COMPARATIVE POSITION OF INSOLVENCY LAWS IN UK, US AND INDIA: A COMPARATIVE POSITION

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ABSTRACT

Insolvency rates have increased significantly around the world due to various issues like economic slowdown and structural pressures. To formulate a robust insolvency regime which balances the interest of the debtor and the creditor is the need of the hour. The research aims to study the two best insolvency regimes of the world US and UK. UK follows the creditor in control model and US follows the debtor in control model, both these models alone can help a stressed company to revive itself with the help of structural process within the law. Currently Insolvency regimes are moving from remaining a mere recovery legislation for the creditor towards a reorganizing legislation whose primary objective is to recuperate the company as a going concern so that it becomes capable to manage its own affairs. In other words balancing the interest of both debtor and creditor. The objective behind the study of US and UK models will help gain insights as to how a reorganizing of corporate insolvency works where both debtor and creditors interest are satisfied. Lastly it can be said that both US and UK insolvency framework have provisions to protect the rights of debtor and creditor and can be regarded as specialized regimes which can dispose of insolvency cases in faster and efficient manner.

Keywords: Corporate insolvency, bankruptcy, debtor, creditor, administration, revival, reorganization.

METHODOLOGY

The current study is a doctrinal research based on theoretical information. The information accumulated is used for analyzing, interpreting and systematizing existing laws, case laws and regulations. The information accumulated comprises of both primary and secondary data. Primary sources like statutes, authorities, precedents and secondary sources like books, research articles, computer data base has been used.

INTRODUCTION

There is a recent rise in insolvency rates around the world dues several reasons economic slowdown, fraud and cheating done by companies are few of the relevant reasons. The major concern is to address the insolvency of the corporates in an efficient and timely manner. The US and UK insolvency regimes are specialized Insolvency regimes that can address the insolvency of the corporates in a timely manner. Insolvency framework in some of the regimes are mere recovery platforms that facilitate the creditors with the opportunity to get back their loan amount by shredding the debtor company. This causes a lot of damage to the debtor, its employees and also the creditor since it accepts huge amount of haircuts in the process of recovery. However current regimes follows a more specialized process which allows recuperation of the stressed company by the creditors of the company so that the company once again becomes a going concern and can pay back its dues. The regimes in US and UK follow the specialized reorganization process which allows revival of the corporate which majorly balances the interest of the debtor and creditor and follows a faster and efficient disposal of the insolvency matter.

The two divergent prominent insolvency frameworks that most of the countries follow are the debtor in possession model followed by the United States and the Creditor in possession model followed by the United Kingdom. Earlier, popularly known as the Anglo-American systems (wood, 2000) both these frameworks are poles apart from each other in relation to substantive and procedural questions related to insolvency.

This paper focuses on the comparative analysis of the insolvency regimes of the United Kingdom and the United States. In doing so, it will try to look into the five pertinent issues that are relevant, namely- the priority that these systems give to corporate rescue, whether it is pro debtor or pro creditor, whether it punishes the errant directors and controls their conduct, how

the insolvency process is conducted in these jurisdictions, whether there are formal and informal approaches for corporate rescue and whether there is a special regime available for the process.

Further, the paper seeks to analyse whether the insolvency regimes of these two jurisdictions balances the interest of the creditors and the debtor in a corporate insolvency. It further explains on the substantive and procedural framework which is existing in these countries to analyse whether it serves the twin objectives of debt recovery for creditors and revival for debtors, without impeding the rights of each other.

In order to achieve this objective the paper will discuss the historical development of insolvency laws in the United Kingdom and the United States, the existing substantive and procedural insolvency frameworks in both these countries and analyse how certain relevant issues in relation to creditor and debtor protection is dealt in these two jurisdictions.

INSOLVENCY LAWS OF UNITED KINGDOM

In the early English society, traces of insolvency can be witnessed in the feudal relationship that existed between the landlords and the tenants. For debts due from the tenant's, landlords used to exercise the right of distrain against tenant's property; wherein they would seize and hold tenant's property until the debts were paid off by the tenants. (Maitland, 1895) Merchant trading was also one instance where indebtness was witnessed in early English society. The laws dealing with debt recovery formulated in early England was strongly influenced by customs and Italian mercantile law.

The first English Bankruptcy Act was passed in the year 1542 with the objective to prevent the debtors from absconding without clearing the dues they owed to creditors. During this time, a default in paying debt was regarded as criminal and the defaulting debtors were also treated like criminals.

The unrest among debtors for the harsh treatment meted out against them for defaulting, brought considerable changes in law after the Victorian period. It led to a more organized regime where debtors were allowed to proceed with bankruptcy. The seventeenth, eighteenth and nineteenth century saw reformers like Donal Veall, Thomas Grantham and judges like Lord Bowen urging for law reforms and lamenting about the treatment meted out to defaulting

debtors as 'diabolical' (Brown, 1907) They emphasised that the system made an honest defaulter suffer while allowing a dishonest defaulter to escape through the loopholes of law.

Another major development was the Act of 1831 that created the office of the Official Assignee which reduced creditors control over defaulting debtors and the Debtors Act of 1869 which took away the powers of the court to imprison the defaulting debtors. (Omar, International Insolvency Law, 1988)The twentieth century saw the passing of Bankruptcy Act of 1883 that dealt with individual bankruptcy followed by the Bankruptcy Act of 1914 and the Insolvency Act of 1986. The Insolvency Act of 1986 was a Code which covered both individual and corporate bankruptcies. (Insolvency Act, 1986) It was with the passing of the Insolvency Act of 1986; a paradigm shift was observed in the treatment of insolvencies in UK.

