimant, and this inefficiency will not be manifest. The extent to which this will be the case depends not only on how much credit the debenture-holder has extended, but also on the extent of any prior claims to which it will be subordinated. The debenture-holder's rights may be subject to a variety of such prior claims. Fixed charges will be trumped by title retainers and lease financiers,[74] and the floating charge is also subordinate to the claims of preferential creditors. However, such prior claims have a countervailing drawback, in that they limit the receiver's ability to *control* the assets. They may therefore undermine the benefits of control by re-introducing the necessity for multi-party negotiations, and the possibility of hold-up costs. The extent to which these issues are significant is, however, an empirical question.

4. Receivership in Practice

We conducted twenty-six open-ended interviews with accountants, bankers and lawyers who are regularly involved in receiverships.[75] Although these provided a rich source of qualitative insights, the small size of the sample and its non-random selection mean that the data may present an incomplete or even misleading picture. Whilst we have tried wherever possible to support the data by reference to the findings of other empirical studies, we should be clear at the outset that these factors mean that our data cannot be seen as a genuine 'test' of our theory. Rather, they provide insights into the *processes* by which decisions are made, and as such were principally of assistance to us in enriching the content of our hypotheses.

A few opening observations about the context in which administrative receivership occurs are warranted. Interviewees told us that in the vast majority of cases, an administrative receiver would be appointed by a bank which was the debtor firm's principal lender. This is supported by statistics showing that appointments are largely confined to companies which fall within the category of 'small and medium-sized

enterprises' (SMEs), with annual turnover of less than £5m (SPI, 1999: 11), and that the majority of appointments are made by banks.[76]

4.1. The decision to appoint an administrative receiver

We were told that clearing banks typically lend to SMEs through local business relationship managers, who are situated throughout their branch network. Some routine monitoring of debtors is carried out, an important element being an analysis of how the bank account is used (Interviews 2, 3, 11, 16, 17, 24, 26).[77] The results are 'scored' to place the debtor in a risk category (Interviews 1, 3, 5, 6, 7, 24, 27).[78] Beyond a certain point, the debtor's file may be transferred from the local branch to a central 'intensive care' division of the bank, where specialist staff will take over. As one banker put it:

> '[T]he whole idea is that … there's a stage in the process … where the objective of the exercise primarily is to turn it around.' (Interview 26).

We were told that the bank's scrutiny of the debtor's finances would then become much more intensive (Interviews 11, 14). Subjects stated that if the company continues to sink, the bank may require the appointment of an accountant to conduct an investigation of the firm's business, known as an Independent Business Review ('IBR') (Interviews 1-10, 13, 26, 27).[79] We would suggest that these various stages of 'escalation' can be seen as the response by a concentrated creditor to various 'triggers', as we discussed in the previous section.

The accountant conducting the IBR will attempt to determine the prognosis for the debtor's business, and will make recommendations to both debtor and bank. These will fall somewhere on a spectrum between 'no action' and formal insolvency proceedings. Those who regularly conduct IBRs emphasise that the system ideally proceeds on a co-operative basis, and without preconceptions on the part of the reviewer. According to one:

> '….really, one of the main tasks of the investigating accountant is to build a bridge between the bank and the company's management, to get everybody thinking in the same way, towards the logical conclusion in the circumstances, which may or may not be receivership.' (Interview 4).

In the context of our theory, an IBR can be seen as an information-gathering exercise initiated by the concentrated creditor, but generating benefits for other creditors in terms of improved quality decision-making.

Unsurprisingly, interviewees emphasised that banks' decision-making is driven by their own financial interests. The bank's capital investment appears to be treated as a sunk cost, with the crucial question being whether a turnaround will achieve a greater return than an exit strategy. If the business is found to be worth less as a going concern than as a collection of assets (i.e. economically distressed), the bank will put it into insolvency and realise the assets on a break-up basis. However, if the business appears to be viable then the bank faces a fundamental choice between continuing the lending relationship, or seeking an exit strategy. If the bank continues to support the firm, other creditors will continue to be paid, and so the firm will only enter insolvency proceedings if the bank decides to enforce. If the bank does not enforce, it will commonly require changes to be made by the debtor. However, the bank will be mindful of the potential for liability as a shadow director if it becomes too involved in directing the company's affairs.[80] Thus a typical strategy will be to 'steer' the company towards professionals whom the bank trusts and are able to orchestrate a turnaround (Interviews 16, 18, 21, 24; See also Belcher, 1997, 19-23; SPI, 1999: 13).

> 'There's an increasing tendency these days towards management-type workouts, which must in the overall commercial situation be the best way, if it's at all possible' (Interview 9).

Accountants we interviewed stated that they were increasingly doing advisory or even 'hands on' turnaround work for firms which had been the subject of an IBR.[81] This option may also involve a rescheduling of the bank debt. Interviewees suggested that banks were generally unwilling to 'forgive' debt outright, but that repayments could be deferred under such circumstances (Interviews 10, 24). Where interest holidays are granted, this would in itself amount to a downward renegotiation of the debt, because of the time value of money. Management will have little choice but to accept turnaround strategies initiated by the bank, as should bank supportbe withdrawn at this stage, the company will be insolvent in the 'cash flow' sense. However, provided the bank continues to support the firm, our interviewees felt that it was unlikely managers would face liability for wrongful trading.

Continuing a lending relationship with a troubled company where a successful turnaround can be achieved will result in future lending business. Furthermore, we were told that banks increasingly differentiate the riskiness of their borrowers, and charge accordingly. One accountant we spoke to said:

> '[N]ow [the banks] are able to segment who their problem customers are, and price accordingly. And relatively speaking—or economically speaking—it's quite justified … the customers who demand care are paying for it and the risk-reward ratio for the bank is more acceptable.' (Interview 16).

