The Nature and Purpose of Transaction Avoidance in English Corporate Insolvency Law

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Introduction

1 Insolvency law without any rules on transaction avoidance is conceivable, but unlikely to be found in practice. Rules on transaction avoidance were a feature of Roman law and rules, which differ in detail but which serve broadly similar purposes, are a feature of all developed legal systems.

2 In terms of English legislation, laws on transaction avoidance came earlier than our first insolvency statute. Thus an enactment in 1376, during the reign of Edward III, provided that property given by debtors to friendly third parties remained available to be taken in execution by the debtor’s creditors,¹ whereas the founding statute providing for a bankruptcy law was not enacted until 1542, during the reign of Henry VIII.² This neatly illustrates a point which remains equally true today, namely that transaction avoidance overlaps with insolvency law but can go wider. Thus, notably, section 423 of the Insolvency Act 1986 “Transactions defrauding creditors” can be invoked by a victim of the transaction even though no insolvency proceedings are taking place.³ Of course, transaction avoidance in the very widest sense takes in rules which have nothing to do with questions of solvency (for example the rules on contracts procured by mistake or misrepresentation and some of the provisions of the Companies Act 2006 regulating transactions by and with directors), but the focus of this article is on rules the application of which is predicated on actual or anticipated insolvency.

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¹ 50 Ed 3 c6 “Fraudulent assurances of land or goods, to deceive creditors, shall be void”.
² 34 and 35 Hen 8 c4 “An act against such persons as do make bankrupts”.
³ Section 424, Insolvency Act 1986.
3 Any examination of the nature and purpose of insolvency transaction avoidance necessarily requires clarity as to which rules are being considered. For the purposes of this paper, insolvency transaction avoidance covers all rules whereby consensual dealings which would otherwise be binding on a company and its counterparty may be rendered ineffective, set aside or adjusted by reason of factors which include the actual or anticipated insolvency of the company. The most obvious examples of such insolvency-related rules are those concerning preferences, transactions at an undervalue and transactions defrauding creditors, but the rules are more far-reaching than that. They include rules on post-commencement dispositions, transactions offending anti-deprivation and pari passu principles, unenforceable securities, extortionate credit and disclaimer.

4 The temptation to identify transaction avoidance rules narrowly must be resisted. Disclaimer is the example which makes the point. Amongst other things, the rules on disclaimer enable a liquidator to procure the discharge of the company from its obligations under an unprofitable contract. Although different in function from, say, preference rules, disclaimer in every sense results in a transaction which would otherwise be binding on a company being set aside in consequence of its insolvency and such a transaction is therefore a vulnerable transaction. A narrow focus on only those rules which are concerned with clawing back assets into the insolvent estate encourages circularity of reasoning, whereby those rules are analysed so as to demonstrate that the restorative function is itself the rationale of all transaction avoidance rules, which therefore do not include rules which do not have a restorative function – a self-fulfilling analysis.

5 Before considering the actual grounds for transaction avoidance in English insolvency law, it is convenient to consider the sources of the rules which are the subject of this article. Insolvency transaction avoidance has common law origins, but has long since been largely the preserve of legislation (now the Insolvency Act 1986). After the statutes of Edward III and Henry VIII already mentioned, stronger measures were enacted during the reign of Elizabeth I. The answer to the question of how far, if at all, common law transaction avoidance now survives, is that there is no room for discrete common law avoidance in any area covered by the provisions of the Insolvency Act 1986, but that there is a continuing role for the

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4 The requirement for the rule to bite on consensual dealings excludes, for example, section 183 avoiding the effects of an incomplete execution.
5 For an explanation of all these terms, if unfamiliar, see “Grounds for avoidance” below.
7 13 Eliz I c5 “An act against fraudulent deeds, alienations, etc.” and 13 Eliz I c7 “An act touching orders for bankrupts”. The former statute dealing with transactions defrauding creditors remained in force until superseded by section 172, Law of Property Act 1925.
common law in matters where the Act is silent, notably the anti-deprivation rule and the pari passu principle, both of which can prevent the operation of contractual arrangements which would otherwise bind the estate.

6 The position is different in Scotland. The survival of Scottish common law rules on transaction avoidance was explicitly confirmed by the Inner House of the Court of Session in Bank of Scotland v Pacific Shelf (Sixty Two) Ltd, where the court held:  

“We have no doubt that the petitioners have the rights of creditors at common law. The common law conferred upon creditors the right to challenge certain actions by their debtors. There is no reason in principle why, after 1856, this right should not, in the absence of statutory provision to the contrary, have been available against debtors who happened to be limited companies. We are in complete agreement with the opinion of the Lord Ordinary that this right has survived successive statutory enactments regulating the affairs of limited companies. As my Lord in the chair pointed out in the course of debate, it would not have been difficult to restrict the common law rights of creditors in clear language if that had been the intention of the legislature. In our opinion those rights could only be abrogated by clear statutory provision or necessary implication. We were not referred to any such statutory provision and the implications point in the opposite direction. It was said by way of criticism of the petitioners that they were unable to found on any relevant authority. Be that as it may, the obvious answer to that criticism is that the soundness in law of the basis of the petition is clear beyond argument.”