In relation of protection of creditor rights which existed under the UK laws, the prevalence of floating charge over the borrower's property needs special mention as this extended to the later form of receivership. Under this, lender could exercise a floating charge and could exercise the contractual right of ownership on it, in case of a default from the borrower. While this benefitted the borrower to use the property in business as the lender will exercise his right over the property only in case of default, it also benefitted the lender by increasing the prospects of debt compliance. Later development in debtor creditor contracts, allowed the lender to appoint a receiver over a default who could exercise all powers, including management of the insolvent company. This administrative receiver appointed by the floating charge holder is different from an administrator under administration order, as only the individual interest of the concerned secured creditor was protected under receivership, which was not a collective process

The recommendation of the Cork Committee (Cork, 1982)which emphasised corporate rescue over creditor interest, resulted in introducing two rescue regimes -the Administration order and Corporate Voluntary Arrangement in the Insolvency Act of 1986. (Insolvency Act, 1986) Administration order and the Corporate Voluntary Arrangement were court monitored business rescue models which was handled by the chancery division of the High Court. But as the banking industry was very strong in the UK, the legislature could not prevent the dominance of the receivership and that of the insolvency practioners created under it. The Main Act underwent significant amendments in 1994, 2004 and subsequently in 2005.The shift from debtor repression to debtor protection in bankruptcy laws globally, resulted in the introduction of a new type of administration order in the Enterprise Act of 2002. The Enterprise Act of 2002

basically changed the dominance of creditors under receivership and brought the focus of rehabilitation of viable business in the forefront, similar to the provisions under Chapter 11 of the US Bankruptcy Code of 1978 which prioritised rescue of the company as a going concern over the interests of creditors. Another change that is brought in UK insolvency laws is the prominent role of insolvency professional and the minimal interference by the court limiting its role to dispute resolution and advisory. (Sharma, 2016)

Administration order under insolvency Act of 1986

A British administration order was preferred over liquidation of the company, if the administration could reasonably achieve the three main purposes which include-rescuing the company, achieving better results for company's creditors, realise property to make a distribution to secured or preferential creditors without harming unsecured creditors interest. Administration could not be used to upset creditor rights as held in *Re Harris Simons Construction Ltd* (Re Harris Simons Construction ltd, 1989) and unless there is a 'real prospect' as held in *Re Lomax Leisure Ltd* of achieving these three main purposes. The most important feature of administration over the previous regime under receivership was that, it adversely affected the interests of secured creditors with a floating charge as it brought a stay over the enforcement of floating charge. It was also a collective action which provided relief to all the creditors unlike receivership which protected only the interest of the secured creditor with a floating charge. As the focus was on corporate rescue, timelines like: proposals to be produced within eight weeks of administrator's appointment and presenting the proposals in the meeting with creditors within ten weeks were also introduced. The process included approval of proposal by the creditors to implement them and in case of rejection, the administrator getting discharged, followed by a liquidation of the company. Another prominent feature of administration was the change of power of management of the company to the administrator who was an insolvency professional. Administration in effect did not provide for a swift debt recovery to creditors, but helped them to arrive at a solution which they could work out through a company voluntary arrangement or a compromise arrangement under the Companies Act, 1985. (H, 1994)Therefore, the effect of administration order was that, it prevented winding up of the company, imposed stays on enforcement of security interest against the company, stayed repossession of goods relating to hire purchase agreements and commencement or continuation of any legal proceedings against the company.

Administration order however, failed to achieve the objectives envisioned by Cork due to a variety of reasons. Firstly, the administration process could be stopped by a secured creditor with a floating charge, who had a better chance of protecting his rights under receivership, as the Insolvency Act of 1986 did not abolish receiverships. Secondly, procedural costs of administration process was very high due to the greater involvement of courts. Thirdly, as administrators could sell the company's property or take action without creditors consent, creditors preferred other alternatives. Another reason for failure was due to the fact that administration orders were generally applied only during the last stages of corporate failure, where rescuing the company was quite remote. This was mainly due to the faulty interpretation that courts can order for administration only when the "company is or is likely to become unable to pay its debts". The fact that courts had a wider discretion to order administration after considering the impact it caused to secured creditors, preferential creditor interest were better protected in winding up, liquidator had wider powers than administrator were some other reasons that led to its failure. (Re Imperial Motors (UK) ltd, 1989)

The discouraging judicial interpretations can also be attributed as a factor for the failure, as evidenced in Powdrill v. Watson, where the Court of Appeal held that, if employees were continuing in their jobs after administration came into effect, then their employment contracts will apply, leading to heavy unrest from creditors, as the administrators had to pay the employees, in priority to most of the creditors. Further, as raised *in Bristol Airport Inc v. Powdrill* the effectiveness of moratorium in preventing all suits and proceedings against the company was considerably compromised by giving discretion to courts to interpret the coverage of moratorium. The courts also gave priority only in protecting the interest of creditors by neglecting employee, public interest and trade interests which are also important objectives of a corporate rescue. Another major failure was the lack of information dissemination of judgements among affected parties in insolvency and the absence of accountability and fairness in the process, as some parties like customers, suppliers and service providers had no voice in administration, if they were not creditors of the company.

The failure of Administration under Insolvency Act of 1986 led to the introduction of reforms to administration under the Enterprise Act of 2002.The main objective of the Enterprise Act was to prevent the vetoing power of holders of floating charge against administration and to bring administration the preferred rescue option for corporates by prohibiting the floating charge holder's recourse of administrative receivership. Under the Act, administrators could

be appointed either by the court on the application of the company, its directors, one or more of the creditors or a combination of these parties. (Moss.G, 2004) Out of court options were also available for the appointment of administrators either on the application of the holder of a floating charge and on the application of the company or its directors.

