Journal of Contemporary Issues in Business and Government Vol. 28, No. 03, 2022
https://cibgp.com/

P-ISSN: 2204-1990; E-ISSN: 1323-6903
DOI: 10.47750/cibg.2022.28.03.043

Corporate Rescue Culture: Realities and Limitations of the Existing Laws of the United Kingdom

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Abstract
Two choices are available to a corporation when it is in financial distress. These choices are either to rescue or to terminate the corporate body. This piece discusses the main procedure of corporate rescue which is administration. The Cork Report 1982 has structured the legal regime on insolvency more specifically, founding the grounds for a corporate rescue culture. The main issue of discussion is whether or not the culture of corporate rescue has been nourished since the Cork Report with regards to the administration in the light of the Enterprise Act 2002 despite that there is occasionally an apparent assumption in favour of the presence of a corporate rescue culture in the jurisdiction of the United Kingdom. This piece scrutinizes the policy issues and practical features of the corporate rescue, administration management complexities, and moratoria implications. The article further inspects institutional concerns and pinpoints the inconsistencies in the judicial attitude of the UK. The article also provides a comparative perspective highlighting that the United Kingdom can learn the lesson for improvements of its existing laws from the United States although several Achilles heels exist in the United States laws.
Keywords: Insolvency of a Corporation, Administration, liquidation, Institutional concerns

Introduction

The existing liquidations regime of the UK is based on the "Report of the Review Committee on Insolvency Law and Practice 1982" (hereinafter 1982 Report) which is also called the Cork Committee Report 1982. The 1982 Report contained several recommendations and such

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recommendations led to the "Insolvency Act 1986" (hereinafter 1986 Act). The foremost purpose of the 1986 reforms was to encourage a reasonable corporate rescue culture and such culture would have the potential to rescue a corporate body from financial distress before sliding such a corporation into insolvency. *Powdrill v Watson* can be cited in this context.

In this regard, rescue is a prerequisite and is "a major intervention necessary to avert eventual failure of the company." Furthermore, the Cork Committee explained that "a concern for the livelihood and well-being of those dependent upon an enterprise which may well be the lifeblood of a whole town or even a region is a legitimate factor to which a modern law of insolvency must have regard. The chain reaction consequences upon any given failure can potentially be so disastrous to creditors, employees and the community that it must not be overlooked" (1982 Report, Para 204). The 1986 Act provides two procedures that include administration order and company voluntary arrangement. However, the Enterprise Act 2002 (hereinafter 2002 Act) has primarily restructured the administration procedure.

This research piece inspects the normative and practical characteristics of corporate rescue culture, issues regarding the policy, moratoria implications, administration intricacies, as well as "susceptibility to abuse." Moreover, this piece inspects institutional concerns containing the latent technicalities, the cost of administration, and the finance continuation. The article highlights that the inconsistencies in the attitude of the United Kingdom courts are creating a hurdle in the promotion and encouragement of the corporate rescue culture. The article further conducts a comparative survey of various jurisdictions to determine that although several loopholes exist in the United States regime it can be a vantage point for the improvement of existing laws of the United Kingdom. The article provides a reasonable conclusion in the end.

The United Kingdom Perspective

Understanding the Logic behind Corporate Rescue

Several justifications can be presented for corporate or business rescue (McCormack, 2009). Reasons to rescue a business include that there is a need to secure jobs (Davis, 2010), promote the enterprise's spirit; pension loss probability as well as the manipulation of the system of the company by the rogue or irresponsible directors (Report, 1982). The firms and corporations are contributing to the economy of the state according to the social and economic perspective consequently; the liquidation of a firm is a much more concerning issue (Baird, 1996).

In the regime of the recession of the company, seemingly two things are specifically important that is the creation of a job and the preservation of the job. However, on the second side, the "socio-economic argument" is generated contrary to the corporate rescue. Certain areas need an argument about whether the endeavors in restructurings, reorganizing, or redeveloping a corporate body will be beneficial or not, whether the difficulties and impediments occur while restructurings, the opportunities or options given by parties are worth the benefits they bring. Whether the resources or capital spent for the corporate or business rescue might be so huge that any accomplishment would be a no-win situation or success at great cost. There is a need to discuss an assumption that the corporate rescue procedure can be initialised by the managers of the corporation due to the existence of the weaker avoidance provisions (Parry, 2001).

