IBA Insolvency Conference

Good morning. May I welcome you to Edinburgh, a city with a great legal and intellectual tradition.

I am here to say something about the themes of this conference, which deals with global insolvency and restructuring. It seems to me that "restructuring" is an important – possibly the critical – part of the title. "Restructuring" indicates perhaps the most important shift in recent years in the emphasis of the law governing corporate and commercial insolvency.

The traditional view of insolvency was described by Brightman LJ in *Re Lines Bros Ltd*, [1983] 1 Ch 1, at 20:

"The liquidation of an insolvent company is a process of collective enforcement of debts for the benefit of the general body of creditors".

The debts in question are those outstanding as at the date of winding up; in the words of Selwyn LJ in *Re Humber Ironworks and Shipbuilding Company*, (1869) LR 4 Ch App 643, at 646-647:

"I think the tree must lie as it falls; that it must be ascertained what are the debts as they exist at the date of the winding up and that all dividends in the case of an insolvent estate must be declared in respect of the debts so ascertained".

As I say, that was the traditional view of insolvency: the debts and assets of the company were ascertained, in a meticulous manner, at the date of its winding up, and the assets were used to pay the debts, in accordance with a strict system of priority. That was frequently an interesting exercise. It has been said that insolvency is the test of all legal rights: almost every area of the law, at least private law, was covered by it, and transactions had to be analyzed in an intellectually rigorous manner which, to some people at least, was an enjoyable challenge.

The new approach: commercial and economic considerations

Nevertheless that approach must now, I think, be regarded as a matter of history. What has happened is that the approach of the law has moved from a strict analysis of legal rights, and the enforcement of those rights, to an analysis based on economic reality, at a practical level. A company is a commercial entity. It is more than the sum of its assets, less the sum of its liabilities. It carries on business, which generates profits and which provides employment to other people. It also provides a customer to its suppliers and a supplier to its customers. These commercial relationships are the very foundation of the modern economic system.

This analysis of economic activity can be said to go back to Adam Smith, one of the greatest economists of all time. He was born in Kirkcaldy, across the Firth of Forth from Edinburgh; if you go a short distance east from here to the Carlton Hill (the obvious Hill with classical monuments on top), and look north, you will see Kirkcaldy very clearly. Smith spent most of his academic career in Glasgow. While he was there he wrote one of the greatest works ever written on economics, *The Wealth of Nations*, published in 1776, which happens coincidentally to be the year of the American Revolution against the British Crown.

Smith's greatest insight is perhaps this. Prior to that time, wealth had been perceived in terms of the accumulation of land, or of money, or of goods, often in the form of precious metals. What Smith realized was that the real source of wealth is none of these: it does not lie in accumulation; it lies rather in economic exchange. In one of the most famous passages ever written about economics, he wrote:

"Whoever offers to another a bargain of any kind, proposes to do this. Give me that which I want, and you shall have this which you want, is the meaning of every such offer; and it is in this manner that we obtain from one another at the far greater part of those good offices which we stand in need of. It is not from the

benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest. We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages".

It is through this exchange that we benefit one another, through the operation of what Smith described as "the invisible hand". This, as I say, is one of the most important insights – perhaps the most important insight – in the whole history of economic thought. This notion, of exchange, or the *quid pro quo*, has been the fundamental basis of nearly all subsequent economics.

Smith himself spent his later years in Edinburgh, holding the office of Commissioner of Customs. He lived in Panmure House, just off the Canongate, the street leading uphill from Holyrood Palace towards the Castle. At that time this was one of the best addresses in the city. Panmure House is about half a kilometre south east of here. Smith died in 1791, and is buried in the churchyard of the Canongate Kirk, which is almost adjacent to Panmure House.

What has happened in insolvency law in recent years is perhaps parallel to Smith's great insight. Following insolvency, the legal system should not embark on a simple exercise of adding up assets and liabilities and then using the realized assets to pay off the liabilities, so far as possible. Instead it should recognized that a company carries on business; that many other persons, natural and legal, deal with it; and that the interest of those persons, considered collectively, is frequently, perhaps normally, that the business and their relationships with that business should continue. In return, it is accepted, it may be necessary to give up existing rights. That operates to the mutual benefit of both sides: their economic activities are dependent on each other.

This is the fundamental basis, it seems to me, for the shift in emphasis in insolvency law from mere insolvency, with its traditional consequences, towards preventative restructuring. Restructuring seeks to preserve the business, or the viable parts of the business, as an economic entity. Of course in any insolvency situation the business is likely to be insolvent, either in absolute terms or in practical terms, through what is essentially a failure of liquidity. That means that it is likely that creditors of the business will have to give up their debts, in whole or in part, although sometimes with the hope that they may receive something in future. With the restructuring, that may well consist of future trading activity.