The objectives479 laid down by the Enterprise Act lays down emphasise on rescuing the company as a going concern or protecting the interests of company's creditors and lays that the administrator must give primacy in saving the business, if it gives better protection to creditors, making it imperative that creditors interest is paramount under the Act. (Frisby, 2003) Another important reform was the change in priority given to crown's debts and abolishment of preferential creditor status. The Act also introduced 'ring-fencing', which enabled providing through the statute a fixed portion of net floating charge proceeds to unsecured creditors and distributing the surplus funds to the floating charge holders. Under Section 176A of the Insolvency Act 1986, unsecured creditors could receive a share from the sale of assets of the debtor, subject to floating charge over the security. Commonly referred as 'prescribed portion', it was given more prominence through the Corporate Insolvency and Governance Act of 2020, which brought a specific calculation to ascertain the prescribed portion.

The arguments from the British Banker's Association (BBA) that, receivership saved businesses in a cost-effective manner further gave a set of substantive rights to bankers where they could appoint administrators even when there was no urgency and led to the stream lining of the Act and limited court interference. (BBA, 2001) The effect technically resulted in a merging of administrative receivership and administration procedures. (S D. , Insolvency and the Enterprise Act of 2002, 2003)

Company Voluntary Arrangements (CVA)

Cork's recommendations for a rescue culture for companies, was formally recognised under sections 1-7 of the Insolvency Act of 1986, that recognised directors of the company taking up the initiative for voluntary arrangements. (M P. , 1996) Under this scheme, directors may propose an arrangement even if the company is not insolvent and could nominate an insolvency professional to administer the CVA and make a proposal for the consideration of its creditors and shareholders. If the unsecured creditors approve the proposal with a seventy five percent vote, the scheme would be binding on all unsecured creditors who are entitled to vote at the meeting but will be binding on the secured creditors only if they have agreed to it. The scheme

also requires approval of fifty percent in value of the shareholders present in the shareholders meeting, to become operational. Though it is a court monitored process, it does not require a regular court intervention. Part 2 of the Insolvency Rules 2016,provides guidelines regarding the working of CVA. However, CVA played a limited role and was not a favourite choice of directors, as it could not alter the preferential ranking of debts in relation to priority of repayment or the secured creditors rights even through a majority decision.

Though this is a flexible restructuring tool for companies it has not been a favourite and has been regarded as a failure in UK. (Walton P, 2002)Statistics showed that the companies that adopted CVA were very low in number (Corporate Insolvency Provisions: Evaluation Report Enterprise Act 2002, 2008), mainly due to the difficulties faced during the adoption of the scheme. Firstly, as it is a debtor in possession model, inefficient management continued and suppliers were hesitant to continue. (Cook G, 2002) Another major reason was that creditors were suspicious of the intention of the directors calling for this process as it could exempt them from charges of wrongful trading on a subsequent liquidation. The higher cost involved in the process was also another reason for its lack of popularity. Uncertainties involved in the process, directors lack of knowledge and insolvency professionals lack of effective control were also reasons for its failure.

Pre-Packages

The recent accelerated response in initiating corporate rescues at an early stage before the actual financial crisis, has led to the emergence of the pre-package administration process in different jurisdictions. The Pre-packs which emerged in UK in the mid 1980's, became more popular only recently. It involves a contractual agreement between the financially distressed company and its creditors, where an administrator is appointed prior to a statutory process. (V F. , 2006) The major advantage of the pre-pack is its fast resolution process which is facilitated by enabling the selection of the resolution plan and voting, prior to the filing of the bankruptcy. (M P. , Pre-Packaged Asbestos Bankrupticies: A Flawed Solution , 2002) Further, minimal professional fees, absence of time consuming negotiations, protection of employee jobs and possibility of full payment to trade creditors make this process more effective compared to other processes. (V V. , 1998) Another advantage of pre-pack, is the possibility of entering into deals even before facing actual financial difficulties that act as a catalyst to continue the business, leading to value maximisation as there is greater chance of retaining key employees.

(D F. , 2006) The judiciary has also played a major role in bringing pre-packs as a popular choice, as held by the High Court that pre-packaged sale minimised disruption to clients and protected employments. (DKLL Solicitors V. HM revenue & Customs, 2007) Studies from UK also show that pre-pack was the reason for forty four percent cases in which corporate rescues were possible, highlighting the effectiveness of this process even during the early 2000. (M K. A., 2006)

However there were also major criticisms against this model and one of the major criticisms attributed to pre-packs, highlight the absence of transparency in the process leading to promoters getting back their entities at a cheaper price at the cost of creditors and other interested parties. (S D. , Pre-Pack - He who pays the piper call the tune, 2006) The fact that connected parties' sales were at a high after the passing of the Enterprise Act, also points to this unethical practise. (S F.) Another criticism against pre-pack is the lack of fairness in the process. As all options in the market is rarely tested to arrive at a faster agreement, better options for value maximisation could be left out, leaving out interested parties who may not be even aware of the process. (G R. , 2005)Critics also argue that it favours secured creditors at the cost of unsecured creditors, as statistics show that the average return for unsecured creditors was only eleven percent in administration pre-packs compared to administration business sales. Another criticism is the lack of accountability issues in the process and the danger of diluting regulatory powers, making it a more managerial and professionally controlled process. (P G. &., 1998)

The Corporate Insolvency and Governance Act of 2020

The Corporate Insolvency and Governance Act, was enacted in June 2020, to provide relief to corporates and to enable them to continue trading without being affected by the pandemic induced disruptions. The Act brought temporary and permanent changes to the insolvency framework. The significant temporary reform of preventing winding up petitions hugely helped companies from being dragged to bankruptcy. Though the ban was on companies specifically affected by the pandemic, it was extremely difficult to bring winding up petitions against any company as laid down by the High Court in *Re a Company case,* that affirmed the objective of bringing this reform. The two permanent reforms that the legislation brought were the imposition of moratorium and a permanent ban on the termination clause in supply contracts. The ban on the termination of supply contracts of goods and services caused huge consequences

and was criticised widely, as the medium sized goods and service provider companies were banned from executing termination clause in their contracts or in making paying of outstanding dues a condition for further supply, if the company it was supplying goes into a 'relevant insolvency procedure'. Another issue was the provision in the Act that allowed small supplier companies to use the termination clause which helped these companies, but brought great hardships to medium sized companies that did not fall into the category of 'small sized enterprises'. The one sided drafting of the clause which allowed the supplying company to use the termination clause against a supplier who became insolvent, was another issue that brought huge outcry. (L) The Act does not look very promising for businesses according to critics, as in giving companies affected by the pandemic a breathing space, the provisions brought by the Act actually suffocated a few other medium sized supplier companies.