7 The English approach has been to treat the common law as a guide to the interpretation of statutory provisions which have replaced it. This can be demonstrated by reference to the rules on preference, where there was a developed common law jurisdiction in bankruptcy prior to statutory intervention and where there is some pertinent high authority on the continuing role of common law. The first legislative statement of the preference rule was section 92 of the Bankruptcy Act 1869.  

“Although the Bankruptcy Act, 1869, is the first statute which contains an express and direct enactment on the subject which has long been known and called and dealt with by the name of ‘fraudulent preference’, and although that statute lays down the law in phrases not used in the preceding statutes, I have no reason to think it introduces any new principle applicable to the subject.”

8 In Butcher v Stead, the issue was the statutory defence of a bona fide purchaser as to which Lord Cairns said in the House of Lords.  

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9 The Joint Stock Companies Act 1856 and successive Companies Acts from 1862 until 1985 simply applied the bankruptcy law on preferences.
10 (1871) LR 12 Eq 358, at 363.
11 (1874-75) LR 7 HL 839, at 846.
There is no doubt that the 92nd section of the Act of 1869 introduced a considerable change into the law on this subject. Before the Act of 1869, payments by way of fraudulent preference were held to be void, but were not forbidden by any express enactment; and the Act of 1869... appears, in the case of fraudulent preferences and many other similar cases, to have endeavoured to reduce into definite propositions the law that hitherto had to be derived from a comparison of decided cases. The Act, however, did not profess to express the existing law without making considerable changes in it. In the case of fraudulent preference, for example, in place of raising an inquiry whether it was done in contemplation of bankruptcy, the Act provided certain definite tests, namely, that the bankrupt should have been at the time unable to pay his debts, as they became due, from his own moneys, and that he should become bankrupt within three months from the date of payment. The Act appears to have left the question of pressure as it stood under the old law; and, indeed, the use of the word ‘preference’, implying an act of free will, would, of itself, make it necessary to consider whether pressure had or had not been used...

The court went on to give effect to the new statutory defence. The House of Lords took the same interpretative approach in Sharp v Jackson. The approach of the English courts was therefore to treat the preference legislation as a partial codification and to have regard to common law in its interpretation but not to treat the common law as continuing to provide an alternative remedy to which the statutory defence was not applicable.

A much more modern example of the same approach is the decision in 1997 of the Privy Council in Lewis v Hyde, an appeal in which the issue was whether the New Zealand preference rules could be engaged in the absence of any actual preference. Lord Browne-Wilkinson, delivering the judgment of the Board, said:

“If the statute does not purport to state the whole law comprehensively, the basic common law assumption that an actual preference is necessary, which Lord Mansfield CJ plainly thought necessary, survives in the common law. The progression is as follows: Lord Mansfield CJ plainly treated an actual preference as a requirement; section 92 of the Act of 1869 was not a comprehensive code regulating fraudulent preference but to the extent that it was silent on the matter left the common law standing; the later statutory provisions (both in England and New Zealand) are simply re-enactments of section 92 of the Act of 1869 and must therefore receive the same construction. Therefore the common law rules of fraudulent preference which only applied where there had been an actual preference remain the law.”

Quite apart from authority, there are some notable differences between Scottish and English law which justify the fundamentally different approaches adopted within those jurisdictions. First, the relevant provisions of the Insolvency Act 1986 dealing with preferences and transactions at an undervalue are themselves different. Whereas in England only the office-holder may make an application, in Scotland creditors can apply and the office-holder is said to have the same rights as creditors. Secondly, the English rules are more detailed and, apparently,
The purpose of such rules, if co-existing with an undefined general common law jurisdiction, would be very questionable. Thirdly, there was a highly material difference in the preceding legislation. In its application to Scotland, section 320(3) of the Companies Act 1948, which remained in force in both jurisdictions until 1 July 1985, had expressly preserved Scottish common law rules in relation to fraudulent preferences without making any equivalent reference to English common law.¹⁶

12 As to the residual importance of common law as a guide to interpretation in England, it is thought that the English rules are now so detailed and comprehensively stated as to make recourse to pre-1869 case law unnecessary, so that its preservation in Lewis v Hyde is of no more than academic interest. The position is otherwise, however, in respect of those rules on transaction avoidance which are not codified. As stated, the most obvious examples are the rules on anti-deprivation and pari passu distribution. Common law also survives in the fiduciary duties of directors (despite the general codification of those duties in the Companies Act 2006). Although transaction avoidance and directors’ fiduciary duties are conceptually distinct, there is, in practice, a measure of overlap because breach of fiduciary duty can result in the recovery of property from directors and even, subject to defences, from third parties. In this connection, the courts are not constrained by the limits of statutory transaction avoidance. The interaction of common law duty and transaction avoidance was examined by Newey J in GHLM Trading Ltd v Maroo where he said:¹⁷

“A director of a company has a duty to act ‘in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole’ (see s172 of the Companies Act 2006). Where creditors’ interests are relevant, it will similarly, in my view, be a director’s duty to have regard to the interests of the creditors as a class. If a director acts to advance the interests of a particular creditor, without believing the action to be in the interests of creditors as a class, it seems to me that he will commit a breach of duty. Whether or not s239 of the Insolvency Act 1986 (dealing with preferences) is in point cannot be determinative…the fact that the conditions laid down by s239 are not all met should not, of itself, preclude a finding of breach of duty.