What is important, however, is that any scheme of preventative restructuring should attempt to ensure two things. First, the creditors and separately the shareholders must be dealt with fairly and equitably; they deserve equal, or at least proportionate, treatment. Secondly, the settlement that is reached with the creditors and shareholders must be the most equitable that can be achieved, at a practical level, in the circumstances in which the company finds itself. Those I think are important policy considerations underlying the notion of restructuring in insolvency. To ensure that they are achieved, it will normally be essential that the restructuring arrangement that is ultimately reached should be considered and approved by a court or other judicial body. That must obviously take place on a basis that is both informed and strictly objective. But judges should, of course, at all times strive to be totally objective in their work.

Preventative restructuring must obviously operate at a time before the company embarks on formal insolvency proceedings. This is the objective of a number of recent pieces of legislation. In the European Union, the Directive (EU) 2019/1023 sets out a detailed framework for preventative restructuring. You will hear more about that in due course from persons who are better qualified than I am to explain how it operates.

In the United Kingdom, Schedule 9 to the Corporate Insolvency and Governance Act 2020 introduces a new Part 26A to the Companies Act 2006. This supplements the existing system of schemes of arrangement, which has been in use for many years. It does, however, introduce a new procedure, the (difficult to say) cross class cram down, which allows shareholders or bondholders of different classes to

be considered together in deciding whether a scheme of restructuring is for the benefit of the company. This can obviously detract from class rights, but the policy decision that has been taken is obviously that it is more important that the business entity should be preserved, in the fairest and most effective way possible, and that if this involves derogating to some extent from class rights, that is to achieve a worthwhile objective. This is an area where, as I have remarked, control by the court may be of great importance, to ensure that the ultimate result is reasonably fair, on an objective basis, to all classes of shareholders, bondholders or other creditors, and is proportionate among those classes. That will not necessarily be an easy exercise, but it appears to me to be completely necessary if the system is to operate in a just manner.

In the United States, similar procedures are found in Chapter 11 of the Bankruptcy Code. It is from those procedures that the concept of the cross class cram down has been derived. Its objective, as with most of the provisions of legislation permitting preventative restructuring, is to enable companies in financial difficulty and that creditors to come to an arrangement, under the supervision of the court, that overrides existing legal rights with a view to the preservation of the underlying business, and the position of those who depend on that business such as employees, suppliers and customers. I look forward to hearing what speakers have to say about these different pieces of legislation, and the extent to which they differ in approach. This includes what they can learn from one another.

In this connection I should mention that I was chairman of the Scottish Law Commission from 2007 to 2011. The Law Commission is a body that is set up to consider the systematic reform of the existing law, with a view to presenting proposals to the Scottish Government and Parliament, and in reserved matters to the UK Government and Parliament, for draft bills that make desirable reforms. During that period one of my favourite sayings was that the law reformer's greatest tool is plagiarism – using what other people have done.

I still think that in assessing the existing law and considering whether it needs reform, the most useful technique is to look at other legal systems and how they handle similar problems. Obviously what they do must be looked at critically, to assess whether it coheres well with the system of Scots law (or any other system). It can also take a great deal of work to understand exactly how the other system operates, and how it may be translated into one's own system. It is also essential to understand the fundamental policy that underlies a particular legislative provision in another system, and to consider carefully how that policy coheres with the fundamental policy that is to be followed in one's own system. Consistency within a system is essential.

Nevertheless, the principle of looking at what other knowledgeable people do in particular circumstances is one of the great tenets of common sense philosophy. In Scotland, in the late 18th and early 19th centuries, a prominent school of common sense philosophy developed. Its most notable proponents were perhaps Thomas Reid, who taught philosophy at Aberdeen and Glasgow Universities in that period, and Dugald Stewart, who taught philosophy at Edinburgh University. I earlier mentioned the Calton Hill, just east of here. On top of it there is a splendid monument, in the Greek style, to Dugald Stewart – a monument to Edinburgh's reputation as the modern Athens. Stewart was particularly keen on the notion that ordinary philosophy, and moral philosophy in particular, should be informed by economic considerations, such as those put forward by Adam Smith. To a lawyer this is in my opinion a most important insight; I think that economics can inform the law at almost every level.