Informal sources

Other than the formal rescues discussed above, the informal rescues prevailing in UK's insolvency regime also needs special mention. Advocates like Brown argue that due to the less publicity involved, the informal process is more beneficial in preserving the value of the company. (D B. , 1996) Informal rescues generally refer to the out of court restructuring or 'work outs' (Kirschner, 1991) agreed between the debtor and creditor for debt resolution. The advantages of informal rescues compared to a formal rescue is its reduced cost, faster resolution, preservation of goodwill of the company on account of less publicity and preservation of the value of the company. (Boxie, 2016) It also allows faster completion of sale of the company compared to a formal route which often witness increased litigation. Another advantage of this route is its flexibility, resulting in higher chances of settlements unlike a formal rescue, which does not allow changes during negotiation between parties without a valid approval mechanism.

The main disadvantage of the informal process is its difficulty in reaching a settlement between debtor and creditor without a mediator who facilitates the process, as in a formal rescue. Another disadvantage is that as it's based on a contractual agreement it binds only those who are parties to it and does not bind a dissenting creditor, resulting in further litigation. Further, the process could also be misused by unscrupulous promoters, as it halts any further investigation into the affairs of the company and charges against directors for wrongful trading. The orderly and collective way by which all creditors and stake holders involved with the

debtor can participate, is also inherently absent in an informal corporate rescue.

A brief analysis of the UK regime

An analysis of the English Insolvency frame work reveal that though there are multiple routes- both formal and informal that is available for corporate rescue, the insolvency framework in UK is more creditor friendly and gives higher priority in protecting the interest of secured creditors compared to business rescue. As the unsecured creditors are given voting rights, their interest is also considerably protected and their consensus matter for agreements. English system is heavily fault based and there is keen supervision and control on the conduct of directors of insolvent companies by insolvency professionals and courts. But in recent times there is a shift from focusing on creditor interest to corporate rescue and protecting viable businesses.

INSOLVENCY REGIME OF UNITED STATES

In the United States, the word bankruptcy is used for corporates as opposed to insolvency, which is used in many other jurisdictions when referring to company insolvencies. The primary legislation which deals with bankruptcy in US is the Federal Bankruptcy Reform Act of 1978, also known as The Bankruptcy Code of 1978(11 USC).

5.3.1 The Act covers liquidation of corporates under Chapter 7, while Chapter 11 covers reorganisation of corporate debtors. A debtor can approach voluntarily for a corporate reorganisation or a creditor can commence an action against the debtor which is called as involuntary proceedings, under Chapter 11. Another feature of the US bankruptcy Code is that, in order to file a case under chapter 7 or 11, the debtor does not even require to be insolvent. It protects the debtors from unnecessarily being dragged to bankruptcy court by the creditor, by stipulating conditions for the amount of default and repeated defaults which can trigger an action.

Another debtor friendly provision of the US Code is the automatic stay given to the debtor's property, immediately after filing of the petition. All actions by creditors against the debtor are stayed to avoid irreparable injury to the debtor. The most unique feature of the US Bankruptcy Code is the debtor in possession (DIP)model , where the corporate debtor continues to control the management of the company and retains the possession of the property. The debtor in

possession model also enables the corporate debtor to exercise most of the powers and duties of the trustee, except the duty to investigate on the financial aspects of the debtor.

The US Code also recognise secured creditors interest and even though there is an automatic stay of all security claims of the creditors with the commencement of bankruptcy proceedings, the secured creditors have first priority in debt payments in the ladder of priority. Their claims are taken into consideration immediately after taking into account the costs and expenses for bankruptcy.

There is also a provision for appointment of creditor's committee comprising of holders and representatives of unsecured creditors. The role of the committee is to supervise and act as advisers of the activities of the corporate debtor. As US follows the debtor in possession model this gives them some control and will help them to monitor the activities of the corporate debtor.

Chapter 11 proceedings under the US Bankruptcy Code, 1978

Proceedings under the United States Bankruptcy Code have strongly influenced corporate reforms globally, as it is based on the powerful notion that business failures can be turned around. (Burke, 2019) The US Supreme Court in US v. Whiting Pools Inc held that the objective of the Code is reorganisation of business. The process under Chapter 11, solely focus on reorganisation of business and continuing the business, and is not a remedy for creditors. (P L. , 1998) The most important aspect of the US insolvency is that it allows a debtor company to file under chapter 11 even when there is no insolvency or a nearing insolvency, as it's an instrument for debtor relief. The process aims at preserving the value of the enterprise and is considered as highly sympathetic to the debtor as it has a number of debtor friendly provisions.