On the other hand, the applicability of s239 of the 1986 Act may have a bearing on what, if any, remedy is available in respect of a breach of duty…

It seems to me that a company seeking redress in respect of a ‘preference’ to which s239 does not apply is likely to need to show: (a) that it has suffered loss, (b) that the director has profited (so that the ‘no profit’ rule operates), or (c) that the transaction in question is not binding on the company. In a typical case, the first of these may be impossible: if the ‘preference’ involved the discharge of a debt, the company’s balance sheet position is likely to be unaffected. The second might well also be problematic if the company has not entered an insolvency regime. If, say, the ‘preference’ involved the discharge of a debt owed to a

¹⁶ The relevant words were not repeated in section 615, Companies Act 1985, which took effect on 1 July 1985, but the Bankruptcy (Scotland ) Act 1985 amended the Companies Act 1985 with effect from 1 April 1986 to introduce the analogues of sections 242 and 243 of the Insolvency Act 1986.

¹⁷ [2012] 2 BCLC 369, at [168]-[172].
director, it could be hard to say whether or to what extent the director was better off than he would have been had he still been owed the money by the company.

As for whether the transaction is binding, ordinary agency principles indicate that a company can disavow a contract which a director has caused it to enter into if: (a) the director was acting in his own interests rather than those of the company, its members or (where appropriate) its creditors as a class, and (b) the other party to the contract had notice of the director’s breach of duty... The transaction may also be open to challenge on equitable principles...

The better view appears to be that, where a director has caused his company to enter into a contract in pursuit of his own interests, and not in the interests of the company, its members or (where appropriate) its creditors as a class, and the other contracting party had notice of that fact, the contract is void rather than voidable... On this basis, it is hard to see how it could matter whether the requirements of s239 of the 1986 Act are satisfied.

Were the relevant contract not void but voidable, the applicability of s239 would still be of no obvious significance."

13 Although this is transaction avoidance in the sense that it has a restorative function and, if successfully invoked, produces comparable results, it is distinguishable in that claims resulting from breach of fiduciary duty do not necessarily have any connection with solvency issues. Where, as in the case of GHLM Trading Ltd v Maroo, the claim arises out of a breach of the duty of the directors of an insolvent company to have regard to the interests of its creditors, the connection is merely circumstantial.

Grounds for Avoidance

14 It is not the purpose of this article to examine the detail any of the rules whereby transactions are rendered vulnerable by reason of insolvency considerations. It is, however, necessary to identify those rules before proceeding to consider their general nature. For this purpose, the rules have been divided into three groups according to their function. Reference has already been made to rules with a restorative function, i.e. rules which enable office-holders appointed in formal insolvency proceedings to have pre-proceeding dispositions set aside and thereby recover assets for the estate which had ceased to be the debtor’s property. These are grouped together as “Restorative” rules in the list which follows. There are, however, other, logically anterior, rules which function so as to prevent the outflow of property from the estate and these are called “Retentive” rules. Finally, there is disclaimer which is, in many ways, anomalous because it operates so as to divest the estate of onerous property and is thus labelled “Dispositive” below.
15 With that brief introduction, the eleven rules (applicable in corporate insolvency),\(^\text{18}\) which may result in pre-insolvency transactions being rendered ineffective, set aside or adjusted, are those dealing with:

A. Retentive

1. Post-commencement dispositions;
2. Transactions offending the anti-deprivation rule;
3. Transactions offending the pari passu principle;
4. Late floating charges;
5. Unregistered charges;
6. Liens on books and records;

B. Restorative

7. Preferences;
8. Transactions at an undervalue;
9. Extortionate credit transactions;
10. Transactions defrauding creditors; and

C. Dispositive

11. Onerous property.

16 These are all rules of general application. (In addition, the Pensions Regulator has powers under the Pensions Act 2004 to take action in respect of transactions at an undervalue and transactions defrauding creditors where there are pension scheme deficits, but those powers exist for the benefit of the members of the scheme and are therefore distinguishable from the rules under consideration in this paper.)

17 In order to consider whether these are more than a miscellany of rules devised to counter a series of specific mischiefs without forming constituent parts of a coherent whole, it is necessary to add a little colour to the bare identification of the rules. Taking each in turn and attempting only the highest level summary:

1. **Post-commencement dispositions.**\(^\text{19}\)

Any disposition of a company’s property after the commencement of its winding-up by the court is void unless the court otherwise orders. Beneficial ownership reverts to the company but the liquidator may need to take action to recover legal title. Any relevant security interests granted by the company will bite on the recovered property.

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\(^{18}\) Despite a large measure of overlap, the equivalent list in personal insolvency is different in some respects.

\(^{19}\) Section 127, Insolvency Act 1986. The rule is necessitated by section 129 which provides that a winding-up by the court is deemed to have commenced on the presentation of the petition. There is no need for an equivalent provision in respect of voluntary liquidation which does not commence until the winding-up resolution is passed (section 86). The rule also has no application to administration.
2. **Transactions offending the anti-deprivation rule**

Agreements which purport to remove an asset from the debtor company’s estate in the event of insolvency proceedings are void. The rule is triggered by a deliberate intention to evade the operation of the insolvency scheme and it applies automatically from the commencement of insolvency proceedings. The rule prevents an outflow of value and therefore operates for the benefit of creditors holding security on the assets.

