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Bankruptcy and a fresh start: stigma on failure and legal consequences of bankruptcy

United Kingdom*

* The scope of this report is limited primarily to the relevant laws governing insolvency in England and Wales.

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TITLE 1. INTRODUCTION

1.1. Historical and Political Development

This section provides an introduction to the aims of and background to English insolvency law together with general description of English insolvency legislation and applicable case law.

Insolvency procedures in England can be split into those applicable to private individuals or partnerships (bankruptcy) and those relating to limited companies (insolvency).

Until the mid-1980s the tools available to the English insolvency practitioners' were extremely limited. Until the entry into force of the Insolvency Act 1986 the insolvency procedure available to limited companies was one of three forms of liquidation procedure: members' (for solvent companies), and creditors' or compulsory, where the company was insolvent. Whilst it was possible for a liquidator to continue the business of a company insofar as it was beneficial for the overall purposes of the winding up, the ultimate goal was the winding up and dissolution of the legal entity.

No intermediate regime existed for companies experiencing temporary financial difficulties where strong underlying businesses needed simply a period free from the creditor action to enable them to restructure or otherwise be rescued.

Increasing concern at the resultant loss both of jobs and creditor return led to the formation in England of a committee under Sir Kenneth Cork. Established in 1977, the UK Government commissioned review, overseen by Cork, focussed on the law of insolvency, bankruptcy, liquidation and receivership. His review of the available insolvency procedures and their operation (set out in the Report of the Review Committee on Insolvency Law and Practice – cmnd 8558 of 1982) ('the Cork Report') formed the basis of subsequent legislation. The report and recommendations recognised the need for mechanisms which would facilitate the rescue and reconstruction of companies in addition to the process of (administrative) receivership (and, to a lesser extent, Schemes of Arrangement under the Companies Acts) which it felt had been the means by which many businesses and jobs had been saved up to that time. The mechanisms introduced by the Insolvency Act 1986 were Administration and Company Voluntary Arrangements.

The principal thrust of the Cook committee was the introduction of a procedure offering companies a statutory breathing space from creditor action provided that certain criteria were met. This took effect as Administration under Part II Insolvency Act 1986 (IA 1986'). The essence of the administration regime is a third party rescuer, operating within a statutory moratorium, taking over the management of a company's operations and eventually putting forward to creditors his proposals as to how the company might be saved or its assets disposed of.

The Cork Committee's consideration of the 'rescue culture', which it espoused, was focussed on the benefits to be had both by secured creditors and by the community at large in terms of businesses and jobs preserved as a result of floating charge receiverships. For Cork, such receiverships were the obvious and preferred means of business rescue. The creation of the administration procedure in the Insolvency Act 1986 was an attempt to fill the vacuum in those cases where companies had not granted a floating charge to a lender and whose business could not therefore be rescued by the traditional means of receivership. The extent to which administration was to be only a complement to receivership was shown by the creation of a veto of administration proceedings, which was exercisable by the holder of floating charge in favour of an administrative receivership.

As mentioned, the Insolvency Act 1986 also created an alternative rescue mechanism for companies, the Company Voluntary Arrangement procedure (‘CVA’s’). This formalised the ability of a company to come to a contractual arrangement with its creditors to pay less than 100 pence in the pound and, with the exception of a moratorium, mirrored the arrangements put in place for individual debtors. However, the take up of CVAs has been considered as relatively low and the absence of a moratorium has been identified as the reason why the procedure is infrequently used.

To combat this problem, the Insolvency Act 2000 provides for an optional moratorium in CVAs for small companies. Much of the Act was brought into force on 2nd April 2001, with the exceptions of those sections introducing the new company moratoriums and the model law on cross border insolvency, (to be introduced at an unspecified date).

While English insolvency law has historically sought to balance the promotion of entrepreneurs to set up in business knowing that the price of failure is not personal ruin, with the deterrence of the reckless and dishonest to gamble with creditors' money, during 1980s it was also felt that the balance had tilted too far towards protecting company management from the consequences of their actions. In this light the 1986 Insolvency Act sought also to impose higher standards of duty on company directors and extended the circumstances in which they could face personal liability particularly for trading whilst insolvent.

Under the new regulations laid in Parliament, bringing most of the provisions of the Insolvency Act 2000 into force from 2nd April 2001, additional fast track powers have been introduced to disqualify directors of insolvent companies whose conduct makes them unfit to be involved in the management of a company.

Much of the insolvency practitioner's work, nowadays is business support and reconstruction. This reflects the changed emphasis away from mechanistic insolvency procedures to a much broader problem solving culture. Provided company directors or creditors seek advice within a realistic time frame there is a good possibility of resolving financial problems before a formal insolvency becomes inevitable.

1.2. Overview of Current Insolvency Legislation

The principal legislation applicable to the reorganisation and liquidation of companies in England and Wales is the Insolvency Act 1986 (the *Insolvency Act*) and the Companies Acts of 1985 and 1989 (the *Companies Acts*). The Insolvency Act is supported by secondary legislation. References to legislation within this report are, unless otherwise indicated, references to the Insolvency Act (hereinafter, "(IA 1986”).