As soon as an application is filed under chapter 11, there is a moratorium imposed and an automatic stay on creditor claims. Another debtor friendly provision is the unique DIP model, which gives a fiduciary role to the management and allows it to continue managing the company, throughout the bankruptcy process. Though under law, the bankruptcy estate does not vest with the management but with a conceptual entity, the DIP, which is considered similar to a trustee, gives a lot of power and control to the directors of the distressed company. While the DIP gives the management many of the powers of the trustee, they also have a number of duties to perform and are monitored by the US trustee. The US Code also have mechanisms to avoid abuse

of powers by the erstwhile management. One instance of this can be found in Delaware, where a company in bankruptcy proceeding may replace an individual director with the approval of the bankruptcy court. Further, the entire board could be replaced and powers of management can be vested with the trustee appointed under Chapter 11, if there is evidence of fraud, mismanagement and incompetency of the board. The Code has also provisions which allows the creditors to approach the court to appoint an officer to investigate the conduct of the directors in cases of abuse. Generally the reorganisation plan has to be approved by the court and by creditors, but if the court approves the plan and if it's not approved by a class of creditors who have been provided with the value of its collateral and interest in the plan, the 'cramdown' provision in the Code, allows the court to impose the plan on them. (Friedman, 1993) This provision is the most differentiating element in the US Code from the UK, which does not allow any reorganisation without creditor approval.

Another important feature of the US Code is the way it deals with the 'issue of fault' in business failure. As Moss observes, "while in England the issue of failure of a business is regarded as a disgrace and the urge to punish the wrongdoer is still real, in US, business failure is regarded as a misfortune and risk takers are rewarded, while creditors are considered to be greedy". (G M. , 1998)According to him this could be due to the cultural differences that exist between these two countries. The role played by the courts and professionals also differ widely in both these jurisdictions. In English administration, while the insolvency practioners who are specialist's accountants play a very important role in streamlining the whole process, in US as the directors run the rescue process there is a close monitoring by the court and US trustee to protect the interest of creditors. Another important difference is the prevalence and usage of different types of rescue processes. While the US rescue system is focused on chapter 11 reorganisations majorly, in UK there is a mix of formal and informal corporate rescue processes.

The main criticism against the US Code is its lenience to debtor protection, ignoring creditor rights. One of the unique features of the Code, the DIP model could be abused by unscrupulous directors who continue to be in possession and control of the management of the company even after the filing of bankruptcy petition. It is often alleged that Chapter 11 is highly abused to settle tort liabilities, environmental damage liabilities and to reduce labour costs. (T.C, 1998) It also results in lack of trust between the management and creditors resulting in increased litigation, as the debtors can use, sell or lease the property of the estate in the ordinary course

of business without the approval of the court. Another criticism is the high expenditure and the delay involved in the Chapter 11 process, as it gives 120 day time to debtors after filing for bankruptcy, to propose a reorganisation plan and a further sixty days to get it approved by the shareholders and creditors, which in many cases gets further extended to one or more years.

Prepacks

In US, the pre-packaged bankruptcy filing became popular in the early 1990's, and more than 20 percent of all public bankruptcies had gone into pre-packaged administration by 1993. (M P. , Pre-packaged Asbestos bankrupticies: A flawed solution, 2002)The reorganisation plan proposed by the debtor needs a 90 percent approval by creditors for the prepack to work, which was followed by a Chapter 11 filing. The advantage of the prepack was that ; statutory process was much quicker as negotiations, distributions and voting happens before the bankruptcy case is filed and often with a single hearing by the court, the plan could be approved.Some of the other advantages of pre-packs include its quick process, less professional fees, protection to employee's jobs and full payment to trade creditors. Another advantage is that, as prepacks can be arranged before financial difficulties arise, the company will have resources and will be able to continue its operations.

In US, two legislations were brought to address the Covid-19 pandemic caused business disruptions namely, the Coronavirus Aid, Relief and Economic Security Act (CARES, 2020) and the Covid 19 Bankruptcy Relief Extension Act of 2021. The CARES Act announced a $2 trillion economic stimulus package to businesses and individuals impacted by Covid-19 (T.G, 2022)and also brought several amendments to US Bankruptcy Code in an effort to bring reliefs to small businesses and individuals affected by the pandemic. CARES Act amended the Small Business Reorganisation Act of 2019, to temporarily increase the debt threshold from filing for bankruptcy under the new Subchapter V to protect small businesses. The Covid 19 Bankruptcy Relief Extension Act of 2021 was brought to extend the provisions of the CARES Act which was to end by March 2021, and continued the enhanced bankruptcy protections provided to small businesses and consumers who were hit by the covid 19 pandemic, to one more year. (Amy Quackenboss, 2022) The notable features of the Act include; allowing small businesses to file for streamlined bankruptcy under Chapter 11 proceedings, by increasing the maximum debt limit from $2.7 million to $7.5 million and other significant changes to Chapter 7 and Chapter 13 to provide relief to individuals and families facing financial hardships due to

the pandemic.

An analysis of the US System

An analysis of the US system clearly shows that though the Code is debtor friendly, it also provides ample protection to secured and unsecured creditors.

In the US, position of debtors was similar to that in the UK and they were jailed for defaults, till the beginning of the nineteenth century, when the Supreme Court abolished the imprisonment of debtors against defaults and upheld the constitutionality of such laws. (Omar, 1998)The First Federal Bankruptcy Act of 1800 had many similarities with the UK Act, like: only creditors could bring an action in bankruptcy and only traders could be made bankrupt similar to that in UK.

The earlier institution of floating charge and receivership was not recognised in US compared to that in UK, where this was widely recognised. The floating charge allowed the debtors to use the property in business, over which charge was given to the creditor. The contractual agreements between the debtor and creditor also allowed the secured creditors, the right to appoint a receiver who were given all powers to take over the management of the company in case of a default from the borrower. But these wide powers given only to the creditors with floating charge was not free of abuse as it created instances where the lenders in order to satisfy their interest neglected other creditors interest and even compromised on the possibility of rehabilitating the business.