3. **Transactions offending the pari passu principle**

Agreements which would result in the debtor company’s estate being distributed amongst its creditors otherwise than in accordance with the statutory scheme are also void. This rule, which is related to the anti-deprivation rule in that they are both sub-sets of the more general prohibition on contracting out of the insolvency scheme, is concerned with effect not motivation and is not engaged unless and until the relevant procedure has become distributive in character (i.e. from the outset in liquidation but not until notice of a proposed distribution has been given in the case of administration).

4. **Late floating charges**

Charges granted by insolvent companies which, as created, were floating charges are invalid except as security for new value if granted within 12 months of the onset of insolvency proceedings (2 years if in favour of a connected person). The charged assets remain subject to any other (valid) security granted by the company.

5. **Unregistered charges**

With limited exceptions, mortgages and charges created by debtor companies are void against liquidators, administrators and other secured creditors if not registered within 21 days of their creation. The charge remains valid as against the company itself and the liability secured by the charge is accelerated. The charged assets remain subject to any other (valid) securities granted by the company.

6. **Liens on books and records**

Liens on book, papers and records (but not title documents) are unenforceable against administrators, liquidators and provisional liquidators (but other proprietary rights are unaffected).

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20 Consider: *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Services Ltd* [2012] 1 AC 383 (SC); *Revenue and Customs Commissioners v Football League Ltd* [2013] 1 BCLC 285.

21 Idem.

22 Section 245, Insolvency Act 1986.

23 The phrase “onset of insolvency proceedings” is an over-simplification, which is used for convenience in this paper. The phrase used in the Act is the “onset of insolvency”, which is very precisely defined in sections 240 and 245 to cover various different circumstances applicable to the commencement of insolvency proceedings.

24 Section 859H, Companies Act 2006.

25 Section 246, Insolvency Act 1986. Such liens will most likely arise by operation of law. Where that is the case, it might be said that the lien is not a consensual dealing but section 246 warrants inclusion in this list of insolvency transaction avoidance rules because the parting with possession which gives rise to the lien will have been consensual even if the parties may not have had the creation of security in contemplation.
7. **Preferences**

An administrator or liquidator can apply to the court for an order restoring the *status quo ante* if an insolvent company does something or suffers something to be done which has the effect of putting one or more of its creditors in a better position than that which he or they would have had in an insolvent liquidation and the company was influenced by a desire to produce that effect. There is a rebuttable presumption of the requisite desire where the creditor is a connected person. The preference must have occurred within 6 months of the onset of insolvency proceedings unless it was also a transaction at an undervalue or the preference of a connected person, in which case the period is 2 years. Any recoveries are made for the benefit of the general body of creditors and are not caught by any security granted by the company.

8. **Transactions at an undervalue**

An administrator or liquidator can apply to the court for an order restoring the *status quo ante* if an insolvent company if the company makes a gift or enters into some other form of transaction under which the consideration it receives is worth significantly less than that which it provides. There is a rebuttable presumption of insolvency where the transaction is with a connected person. The transaction must have occurred with 2 years of the onset of insolvency proceedings. No order can be made if the transaction was entered into in good faith for the purposes of carrying on the company’s business and there were reasonable grounds for believing that it would benefit the company. Any recoveries are made for the benefit of the general body of creditors and are not caught by any security granted by the company.

9. **Extortionate credit transactions**

An administrator or liquidator can apply to the court for an order setting aside or varying a transaction involving the provision of credit to the company (and repayment of money paid or an account) if the terms required the company to make grossly exorbitant payments or otherwise grossly contravened fair dealing principles. There is a rebuttable presumption that the transaction was extortionate. The transaction must have been entered into within 3 years of the company going into administration or liquidation. In principle, any recoveries should also form part of the general estate.

10. **Transactions defrauding creditors**

An administrator, liquidator, company voluntary arrangement supervisor and a “victim” of the transaction can all apply to the court for an order restoring the *status quo ante* and protecting the interests of the victims, if a company enters into a transaction at an undervalue for the purpose of putting assets beyond the reach of present or future creditors or otherwise prejudicing their interests. Any application is made on behalf of all the victims.

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28 Section 244, Insolvency Act 1986.
30 The term is defined in section 423(5).
11. **Onerous property**

A liquidator may, by notice, disclaim any unprofitable contract or unsaleable property. The disclaimer ends the obligations of the company but only affects others to the extent necessary to achieve the release of the company. Anyone suffering loss as a result of the disclaimer can prove in the liquidation.

18 Even the foregoing highly abbreviated summary reveals profound differences in both the availability and nature of the eleven different ways in which pre-insolvency transactions can be reopened. The table in Appendix One, in which red signifies “yes” and blue “no”, is designed both to highlight that fact and to provide a quick aide memoire.

**Jurisprudence**

19 At first sight all insolvency-related transaction avoidance rules, whether statutory or common law, are incidents of insolvency law. It has been suggested, however, that the rules (or at least some of them) could be analysed as part of the law of unjust enrichment. The purpose of doing so would be to inform the exercise of the court’s discretion in granting remedies and to open the door to potential change of position defences. The utility of this approach seems limited.

