

Critically evaluate
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of 'pari passu' is
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Critically evaluate how far the principle of 'pari passu' is embodied in Insolvency Law and how far should it be. It is critical to an understanding and appreciation of insolvency law to identify the principles on which the law is granted and the principles which it seeks to achieve. According to Professors Baird and Jackson, 'insolvency law has only one function: to maximise the returns to creditors and it is not a function of insolvency law to concern itself with employment protection or the interests of the wider community.' To take it into consideration, it is important to say that 'pari passu' principle is the 'foremost principle in the law of insolvency around the world' and it is at the very heart of the whole statutory schemes of bankruptcy and winding up. The leading authority of the 'pari passu' principle was received from the House of Lords decision in *British Eagle International Airlines Ltd v Compagnie Nationale Air France*. Vanessa Finch stated that 'pari passu' is 'the normal rule in a corporate insolvency is that all creditors are treated on an equal footing - 'pari passu'- and share in insolvency assets pro rata according to their pre-insolvency entitlements or the sums they are owed. Security avoids the effects of pari passu distribution by creating rights that have priority over the claims of unsecured creditors.' To emphasize that, the statute itself confirms Finch's 'normal rule', that all creditors of an insolvent company are to be treated 'equally'. Basically, 'there is a difference between treating people equal, with respect to one or another commodity or opportunity, and treating them as equals.' To illustrate that, the problem is that a rule based on formal equality does not take into account important differences between people, even though those differences are relevant to any consideration of rule's fairness. Generally, therefore, the determination of who are equals is not a concern of insolvency law. In *Re Smith, Knight &* <https://assignbuster.com/critically-evaluate-how-far-the-principle-of-pari-passu-is-embodied-in-insolvency-law-and-how-far-should-it-be/>

Co Lord Romilly M. R. stated that ' the Act of Parliament unquestionably says that everybody shall be paid ' pari passu', but that means everybody after the winding up has commenced. It does not mean that the court shall look into past transactions, and equalise all the creditors.' The general justification for the principle is its' economical efficiency, in the sense that it reduces strategic costs and increases the aggregate pool of assets through the collectivity of dealings. Hence, it avoids the costs of dealing with claims on their individual merits. Indeed, Keay and Walton are of the view that the underlying aim behind the use of the equality principle is to produce fairness, so that every creditor is treated in the same way. Fairness, in the procedural and substantive senses, can also be said to be assured by the ' pari passu' principle as it prevents a race to enforce claims that is destined to be won by the strongest, wealthiest, and it also involves equality of treatment between unsecured creditors. In fact, it has been seen as a way of preventing an intra-class race to enforce claims and can therefore be described as bringing about equality of treatment between unsecured creditors. However, the application of the ' pari passu' principle is not absolute, nor does it achieve its aim with any degree of spectacular success as noted by the Cork Report.. The ' pari passu' principle is rather less important than it is sometimes made out to be, and does not fulfill any of the functions often attributed to it. For reasons of policy insolvency law provides certain deviations. The principle of ' pari passu' distribution of assets does not apply to the rights of secured creditors, suppliers of goods under agreements reserving the title or creditors for whom the company holds assets on trust. To bear this in mind, unsecured creditors usually receive little, by the of dividend also, it is argued that what the law disallows is not <https://assignbuster.com/critically-evaluate-how-far-the-principle-of-pari-passu-is-embodied-in-insolvency-law-and-how-far-should-it-be/>