One of the unique features of the US Bankruptcy Code that-in order to file a case under Chapter 7 or 11, the debtor does not even require to be insolvent, clearly shows a pro-debtor attitude and the legislative intent for rescuing every possible struggling business when it needs help from the system. Another debtor friendly provision of the Code ensures that, minimum three creditors must file an involuntary proceeding against the debtor jointly, with total unsecured claims of not less than $10,000, if he has more than twelve creditors. This section also provides that these claims must not be disputed or should not be a contingent one. If the debtor does not have twelve creditors, then any one or more creditors with a total unsecured claim of $10,000 can file the case under section 303(b)(2). Another important feature which is also noteworthy of the US Code is that, ordinary failure to pay a single creditor is not enough to bring an action against the corporate debtor. All these provisions clearly protect the interest

of the CD as against the UK law which allows any one creditor to bring an action against the corporate debtor for the default of payment of a small amount.

The debtor in possession provision or the DIP is another significant debtor friendly provision of the US Bankruptcy Code that allows the management to continue in possession and control the assets of the company, even after the filing of bankruptcy.This enables smooth functioning of the working of the company as there is no change in management unlike in UK, where it gets transferred to the insolvency practioner and the creditors. Under the Code "the cramdown provision" which allows the court to approve a reorganisation plan even when it's objected by the creditors, also makes reorganisation possible in appropriate cases.

Though the Code is debtor friendly, it also gives ample protection to secured and unsecured creditors. Generally only the debtor can propose a reorganisation plan initially, within 120 days, but the possible delay in bringing this is prevented by giving an option to creditors to file a competing reorganisation plan. The formation of a creditors committee by the US trustee consisting of unsecured creditors who consults the management, investigates the conduct of the management, its business, and participates in the formation of a plan ensures that their interest is duly protected. Mostly, the committee acts as a safeguard against possible abuse by the management who continues in possession, as the committee can hire with the approval of the court, attorney's and other officials to assist them in the discharge of their obligations. Another provision which protects the interest of secured creditors is the requirement of their approval for adopting the reorganisation plan. Under this provision the plan needs the approval of majority and two third in value of the creditors of each class, to approve the reorganisation plan. Even impaired class of creditors must approve the plan and unsecured creditors can insist that they will approve the plan, provided the shareholders should not be given anything, as per the order of priority. The dissenting creditors are protected by the 'best interest test' by which each creditor will receive a value not less than the liquidation value and a 'feasibility test' which ensures that company must be able to comply with the promise it makes in the plan and ensures protection to them.

A COMPARISON BETWEEN THE UK AND THE US JURISDICTIONS IN MATTERS RELATED TO THE RESOLUTION AND INSOLVENCY PROCESS OF COMPANIES.

Firstly, in highlighting the differences between the United Kingdom and the United States it is

emphasised that the usage of the word 'insolvency and bankruptcy' itself is used in different contexts in these two prominent jurisdictions. (McCormack G, 2007) While in the UK, the word insolvency is used to refer to corporate insolvencies and bankruptcy refers to individuals, in the US Bankruptcy Code, the word bankruptcy covers both corporates and individuals. (R.Franks, 1996)

Secondly, in comparing the corporate insolvency process in these two main jurisdictions the universally recognised test adopted by Philip Wood is followed, to analyse the substantive and procedural aspects followed by these jurisdictions in relation to corporate insolvency, namely- the entry criteria for insolvency, the insolvency test that is adopted, how rescues are dealt, insolvency process that is involved, whether there is due protection of creditors rights and to business and whether there is provision for renegotiation of existing liabilities. (Philip R. Wood, 2007)

The criteria for filing an application for insolvency

Under the first category of the entry criteria for insolvency, two aspects that have to be considered are; proof of insolvency and the claimants who are entitled to apply for insolvency proceeding. While the US Bankruptcy Code do not require insolvency or near insolvency of the company to file a voluntary petition under Chapter 11 proceedings (which aims at reorganisation of business), the involuntary provision which allows creditors to file, protects the debtor, as it does not allow a single creditor from bringing a petition against the company nor can they bring action for a single default, unless it falls under section 303(b)(2).576 However in comparison, the UK insolvency framework allows a single creditor to file for insolvency, but only in cases where the company does not pay or is likely to default (which is a negative result of both "cash flow and balance sheet test") or if administration is necessary.

With regard to the claimants who can apply for insolvency proceedings in UK generally the company, directors and creditors are eligible, but not a shareholder. Shareholders may initiate a winding up which is more related to a liquidation proceeding and not a corporate rescue. Similarly, when there is public interest involved, a government official and in case of failure of a bank or insurance, concerned regulators can also initiate an insolvency proceeding. In the US; the debtor, creditor, shareholder and courts can file for Chapter 11 reorganisation.

There are also two divergent tests adopted by these jurisdictions as proof of insolvency- namely

the "balance sheet test and the cash flow test" which is explained in detail below.

The test adopted- Cash flow test or balance sheet test?

In arriving at the question of insolvency, generally there are two tests that is followed globally- the "cash flow test and the balance sheet test". But it is important to understand that they do not give a conclusive answer on whether the company is insolvent as both tests differ drastically in its application. (G T. P., 2010) While the cash flow test or the commercial insolvency test relies on the company's inability to pay debts, the balance sheet tests assess whether the company's liabilities exceed its assets.

Under the cash flow test, the companies' inability to pay its debts when it falls due, may indicate a financial distress as indicated by the Staughton L.J in Taylors Industrial Flooring Ltd v. M & H Plant Hire Ltd, where the creditors were allowed to file an insolvency petition. In order to establish insolvency under the second test, an accurate valuation of company's assets and liabilities must be undertaken; including its current, contingent and prospective liabilities. (S.M, 2021) The difference between a prospective liability and a contingent liability was clarified in two important judicial decisions. While Re Dollar Land Holdings Plc held that prospective liability includes a binding liability that is not yet matured as in the case of an obligation to repay a loan, the decision in Winter v. IRC clarified that a contingent liability depends on an event to occur, which triggers repayment and its enforceability.