20 Although the Restorative transaction avoidance rules – for example, preferences, and transactions at an undervalue - are concerned with the recovery of assets from disponees, the Retentive rules - for example, anti-deprivation and rules on unenforceable security - are more obviously concerned with the preservation of value within the estate. The Dispositive rule on disclaimer has no apparent similarity with the concept of unjust enrichment. Even where the rules perform a Restorative function, such that they are more amenable to an unjust enrichment analysis, they are the product of legislative intervention. For reasons already explored, common law, if it was ever relevant, is no longer the basis of any

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32 The Cork Report, *Insolvency Law and Practice* (1982) (Cmd 8558), at paragraph 1201, treated the avoidance of transactions defrauding creditors as being part of the general law because the remedy does not depend upon the debtor/transferor being subject to insolvency proceedings. This was a legitimate distinction in context but, for present purposes where a distinction is being drawn between rules which relate to present or future ability to pay debts and those which turn on entirely different considerations (e.g. mistake), transactions defrauding creditors can be regarded as part of insolvency law (not least because the legislation is now part of the Insolvency Act 1986).
34 Consider *4Eng Ltd v Harper* [2010] 1 BCLC 176.
35 There was, for example, no common law precursor of section 238, Insolvency Act 1986, dealing with transactions at an undervalue.
independent remedy in England. It follows that the practical effect of the unjust enrichment analysis would be to afford a gloss on the words of the legislation that is arguably neither warranted nor helpful. In particular, the recognition of a change of position defence would be at variance with the carefully articulated statutory provisions governing when and against whom orders can be made.

21 Comparisons with the law of unjust enrichment might nonetheless facilitate a principled approach to any future consideration of possible reforms of the existing law. The law of unjust enrichment may also have a part to play in determining the orders to be made where property which has to be returned to the estate has been enhanced in value by the transferee.36

Policy Objectives

22 There are difficulties in advancing any analysis of the policy behind transaction avoidance because so many of the statements of policy and purpose, whether in a legislative or judicial context, are dealing with the rules selectively and there are competing policies in play.

23 As so often when examining the purposes of modern English insolvency law, it is instructive to start with the Cork Report,37 in which it was said that:

“Most advanced systems of law recognise the need to enable certain transactions between a debtor and other parties to be set aside in appropriate circumstances, so that assets disposed of by the debtor may be recovered and made available to meet the claims of his creditors...

From the earliest attempts to introduce a bankruptcy code in England in the Sixteenth Century, it has been found necessary to provide for the setting aside of certain transactions between the debtor, later made bankrupt, and other parties in the period preceding his bankruptcy. There are two types of case. In the first, the transaction is one in which the initiative is taken by the creditor who, foreseeing the probable insolvency of his debtor, takes active steps to recover the debt or otherwise improve his own position in that event. In the other, the initiative is taken by the debtor himself who, in contemplation of his own imminent insolvency, seeks to preserve his assets for the benefit of his family and friends or favoured creditors...

Cases where the initiative is taken by the creditor are dealt with by various statutory provisions which enable mortgages and charges created over the insolvent’s property within a limited period before the insolvency to be set aside in certain circumstances... and incomplete executions over the insolvent’s property to be rendered ineffective in an insolvency...

36 In Weisgard v Pilkington [1995] BCC 1108, a section 239 case, transferees were given liberty to apply in respect of development expenditure. In preference cases the statutory discretion as to the order is sufficiently wide to make it unnecessary to invoke the law of unjust enrichment as such but the case would be otherwise if the relevant transaction was void.
37 See above footnote 32, at paragraphs 1200-1209.
The statutory provisions dealing with [preferences and transactions at an undervalue] are directed at an altogether different objective from that at which [statutes dealing with transactions defrauding creditors] were directed. The latter were designed to protect creditors from fraud; the bankruptcy code, on the other hand, is directed towards achieving a pari passu distribution of the bankrupt’s estate among his creditors. The jurisdiction for setting aside a disposition of the bankrupt’s assets made shortly before his bankruptcy is that, by depleting his estate, it unfairly prejudices his creditors; and even where the disposition is in satisfaction of a debt lawfully owing by the bankrupt, by altering the distribution of his estate it makes a pari passu distribution among all the creditors impossible."

24 However, this is an incomplete account of the full range of the transaction avoidance rules.

25 Another statement of legislative policy can be taken from A Revised Framework for Insolvency Law:38

“The principal purpose of fixing a date prior to that of the relevant order for the commencement of proceedings is to allow the liquidator… to avoid transactions involving the disposition of the debtor’s estate to the detriment of the general body of creditors… the underlying principle is that transactions in the ordinary course of business and without actual knowledge of the commencement of insolvency proceedings will usually be valid. The provisions are principally aimed at upsetting transactions entered into with the deliberate intention of giving a particular creditor an unfair advantage over others and to preserve the collective nature of the proceedings by preventing individual creditors from retaining the fruits of enforcement action taken by them.”