The Insolvency Act 1986 is divided into a number of different parts. The first group of Parts deal with Company insolvency and companies winding up. The second group of Parts deal with insolvency of individuals and bankruptcy, Part 3 covering miscellaneous matters bearing on both company and individual insolvency.

The Insolvency Act 1994 amended the Insolvency Act 1986 in relation to contracts for employment adopted by administrators, administrative receivers and certain other receivers; and makes corresponding provision for Northern Ireland. The Insolvency (No 2) Act 1994 amended the law relating to company insolvency and winding up, and the insolvency and bankruptcy of individuals, so far as it concerns the adjustment of certain transactions, and for connected purposes

The Insolvency Act 2000, mentioned above, obtained Royal Assent on 30 November 2000. It was intended to demonstrate the Government's commitment to support viable businesses and encourage entrepreneurship. The Act aims to:

- give small companies in financial difficulty the option of a breathing space within which to put a rescue plan (a Company Voluntary Arrangement (CVA)) to their creditors.
- improve the efficiency and effectiveness of the procedure for the disqualification of unfit company directors.

The Insolvency Act 2000 also makes other technical amendments to improve the operation of the current provisions in the Insolvency Act 1986 and the Company Directors Disqualification Act 1986.

There are a number of further changes currently underway in insolvency practice and procedure in the UK. Most notably, following much consultation, on 26 March 2002 the Enterprise Bill was introduced to the House of Commons. The Bill aims to modernise the UK's insolvency regime and contains provisions on both personal bankruptcy and corporate insolvency. These included: reducing the discharge period for most bankrupts; reviewing the relevance of statutory restrictions on un-discharged bankrupts; providing a tougher regime for bankrupts whose conduct has been irresponsible or reckless; restricting the right to appoint an administrative receiver; streamlining administration; abolishing Crown preference and modernising the financing regime of the Insolvency Service.

Various other legislation impinges on the insolvency process in the United Kingdom, much of which is beyond the scope of this report to discuss in detail. Most notably, among these are the Companies Acts, the Law of property Acts, the Civil Procedure Rules, Insolvency (Amendment) (No.2) Rules 1999, Insolvent Companies (Disqualification of Unfit Directors) Proceedings (Amendment) Rules 1999, the Insolvent Companies (Reports on Conduct of Directors) (Amendment) Rules 2001, the Welfare Reform and Pensions Act 1999 (Commencement No. 7) Order 2000.

A key element impinging on the insolvency process is the priority of creditors as this can often influence the procedure used and outcome reached, for example, unsecured creditors will try and avoid liquidation, while receivership tends to favour banks and other fixed charge holders. The order in which payments are made is fixed by statute (Insolvency legislation). The general rule is that the creditors are paid in the following priority:- (i) Secured creditors holding fixed charges such as a bank lending money backed by a mortgage on land and buildings. (ii) Preferential creditors, who can include, for example, government/crown departments who are statutorily preferred in the order of payment. (iii) Floating charge holders; floating charges "crystallise" on assets which are held by companies from time to time, e.g. perishables. (iv) General creditors, such as suppliers of goods and services, and other lenders who have a higher priority for recovering their losses than shareholders.

1.3. Overview of Insolvency Procedures

The Insolvency Act 1986 (IA 1986) established the regime for dealing with the affairs of both insolvent companies and individuals. It provides several courses of action available to a company or an individual in financial difficulty.[1] These will be described briefly below:

1.3.1 Options available for Companies

Administration: (Moratorium by creditors to allow a company to restructure) is a court-approved scheme under which the company obtains protection from a creditor's claims during a period where a scheme for its sale or reconstruction is approved by creditors. Described as equivalent in some ways to the US Chapter 11 procedure, the requirements for administration are prescribed by Section 8 IA 1986. Administration requires a court order, which may only be made where the court is satisfied that the company is or is likely to become unable to pay its debts. An order may be made on the petition of the company, its directors or a creditor. There are generally only a few hundred administrations per year in the UK, as other procedures may be cheaper and more flexible. In 2001, there was a total of 737, and in, as of April 2002 there were 220.[2] The administration procedure is seen as a highly effective way of securing reconstruction for more substantial business.

A Corporate Voluntary arrangement (CVA): (Voluntary Arrangement between the company and its creditors supervised by an insolvency practitioner), is a contractual agreement with a companies creditors, under which the company compromises its debts. It is a reasonably cheap procedure, as there is normally little court involvement, especially in those circumstances where creditors can expect a significant return. CVA's can be a highly beneficial way of dealing with what is perhaps a temporary crisis.