Hence 'troubled' companies can expect to pay a significant premium for the continuation of their lending relationship, in turn making continuation a more viable option for the bank. However, if the IBR suggests that the incumbent management are incapable of making necessary changes, their turnover must be engineered. In owner-managed businesses, this will necessitate a sale of the business in some form or other (Interviews 12, 15, 21).

If the bank decides to exit, it must also decide which strategy to use. Receivership is one possible technique, which must be weighed against alternatives such as the introduction of alternative finance, a solvent sale of the business, or other insolvency proceedings such as administration or a CVA. As between these, interviewees stated that banks generally preferred to avoid insolvency proceedings wherever possible (Interviews 4, 12, 21), since the initiation of formal insolvency proceedings *per se* generates costs (eg Interview 14). These will increase with the debtor's size, making formal insolvency more unattractive for larger debtors, and also vary with the type of business concerned (Interviews 11, 19). First, the value obtainable through any sale of the debtor's business would have to be discounted to reflect the fact that it was a distressed sale, without due diligence or the benefit of any vendor's warranties (Interview 12). Second, the debtor's goodwill would suffer through adverse publicity associated with the commencement of insolvency proceedings. Suppliers and customers may be unwilling to continue to trade with a firm in receivership, for example. We were told that the impact of this factor depends on the type of business, being most significant for firms offering long-term contracts and services, and less pronounced for manufacturing firms (Interviews 10, 13). Third, interviewees stated that book debt values would have to be discounted to reflect the fact that many company creditors would dispute their debts on the basis that the firm was insolvent (Interviews 14, 21). In interview 17, the subject said:

> 'Well you have a ledger and it all looks good, and then you say to Joe Bloggs, 'come and pay me,' and they say— 'there is this wrong, that wrong and the other wrong—so there is no way I am going to pay you!' —and suddenly all your security is evaporated. So it is a high risk strategy for a bank to enforce on its security.'

Interviewee 6 put the position more succinctly:

> 'What started out as £1m book debts becomes £1m of disputes and aggravation.'

Fourth, we were told that after receiving a very bad press during the early 90s recession,[82] banks now wish to 'descend' the 'league tables' of appointments by institution (Interview 14). The adverse publicity associated with appointments may, it is feared, lead to less business being directed to that bank in the future, and our interviewees did not explain how this could be quantified, although our source in this case was sceptical of its significance (Interview 14)[83] Nonetheless, it is noticeable that the number of receiverships, as a percentage of all formal insolvencies has fallen dramatically from 38% in 1992 to 12.9% in 1998 (DTI, 1999).

In discussing the choice between receivership and other procedures, interviewees felt that where a bank had a floating charge, they would tend to recommend receivership. This allowed them best to protect the bank's interests, and afforded speed and flexibility. Administration was seen as being excessively costly, and more difficult to commence than receivership (Interviews 16, 24). The CVA was seen as hampered by the lack of a statutory moratorium (Interview 16). However, both were perceived as involving less adverse publicity for the banks than a receivership, and there were some circumstances in which administration was considered preferable, as where the benefits of the statutory moratorium outweighed the costs involved (Interviews 2, 6-9).

Our interviewees suggested that of firms which are the subject of an IBR, only a minority enter formal insolvency proceedings (Interviews 2, 4, 13, 24). This picture of the ratio of IBRs to receivership appointments is difficult to substantiate because of the paucity of quantitative data. All parties to an IBR will have an interest in minimising publicity, and no published figures are available for the number of IBRs. A very rough indication may be gleaned from the SPI's survey data on turnaround activity, which estimates that 1800-2100 firms may have received informal 'intensive care' from Insolvency Practitioners during the period 1995-96 (Smith, 1997). When compared with a figure of 2982 receiverships for the same period (SPI, 1997), this appears to run contrary to our interviewees'

assertions. However, the SPI's turnaround figures are likely to be under-inclusive, since many of the IBRs and turnaround activity will not be conducted by licensed Insolvency Practitioners, who form the SPI's sample.[84]

4.2. Decision-making in Receivership

Our interviewees who acted as receivers stated that generally they saw their role as being to maximise recoveries for the bank. In this regard, they admitted to regular communication between themselves and bank officers, with the latters' approval being sought for significant decisions, such as whether or not to attempt a sale. It was acknowledged that intervention by a bank in the decision-making process might attract liability for those decisions,[85] and hence the process was structured so that decisions were *initiated* by the receiver, but *confirmed* by the bank. As Interviewee 14 put it:

> 'I don't think there's anything wrong in the receiver liasing with the bank and saying, "Look: this is what I'm going to do, are you content with this?" That's a long way from the bank saying, "I want you to go and do this, that and the other." Once a bank does that, then it's putting itself at risk.'

A crucial decision in receivership is whether or not to continue trading.[86] Subjects stated that they would base their strategy on the findings of the IBR, and continue trading where they felt a going concern sale was achievable (Interviews 16, 17). Interestingly, a number of subjects indicated that the uncertainty associated with this question led them to begin with a presumption that they would continue trading and sell as a going concern (although Interviewee 17 denied that he operated under any such presumption). As Interviewee 10 put it:

> '[You] never went into a receivership really without a pre-supposition that you would try and sell it. … [A]nything of any size, you went in on the assumption that the job was to sell the

> business, keep the business going and sell it … [T]he person I worked for—long retired now—when I first started work, said to me "We always give them a whirl".'

SPI data show that around half of all receiverships result in a preservation of the business either in whole or in part. In 1996-97, the figure was 44%, rising to 53% over 1997-98 (SPI, 1999: 14-15).