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It is highly debatable that it is very uncertain and high-risked to drag a corporate body that has an inactive or very poor economic condition as such company might hamper competition, which is not a positive thing as competition usually works on the side of the masses. Consequently, rather than counting the benefits of corporate rescue, there must be a discussion on real and actual prospects of recovery. The court upheld that corporate rescue means to preserve the business which is viable and if the business is not viable then it is useless and unproductive to spend the resources to rescue such business. *Powdrill v Watson* can be cited in this regard.

Reservations in Corporate Rescue

Corporate rescue is defined as any major intervention for averting or preventing the failure or debacle of a corporate body (Belcher, 1997). It is unclear what does that a "major intervention" means and how it is different from an "ordinary managerial response" to a troubled and distressed business or corporation (Finch, 2010). Major intervention might be any kind of action taken to rescue a company that is exposed to distress or that is slipping into trouble. This correspondingly results in a complex problem when it is suitable to engage in corporate rescue. It is also uncertain what major intervention will result in successful rescuing a corporate.

Certain approaches can be utilised to rescue any business even before the rising of the problem or before the company is exposed to distress (Stallworthy, 1998). However, it will be inconsistent in terms of purportedly engaging in a corporate rescue when there will be the existence of no issue or problem at all. To ask what would be a suitable measure that could result in a successful corporate rescue, it may also be compulsory to decide when to ask the question (Belcher, 1993) as after the restructuring and reorganizing, a corporation might seem prosperous however, it might end up functioning and operating rather skeletally. It is also very necessary to determine the right time for asking the question as a false alarm could unreasonably promote panic that can add more complications to the existing matters of the corporation. In case of a false alarm, the company could face bad consequences like the sudden exit of funds and reputational damages to the company and business as well as potential investors might become suspicious about the existence and condition of the company. To this end, it is submitted that despite the importance of appropriately determining the suitable time to ask the question, the 2002 Act provides that a corporation "enters administration when an administrator is appointed."

It is generally argued to answer the question of "commencement of the corporate rescue" but the debate ends up due to various post-commencement concerns and problems that include the need to ensure the 'minimum costs'. The proper time for the commencement of the corporate rescue can be judged by the efficiency of supervision that precedes the business rescue (Singh, 2011). However, this is a passive approach because it recommends that various attempts to rescue the corporation might be made although there is no chance or probability of success if this approach is applied, may lead to waste of resources and an abuse of the process as well. Resultantly, the right time for intervention will be when there are perceptible restrictions from the cash flow perspective. The question arises whether administration due to its transitory nature could not in itself be a restructuring procedure. This question although has no practical basis because the administration is a way of finding out a better direction rather than a destination. When there is a probability of corporate rescue then administration is initialised, to this level, it might be counted under the restructuring or reorganisation.

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Administration

The 1982 report deliberates the early corporate rescue efforts being consistent with this concept the 2002 Act has brought the insolvency regime of the UK closer to it (Report, Para: 198), Furthermore, the 2002 Act highlights that the insolvent corporation must be placed under the shadow of external management to rescue the corporation rapidly and proficiently beneficial to all the creditors of the company rather than just a few secured one. In this way, the traditional potency of the floating charge is overridden by the power of the administrators. Due to this, a probability of entering into the administration without the order of the court is generated. It is practical but is susceptibly abused to show the actual or coming insolvency without any requirement. For instance, it is fact that it is very hard to regain the lost reputation and confidence of the public in a competitive industry although such confidence is lost due to mere speculation.

After perusal of correspondence between the 1982 Report and the 2002 Act, a question arises whether or not the introduction of the 1982 Report has strengthened the corporate rescue culture in the UK. However, it can be noticed that the 1982 report contains several deficiencies. For instance, "the recognition of the need to cater for unsecured creditors did not translate to any realistic assessment of how adequate funds may be set aside" (Report, Para 233). The 1982 Report has proposed a 10% fund for practical concerns of unsecured creditors however, this was debatably insufficient when it is compared with the 'ring-fencing' provision enshrined under section 252 of the 2002 Act.

But one noticeable thing is that the 1982 Report has revolutionised the law of insolvency as well as encouraged and established the corporate rescue culture.