Receivership, (Appointment of receiver under a charge or debenture to recover a creditors funding (usually a bank)) involves the appointment of a receiver to collect in those assets over which he is appointed. A receivership can only be initiated by the holder of a charge who makes the appointment. In the case of an administrative receiver, he will be appointed over the whole or substantially the whole of the company under the provisions contained in a floating charge. Normally appointed by banks the procedure has the advantage of being able to be set up at very short notice and with the agreement of the receivers appointing bank, the funds will often be available to keep a business trading, where it is believed it is correct to do so. One of the main roles of receivers these days is trying to find a buyer so that the company does die off – as this increases the creditors chances of getting larger proportion of the debt back.

Liquidation: (Winding up a company voluntarily or through the courts) There are three types of liquidation. A member's voluntary liquidation takes place where the company will ultimately be able to pay all its creditors in full whilst a creditors' voluntary liquidation deals

[1] A consolidated Act of most of the Insolvency Act 1985 and relevant sections of the Companies Act 1985. It contains the legislation relating to insolvent companies and individuals in England and Wales since 29 December 1986.

[2] Deloitte & Touche UK and the London & Edinburgh Gazette.

with the affairs of a company which will not ultimately be able to pay in full. A compulsory liquidation is one initiated by a petition presented to the court. The liquidator's duty is to get in the company's assets, sell them and pay the creditors in order of statutory priority.

Deeds of Arrangement: Arrangement (governed by the Deeds of Arrangement Act 1914) proposed by the debtor for payments to his or her creditors. It is occasionally used instead of an individual voluntary arrangement, particularly where creditors already agree to the terms of the arrangement and are not likely to take other action to recover their debt.

These are now out of date for use in modern day insolvency. Individual Voluntary Arrangements have almost completely replaced Deeds of Arrangement because they are much more flexible in dealing with the various difficulties a debtor may face.

Schemes of Arrangement: Under Section 425 of the Companies Act 1985 a Company to which the Act applies can make an arrangement with its creditors or a class of them which is binding on all such creditors or class of creditors. To be binding, the Scheme must be accepted by the majority in number of the creditors representing 75% in value and must be approved by the Court regulatory authorities.

Informal Wind Downs: It is also possible for a business to cease trading without a formal procedure governed by the Insolvency Act 1986.

1.3.2. Options available for Individuals and Partnerships

Personal Insolvency deals with the affairs of those who are not protected by limited liability. In other words, individual persons with debts, partnerships and some unincorporated businesses. Difficulties are addressed via Individual Voluntary Arrangements, Partnership Voluntary Arrangements, Bankruptcies, Deeds of Arrangement and informal settlements with creditors.

Individual voluntary arrangement (IVA): Voluntary arrangement between an individual and creditors, supervised by an insolvency practitioner. An Individual Voluntary Arrangement is a binding agreement between a person and their creditors that gives them time to pay the money owed, or to pay at a reduced percentage. The intention is for the individual to avoid going Bankrupt whilst giving creditors more money back than they would get in a Bankruptcy.

The individual makes a proposal to repay what money they can, when they can, and the creditors then vote on whether this is acceptable to them. The creditors are free to ask for modifications to the proposals and may ask for more money over a longer period of time.

A Voluntary Arrangement is a very flexible procedure where an individual is free to propose what they want to creditors and can therefore meet their own needs for going forward whilst still giving a better return to creditors than if they went Bankrupt. An Insolvency Practitioner will normally assist the person in preparing their proposals and the person then asks the Insolvency Practitioner to act on their behalf. At this stage the Insolvency Practitioner is called a Nominee and must make a report to Court on the value of the proposals. The proposals are lodged at Court and a Judge is asked to grant the individual short-term protection from their creditors. The Nominee calls a meeting of the creditors, at which a vote his held as to whether or not the proposals are acceptable.

If more than 75% of creditors who vote support the proposals, then all those unsecured creditors who were notified of the creditors' meeting have to be bound by the terms of the proposals, whether or not they have accepted them. Shareholders only need to vote by majority for it to be approved by them. Once the proposals are accepted an Insolvency Practitioner becomes a Supervisor instead of a Nominee. Generally the Supervisor will not run the company but will merely monitor the trading which remains under the directors' control.

Bankruptcy: Bankruptcy is the traditional procedure for an individual who is unable to pay his debts. This can either be initiated by a creditor petitioning the court for the debtor to be made bankrupt or can be initiated by the debtor himself. A person becomes bankrupt when a Judge makes an Order in court declaring them to be insolvent in their own right. The person's assets are then treated on a similar basis as if the bankrupt had died intestate thereby creating a distribution. A trustee is appointed to take charge of the assets and distribute the value to the Bankrupt's creditors. The trustee is initially the Official Receiver and if there are assets they will generally seek to get an Insolvency Practitioner involved in their place.

Partnership administration: Moratorium to allow partnerships to restructure.