26 However, as is apparent, this passage is only focused on the rules dealing with post-petition dispositions, which it describes in terms which are difficult to reconcile with the relevant statutory provision.39

27 In Rubin v Eurofinance SA, Lord Collins said of the nature of transaction avoidance proceedings:40

“In order to achieve a proper and fair distribution of assets between creditors, it will often be necessary to adjust prior transactions and to recover previous dispositions of property so as to constitute the estate which is available for distribution. The principle of equality among creditors which underlies the pari passu principle may require the adjustment of concluded transactions which but for the winding up of the company would have remained binding on the company, and the return to the company of payments made or property transferred under the transactions or the reversal of their effect. Systems of insolvency law use avoidance proceedings as mechanisms for adjusting prior transactions by the debtor and for recovering property disposed of by the debtor prior to the insolvency. Thus under the Insolvency Act 1986 an administrator, or liquidator, or trustee in bankruptcy may, where there has been a transaction at an undervalue, or amounting to an unlawful preference, apply for an order

38 (1984) (Cmnd 9175), at paragraph 62 (the White Paper which preceded the Insolvency Bill which became the Insolvency Act 1985).
39 Section 127, Insolvency Act 1986, which makes post-petition dispositions automatically void unless validated by the court and which makes no reference to the ordinary course of business, intention or counterparty knowledge of insolvency.
40 [2013] 1 AC 236 (SC), at [94] and [95].
restoring the position to what it would have been had the transaction not taken place: ss238 et seq and 339 et seq. Other systems of law have similar mechanisms, but they will differ in matters such as the period during which such transactions are at risk of reversal and the role of good faith of the parties to the transaction.

The underlying policy is to protect the general body of creditors against a diminution of the assets by a transaction which confers an unfair or improper advantage on the other party, and it is therefore an essential aspect of the process of liquidation that antecedent transactions whose consequences have been detrimental to the collective interest of the creditors should be amenable to adjustment or avoidance...

28 “Fairness” in this context is not synonymous with equality. Creditors only receive equal treatment within their respective classes (secured, preferential and unsecured). The objective of the Retentive and Restorative forms of transaction avoidance is to achieve an appropriate balance between the interests of parties to transactions and the interests of the estate as a whole - which ultimately, in the case of the latter, lie in its timely distribution in accordance with the statutory scheme after the inception of insolvency proceedings. In order to strike that balance, it is necessary to curb certain forms of debtor behaviour and to impose some limits on the extent to which individual creditors can secure advantages through their own diligence.

29 It would be as unfair to reopen all past transactions as it would be to reopen none. Finality in commercial transactions is itself an important policy objective. Different legal systems strike the balance in different ways and are sometimes classified as “creditor-friendly” or “debtor-friendly” according to the severity of their rules. Those terms themselves reflect policy objectives. Creditor-friendly sets of rules adopt a restrained approach to depriving creditors of the benefits of their diligence and are thus perceived as facilitating the extension of credit. Debtor-friendly measures, on the other hand, adopt a much more liberal approach to clawing back assets into the insolvent estate and are seen thereby to be more supportive of rescue and restructuring. In reality, this is an increasingly artificial division because all modern systems recognise the value of both objectives and will adjust the balance from time to time to reflect changing economic conditions and social attitudes.41

30 Some of this tension was reflected in the section of the Cork Report dealing with secured creditors:42

“The right of a prospective creditor to stipulate for security and thus, by prudence and foresight, to obtain that priority over other creditors in the event of the debtor’s insolvency

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41 France provides a good current example of such policy changes. The legislation introducing its sauvegarde procedure (inspired by Chapter 11 of the US Bankruptcy Code) was passed in 2005 and amended in 2008 and 2010 by measures making it more effective for debtors. The latest changes in the 2014 Ordonnance portant réforme de la prévention des difficultés des entreprises et des procédures collectives will reverse this trend by making amendments to strengthen the powers of creditors.

42 See above footnote 32, at paras 1481-1484.
which the security gives him, is part of the general law of contract. It cannot be curtailed without some erosion of the general freedom of contract. This has been relied upon by some of those who have given evidence to us as an argument for leaving the present law unchanged. We have been referred to Lord Macnaghten’s statement in the celebrated case of Salomon v Salomon & Co., [1897] A.C. 22 at p 52: ‘Every creditor is entitled to get and hold the best security the law allows him to take’.

Yet, as the passage itself shows, it is for the law to define the security which a creditor may be permitted to take. Over the years the legislature has intervened by enacting successive provisions curtailing or destroying the effectiveness of certain kinds of security in the event of the debtor’s insolvency. Some securities are void if not duly registered; others are invalidated in certain circumstances if the debtor becomes insolvent within a specific time after their creation. Since 1897 the debt secured by a floating charge has been postponed by statute to the claims of unsecured but preferential creditors.

Freedom of contract is thus far from sacrosanct; Parliament has recognised that the right of the creditor to take security needs to be constrained if a fair balance is to be achieved in the interest of all the creditors.

At the same time, it is important not to make it more difficult for commercial enterprises to raise finance by unduly restricting the value of the security which they can offer in return; and it would be unjust to deprive the diligent creditor altogether of the priority for which he has had the prudence and foresight to bargain. There is a balance to be struck.

31 Some transaction avoidance rules, notably those dealing with transactions defrauding creditors, also have as part of their function the deterrence of malpractice. The same is obviously true of the possibility of parallel proceedings against directors for breach of fiduciary duty. A similar policy consideration is discernible in the differential treatment sometimes accorded to transactions with “connected persons” involving the reversal of the burden of proof and extending the periods within which transactions must have occurred in order to be susceptible to being set aside.