The administration although is considered an attractive tool for corporate rescue even by the troubled corporations (Milman, 2010). It seems that the 2002 Act has encouraged the administration as *"an exit route from over-indebtedness without any correlational entrepreneurial effort"* (Cranston, 2011). The main reason could be the 'moratorium' that has correspondence with the administration, as well as it is a distinct and unique characteristic of the 2002 Act. 'Moratorium' is capable of saving the corporation or business from being torn apart by creditors of the company. 'Moratorium' is a transitory halt that makes an effort to save a company from momentary financial hardships. However, there are several problems with the 'moratorium' as well.

The principle *"pacta sunt servanda"* is delineated due to the 'moratorium' and that is very crucial and critical for the entrepreneurial activity –the consequences of not paying back the debt can be faced by the debtor–. Allowing the debtor who is not in a good financial situation and is unable to pay back his debt to be a part of a business or company could challenge and destabilise the business trust and equally, it could weaken the confidence of the public. So, regarding such issues, to maintain the balance with the creditors' rights there is undoubtedly a need to initialise the court proceedings. *Innovate Logistics Ltd v Sunberry Properties Ltd* can be cited in this regard. Consequently, 'moratorium' is a kind of weak justification as is only justifiable by economic concerns.

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The Scope of Administration Management

It is evinced from the aforementioned perspective of the administration's possible abuse that the regime of "manager-displacing insolvency" looks acceptable to the United Kingdom jurisdiction. Australia and Germany are antagonistic to the model or conception of the debtor in possession. More specifically, In Germany, all the proceedings are initialised as liquidation but usually are transformed into the "Organisation proceedings" (McCormack, 2007).

It can also be evinced from the practical perspective that the "English practitioner in possession" and "American debtor in possession" appear rather extreme. It can be concluded that the effort for rescuing a corporation will be more proficient if the management that is existing should be integrated and incorporated but without retaining or holding the managerial power because such exiting management would have considerable experience, understanding, and information to offer as well. Hence, this is an eminent character of the "bifurcated co-determination model" (McCormack, 2007). This model seems to anticipate an extensive combination of administration. However, it is unreasonably fatalist to "regard the reservation of previous managers as the inevitable costs" of corporate rescue (Qi, 2008).

The existing approach that is known as the extremist approach argues and supports that the complete displacement of the previous management might have promoted the diminutive growth of the culture of rescuing a corporation. As the external employees or personnel are obliged to ascertain everything for themselves, as well as a few of the external personnel, may not be obvious from cold print, for instance, the statement regarding the affairs of the corporate body that the administrator must be provided with.

Institutional Issues

The universal and most accepted perception is that the least rigidity and more flexibility of the administration encourage the rescue culture. For instance, in the light of section 18-21 of the 2002 Act, "the administrator can be appointed using the out-of-court procedure which has been described as involving "merely the completion of forms and lodging of the same at court" (Friece, 2008). However, the reality and practice are quite different from it. In *Re G-Tech Construction Ltd,* the court held that:

> "Notice of the appointment of an administrator had not been effectively approved and all his actions concerning the company's assets were in fact as a trespasser. This was essentially due to the misapprehension about the correct forms which should have been lodged in court."

Consequently, the undefined structure for paying the cost of administration does not rest well on institutional flexibility (Bacon, 2007). More specifically, it strikes at the root or base of the rescuing process of a corporation (Flood, 1995).

In the United Kingdom, there are no express provisions for "continuing finance" though, this actually exists in the practice. However, the jurisdiction of the United States is totally opposite to

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the United Kingdom in this perspective (Bankruptcy Code s.364). It is usually stated that the nonexistence of the "post-petition financing provisions" provisions obviously defining a "hierarchy of priorities" for potential creditors or lenders disparage an effective and active corporate rescue culture. It can be observed that the practical issues such as the strain or trouble in attracting finance when the corporate body is in the administration have not been factored in by the existing legal regime of insolvency. That can be aggravated by the statutory necessity of publicity (Qi, 2008). It is a good way that provides a justified reason why the informal path to rescue a corporation is a more viable option (Finch, 2009). In any of the circumstances, continuing financing is not capable to recover a corporate body that ought to be liquidated.