Partnership Voluntary arrangement (PVA): Voluntary arrangement between a partnership and its creditors, supervised by an insolvency practitioner. A Partnership Voluntary Arrangement is a fairly recent addition to insolvency law and is a binding agreement between a partnership and their creditors that gives them time to pay money owed, or even a reduced percentage. The intention is to allow the partners to avoid going Bankrupt whilst giving creditors more money back than they would get in a Bankruptcy of each of the partners. The partners make a proposal for repaying what money they can, when they can, to their creditors and the creditors then vote on whether this is acceptable to them. The creditors are free to ask for modifications to the proposals and may ask for more money over a longer period of time.

The Limited Liability Partnership: It has been possible to form Limited Liability Partnerships (**LLPs**) in England and Wales since 6 April 2001. The driving force for change was from professional partnerships, seeking to avoid joint and several liability for other partners' errors. Limited Liability Partnership Act 2000 and Limited Liability Partnership Regulations 2001 govern the legal position. Once the Insolvency Act 2000 has been fully implemented, it will be applied, as appropriate, to LLPs.

1.3.3 Miscellaneous Procedures

A number of problems fall between personal and corporate insolvency and are tackled by the use of Law of Property Act Receiverships, Fixed Charge Receiverships, informal wind-downs and treating unincorporated enterprises or partnerships as if they were actually companies.

LPA receiverships: LPA Receiverships are governed by the Law of Property Act 1925 and are one of only two types of formal appointment where the person appointed does not need to be an Insolvency Practitioner. A mortgagee who has lent money under a legal mortgage can appoint an LPA Receiver if a repayment has not been made for more than 3 months and a notice has been made on the borrower requiring repayment. The legal mortgage is created by a deed and if the deed or Law of Property Act are breached by the borrower then the mortgagee can also appoint an LPA Receiver. The borrower can be a company or an individual.

Fixed Charged Receiverships: These Receivers are very similar to LPA Receivers. They have similar powers and are appointed by a power in an instrument governing a fixed charge over assets. This is a rare instance where the Fixed Charge Receiver does not need to be an Insolvency Practitioner. The appointment can only be made when an event occurs which is defined in the security documentation as a default. The security documentation can allow a floating charge to be created as well as the fixed charge. The Receiver is limited to those powers defined in the security documentation alone, although this will generally allow them to take control and sell any charged assets.

1. DEFINITIONS AND TERMINOLOGY

Administration: The process where an insolvency practitioner (IP) is appointed by the court. In such a case the IP is known as the administrator.

Administrative receivership: The process where an IP is appointed by a floating charge holder to realise a company's assets and pay preferential creditors and the floating-charge holders' debt. In such a case the IP is known as the administrative receiver.

Administration Order: An administration order is a court order placing a company that is, or is likely to become, insolvent under the control of an administrator following a petition by the company, its directors or a creditor. The purpose of the order is to preserve the company's business and assets to allow a reorganisation or ensure the most advantageous realisation of its assets whilst protecting it from action by its creditors.

Bankrupt: Someone against whom a bankruptcy order has been made and who has not been discharged from bankruptcy.

Bankruptcy Order: The court order making an individual bankrupt (this replaces the concept of the receiving order and adjudication of bankruptcy in the old Act cases).

Charge: The appropriation of real or personal property for the discharge of a debt without giving the creditor any property in, or possession of, the subject of security.

Charging Order: Court order placing restrictions on the disposal of certain assets, such as property or securities, given after judgement and give priority of payment over other creditors.

Company Voluntary Arrangement (CVA): A voluntary arrangement for a company is a procedure whereby a plan of reorganisation or composition in satisfaction of debts, is put forward to creditors and shareholders. There is limited involvement by the court and the scheme is under the control of a supervisor.

Court-Appointed Receiver: A person not necessarily a licensed insolvency practitioner, appointed to take charge of assets usually where they are subject to some legal dispute. Not strictly an insolvency process, the procedure may be used other than for a limited company, e.g. to settle a partnership dispute.

Debenture: A document stating the terms of a loan, usually to a company. Debentures may be secured on part or all of a company's assets, or they may be unsecured. Often also referred to as a floating charge, and the lender is often referred to as the debenture holder.

Fixed charge: A security interest held over specific assets. The debtor cannot sell the assets without the consent of the secured creditor or repaying the amount secured by the charge.

Floating charge: A security interest held over general assets of a company. The assets may change (such as stock) and the company can use the assets without the consent of the secured creditor until the charge "crystallises" (becomes fixed). Crystallisation occurs on the appointment of an administrative receiver, when then company is wound up, or as otherwise provided for in the document creating the charge (in England and Wales).

Income payment order: The court may order payment of part of your wages, salary or other income to the trustee if your income is more then you or your family need to live on.

Individual Voluntary Arrangement (IVA): A voluntary arrangement for an individual is a procedure whereby the person comes to an arrangement with their creditors in how their debt will be discharged. Such a scheme requires the approval of the court and is under control of a supervisor and insolvency practitioner.

Insolvent: The state of not being able to pay one's debts as they fall due or having an excess of liabilities over assets. (Probably 90% of the adult population in this country or indeed the world are insolvent in real terms).

