Company reorganisation—a comparison of practice in the United States and the United Kingdom

Note of an occasional paper published by the Bank

The Bank published on 21 February an occasional paper, 'Company reorganisation: a comparison of practice in the United States and the United Kingdom'. The paper describes the essential features of US procedures for dealing with insolvent companies, and discusses their possible relevance to the United Kingdom. Copies are available from the Bank at the address given on the reverse of the contents page in this *Bulletin.*

In this country, the affairs of insolvent companies are usually dealt with by a receiver and manager appointed by a bank under its floating charge; such charges are commonly given as security for lending and confer wide powers on the lender. In recent years the receivership system has come under some criticism; it has been described by some as taking insufficient account of the interests of unsecured trade creditors, and as being somewhat inflexible, in that the receiver's overriding duty is to the bank holding the floating charge, for whom he attempts to secure the maximum possible recovery as rapidly as possible. Although receivers do in practice take account of the other creditors' interests, there have been suggestions that, particularly where larger companies are concerned, a procedure analagous to the US Chapter 11 system might be more equitable between secured and unsecured creditors, and more constructive, in the sense of preserving more viable business assets.

The Cork Report[1] made proposals for clarifying the fiduciary nature of the receiver's duties and for improving the lot of the unsecured creditor: in particular, it suggested that they should receive 10 per cent of the recoveries made under any floating charge, and that the extensive preferences presently accorded to Crown claims should be reduced, a measure that could assist both secured and unsecured lenders. It also proposed that provision be made for appointment by the court of an administrator—with powers similar to those of a receiver—who would manage the affairs of a company facing acute financial pressures and develop, if possible, an appropriate reorganisation plan. The committee envisaged, however, that administration would be available only where there was no floating charge or where the holder of such a charge agreed. This limitation would probably reduce its availability, as in circumstances where an administrator might be appointed the secured lender would often wish to enforce his security and appoint his own receiver; and it could also result in banks being more reluctant to lend unsecured.

An important difference between the UK system and Chapter 11 practice is that under the latter the courts may in some circumstances override the rights of secured creditors; and in the formulation of a reorganisation plan, to which the Chapter 11 system is directed, it is possible for unsecured creditors and even for shareholders to have a much larger influence than is the case in the United Kingdom. Chapter 11 also allows for more continuity, in that existing management may remain in place and play some part in developing and implementing any reorganisation plan. Chapter 11 may also give more time for such a plan to be prepared. Advocates of a similar system in the United Kingdom see these as significant benefits.

The Cork Report did not discuss the merits or otherwise of US practice. One purpose of the paper issued by the Bank is to provide, for a UK audience, an account of the Chapter 11 system and its practical operation; it reflects discussion with practitioners on both sides of the Atlantic. The paper also offers a preliminary assessment of the possible merits of Chapter 11. It observes that in practice Chapter 11 is complex (involving extensive recourse to the courts) and costly; receivership, by contrast, normally involves no court process and is generally straightforward and relatively inexpensive. The paper goes on to suggest that there is no *prima facie* reason why Chapter 11 should be more effective than receivership in preserving viable business assets, or why a UK receiver, or those to whom he disposes of the underlying business of a company, should be less successful than the management of a company under the Chapter 11 process.

There may be benefits to shareholders and unsecured creditors in the Chapter 11 approach, but these need to be set against the possible impact on secured bank lenders, whose interests would probably be impaired by any move towards such a system and whose attitude to lending at an earlier stage might therefore be affected. Some benefit might be gained from a system which provided for a moratorium on payment of debts to allow time for a reorganisation plan to be developed; but if such a system were to involve any restraint on the exercise by banks of their security rights (as it would have to do, to be effective) it could make banks less willing to provide finance for companies in actual or potential difficulty, possibly precipitating failure at an earlier stage.

(1) Report of the *Review Committee on Insolvency Law and Practice*, HM Stationery Office, Cmnd 8558, June 1982.