We noted that a potential drawback with our theory was that priority to returns may give banks perverse incentives in making decisions about the firm's future. However, our interview data suggest that this is rarely likely to be a significant problem. First, we were told by a number of interviewees—although not all felt that their experience revealed a discernible pattern—that in their experience banks tended not to recover in full after a receivership. This is supported by the SPI's survey data suggesting that secured creditors receive an average return of 37% of the face value of their debt (across all insolvencies), and that only 18% of secured creditors recover in full (SPI, 1999). Second, interviewees emphasised 'soft' factors, which in their experience made banks unwilling to close marginal businesses. In particular, they adverted to possible indirect costs for the bank associated with closure. The firm's customers, suppliers and employees would be likely to be adversely affected by its closure. Some or all of these parties may also be customers of the appointing bank, and hence its business may be indirectly harmed (Interviews 10, 15, 24).

Third, banks often find that their 'priority' is subordinate to a number of other proprietary rights. Where creditors have taken fixed charges, made use of finance leasing or hire-purchase structures, or supplied goods subject to retention of title, they have claims to specific assets which in law rank ahead of a floating charge.[87] We noted earlier that whilst this factor might tend to ameliorate the bank's incentives as a decision-maker, it might nevertheless introduce decision-making costs. Our interviewees told us that whilst this was indeed the case,

they had nevertheless developed various strategies for reducing the disruption caused by such claimants (eg Interviews 13, 14, 19, 20).

A common stratagem in response to title retention claims is simply to dispute the claim (Interview 20). Despite the focus of reported decisions on questions pertaining to 'extended' title retention,[88] we were told that most such claims are rejected by receivers simply because of failure to incorporate the terms or to identify the goods in question.[89] Furthermore, trade creditors may well be insured, greatly facilitating the receiver's task as negotiations need only be conducted with the indemnity insurer (Interview 27). Another avenue open to the receiver is to negotiate with the creditor. In most cases, the latter will only be concerned with receiving payment, and hence this will be enough to release the assets (Interview 13). However, the business will often not have sufficient liquidity for the receiver to make large payments immediately. He may alternatively offer the creditor a personal guarantee of payment in return for the creditor's forbearance. Where such a guarantee has been given, then it appears that a court may look unfavourably on an attempt to repossess the goods.[90] A similar development is in the use of the equitable jurisdiction to grant relief against forfeiture where hire-purchase vendors or finance lessors seek to repossess goods, in the face of an offer by the receiver to pay outstanding instalments.[91]

5. Reforming Receivership?

So far, we have shown how receivership can offer parties cost savings over a regime in which no creditor has a floating charge. In this section, we would like to compare the current legal framework with possible alternatives. This sort of enquiry is particularly topical in light of the current Insolvency Bill,[92] and the Insolvency Service's ongoing Review of Corporate Rescue Mechanisms (Insolvency Service, 1999). Hence we consider the impact of the following possible reforms: (i) a 'debtor in possession' moratorium (Insolvency Service, 1993, 1995, 1999), and (ii) modifications to the existing

administrative receivership procedure (Milman and Mond, 1999: 48-51).

5.1. A debtor in possession regime

The basis of a debtor in possession ('DIP') procedure is that the debtor firm's existing management continue to run it, whilst a moratorium of creditors' claims is imposed to prevent them from pursuing individual enforcement (see Baird, 1993). The Insolvency Bill 2000 will introduce such a procedure for small companies,[93] based on the existing Creditors' Voluntary Arrangement provisions.[94] It will be geared towards the reorganisation of the capital structure of the debtor company. The process will be initiated by the debtor's management, subject to the scrutiny of a nominee, who must refuse to support firms with no reasonable chance of persuading their creditors to agree to an arrangement, or which will be unlikely to have sufficient funds available to continue in business during the moratorium.[95] Once the procedure has been commenced, all creditors' claims will be stayed, and it will no longer be possible to appoint an administrative receiver.[96] The nominee must call a creditors' meeting within 28 days, either to decide on the arrangement or to extend the moratorium for up to a further two months.[97]

However, the consent of the bank will be necessary in order to secure funding for the company whilst it is in the moratorium period (Trade and Industry Select Committee, 1999: Minutes of Evidence, Qs 17, 38). This is of crucial importance, because it means that it is most unlikely that a nominee will be able to agree to a moratorium proposal without the bank's support. The new procedure would therefore offer the debenture-holder an *additional* option in their decision-making.[98] The enactment of this new procedure would therefore make very little change to the dynamics of power in financially distressed small companies. That said, it offers a concentrated creditor an additional option, which we consider is likely to enhance efficiency, albeit in a modest fashion.

It is possible to conceive of more radical DIP regimes, which would alter the decision-making structure more significantly. These ideas are worth considering because even after the introduction of the Insolvency Bill, discussion of reform will continue under the aegis of the Insolvency Service/Treasury Review of Company Rescue Procedures (Insolvency Service, 1999). The extent to which a more radical regime would shift decision-making rights away from banks would depend on at least two factors. The first is whether the new procedure would require debenture-holders to give notice of their intention to appoint a receiver, as was floated in the Insolvency Service' 1993 consultation paper (Insolvency Service, 1993), and was part of the 'draft clauses' representing the genesis of the Insolvency Bill.[99] A notice period requirement would give the debtor's directors time to introduce a moratorium proposal unilaterally, 'trumping' the debenture-holder's ability to appoint. That said, a proposal for a moratorium would still not be acceptable to a nominee unless there were *funding* available for the debtor. This leads to consideration of the second factor: whether the new procedure would allow the debtor to grant 'statutory super priority' (SSP) to providers of finance (Insolvency Service, 1993, 1999: 12-13; 18-19). SSP would mean that lenders to a firm in the moratorium procedure would be given priority ranking ahead of pre-moratorium creditors, at the option of the debtor.