In US, the practise is to follow the balance sheet test and that is probably the reason for more liquidation proceedings under chapter 7 compared to the volume of cases brought under Chapter 11 for reorganization of business.

The cash flow test has a broader application in UK. But the Insolvency Act of 1986, do not mention how valuation of contingent liabilities are conducted nor whether valuation of a business is "as a going concern" or whether the assets are being sold separately.

Rescue, the ease of entry into the proceedings

Protecting a viable business and debt realisation to creditors are the twin challenges of any bankruptcy regime. In order to realise this, the process by which a business is selected for protection and how the business is managed becomes paramount.With regard to both these aspects the US and the UK follow divergent views. In the US, Chapter 11 proceedings can be

initiated by any business by filing an application in the local bankruptcy court. While this liberal provision is useful for all businesses which genuinely needs rescue, it can also be misused by fraudulent promoters to alter their contractual commitments, though this is considerably reduced by the right to litigation. In UK, the decision to select a business for protection is made by the judge based on the documents prepared by accountants.

In the US, while the existing management can continue management of the business even after bankruptcy filing, in UK the control is passed to an administrator who is a qualified and is an experienced insolvency professional under the court monitored administration process

Liquidation and running the entity as a going concern

The objective behind Chapter 11, being to preserve the company and run it as a going concern, the US Bankruptcy Code provides every opportunity to the companies to achieve this objective by allowing them to continue running the company, and preserve the value of the entity by managing its debts through court supervision. Though this helps in saving viable entities it also has the risk of preventing creditors from getting the liquidation value in cases where the company incur further loss.

In UK as the process is pro-creditor, creditors will decide whether the company should go into liquidation and this usually occurs when the liquidation value is higher than the fair value of the entity. While this protects the interest of creditors the disadvantage is that, viable entities could be pushed to liquidation as the creditors could only look at realising their personal rights and the entity would not be saved or rehabilitated

Moratorium and stay of creditors claim

In UK though it follows a creditor friendly approach, the administrator can stay or delay the claims of creditors and can stay interest or repayment of loans of the CD as he represents the interest of all creditors compared to a receiver. This is also one way by which the assets of the debtor are preserved under the UK law. Under the US bankruptcy Code which follows a pro-debtor approach, the company is protected from all attachment claims of the creditors as there is an automatic stay of creditor claims and the company gets a breathing time till a reorganisation or sale is arranged under Chapter 11 proceedings.

Whether the right to manage business is with the corporate debtor or with the creditor?

The US Bankruptcy Code follows the DIP model. This arrangement allows the promoters to continue in the management of the company and helps them to continue run the business which is already under considerable stress. It is also good for the company, as its equity value is preserved because of the same management continuing. The main disadvantages of this model are that, it could lead to syphoning of assets by unethical promoters in the management, resulting in loss to creditors. But this is considerably prevented by ensuring that, the management of the company, selling of assets, raising further capital for business and other related functions of the management is strictly monitored by the US trustee and the courts. Under Chapter 11 of the US Bankruptcy Code, the management has also exclusive rights till a particular period of time and has the first preference to propose a reorganization plan.

The United Kingdom on the other hand, follows the creditor in control model. In UK, the control of the company is no more vested with the erstwhile management and it passes to a receiver. Before the passing of the Insolvency Act of 1986, the three possible options available to the parties in a corporate insolvency were- liquidation, receivership and company voluntary arrangements. The 1986 Act brought administration also as a formal route for reorganization of business. Under the pre-1986 era, an exclusive right was given to a secured creditor with a floating charge, who may not be duty bound to take in account the interests of other creditors and could appoint a receiver who had ultimate control over the entity. The receiver did not require the permission of the court or other creditors to decide on matters related to resolution and even had powers to cancel the contracts the company had with its suppliers resulting in many infringements. But the receiver will not be able to get control of the assets on which a secured creditor has a lien, even if he wishes to run the company. The Insolvency Act, 1986, brought administrators to carry out corporate insolvencies, who could be appointed only with the order of the court and only in possible cases of running the entity as a going concern.

Priority List and order of claims

Generally in an insolvency whether corporate rescue or liquidation, as the assets are not enough to pay all, often everyone's interest may not be adequately protected and it is important to justify this discrimination and inequality through some very clearly laid down logical provisions. In most cases the priority rules framed under liquidation is also followed in reorganisations. The usual ladder of priority followed is- first the super priority creditors, followed by priority creditors, then the pari passu creditors, then subordinated creditors,

followed by equity shareholders and expropriated creditors. While the super priority creditor list includes secured creditors and title finance creditors, the priority creditor list includes the taxes, employee remuneration and administrative claims. The pari passu creditors include the unsecured creditors of the insolvency company who are paid only after paying the first two categories. The subordinated creditor category includes creditors who are subordinated due to reasons like misconduct. While equity creditors are those whose debts resemble shares the expropriated creditors include late claimants, tort claimants and in some cases foreign revenues and penalties who are not even eligible to claim in bankruptcies.

In US under Chapter 11 proceedings, the secured creditor ranks first, but subject to post commencement finances. Unpaid federal taxes and employee priority comes only after ensuring secured creditors interests. Regarding unsecured claims, first priority is given to administrative expenses followed by employee benefits plans, various taxes, customs duty and other personal injury claims. Tort obligations come under general unsecured claims and claims subordinated by agreement, rank below general unsecured claims. In UK fixed charge holders have the first priority and the order usually followed after the fixed charge holders is administration expenses, claims of preferential creditors including employee remuneration, ring fencing amount by the administrator to unsecured creditors,floating charges, taxes and obligations to pension trustees followed by subordinated claims and equity.

Another significant practice that is observed in US and UK is that, both in judicial rescues and private work outs there is reversal of these legal priorities and trade creditors who otherwise rank equally with banks, often getting paid first, mainly to facilitate continuation of the business.The argument in giving top priority to the trade creditor is; they supply goods to keep the business afloat, so that debtor can pay early and they are more vulnerable to the cascading effects of bankruptcy.