32 Another policy objective must be predictability. After the event retrieval should be a last resort because of the costs and inherent litigation risks. An effective set of transaction avoidance rules should be sufficiently predictable to enable companies and their advisers to determine in advance, and refrain from undertaking, transactions which will offend those rules. That necessarily assumes that company directors are acting properly and it is no protection against those that are not despite the risks of personal liability and disqualification.43 In that connection, it is noticeable on a general review of the reported court decisions that there is a preponderance of cases dealing with individuals and small companies.

33 Finally, there is Dispositive transaction avoidance where the purpose is rather more pragmatic. The Cork Report said of a liquidator’s power of disclaimer:44

43 Note Schedule 1, Part 2, paragraph 8, Company Directors Disqualification Act 1986.
44 See above footnote 32, at paragraphs 1182 and 1186.
“Among the assets of an insolvent, whether individual or corporate, there may be found items of property which are best regarded as a commercial liability. These include land subject to onerous obligations, unprofitable contracts, and other items not readily saleable... A disclaimer by a liquidator releases the estate of the company being wound up, creates claims in the liquidation capable of proof and enables the liquidation to be completed.”

The function of the power to disclaim was explained by Lord Nicholls in Hindcastle Ltd v Barbara Attenborough Associates Ltd in the following terms: 45

“The fundamental purpose of these provisions is not in doubt. It is to facilitate the winding up of the insolvent’s affairs... Equally clear is the essential scheme by which the statute seeks to achieve these purposes. Unprofitable contracts can be ended, and property burdened with onerous obligations disowned. The company is to be freed from all liabilities in respect of the property. Conversely, and hardly surprisingly, the company is no longer to have any rights in respect of the property. The company could not fairly keep the property and yet be freed from its liabilities.”

and in Re Park Air Services Plc, Lord Millett more succinctly stated the purpose thus: 46

“...the reason the liquidator is given the right to disclaim onerous property is in order to enable him to achieve an early closure of the liquidation.”

Rationale

The final question to be addressed in this paper is whether the various forms of transaction avoidance, Retentive, Restorative and Dispositive, can all be seen as manifestations of any unifying principle or whether they are simply different rules dealing with different problems. In short, it is suggested that all insolvency transaction avoidance is about defining the insolvent estate and facilitating its distribution in a way that is fair as between creditors (and former creditors). To that extent, the different forms of transaction avoidance can all be seen to be part of a coherent whole even though in their specific applications they perform very different functions.

The concept of the insolvent estate is central to the operation of any form of insolvency proceeding. In Cambridge Gas Transportation Corpn v Official Committee of Unsecured Creditors of Navigator Holdings plc, 47 Lord Hoffmann described the function of insolvency proceedings in the following way:

45 [1997] AC 70 (HL), at 86H–87B.
46 [2000] 2 AC 172 (HL), at 184H.
47 [2007] 1 AC 508 (PC), at [14] and [15].
The purpose of bankruptcy proceedings...is not to determine or establish the existence of rights, but to provide a mechanism of collective execution against the property of the debtor by creditors whose rights are admitted or established. That mechanism may vary in its details. For example, in personal bankruptcy in England, the assets of a bankrupt are vested in a trustee for realisation and distribution to creditors. So the mechanism operates by divesting the bankrupt of his property. In corporate insolvency, on the other hand, the insolvent company continues to be owner of its property but holds it in trust for the creditors in accordance with the provisions of the Insolvency Act 1986...In the case of personal bankruptcy, the bankrupt may afterwards be discharged from liability for his pre-bankruptcy debts. In the case of corporate insolvency, there is no provision for discharge. The company remains liable but when all its assets have been distributed, there is nothing more against which the liability can be enforced...At that point the company is usually dissolved."

37 A moment’s reflection shows that it is not possible to identify the property which is to be the subject of the collective execution described by Lord Hoffmann without first identifying a cut-off date, as at which an account of that property must be taken. The first and most simple approach is to identify the composition of the insolvent estate at the precise moment at which the relevant insolvency proceedings begin. This is what happens when an administrator is appointed (although there are slight differences which reflect the differences between the various different ways in which administrators are appointed). Thus there is no retrospective application of the statutory stay (even though transaction avoidance rules may be used to claw back property into the estate). The approach in compulsory liquidation is different in that the liquidation is usually deemed to have commenced on the presentation of the winding-up petition rather than the making of the winding-up order. Radically different approaches are equally possible. Under the Bankruptcy Act 1914, bankruptcy depended upon the debtor having committed one or more “acts of bankruptcy”. If subsequently made bankrupt then, under the doctrine of “relation back”, the property available for payment of the debtor’s debts was determined by reference to the property owned by the debtor when the act of bankruptcy was committed.