Comparative Perspective

Basically, the two foremost approaches support and encourage the culture of corporate rescue. These approaches include the "pro-debtor" and "pro-creditor administration" approaches (McCormack, 2009). Contrary to the opinion, France had a broader and more objective culture for rescuing a corporation and the corporate rescue culture of France had a very sophisticated and reasonable procedure (Milman, 1995). However, it is arguably submitted that France has the very least developed and established corporate rescue regime than that of the four biggest economies of Europe (Zukin, 2005).

In the United Kingdom, the interest of the state has been substantially relegated to the background as "abolition of Crown preference." However, in France the interests of the state take priority. The United Kingdom lacks the cram-down provisions. It is debatable that simply the "loss of creditors' veto" is not enough. However, such provisions exist in the United States and Germany (Bill, 2010). It can be stated that in the administration, the existence of express cram down's provision promotes a strengthened corporate rescue culture.

Hong Kong is included in the jurisdictions that lack formal and proper corporate rescue culture (Wu, 2010). But Hong Kong is trying to generate an ideal culture that would be cheaper, simpler, quicker, and more effective (Oladele, 2009). However, various states have no defined and distinct corporate rescue culture. Such jurisdictions in the classical sense, equate "restructuring mechanisms like mergers and acquisitions" with the corporate rescue culture (Allied Matters Act 2004). In Europe, the 2002 Act is considered the most reasonable regime for corporate rescue culture (Zukin, 2005). But such culture could be improved and be made more efficient by a selective application of the US Chapter 11 system.

The inconsistency in the judicial attitude of the United Kingdom can be seen. In various cases, the courts support the corporate rescue culture. *Huddersfield Fine Worsteds Ltd* can be cited in this context. However, in *Exeter City Council v Bairstow,* the court has indicated a preference for "legislative technicality." Consequently, it can be evidenced that "it has actually been on the decline." Nearly 19,077 liquidations had been recorded in the year 2009 while in 2010 nearly 500 administrations had been recorded (Milman, 2010).

This research is although limited and the scope of this piece does not allow for discussion of the pre-pack. However, the "pre-packaging administration" practice has become a welcome initiative following the 2002 Act. Notwithstanding the benefits like "convenience, transparency issues, and

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the independent review" causing the loss of confidence of the public has led it to be outlawed (Walton, 2010). It is debated that "the strategy of pre-packs is normally constructed to sell the business of an ailing company, almost inevitably as a going concern" (Xie, 2010). The ground of this argument is that the administration is a tool that can ensure a reasonable corporate rescue culture in a few circumstances. However, there is a need to explore whether there is potential for a relationship or association between the practical significance of the pre-pack and the viability of administration as a tool for the rescuing of a corporation.

Conclusion

The 1982 Report was a commendable job and it had undoubtedly formed reasonable grounds for the corporate rescue culture however, it is an exaggeration when it is stated that the corporate rescue culture has been strengthened. Various concerns need attention as there is a need for the potential existence of a practical corporate rescue culture based on the 1982 report. The rescue culture is weakened and is complicated when uncertainties and ambiguities regarding when to rescue a corporate and how to assess an efficacious corporate rescue culture came into existence. The abuse of corporate rescue procedure and process, restructuring of moratoria mechanisms, administration management, and inconsistent attitude of the United Kingdom Courts are several questions to the corporate rescue culture.

Continuing finance which is a foremost institutional concern evince there is a need for improvement and reform. Entire suggested recommendations, particularly during the economic recession regime, could be adjusted to maintain a balance between helping the debtor, respecting the genuine and legal claims of the creditors, and societal macroeconomic needs. The liquidity and enterprise structure on which the corporate rescue culture is aimed would face a breakdown when the general law of obligations and *pacta sunt servanda* are unnecessarily denigrated. This will obviously destabilize and undermine the universal purpose of insolvency and its legal regime and more specifically corporate rescue culture.

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B. Xie, "Protecting the interests of general unsecured creditors in pre-packs: the implication and implementation of SIP 16" (2010) 31 *Company Lawyer* 189.

Bacon, "Administrative costs: some welcome news" (2007) 20(1) Insolv. Int. 1.

Bankruptcy Code s.364. The DIP "super priority" financing facility is in place to effectively rescue assets of the debtor's estate; Usually by a liberal construction of Insolvency Act 1986 Sch.B1 (Sch.B1 added by EA 2002) para.99

Belcher, "The Economic Implications of Attempting to Rescue Companies" in H. Rajak (ed.), *Insolvency Law Theory and Practice* (London: Sweet & Maxwell, 1993), p.237.