A DIP procedure which allowed for unilateral access by the debtor and granted SSP to post-commencement financiers would alter the structure of decision-making about default quite dramatically. This would reduce the bank's ability to exit from the relationship, should it decide either that the firm was economically distressed, or that there had been managerial misbehaviour. One consequence may be that this increases the incentives of banks to monitor their debtors (Triantis and Daniels, 1995). However, a countervailing problem is that it will reduce the *credibility* of any threats which a concentrated bank lender could make to a debtor firm regarding default (Baird and Picker, 1991). This would in turn reduce the effectiveness of concentrated debt as a governance tool.

5.2. Modifications to receivership

In this section, we discuss proposals to alter the structure of parties' rights once receivership has commenced. These proposals will not, however, impact on the decision-making process by which the firm enters into insolvency proceedings, which we expect would continue to be orchestrated by the debenture-holder. One proposal would be to subject the receiver to more wide-ranging duties to other interested parties, such as the company and/or junior creditors (eg Milman and Mond, 1999: 49-50). There are a number of hurdles to the implementation of such a duty.[100] First, at a conceptual level—as pointed out by Sealy (1987) in respect of directors' duties to creditors—is the difficulty of specifying what should be the *content* of the duty. If priority is respected, such a duty only has content where there are actions which do not harm the interests of senior creditors but can advance the interests of others. Even if priority is disregarded, the content of the duty does not become immediately clear. Consider the position of a receiver who is required to consider the interests of all creditors *pari passu* in his decision-making. He would still be generally bound to go along with the wishes of a concentrated lender, and the contours of the duty to other parties would be more akin to a 'minority protection' measure, again somewhat difficult to stabilise.

Second, there is a practical issue of the court's ability to *verify* the appropriateness of the receiver's actions. Courts must assess the issue with hindsight, on the basis of the evidence provided to them. Whilst counsel and the judiciary are likely to possess substantial experience of business matters (*cf.* Cheffins, 1997: 309-310), the information available to them about the specific facts of the decision is almost always likely to be less than that available to the decision-maker in question. Furthermore, their decision must be made with hindsight. Actions which at the time of taking were known to be risky but justifiable in terms of expected benefits, can seem unjustifiable with hindsight when a 'bad' outcome has materialised (Baird and Jackson, 1985). Judicial decisions which are not as well-informed as those of the decision-maker, or which tend to condemn failed risk-taking

without full assessment of the expected benefits at the time, are likely to give receivers incentives to behave in too risk-averse a fashion, thus reducing the expected returns to all parties (Cheffins, 1997: 543-544). Finally, even if it *is* possible for the court to make informed and appropriate decisions, one must ask: at what price? The instigation and conduct of legal proceedings is highly costly, and may well amount to more the funds available in the company.

Another possible modification of the law would be to remove the debenture-holder's right to priority of payment of returns. We noted earlier that the combination of senior priority to returns plus control post-default might lead to negative synergies in the decision-making process. However, we do not think this problem alone justifies a reform of this magnitude. The empirical evidence suggests that the problem is fairly insignificant in practice because banks are usually undersecured in administrative receivership situations. Hence the case for the priority (or not) of secured credit must be argued on other grounds.

6. Conclusions

In this paper, we have sought to explain and justify the law relating to administrative receivership on the basis that it enhances efficiency. Our theory suggests that receivership's role as a *private* insolvency procedure is efficient in the context of SMEs which concentrate their debt finance in the hands of a single bank. A debtor firm of this sort is highly unlikely to enter any form of insolvency proceeding if its bank continues to support it. Hence banks act as 'gatekeepers' in deciding whether or not to enforce against the debtor. The bank, as concentrated creditor, will have good incentives to invest in information about the causes of financial distress in order to make this decision. A private insolvency procedure orchestrated by the bank allows this information to be harnessed in enforcement proceedings where the bank decides not to continue its support. Furthermore, such post-default control can enhance the efficacy of bank debt as a governance mechanism. Control over enforcement proceedings means

that the bank can expect to recover more, and thus its threat to enforce if managers underperform will be more credible. This threat would be most useful in the context of SMEs which are owner-managed, where shareholder governance mechanisms are non-existent. This theory suggests that whilst the reforms contained in the Insolvency Bill are welcome, a more dramatic shift to a US-style Chapter 11 procedure would be a retrograde step.

We have several suggestions for future research. Whilst the empirical findings we present are consistent with our theory, the objectivity of our data is questionable, and they cannot be relied upon in any conclusive way. Further research might usefully seek to test the theory more rigorously. Our theory predicts that receivership will be used principally as a means of 'ousting' underperforming managers. We would expect to find it used more frequently, *ceteris paribus*, in owner-managed firms than public companies, because in the latter case management turnover can be engineered without the need for creditor enforcement. We would also expect to find that where a receivership sale is to the firm's existing managers, the appointing bank is unlikely to provide them with finance.

Another limitation of our theory is that the conclusions about receivership are, in a sense, 'situated' in the context of a system in which bank-based governance is important for small firms. Venture capital is an alternative governance mechanism, which arguably may function more efficiently than bank debt. Future research might usefully consider the interrelationship between the degree to which the legal system allows banks control over firms and the relative attractiveness of bank and venture capital finance (*cf.* Black and Gilson, 1998).

Notes

1. Eg, '"Greedy" Banks Come Under Fire', *Cambridge Evening News* 13 August 1999; 'How "Rip-off" Receivers Cash in on Carve-ups', *Evening Standard* 25 November 1999.

2. Throughout this paper, we use the word 'receiver' interchangeably with 'administrative receiver'.

3. Insolvency Act 1986 (henceforth 'IA 1986') s 4(3). The practical effect of this provision is that a putative CVA may be overridden at any time by a receivership appointment.