Management of Insolvency Proceedings

While in every proceeding of liquidations there is the presence of a liquidator in charge of management of the company and transfer of power from the management to the liquidator, it is very different in reorganisations. In UK, the management of insolvency proceedings is vested still with states and often an official receiver or a government official manages the proceedings. In an English administration, business is run by the administrator who is in control and has the power over management of the company. An administrative receiver does not owe a duty of

care to each individual creditor but his duty is to the company as a whole. In case of a company voluntary arrangement, management stays in control but is under the supervision of the insolvency practioner.

In the US, the power of Securities Exchange Commission to manage reorganisation of public companies was dropped in 1978 but the State has retained the quasi-control of bank insolvencies which are exclusively run by the Federal Deposit Insurance Corporation. US follows the DIP model, where the company management remains in power. This was introduced to encourage businesses to use formal reorganisation process compared to private workouts. The Code also has provisions to control misuse of power by the existing management, as a creditors committee comprising of unsecured creditors could be appointed by the US trustee with investigative powers and there are provisions for displacement of management, by a court appointed trustee.

Another issue is related to; who manages the insolvency proceedings- whether by ordinary commercial or company courts or special bankruptcy courts? While it is managed by ordinary commercial or company courts in Britain, special courts or tribunals are constituted in US for this purpose.

Renegotiation of liabilities

In UK as the administrator is appointed by the court, the administrator has to get the permission of the court and of all the creditors in incurring new loans and in renegotiating existing liabilities. Generally, the administrator can pay off liabilities if its beneficial to the administration and approved by the court. In US, as there is a lot more flexibility, when the administrator decides to run the company as a going concern, he can raise fresh loans, by getting an approval from the court and with an approval of seventy-five percentage of the creditors.

CONCLUSION

To conclude it needs to be established whether the insolvency regimes of these two jurisdictions balance the interest of the creditors and the debtor in a corporate insolvency. In order to achieve this objective, it will only analyse the rescue provisions and not the liquidation processes of these jurisdictions as the primary research is on resolution process.

In UK there are both formal and informal corporate rescue processes under the Insolvency Act, 1986 and the Enterprise Act, 2002. The popular formal routes include the administration order, company voluntary arrangements and pre-packs while the informal ones include work outs and other voluntary agreements with creditors.

The formal routes adopted in UK, generally takes a creditor lenient approach by ensuring that even rescue process like administration orders are allowed only if it provides better realisation to secured creditor interests rather than prioritising on the rescue of the company. Though administrative receiverships by floating charge holders were banned by the Enterprise Act, provisions are retained for bankers to appoint receivers if required. Both the administration order and the CVA requires an insolvency professional to take control of the process. In administration, the management and control pass to the insolvency professional and creditors while in CVA, a debtor in possession approach is followed but is closely monitored by the insolvency professional and any plan for compromise need to be approved by the majority of creditors. Unsecured creditors are often protected by the 'ring fencing' practise where the administrator is duty bound to set aside a percentage of amount for them that is realised from floating charges. The provision of application of moratorium with the commencement of the administration order and CVA clearly brings out the limited pro debtor provisions and the prevalent creditor friendly provisions under the UK law. The Insolvency Act of 1986 provides only a limited moratorium of twenty business days to the debtor under an application from its directors.It allows for an extension for a further period either with the consent of creditors or without creditor consent on an application to the court after fifteen days of commencement of the moratorium. While the moratorium gives some relief to the debtor, by restricting petitions for winding up of the company, orders for winding up except by the directors appointment of receiver by creditors preventing the company from entering into any market contracts, granting any security over its property, paying pre-moratorium debts and disposing any property it also protects the interest of creditors. Debtor protection was brought to the forefront by the changes brought by the Enterprise Act 2002, which shifted focus from creditor protection to rescue of viable companies. While limited interference by courts ensures a quicker administration process, management by professionals who are insolvency practioners, assures an efficient and unbiased process.

With the growing popularity of the pre-packaged administration process which ensures a debtor in possession, transparent, cost efficient, quick and timely process it can be stated that there is

a balance in protecting the interest of both secured, unsecured creditors and debtors in UK, as there is more emphasis on corporate rescues in the current insolvency frameworks.

In comparison to UK the bankruptcy framework in US is more streamlined and court monitored. Though US follow a pro debtor approach it also gives ample protection to creditor rights. The fact that Chapter 11voluntary proceeding can be initiated by a debtor even when there is no insolvency or near insolvency is the most important feature of the US Bankruptcy Code which aims solely at corporate rescue. The DIP or the debtor in possession is another unique feature of US bankruptcy code, which gives control and power to the existing management even during a chapter 11 proceeding, to facilitate continuation of business. The provision of stay of creditor claims through moratorium is also present. As the focus is on reorganisation, it is ensured that all provisions are present in law to realise this objective. The 'cramming down' provision is an excellent example for this, which ensures that if creditors do not approve a genuine reorganisation plan, courts can approve it, subject to the satisfaction of some conditions, that ensures protection to those creditors also. The requirement that there should be constitution of a creditors committee comprising of unsecured creditors with voting rights, who monitors the actions of the management and the continuous supervision by the US trustee and court prevents abuse of power, if any, by the management. Further, the approval of the reorganisation plan by creditors and their right to propose another plan in case of delay also protects the rights of creditors. As the US follows a thorough court monitored process and have constituted specialised courts with judges who have expertise in bankruptcy cases, there is better efficiency and faster disposal of cases.

As far as balancing the interest of secured, unsecured creditors and the debtor is concerned, the bankruptcy framework of US and UK can be regarded as a satisfactory one as both regimes have provisions for protecting the rights of both the creditor and the debtor.

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