Insolvency Practitioner (IP): authorised Person by one of the chartered accountancy bodies, the law societies, the insolvency practitioners association or department of trade. The only person who may act as office holder in an insolvency proceeding.

Interim Order: An individual who intends to propose a voluntary arrangement to his creditors may apply to the court for an interim order which, if granted, precludes bankruptcy and other legal proceedings whilst the order is in force.

Judgement: Recognition of a debt given by a court.

Lien: Right to retain possession of assets or documents until settlement of a debt is made.

Liquidation: (Winding up) The procedure whereby the assets of a company or partnership are gathered in and realised, the liabilities met and surplus, if any, distributed to creditors.

Liquidator: The person appointed to deal with the assets and liabilities of the company or partnership once the resolution to wind up has been passed or a compulsory winding up order has been made.

Mortgage: A transfer of an interest in land or other property by way of security, redeemable upon performing the condition of paying a given sum of money.

Nominee: The person chosen by the individual or corporate debtor to report on the debtors proposals for an IVA or CVA.

Official Receiver: A civil servant employed by DTI to head the regional offices whose responsibilities cover bankruptcies and compulsory liquidations.

Petition: A written application for relief or remedy to the court.

Preferential creditor: A creditor in bankruptcy proceedings who is entitled to receive certain payments in priority to other unsecured creditors. These creditors include government departments, occupational pension schemes and employees.

Proof of Debt: The document submitted in an insolvency to establish a creditors claim, it may be informal (by letter) or in a prescribed form for bankruptcy and compulsory liquidations.

Proxy: The authority given by a creditor or member to another person (proxy holder) to attend a meeting and speak and vote at a meeting on behalf of the creditor or member.

Receivership: The general term applied when a person is appointed as a receiver or administrative receiver over certain assets.

Security: A charge or mortgage over assets taken to secure payment of a debt. If the debt is not paid, the lender has a right to sell the charge assets. Security documents can be very complex. The most common example is a mortgage over a property.

Statutory Demand: A formal notice requiring payment of a debt exceeding £750.00 within 21 days, in default of this demand bankruptcy or liquidation proceedings may be commenced without further notice.

Unsecured Creditor: Strictly, any creditor who does not hold security. More commonly used to refer to an ordinary creditor, who has no preferential rights, although, in fact preferential creditors will almost always be unsecured. In any event, the last in the queue, ahead only of shareholders.

TITLE 3. WARNING LIGHTS AND PREVENTION OF INSOLVENCY

One of the core concepts of company law, which can serve as a warning light of companies in financial difficulty, is that information about a company, 'its constitution' and financial status should be made available to the public. The purpose of this policy of openness and transparency is to enable anyone interested in the affairs of a company to have access to information they need to make an informed judgement on the company's financial affairs and the abilities of the company's management.

Section 711 of the Companies Act 1985 requires the Registrar of Companies to advertise the issue by him or receipt by him of certain documents in the *London Gazette*.[3] This is called the official notification and applies for all companies to among others things, the issue of any certificate of incorporation, the receipt of the company's accounts, the receipt of a copy of a wining up order.

The Registrar of Companies also keeps copies of the information supplied to him by the company and this is available for public inspection. This information includes the following:

- Particulars of the issue of shares
- Particulars of most charges (within 21 days)
- Particulars of all special, elective and extraordinary resolutions (within 15 days)
- The notice of accounting reference date
- The notice of any increase of capital
- The annual return (s.363 CA 1985

Limited companies are required by law to prepare a set of final accounts s.266 CA 1985. Once prepared the final accounts are laid before the company in general meeting s.241. This must be done within 7 months after the end of the company financial year in the case of a public company and within 10 months in the case of a private company. With some exception for small and medium companies all companies must also send a copy of their accounts to the Registrar of companies. These accounts are then a matter of public record s.241(3). However, the inherent limits of public accounts as a warning light of financial difficult are the risks of outright fraud and that the accounts can be considerable out of date by the time they are published.

In addition to these general reporting requirements we there are generally also statutory obligations on company directors providing penalties for those who carry on trading knowing that a company is or may become insolvent, these measures can in some cases provide a strong incentive for directors to blow the whistle at a early stage when rescue may be possible.

A number of organisations (both governmental and non-governmental) also seek to provide advice, guidance and assistance to individuals and companies experiencing financial difficulties and since the 1980, commentator's point to the contribution that may have been made by a change of approach over recent years on the part of banks with greater attention

[3] Official publication of the Government which contains legal notices.

being paid by them to the early identification of borrowers' problems and support for their resolution.[4]

In addition to formal "rescue" proceedings there are many informal "workouts" of situations in which companies have got into financial difficulty. A workout is usually a consensual arrangement between a company and its major creditors. An obvious example is the banks' "intensive care" strategies which encompass small and publicly quoted companies, of which the best known may be the so-called "London Approach" involving very large, multi-banked companies. The Bank of England has sponsored the framework for this approach in the UK. However, it is difficult to quantify to what degree "workouts" actually represent attempts at business rescues rather than merely an attempt to ensure repayment of a company's indebtedness over time so that the lender/creditor can end the relationship.