4. See eg, *Re Crigglestone Coal Co* [1906] 1 Ch 523.

5. *Re David Lloyd & Co* (1877) 6 ChD 339; *Re Northern Garage Ltd* [1946] 1 Ch 188; *Sowman v David Samuel Trust Ltd* [1978] 1 All ER 616; *Re Potters Oils Ltd* [1986] 1 WLR 201. In such circumstances the receiver requires the leave of the court to take possession from the liquidator, but he is entitled to such leave as of right (*ibid*, 206 *per* Hoffmann J).

6. IA 1986 s 9(2)(a).

7. *Ibid* s 9(3).

8. *Bank of Baroda v Panessar* [1987] Ch 335.

9. *Ibid.* See also *Lloyds Bank plc v Lampert* [1999] BCC 507.

10. *Shamji v Johnson Matthey Bankers Ltd* [1991] BCLC 36. A single qualification is that the chargeholder should exercise reasonable care not to appoint an incompetent receiver(*ibid*, 42 *per* Oliver LJ). Given that administrative receivers must now be professionally qualified (IA 1986 ss 230(2), 389(1)), it would appear unlikely that a debenture-holder would be in breach of

this duty unless he had subjective knowledge of an appointee's incompetence.

11. *Ibid* s 29(2).

12. See eg, *Re Yorkshire Woolcombers Association Ltd* [1903] 2 Ch 284.

13. See the Preferential Payments in Bankruptcy Act 1897. The contemporary statutory provision is IA 1986 s 40.

14. Only floating charge assets are available to pay preferential debts (*Re Lewis Merthyr Consolidated Collieries Ltd* [1929] 1 Ch 498).

15. As a genus of property, book debts appear to sit most comfortably under the 'floating charge head', since they display all three of the characteristics indicative of a floating charge as identified by Romer LJ in *Re Yorkshire Woolcombers Association Ltd* (n 12 above, 295). The courts have nonetheless sanctioned the concept, provided that the chargee can demonstrate a sufficient degree of control over the proceeds of such (eg *Siebe Gorman & Co. v Barclays Bank* [1979] 2 Lloyd's Rep. 142; *Re New Bullas Trading Ltd* [1994] 1 BCLC 485; *Cf NatWest v Royal Trust Bank* [1996] 613, 617-620 *per* Millett LJ).

16. n 7 above.

17. [1990] BCLC 844.

18. IA 1986 s 44(1)(a). Whilst liquidation terminates the receiver's agency for the company, it does not affect his power to deal with charged assets (*Gosling v Gaskell* [1897] AC 595; *Re Henry Pound Son & Hutchins* (1889) 42 Ch D 402), and his power to

realise them remains undisturbed (*Sowman v David Samuel Trust* [1978] 1 WLR 22).

19. The receiver's agency originated as a technique by which a mortgagee could escape liability to a mortgagor as mortgagee in possession. For a description of this practice see the dissenting judgment of Rigby LJ in *Gaskell v Gosling* [1896] 1 QB 669, 692.

20. *Re B Johnson & Co. (Builders) Ltd* [1955] 1 Ch 634; *Downsview Nominees v First City Corporation* [1993] AC 295.

21. *Meigh v Wickenden* [1942] 2 KB 160.

22. *Gomba Holdings UK Ltd v Homan* [1986] 3 All ER 94; *Routestone v Minories Finance* [1997] BCC 180.

23. *Gomba v Homan*, *ibid.*

24. See eg, *Re B Johnson & Co (Builders) Ltd* [1955] Ch 634

25. *Downsview Nominees v First City Corporation Ltd* [1993] AC 295; *Cuckmere Brick Co. Ltd v Mutual Finance Ltd* [1971] Ch 949.

26. [1999] 3 All ER 97.

27. Scott VC accepted that there could be no liability for choosing not to continue to trade.

28. IA 1986 s 42(1); Sch 1. A person dealing with an administrative receiver in good faith and for value is not concerned to enquire whether the receiver is acting within his powers (s 42(3)).

29. *Ratford v Northaven District Council* [1987] QB 357; *Re Sobam BV (In Receivership)* [1996] 1 BCLC 446.

30. [1920] 2 KB 497.

31. *Lathia v Dronsfield Bros* [1987] BCLC 321; *Welsh Development Agency v Export Finance Co. Ltd.* [1992] BCLC 148.

32. *Airlines Airspares Ltd v Handley Page Ltd* [1970] Ch 193.

33. There is one qualification. Where the counterparty has, prior to crystallisation of the floating charge, acquired a proprietary right superior to that of the debenture-holder, this may lead to injunctive relief or an order of specific performance against a receiver (see eg, *Freevale Ltd v Metrostore (Holdings) Ltd* [1984] 1 Ch 199; *Astor Chemicals Ltd v Synthetic Technology Ltd* [1990] BCLC 1; *Ash & Newman Ltd v Creative Devices Research Ltd* [1991] BCLC 403). The circumstances in which such a remedy will be available are less than comprehensively defined by the courts, and it remains the case that, for the most part, a receiver will be able to breach company contracts with impunity in order to promote his appointor's interests, notwithstanding the corresponding impairment to the contracting partner.

34. *Montgomerie v UK Mutual SS Association Ltd* [1891] 1 QB 370.

35. IA 1986 s 44(1)(b).

36. *Re Leyland DAF (No 2); Re Ferranti International plc* [1994] 2 BCLC 760. It would appear that this conclusion is not disturbed by the decision of the House of Lords in *Powdrill v Watson* [1995] 1 BCLC 386.

37. IA 1986 s 44(1)(c).

38. *Ibid.*

39. There is some question as to whether the statutory indemnity survives the termination of his agency consequent upon liquidation (see s 44(3)). It is arguable that the indemnity is *not* dependent upon the receiver's agency status. A non-administrative receiver is not deemed to be the company's agent, but is nevertheless entitled to a similar indemnity (s 37(1)(b)). In any event, it is submitted that any contractual liability incurred could still be discharged out of the company's assets as 'expenses' of the receivership (s 45(3)(b)).