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Belcher, Corporate Rescue (London: Sweet & Maxwell, 1997), p.12.

By this approach (and questionably coming to the conclusion that the law on rescue is "substantially adequate"), the authors miss the point especially as there is a more fundamental problem with s.409 of the Nigerian Companies and Allied Matters Act 2004 which provides that a company may be wound up for owing a sum exceeding the equivalent of £8.

D. Milman and F. Chittenden, Corporate Rescue*: CVAs and the Challenge of Small Companies* (London: CAET, 1995), p.30.

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G. McCormack, "Apples and oranges? Compare rescue and functional convergence in the US and UK" (2009) 18(2) I.I.R. 109.

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Innovate Logistics Ltd v Sunberry Properties Ltd [2009] B.C.C. 164 CA (Civ Div)

J. Zukin, "Are More Restructuring Regimes Becoming Like the U.S Chapter 11 System?" in M. Pormoleano and W. Shaw (eds), Corporate *Restructuring: Lessons from Experience* (Washington: World Bank, 2005), p.131. However, the tide turns against this opinion now especially as French reforms in 2008 and 2009 seem to establish viable bases for the

P-ISSN: 2204-1990; E-ISSN: 1323-6903
DOI: 10.47750/cibg.2022.28.03.043

promotion of restructuring rather than bankruptcy proceedings--see generally Ordonnance 2008 (1345) and regulation décret 2009 (160).

L. Qi, "Availability of continuing financing in corporate reorganisations: the UK and US perspective" (2008) 29(6) Company Lawyer 162; Insolvency Act 1986 Sch.B1 (Sch.B1 added by EA 2002) para.45.

L. Qi, "Managerial models during the corporate reorganisation period and their governance effects: the UK and US perspective" (2008) 29 *Company Lawyer* 131, 140.

McCormack, "Control and Corporate Rescue" (2007) 56(3) I.C.L.Q. 523, 524.

Milman, "Jurisdictional Reflections in the Administrative Process: a 2010 Perspective" (2010) 2 Co. L.N. 283.

O.O. Oladele and M.O. Adeleke, "The legal intricacies of corporate restructuring and rescue in Nigeria" [2009] I.C.C.L.R. 182, 189.

Other reasons for an informal route include flexibility, possible reduction in delay and less cost. However, the "potential to prejudice the interests of less-well-placed creditors" is conceded. See V. Finch, Corporate Insolvency Law (Cambridge: Cambridge University Press, 2009), p.253.

P. Cranston, "Fearful Silence" (2011) 24(2) Insolv. Int. 32.

P. Walton, "Government Consultation: is it time to re-pack the pre-pack?"(2010) 1 Co. L.N. 273. It is submitted that this is an extreme and unnecessary measure.

Powdrill v Watson [1995] 2 A.C. 394 HL

R. Parry, *Transaction Avoidance in Insolvencies* (Oxford: Oxford University Press, 2001), p.26

Re G-Tech Construction Ltd [2007] B.P.I.R. 1275 Ch D

Re Huddersfield Fine Worsteds Ltd [2005] EWCA 1072; [2005] B.C.C. 915. The Court of Appeal held that protective awards are not payable as administration expenses.

Report of the Review Committee on Insolvency Law and Practice Cmnd 8558 (1982) is also known as the Cork Report, deriving this name from the committee's chairman, Kenneth Cork.

S.A. Friece, "Company in financial difficulties: the alternatives" (2008) 21(8) Insolv. Int. 124.

The German legal regime on Corporate Rescue is apparently modelled on Chapter 11. It is however important to note that the draft bill of the Act to Facilitate Further the Restructuring of Companies in July 2010 was a major step in current reforms with

P-ISSN: 2204-1990; E-ISSN: 1323-6903
DOI: 10.47750/cibg.2022.28.03.043

respect to the German insolvency legal regime.

This is clearly far below the London Approach which has been termed "infinitely flexible" but seems better suited to CVAs and large companies. See J. Flood et al., *The Professional Restructuring of* Corporate Rescue*: Company Voluntary Arrangements and the London Approach* (London: CAET, 1995), p.32.

Zukin, "Are More Restructuring Regimes Becoming Like the U.S Chapter 11 System?" in Corporate *Restructuring: Lessons from Experience* (2005).