[4] Review of Company Rescue Mechanisms **A** Review of Company Rescue and Business Reconstruction Mechanisms. A Joint DTI / Treasury Review of Company Rescue Mechanisms available at http://www.insolvency.gov.uk/introduction/condoc/section1.htm Published in September 1999.

TITLE 4. LEGAL POSSIBILITIES TO CONTINUE ECONOMIC ACTIVITIES

Corporate Insolvency

As discussed above corporate Insolvency deals with the affairs of limited companies. The various scenarios that companies can enter into are Administrations, Administrative Receiverships, Creditors' Voluntary Liquidation, Members' Voluntary Liquidation's, Compulsory Liquidation's, Company Voluntary Arrangements and informal wind downs.

While liquidations can almost certainly spell the end of a business, depending upon circumstances the other actions may leave a viable enterprise. Restructuring a company's capital can even avoid the need for a formal insolvency procedure altogether. The Companies Acts also have a major bearing on what can and cannot be done, as well as The Insolvency Act 1986 and Company Directors Disqualification Act 1986.

Receivership

§ 1. Comprehensive description of the Regime and its underlying philosophy

1.1 Description

Although not strictly a form of rescue or restructuring, administrative receivership can sometimes result in the restructuring of a company. However, more usual then not the result will be liquidation. A receiver is a person who is appointed by or on behalf of a creditor to realise a security. His principal duty is to the appointing debenture holder. Receivers may be appointed by the debenture holder (provided the debenture so provides) or by the court. In practice the debenture holder makes nearly all appointments. The powers of the receiver are derived from the debenture under which he is appointed and certain sections of the Law of Property Act 1925. However, administrative receivers, as defined by the IA 1986, have additional statutory powers.

As receivers have more restricted powers then Administrative receivers, having no general powers of management over the company, the procedure in this way is not really designed for company rescue.

However, most receivers come within the definition of 'administrative receiver' (IA s.29(2)). The IA 1986 imposes certain duties on and grants certain powers to administrative receivers, which do not apply in the case of other receivers. Only a qualified insolvency practitioner can be appointed as an administrative receiver. An administrative receiver is:

a) a receiver or manager of the whole (or substantially the whole) of a company's property appointed by or on behalf of the holders of any debentures of the company secured by a charge, which as created, was a floating charge, or by such a charge and one or more other securities; or

b) a person who would be such a receiver or manager but for the appointment of some other person as the receiver of part of the company's property.

In practice, the person with a floating charge over the whole or substantially the whole of the company's property will usually be a bank. The bank is also likely to have fixed charges over land owned by the company and certain other assets (e.g., book debts) but these do not prevent it from appointing an administrative receiver.

1.2. Critical analysis

From the point of view of corporate rescue, the advantage of receivership is that a receiver has the power to step into the shoes of the directors and continue to manage the business of the company as a going concern, if that is regarded as the appropriate course. For that reason, when in 1982 the UK Cork Committee on Review of Insolvency Law proposed a corporate rescue procedure (the administration order) they stated that it was designed to fill a lacuna where there was no charge holder in a position to appoint a receiver who would have control over all or most of a company's assets. In other words, receivership was regarded as serving adequately to ensure survival of viable businesses or parts of businesses as going concerns, so that in those situations there would be no justification for a corporate rescue procedure. In addition, the administration order procedure in the UK includes power for such a charge holder to effectively veto any administration order by appointing a receiver. The reasoning behind this was that the receiver, given similar powers as an administrator, could do everything an administrator could do to "rescue" a company so there would be little point appointing an administrator.

However, the main disadvantage of receivership as a major corporate rescue procedure is that receivers' primary duties and loyalties are to the secured creditor who appointed them. Unlike liquidation, or other corporate rescue procedures, the receiver is not appointed as an agent of all creditors collectively, in order to maximise returns to all creditors. The main objection to the receivership process is that whilst receivers owe a duty of care to their appointors, they have very limited obligations to others. However, the Court of Appeal has recently clarified the position regarding receivers' obligations to debtors in the case of Medforth vs. Blake and others, and concluded that the receiver has wider obligations than was previously thought to be the case.[5]

Receiverships tend to be characterised by poorer returns to creditors than those in CVAs but better than in liquidations.[6] In most cases the administrative receiver will at least continue the viable parts of the business, with a view to a sale as a going concern. The receiver will draw up a strategy based on the facts that emerge from company staff and from his own professional valuers and legal advisers. He will assemble a sales package or memorandum for distribution to potential purchasers of the business. He will advertise the sale of the business and invite bids.