38 Important though these differences are in practice, two things are more significant for present purposes. First, there is room for more than one approach to what the cut-off date should be but, secondly, whatever date is chosen there will be anomalies resulting from whether dispositions occur before or after the date. It is the second of these features which is addressed by many of the transaction avoidance rules which form part of insolvency law. The law seeks to counter the mischief of arbitrary injustice between creditors by setting aside transactions which

49 Section 129(2), Insolvency Act 1986. The differences between bankruptcy and compulsory liquidation are more apparent than real because the restrictions on dispositions of property contained in section 284 apply to the period beginning with the presentation of the bankruptcy petition.
50 Which covered various forms of debtor misconduct going beyond straightforward default in the payment of debts: section 1, Bankruptcy Act 1914.
51 Section 37, Bankruptcy Act 1914. “Relation back” was abandoned in the reform of personal insolvency law resulting from the Insolvency Act 1985.
have or would have depleted the insolvent estate and thus restoring the composition of the estate to what it would have been if the transactions had not taken place.\footnote{52} This is the role of Retentive and Restorative transaction avoidance although it has to be conceded that to the extent that Retentive and Restorative transaction avoidance involve hardening periods some element of arbitrariness necessarily survives.

39 Another cut-off date (which may, in practice, be the same date) is that concerned with the determination of the liabilities to be satisfied out of the insolvent estate.\footnote{53} As Lord Neuberger observed in \textit{Re Nortel GmbH}:\footnote{54}

\begin{quote}
“In general, the unsecured debts of a company after an insolvency event are payable pari passu to the relevant creditors, who claim payment by proving their debts. There has to be a cut-off date to determine the class of creditors who are to participate in the distribution of the company’s available net assets.”
\end{quote}

40 A consequence of the selection of a cut-off date for the purpose of determining liabilities is that it involves the acceleration of all the company’s liabilities as provable debts\footnote{55} but, at least in the case of liquidation, it also necessitates a mechanism for the final disposal of all property forming part of the insolvent estate. In \textit{Re Celtic Extraction Ltd}, Morritt LJ referred to:\footnote{56}

\begin{quote}
“...the very considerable and oft-repeated public policy requirement that the property of insolvents should be divided equally amongst their unsecured creditors.”
\end{quote}

and said of it:

\begin{quote}
“An important aspect of the implementation of that policy is the ability to disclaim onerous property; otherwise the available assets are, in practice, appropriated to the future or prospective creditor who holds the right corresponding to the onerous property...”
\end{quote}

41 The significance of this function was endorsed by Chadwick LJ in \textit{Re SSSL Realisations (2002) Ltd}, holding specifically in relation to unprofitable contracts that:\footnote{57}

\begin{quote}
A different view is that the rationale of transaction avoidance rules lies in nullifying the “perverse” incentives which (a) encourage directors to disregard the interests of creditors and (b) encourage individual creditors to compound the company’s difficulties, see R. Mokal, \textit{Corporate Insolvency Law} (2005, OUP, Oxford), at Chapter 9.

\footnote{53} In compulsory liquidation the dates are different, see sections 127 and 129, Insolvency Act 1986 and rules 12.3 and 13.12, Insolvency Rules 1986.

\footnote{54} [2013] 3 WLR 504 (SC), at [35].


\footnote{56} [2001] Ch 475 (CA), at [42].

\footnote{57} [2006] Ch 610 (CA), at [42], citing and applying Chesterman J in \textit{Transmetro Corporation Ltd v Real Investments PTY Ltd} (1999) 17 ACLC 1314 (Supreme Court of Queensland).
42 By comparison with Retentive and Restorative transaction avoidance, Dispositive transaction avoidance performs an essentially administrative function. It is nonetheless also concerned with the fair treatment of creditors because of their collective interest in having the estate efficiently wound-up and the net proceeds distributed amongst them.

43 The analysis of transaction avoidance as relating to the concept of the insolvent estate and its distribution is ostensibly more difficult in the case of section 423 “Transactions defrauding creditors” which, as already noted, is capable of being applied outside insolvency proceedings. The first point to note in this connection is that, even though section 423 proceedings can be brought by any victim of the transaction without the need to obtain leave if there are no insolvency proceedings on foot, such an application is always made on behalf of every victim of the transaction. From this it would appear that any resultant order should not be for the benefit of the applicant alone (unless the applicant was the only victim). Indeed, it is difficult to see how it could be otherwise given an order on a section 423 application is for the purposes of restoring the status quo ante and protecting the interests of the victims generally. Secondly, where there is a liquidator or administrator, a victim cannot apply under section 423 without the leave of the court (and the same rule that the application is brought on behalf of every victim applies in either eventuality). These unusual features of insolvency-related transaction avoidance initiated otherwise than by an office-holder can therefore be seen to serve the purpose of reconstituting the debtor’s estate if there is an estate and the next nearest thing if there is not.

44 It is, however, important not to overstate the coherence of analysing insolvency transaction avoidance in terms of measures taken to define the insolvent estate and facilitate its distribution amongst the creditors. Although each is the adjunct of the other, they are different things and the specific transaction avoidance rules relate to one or the other. It also has to be recognised that the rules themselves (and the various policy and purpose statements which have been made both from the bench and in a legislative context), show little sign of the subject having been developed as a whole in an integrated manner. In order to put any uniform conceptual framework around the rules it is necessary to stand well back from their detailed content. The rules are best viewed not as a discrete subject but rather as incidents in the working out of the general purpose of insolvency proceedings.

58 Section 424(2), Insolvency Act 1986.
59 This restriction does not apply in company voluntary arrangements (section 424(1)(b)).