40. In general, an administrator will conduct his administration with reference to the creditors' meeting (IA1986 ss 17(2), 24); a liquidator will similarly consult the company's creditors, in particular with reference to the exercise of certain of his powers (IA 1986 s 167(1)).

41. See *Gomba Holdings UK Ltd v Homan* [1986] 3 All ER 94; *Independent Pension Trustees Ltd v L.A.W. Construction Co. Ltd* 1997 SLT 1105.

42. With the possible exception, in narrowly defined circumstances, of causes of action - *Newhart Developments Ltd v Co-operative Commercial Bank Ltd* [1978] QB 814; *cf. Tudor Grange Holdings Ltd v Citibank NA* [1992] Ch 53.

43. The relevant provisions require the calling of a meeting of creditors (IA 1986 s 48) and the establishment of a creditors' committee (*ibid* s 49).

44. In addition, a creditors' *meeting* is called for the purpose of disseminating the information contained in the administrative receiver's report. This must detail, *inter alia*, the amount likely to be available to satisfy their claims. It might therefore seem pointless for an administrative receiver to gather together unsecured creditors in order to tell them what they have already

worked out for themselves, namely, that their debts are unlikely to be satisfied.

45. Insolvency Rules 1986, r 3.18(1).

46. The creditors' committee in administration may reject the administrator's proposals (IA 1986 s 24).

47. Or more precisely, by state officials on their behalf.

48. There are, however, some terminological differences between authors. See Belcher (1997: 39-41).

49. One must be careful, however, not to confuse the costs of financial distress—those associated with the firm's inability to pay its debts—with those of *economic* distress—associated with the failure of the firm's *business*. These costs—for example, the loss in value of 'soft' assets that depend on the firm's long-term survival—would be incurred even if firms were financed entirely with equity. Rather, the costs of financial distress are those which would *not* arise were debt not used to finance a firm See Megginson (1997: 330-331).

50. IA 1986 s 123(1)(e). See Goode (1997: 77-82).

51. See also *Oakdale (Richmond) Ltd v National Westminster Bank plc* [1996] BCC 919.

52. This is obviously a gross oversimplification, but it nicely captures the essential point that default in these circumstances is not the result of managerial failure. 'Failure' in this sense is necessarily a subjective assessment by the creditor.

53. Shleifer and Vishny (1992) argue that at times when firms are suffering from financial distress, other firms in the same industry—which would be the natural buyers of its assets—are

likely to be suffering liquidity problems, because financial distress is often linked to industry-wide downturns. Hence assets will be sold at a severe undervalue.

54. Through the removal of their stake in the firm and harm to their reputation. Where they have given personal guarantees, the consequences may be even more severe.

55. Owner-managers, as entrepreneurs, bear at least part of the risk that their firm will become economically distressed, however they finance it. What is being described here is an additional and unnecessary source of risk that would be created by non-renegotiable debt finance: the risk that financial distress (i.e. breach of debt contracts) *per se* would lead to harsh consequences.

56. Under English law, this maps onto the right to petition either for winding-up or for administration (IA 1986ss 9(1), 124(1)).

57. Under English law, winding-up of course does *not* collectivise the enforcement rights of secured creditors. See n 5 above.

58. An example is the US Chapter 11 procedure, under which the debtor's management remain in possession, and creditors are coerced into agreeing to a reorganisation by the threat of a 'cram-down' procedure if they do not. See generally Baird (1993: 214-266).

59. In effect, the other creditors are doing what LoPucki (1994) refers to as 'cash-flow surfing'.

60. For a survey, see Shleifer and Vishny (1997).

61. Text to nn 49-50 above.

62. See *Zartman v First National Bank of Waterloo* 189 NY 267, 82 NE 127 (1907); *Benedict v Ratner* 268 US 353 (1925), 359-361; UCC §§ 9-204, 9-205, 9-306. Scotland is another example of a jurisdiction which rejected floating charges at common law, and where they were subsequently introduced by statute (Companies (Floating Charges) (Scotland) Act 1961).

63. US Bankruptcy Code (11 USCA) §§ 362(a)(3), 541(a)(1). Similarly, holders of statutory floating charges in Scotland were unable to appoint a receiver until a further enactment specifically granting them this right (Companies (Floating Charges and Receivers)(Scotland) Act 1972).

64. The possibility of a 'lightweight' floating charge does not*per se* undermine the force of this point. A lender who held nothing but such a charge, and who consequently was not entitled to appoint a receiver of 'substantially the whole' of the company's property would not fall within IA 1986 s 29(2). See above, text to n 11.

65. IA 1986 s 44(1)(b).

66. Further, in relation to his personal liability, the receiver has his s 44(1)(c) indemnity to fall back on. The effect of this is that a receiver can trade risk-free and for the benefit of hisappointor.

67. *American Express International Banking Corp v Hurley* [1985] 3 All ER 564.

68. IA 1986 s 251; *Re Hydrodan (Corby) Ltd* [1994] BCC 161; *Secretary of State for Trade v Deverell* (Court of Appeal, 21 December 1999).

69. For reviews, see Schwartz (1981); Triantis (1992); Scott (1997); Finch (1999); Armour (1999).

70. n 63 above.

71. There are a number of exceptions. Picker (1992) and Buckley (1994) have shown how secured credit can act prevent a 'race to collect' by creditors. Mann (1997) has emphasised the governance benefits of the leverage which secured credit affords the creditor, although not in the context of insolvency. Perhaps closest to our theory is Scott (1986), who has investigated the link between a 'relational' lender, secured credit and efficiency. However, he does not examine the implications for the borrower's insolvency.