§ 2. Classification of the procedure among branches of law, competent jurisdictions, overview of the procedure followed before these jurisdictions, implications of private international law

2.1. Description

The debenture or document stating the terms of the loan establishes whether a receiver can be appointed and, if he has been appointed the powers that he actually has. Receivers may also

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[5] *Medforth v Blake* [1999] BCC 771

[6] Survey by the UK Society of Practitioners of Insolvency 1999.

be appointed by the court. A Law of Property Act Receiver is appointed by a lender who has a fixed charge over property under the statutory power given in section 109 Law of Property Act 1925.

The Insolvency Act 1986 introduced a codification of the appointment and powers of a receiver under a floating charge or by a floating charge and other securities.

The appointment of a receiver is only one of the remedies available to the debenture holders, who also have recourse to avenues of recovery open to creditors generally. A bank or other creditor with a floating charge may go to court to seek an administration order or seek a winding up.

2.2. Critical analysis

No additional comments

§ 3. Criteria to benefit from the regime

3.1. Description

As stated above receivers may be appointed by the debenture holder (provided the debenture so provides) or by the court. In practice the debenture holder makes nearly all appointments. The powers of the receiver are derived from the debenture under which he is appointed and certain sections of the Law of Property Act 1925. However, administrative receivers, as defined by the IA 1986, have additional statutory powers.

The debenture holder loses the right to appoint an administrative receiver once an administrator has been appointed but, until that time, can effectively veto administration by appointing an administrative receiver.

3.2. Critical analysis

As stated above the main disadvantage of receivership, as major corporate rescue procedure is that the receivers' primary duties and loyalties are to the secured creditor who appointed them.

§ 4 Specification of the possible initiators of the procedure

4.1. Description

See above point 3.1.

4.2. Critical analysis

See above point 3.2.

§ 5. Restructuring plan

5.1. Description

An administrative receiver is entitled to a statement of affairs from the directors (or in certain cases other officials) of the company. Within three months of his appointment (or longer if the court so directs) he must make a report which he must send to the Register of Companies and to creditors.

The report must give details of the events leading up to the appointment of the receiver, his dealings with the property of the company, his payments to the creditor who appointed him and to preferential creditors and an assessment of what will be available (if anything) to ordinary creditors, together with information on his carrying on or proposed carrying on of the business of the company.

As in most cases the administrative receiver will at least continue the viable parts of the business, with a view to a sale as a going concern, a strategy will be drawn up based on the facts that emerge from company staff and from his own professional valuers and legal advisers. He may also assemble a sales package or memorandum for distribution to potential purchasers of the business. He will advertise the sale of the business and invite bids.

The powers of a receiver are set out in Schedule 1 of the IA 1986.This includes the powers to take possession of property, to raise or borrow money, appoint solicitors or accountants, bring or defend legal actions, refer to arbitration, effect and maintain insurances, use the company seal, execute in the name of the company any deed receipt or other documentation, draw accept and endorse any bill of exchange or promissory note appoint agents, carry on the business of the company, establish subsidiaries, grant or accept a surrender of lease or tenancy, called up uncalled capital, present or default petition for the winding up of the company, and to change the situation of the registered office.

5.2. Critical analysis

No additional comments.

§ 6. Administration of the procedure

6.1. Description

The administrative receiver, when appointed, effectively replaces the directors in the management of the company. His appointment is therefore a matter of great importance to the members, creditors and employees of the company. The law recognises this and so grants powers to and imposes obligations on an administrative receiver, which makes his position very similar to an administrator.

An administrative receiver has all the powers conferred on him by the debenture under which he is appointed and also specific power listed in the IA 1986. The statutory powers include power to deal with the assets of the company, take or defend proceedings in its name and power to carry on the business of the company. These powers, listed in schedule 1 IA 1986 are the same as those granted to an administrator.

6.2. Critical analysis

The primary duty of any receiver is to realise the security of the debenture holder who appointed him. A receiver appointed on behalf of a floating charge holder (whether or not he is an administrative receiver as defined) is however, under a duty to pay preferential creditors in priority to the debt secured by the floating charge.

The administrative receiver is deemed to be the company's agent unless and until the company goes into liquidation. He is personally liable for contracts entered into by him, unless he has specifically contracted without personal liability. However, where the receiver is personally liable, he will be entitled to an indemnity out of the assets as long as he has acted within his powers and not negligently.

§ 7. The degree of protection of the actors implied in the procedure: public investors, creditors (secured and unsecured), shareholders stake holders,…), as well as the way to carry out this protection

7.1. Description

The registrar of companies must be informed of the appointment of a receiver within seven days. The registrar records the appointment in the register of charges. Additionally, every invoice, order for goods or business letter issued by or on behalf of the company being a document on or in which company's name appears, shall contain a statement that a receiver or manager has been appointed.

As stated above, while the primary duty of any receiver is to realise the security of the debenture holder who appointed him, a receiver appointed don behalf of a floating charge holder (whether or not he is an administrative receiver as defined) is however, under a duty to pay preferential creditors in priority to the debt secured by the floating charge.