I would emphasize the word "inform", however. Economics should not, as some American academics may have suggested, dictate the content of the law, but should rather be used as a tool to assess how effective legal rules are in practice. That is of great utility in deciding whether and if so how the existing law should be reformed. It is also in my view an important tool in the final stage of every legal decision – how the law should be applied to the facts. Every case in court must end with the application of the law to the facts as found by the judge, and my opinion the economic impact of any particular application of the law to the

facts as so found can be an important factor in deciding how the law should be applied in a particular situation.

The fundamental point that I would like to make is this: that in proposing or assessing legislation to deal with a particular subject it is always appropriate to look at how other comparable jurisdictions have treated that subject, and to consider what lessons can be learned from that treatment. That applies to legislation governing preventative restructuring. It applies in particular to the framework of such legislation and the procedures used. It applies to the factors that are considered relevant in evaluating a restructuring exercise; an obvious example of this is the significance of various classes of shares. It also applies to the significance of preferred creditors as against ordinary creditors. Finally, looking at other systems can provide valuable guidance as to the manner in which particular factors, commercial factors in particular, should be taken into account. In all of this, "plagiarism" can be very useful.

Transnational considerations

I have attempted to describe, briefly, how preventative restructuring represents a new approach to insolvency, based on commercial and economic considerations. The new approach is also supported by, and indeed greatly informed by, two other important changes that have affected the attitude of the law to insolvency.

The first of these is the much greater international dimension involved in modern economic dealings. This must obviously be addressed fully by the law.

It is no doubt true that commercial dealings have always crossed borders. Perhaps I can mention Scotland as an example. In the early modern period – the period from about 1450 to 1700 – Scotland had extensive dealings with countries ranging from France (the Bordeaux wine trade in particular) in the West to Poland and the Baltic in the east. There was a very active trade with the Netherlands, where the port of Veere in Zeeland, on one of the mouths of the Rhine, was declared a Scottish staple port; this gave Scottish merchants certain extraterritorial privileges. After the creation of the United Kingdom in 1707 Glasgow developed an enormous trade in tobacco with the British colonies in North America, and after the Industrial Revolution, from about 1760 onwards, Scottish manufactured goods were exported around the world, and raw materials were imported from around the world.

Nevertheless, the internationalisation of trade has increased dramatically over the last 60 years or thereby. This has led to the setting up of international entities, notably the European Union, but including a range of others around the world. These have greatly facilitated international trade, by reducing duties but more importantly by eliminating non-tariff barriers. Other important factors in the internationalisation of trade have been the growth of air transport and containerisation of goods transport. (The container was devised by Malcolm McLean, an American who came from a farming community in North Carolina which originated with settlement by Scottish Highlanders, mostly Jacobites, between about 1750 and 1775).

Also of enormous importance has been the growth of electronic means of communication. The telegraph and then the telephone (invented by Alexander Graham Bell, born in Edinburgh) started this trend, but the telephone is wholly eclipsed by the use of emails and the Internet, which have improved international communication to an almost unimaginable degree.

This is important at a very basic level. One of the topics that you will be considering is retail business and insolvency. The Internet has enabled retail business to cross borders with remarkable ease. This extends not merely to the retail sales themselves, but to the supply chains, often extremely elaborate, that enable goods to be supplied to the shops or now commonly warehouses that deal with the public. Goods can be ordered with the greatest of ease, and delivery systems have tried to keep pace.

Furthermore, retailers often carry on business with customers, either through shops or over the Internet, in a range of different countries. That in itself gives rise to transnational legal problems. Consumer rights will typically vary from one country to another. For example, in the United Kingdom under the Sale of Goods Act, if defective goods are supplied, the main remedy is to reject the goods and obtain a refund of the price. In other legal systems, for example the German Civil Code, the primary remedy is that the seller should have an opportunity to repair or replace the goods, before they can be rejected. About 13 years ago the European Union tried to harmonize consumer remedies, precisely in order to facilitate cross-border transactions. The proposal failed, however, because that was such a striking difference between the remedies available in different systems.

Apart from the position of consumers, employees in different countries are likely to have different legal rights. The property held in each of the countries concerned will almost invariably be subject to different legal regimes. All of this leads to inevitable complexity.

This internationalisation has important legal implications. The insolvency of, for example, a retail warehouse will involve dealings with and claims by parties who may be in a wide range of jurisdictions and a wide range of legal relationships. Those relationships may obviously be categorized differently by different jurisdictions. At this level, some degree of systematic rationalisation is clearly important. How can that be addressed? That is what you will be hearing about.