evasion of the ' pari passu' principle as such but rather attempts to by-pass the collective mechanism which an insolvency proceedings is designed to produce. Indeed, it is important to bear in mind impact of ' pari passu' principle in consideration. There are various types of arrangements, which are not considered to offend against this particular principle. These include ' subordination agreements, provisions for acceleration of liability on winding-up, interests limited by reference to solvency...provision for termination on winding-up of interest annexed to membership status.' In *Money Markets Ltd v London Stock Exchange Ltd* Neurberger J. held that ' it is not possible to discern a coherent rule to enable one to assess in any particular case whether such a provision falls foul of the principle.. and it is not entirely easy to reconcile the conclusions, and indeed the reasoning, in some of the cases.' Thus, there are agreements which contravene the ' pari passu' principle, such as ' provision for divestment of ownership on winding-up, vesting clauses in building contracts, direct payment in building contracts, provision for security or increased security on winding-up, sale with provision for retransfer on winding-up.' At this point, it is worth noting that modern insolvency law recognizes that some exceptions to the ' pari passu' rule are necessary and permits of exceptions. Also, F. Odith explained that ' pari passu' principle ' does not explain the obvious truth that insolvency law largely respects rights acquired prior to insolvency.' During the course of exceptions, the first is a right of insolvency set-off, which is well-established principle of insolvency law ' that where there are mutual debts existing between a creditor and an insolvent company, the smaller debt is to be set against the larger debt and only the balance is to be paid to the creditor out of the insolvency estate.' Set-off applies whenever there have been mutual

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credits, mutual debits or other mutual dealings, before the onset of liquidation, between the debtor and any of its creditors. So insolvency set-off responds to the principle of respecting legitimate expectations. In *Forster v. Wilson Parke B.* stated that 'the aim of insolvency set-off is not to avoid circuity of action, the main consideration underlying set-off between solvent parties, but to do substantial justice between the parties.' In fact, the expenses properly incurred in the winding-up, including the remuneration of the liquidator, are payable out of the assets in priority to all other claims. The statute provides that creditors claims are to be treated as part of the expenses of liquidation are matters not of proof but of payment. This of course is to the advantage of creditors. In *Re Levi & Co. Ltd* it was explained that 'it enables many post-liquidation creditors to be paid in full and, in certain circumstances, to receive payment in respect of pre-liquidation obligations.' The Cork Committee noted that 'pari passu' distribution of uncharged assets was in practice seldom, if ever, attained because, in the overwhelming majority of cases, the existence of preferential debts frustrated such distribution. Preferential unsecured creditors rank above other unsecured creditors as well as above creditors holding a floating charge. Since they are payable after winding-up expenses, pre-preferential creditors also rank above floating charges. In *Re M. C. Bacon Ltd. (No. 2)* Millett J. held that 'such expenses did not include the cost incurred in proceedings initiated by the liquidator to set aside the floating charge as a transaction at an undervalue and a preference.' Indeed, various types of debt have been deferred by statute. These include debts owed by the insolvent to a director found liable for wrongful or fraudulent trading, and ordered to be deferred by the court. Moreover, claims held by the debtor's

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shareholders or other members qua members also fall under this head. As the result, the claims of creditors able to assert set-off, utility companies, post-liquidation, pre-liquidation creditors with post-insolvency leverage, different types of preferential claims, claims of deferred creditors, all fall outside the purview of the 'pari passu' principle. These deviations from the 'normal rule' might be 'something of a minor qualification' to the equality norm. With respect, such assertions push the 'pari passu' principle to the force as currently the dominant method for distribution of insolvent estates. To emphasize above information, the principle of 'pari passu' that creditors should be treated equally, that the insolvent's assets should be shared proportionately between them and their debts should abate and be paid in 'equal steps' is not fundamental, nor does it achieve spectacular success. Indeed, it is important to look to alternative approaches in order to achieve more satisfactory modes of distribution. Also, it is important to consider whether the current exceptions to 'pari passu' are in need of reform. According to Ho Swan, 'saying the 'pari passu' principle is fundamental does not make it so. Saying 'pari passu' underlies insolvency practice does not make it so. Avowing 'pari passu's' importance merely because others do so certainly does not make it so. And though 'pari passu's' apologists may continue to calcify their self-affirming echo chamber, their voices ricochet aimlessly in the hollow within.'

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