72. Text to nn 48-50 above.

73. The question is, however, discussed in more detail in Armour (1999).

74. Text to n 13 above.

75. Further information about our empirical methodology, and tabulated data about our interviewees, may be found in the Appendix. References in this section to interview numbers correspond to those in Table 1 of the Appendix.

76. The PricewaterhouseCoopers database of insolvency appointments lists 1145 receiverships in 1998, of which 68% (773) were made by banks. If the 79 cases for which there is no information about the appointor are discounted, the proportion rises to 73% (http://www.insolvency.com/cgi-bin/gazette/rec/recall8.pl?no).

77. For details of the system at Barclays, see 'Learning How to Lend', *The Economist Survey of Technology in Finance* 26 October 1996, 12-18.

78. The BBA Statement of Principles (BBA, 1996), lists the following as examples of the sort of factors which would give a

bank 'cause for concern': '(i) not supplying agreed monitoring information on time; (ii) failing to make loan repayments or to keep conditions specified in the loan; (iii) going over your agreed overdraft limit, especially repeatedly; (iv) the sudden loss of a key customer or employee; (v) unexpected or persistent trading at a loss; (vi) using the facility for purposes for which it was not agreed; (vii) substantial increases or decreases in turnover; (viii) disposal of a substantial part of the business; (ix) a winding-up petition brought by another creditor'.

79. Principle 6 of the BBA Statement (BBA, 1996) specifies that after the bank has developed 'cause for concern', an IBR may be requested if the debtor does not rectify matters, and is to be paid for by the debtor.

80. n 68 above.

81. Advisory work is limited to the provision of advice about how the turnaround can be effected. 'Hands on' turnaround work involves teams of consultant managers actually effecting the changes for the business. Fees for the latter are considerably larger.

82. See eg, Houlder, 'Act of Goodwill', *Financial Times* 8 October 1996.

83. 'I personally don't think it [affects where businesses choose to bank] for one minute! Indeed, I don't understand why the banks are so sensitive about it because to be honest, I think if you're a small businessman and you're looking for money, you will go to whoever will give it to you. You sure as hell don't sit there and think, 'I may go bust in five years - what's going to happen to me?' You wouldn't go into business if you thought that!'

84. The SPI figure is acknowledged to be at best an estimate even within this sample.

85. nn 67-68 above.

86. This decision may now be coloured by the decision in*Medforth v Blake* (n 26 above). The precise scope and content of the equitable duty to exercise skill and care in the management of the company's business is difficult to presage. There is at least a possibility that too enthusiastic an application of this principle on the part of the courts will be counter-productive, in that receivers will be deterred from 'trading on' by the prospect of equitable liability.

87. Text to n 13 above.

88. See eg, *Borden (UK) Ltd v Scottish Timber Products* [1981] Ch 25; *Re Peachdart* [1984] Ch 131; *Clough Mill v Martin* [1985] 1 WLR 111; *Tatung (UK) Ltd v Galex Telesure Ltd* (1989) 5 BCC 325; *Compaq Computer Ltd v Abercorn Group Ltd* (1991) BCC 484.

89. Interview 20 ('It is possible to create substantial barriers for the [retention of title] creditors – you write and ask them for further details and … you reject the claim, you take a view on whether they will come back and sue at a later date. But it'sstill the case that … the majority fail. For various reasons: because they make elementary mistakes in not tying up their terms of business, failing to identify their goods and showing that their goods have to be the goods which are unpaid'). See generally Wheeler (1991). The problem of identification was an issue in *Ian Chisholm (Textiles) v Griffiths* [1994] BCC 96.

90. *Lipe Ltd v Leyland DAF Ltd* [1993] BCC 385.

91. See *Transag Haulage Ltd v Leyland DAF Finance plc* [1994] BCC 356; *On Demand Information plc v Michael Gerson (Finance) plc* (5 March 1999), *The Times* 28 April 1999

92. http://www.parliament.the-stationery-office.co.uk/pa/ld199900/ldbills/028/2000028.htm

93. Insolvency Bill, cl 1; Sch 1 para 4 (inserting a new s 1A and Sch A1 into the IA 1986, at para 2); Companies Act 1985 s 247(3). A 'small' company is defined by the 1985 Act as one which satisfies two or more of the following three criteria: (i) its annual turnover is not greater that £2.8m; (ii) its balance sheet total is not more than £1.4m; and (iii) it does not employ more than 50 persons.

94. IA 1986, Part I.

95. Insolvency Bill, cl 1; Sch 1 (inserting s 1A and Sch A1 into IA 1986, at para 6(2)).

96. *ibid* at para 12(1)(e).

97. *ibid* at paras 8(3); 27; 30(2). A general meeting of the debtor company must also be called (*ibid*), but this will be of less significance. If the creditors' wishes on any matter conflict with those of the members, then the former prevail, subject to the court's discretion on a petition from a member (*ibid* para 34). It is difficult to see that this discretion would be exercised anything more than very rarely.