Intangible property

Yet a third development is of great importance to the manner in which insolvencies are structured. This is the increase in the importance of intangible, or incorporeal, property in commercial and economic life. Intangible property is a subject that has perhaps attracted less attention than it deserves in the teaching of law and in legal textbooks. Such property has no existence outside the legal system; it is entirely abstract, and thus has relatively limited contact with physical reality. Nevertheless, intangible property is of immense practical importance. In value terms, it is generally considered to amount to between 85% and 90% of the property in existence in a modern western economy.

Its shadowy nature, however, means that intangible property is often overlooked by those who seek to reform the law. Its abstract nature also means that it is often difficult to attribute an item of intangible property to one particular jurisdiction. This is especially true of matter held on the Internet. I recall being told when I was chairman of the Scottish Law Commission that the Commission's website was based on a server on the outskirts of Paris, and in most cases it is difficult if not impossible for an ordinary member of the public to discover where Internet material is physically located (in so far as one can speak of physical location – the "location" of such material is nothing more than a large series of ones and zeros in a computer which, as I have said, can be anywhere).

Intangible property takes a variety of forms, which are subject to a range of legal regimes. Several of those regimes are relatively prescriptive, which means that the general law is not as important as the basic statistic of 80 to 90% might suggest. Moreover many of those regimes take effect through international treaties or instruments. The special regimes include intellectual property rights – patents, copyrights and trademarks in particular. Copyrights were made the subject of an international convention, the Berne Convention, as long ago as 1886, although the Convention was only fully incorporated into the law of the United Kingdom by the Copyright, Designs and Patents Act 1988. Patents and trademarks are generally governed by EU law. It is clear from these examples that the regulation of intellectual property rights at an international level requires treaties or other international regimes which have force of law in a large number of different countries; that is the only way that consistent treatment and effective enforcement of such rights can be achieved. Otherwise the rights are too abstract, and cross borders too easily.

Other forms of intangible property include shares and bonds, which will usually be governed by the place of incorporation of the company and are thus perhaps less of a problem. Another important type of

property consists of interests in pension schemes; in the United Kingdom these are generally structured as trusts, because this ring-fences the necessary funds and thus gives a degree of protection against insolvency. Elsewhere, however, other structures are used.

Apart from the foregoing examples, intangible property includes debts and claims of every sort. These obviously include contractual debts, which are of importance in every insolvency, and remain of great importance in any restructuring arrangement. Those debts may be subject to numerous legal systems; indeed in a supply chain every step can conceivably be subject to a different legal regime. All of this inevitably produces pressure to standardize treatment on a transnational basis.

Mediation

Finally, I should refer to the session that is due to take place on Tuesday morning, dealing with mediation and reorganization proceedings. As is I hope clear from the foregoing discussion, the claims that are relevant to a reorganization are liable to vary greatly, not merely on the facts but in the law that is applicable to them and the differing legal regimes under which they may be enforced. Those claims are intangible property in themselves. A contractual claim may often relate to other intangible property. Intangible property, because of its abstract nature, leads to a lack of clarity, and sometimes uncertainty, in the way that rights are formulated. Moreover, the claims under consideration may have evidently differing prospects of success.

That is classic territory for the use of mediation. Mediation is especially useful in cases where there is an inherent uncertainty about the rights of the parties, as often results from transnational factors or the inherently abstract nature of intangible property. The mediator can point out the uncertainties, as well as the weaknesses of each side. This leads, frequently, to a willingness to compromise.

Furthermore, as I have tried to indicate, reorganization as an alternative to winding up reflects a modern, economically based, view of insolvency. Insolvency is not seen as the determination of the strict legal rights of the parties and the rigorous enforcement of those rights – the tree lying where it falls, as was said under the traditional approach. Instead, under the new approach, a major objective is the preservation of the business, or the viable parts of the business, as a commercial entity. In this way benefits are seen to accrue to the parties involved – employees, suppliers, customers, landlords, and those with intangible rights. The same applies to classes of shareholders, who may be asked to renounce some of their rights in order that the business can be preserved. This results, for example, in the so-called "cross-class cram down".

Pointing out the benefits of preserving the business, in whole or in part, can be a major advantage of mediation. This can lead to compromises, often of a complex nature, among the various parties involved. Achieving such compromise, however, is a skilled task, and is one which in my opinion is well suited to mediation. It is difficult to see how a judge can do that exercising ordinary judicial powers; judges generally speaking decide and enforce rights, duties, powers and liabilities; they do not, or should not, fudge that basic duty. But the mediator can, and should, do so, taking account of the importance to the parties involved of preserving the business or its viable parts.

I hope that this talk is given some flavour of what follows in this conference. I think that the topics covered are of great importance. In many insolvencies, reorganization represents the way ahead, and everything possible should be done to promote it and to refine the procedures that are used.