98. There are a number of reasons why a bank might concur in the new CVA procedure as an alternative to receivership. Provided that the bank has confidence in the management, (i) the moratorium would prevent the difficulties encountered with retention of title claimants, leasing financiers, etc, in receivership; and (ii) the retention of management would reduce costs as compared to existing procedures where the firm's management is conducted by an outside official; (iii) there

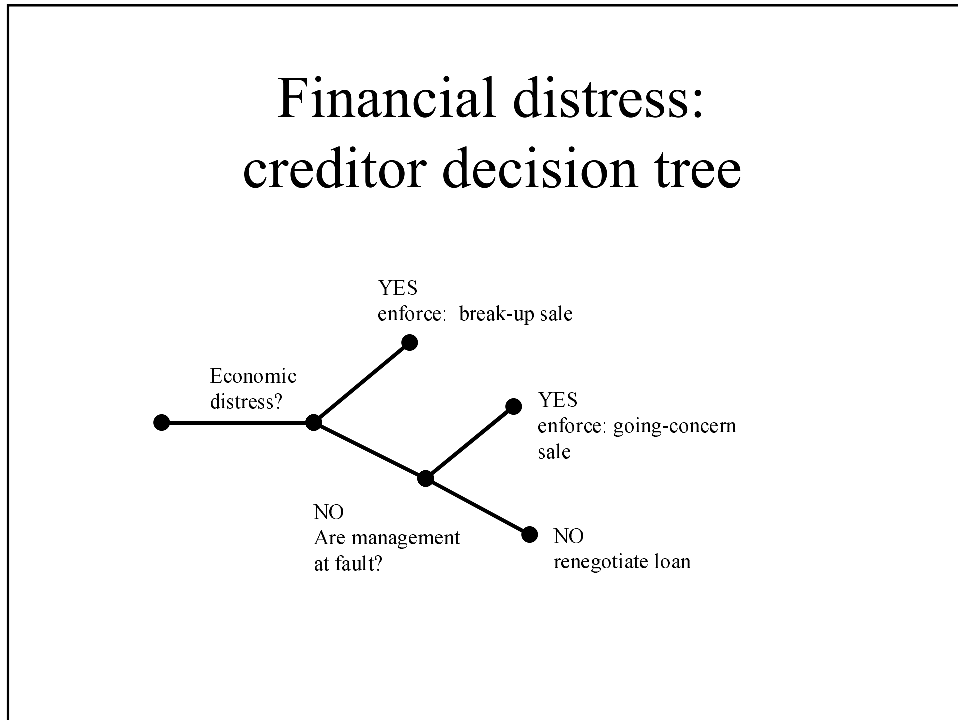
would be less adverse publicity associated with a CVA for the bank than with receivership.

99. These clauses were circulated privately from July/August 1999 onwards. The Select Committee was highly critical of the lack of public consultation and Parliamentary scrutiny during this period (Trade and Industry Select Committee, 1999:paras 6-7).

100. Indeed the Cork Committee, presented with a proposal that receivers should, by statute, be under a duty to have regard to the interests of all creditors, dismissed it as unworkable and potentially counter-productive (Insolvency Law Review Committee, 1982: paras 448-451).

FIGURE

1 **Figure 1**



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APPENDIX

Appendix: Empirical Methodology

The interviews which provided the empirical data reported in this paper are drawn from two separate investigations. Frisby conducted nine interviews with practising administrative receivers working in the East Midlands. As part of a different study, Armour conducted 25 interviews with professionals involved in dealing with financially distressed companies. Of these, 17 had experience of the operation of administrative receiverships, and the interviews therefore provided data which were germane to this paper's enquiry. In both cases, the purpose of the interviews was to enhance understanding of the practical operation of corporate insolvency law, and the context of financially distressed companies in which it operates. The 'snowball' technique (see Wheeler, 1991) was used to identify and select interviewees, on the basis that (i) it greatly facilitated approach to interviewees; (ii) the data being sought were necessarily of a subjective nature. Interviews were structured in an open-ended fashion, with the objective being to draw out the interviewee's perceptions of the practices of professionals in relation to troubled companies. In most cases, the interviews were tape recorded and subsequently transcribed. In six cases, the interview was not tape recorded, as a result variously of interviewee requests and tape recorder failure. In these cases, notes were taken during the interview. The names and specific details of the interviewees have not been disclosed for reasons of confidentiality.

Table 1 : Interviewee Details

Interview Number	Date	Profession	Geographic Location	Expertise	Transcript
1.	18-06-98	Accountant	E Midlands	2ac 3ac	Y
2.	22-06-98	Accountant	W Midlands	2acd 3acd	Y
3.	08-07-98	Accountant	E Midlands	2acd 3acd	Y
4.	10-07-98	Accountant	E Midlands	2acd 3acd	Y
5.	13-07-98	Accountant	E Midlands	2acd 3acd	Y
6.	04-08-98	Accountant	W Midlands	2ac 3ac	Y
7.	02-09-98	Accountant	E Midlands	2ac 3ac	Y
8.	15-09-98	Accountant	E Midlands	2ac 3 ac	Y
9.	21-09-98	Accountant	W Midlands	2ac 3ac	Y
10.	25-02-99	Accountant	London	2c 3cd	Y
11.	16-03-99	Accountant	London	1b 2bc	Y
12.	15-04-99	Accountant	London	1ab 2bc	N
13.	16-04-99	Accountant	North	2c 3cd	Y
14.	19-05-99	Accountant	London	2bc 3c	Y
15.	08-06-99	Accountant	London	1ab 2bc	Y
16.	09-06-99	Accountant	North	2c 3c	Y
17.	02-07-99	Accountant	London	2c 3c	Y
18.	24-02-99	Lawyer	London	1b 2bc	Y
19.	09-03-99	Lawyer	London / SW	1b 2bc 3c	Y
20.	12-03-99	Lawyer	E Midlands	3cd	Y
21.	23-03-99	Lawyer	London / N	2bc 3c	N
22.	28-07-99	Lawyer	London	1b 2bc	N
23.	08-02-99	Banker	London	1b 2bc	N
24.	17-03-99	Banker	London	2bc 3c	N
25.	24-03-99	Banker	London	1b 2bc 3c	Y
26.	25-05-99	Banker	London	2bc	N

Expertise codes

Numerical: size of firms : 1 International; 2 Large domestic; 3 SME
Alphabetical: type of work: a Turnaround consulting; b Debt restructuring; c Receivership / Administration; d Liquidation