The order of debts dealt with in Receivership are as follows:

(a) Realisations from assets with a fixed charge are paid to the fixed charge holder first and any surplus paid over to a liquidator.

(b) Realisations from a floating charge must be used to pay the Preferential Creditors in full before the debenture holder receives any payment.

(c) The receiver can not agree the unsecured claims or pay a dividend to unsecured creditors. This is for the liquidator to do.

As mentioned above, the administrative receiver must summon a meeting of the unsecured creditors within three months of his appointment to present the report.

To vote at the meeting, an unsecured (or partly-secured) creditor must have submitted written details of the claim to the receiver and any necessary proxy no later than noon on the business day before the date fixed for the meeting (unless the circumstances were beyond the creditor's control and the chairman allows). A creditor may not vote in respect of a debt that is unliquidated or not ascertained, unless the chairman admits a minimum value. A secured creditor can vote only in respect of the balance of the debt after deducting his estimate of the value of his security

7.2. Critical analysis

See above point 3.2.

§ 8.Termination of the procedure

8.1. Description

An administrative receiver of a company may at any time be removed from office by order of the court (but not otherwise) and may resign his office by giving notice of his resignation in the prescribed manner to such persons as may be prescribed. (s.45 (1) 1A 1986).

The administrative receiver is deemed to be the agent of the company (s.44 IA 1986). Any contract which he makes is therefore, binding on the company. The agency, however, ends when the company goes into liquidation.

8.2. Critical analysis

No additional comments

§ 9. Degree of information on the development of the procedure towards creditors (e.g. access to (court) files, etc.)

9.1. Description

Creditors should be notified within 28 days of the appointment of an administrative receiver (s.46 (1) (b) IA 1986)).

As well as reporting to the appointing debenture holder, the administrative receiver must send a report to the Registrar of Companies and to all creditors within three months of his appointment unless that period is extended by the court. (s.48 1A 1986).

The report will deal with the events leading up to his appointment, a summary of any statement of affairs submitted and any comments by the receiver, the manner of disposal of assets and the carrying on of business, the amounts of secured and preferential creditors and the likely outcome as regards other creditors. In the case of unsecured creditors this obligation need not be complied with if a notice is advertised in the same period stating an address from which the report can be freely obtained, or if the company has gone or goes into liquidation and a copy of the report is sent to the liquidator within the three-month period.

9.2. Critical analysis

No additional comments

§ 10. Costs related to the procedure, if applicable (e.g. fees trustee, receiver etc)

10.1. Description

The administrative receiver's remuneration is usually agreed with the appointing debenture holder and takes into account the responsibility and complexity of the work involved.

10.2. Critical analysis

No additional comments

§ 11. Competence, knowledge and functioning of insolvency (bankruptcy) courts

11.1. Description

See above point 1.1.

11.2. Critical analysis

See above point 1.1.

§ 12. Publicity conditions, if applicable (e.g. newspaper, official gazette);

12.1. Description

The liquidator shall, within 14 days after his appointment, publish in the Gazette and deliver to the registrar of companies for registration a notice of his appointment in the form prescribed by statutory instrument made by the Secretary of State.

Notice of the Creditors meeting must also be advertised in the newspaper in which the appointment of the administrative receiver appeared

12.2. Critical analysis

No additional comments

ADMINISTRATION

§ 1. Comprehensive description of the Regime and its underlying philosophy

1.1 Description

Prior to the Insolvency Act 1986, a company in financial difficulties that could no longer continue in business could go into liquidation, which would terminate the company, or it could go into receivership if, and only if, there was a debenture that contained the power for a receiver to be appointed. That meant that where there was no debenture, a receiver could not be appointed and liquidation was the only inevitable alternative. The administration order was intended to be the method by which companies could achieve the same effect as receivership even though there was no debenture.

An Administration is an effort by the company to buy some time from creditors to reorganise its business in order to avoid formal liquidation. A moratorium is obtained from the court for a company or partnership staying actions that creditors are taking or about to take. The Administration ring fences the assets of the company and prevents any single creditor attacking the company. An Order is granted by a Judge and an Insolvency Practitioner appointed as Administrator and takes control of the business. The Order is granted so that at least one of the following aims may be achieved.

a) The survival of the company, or a core part of it, as a going concern.

b) The approval of a voluntary arrangement or a composition in satisfaction of the company's debts, or a compromise or arrangement between the company and some or all of its members under s. 425 CA 1995; or by

c) A better realisation of the assets of the company than could be achieved in Liquidation.

The order can only be applied for if the business is insolvent or likely to become so in the near future. It must be proved to a Judge in court that the company will not be able to pay its debts. The Administrator is an officer of the court and should any creditor attempt to avoid the protection granted by the court then they can be held in contempt of the court. Secured creditors have to effectively agree to the Administration Order being applied for.

The presentation of the petition for administration order has an immediate and dramatic effect on the company. From the time when the petition is presented until the time when the court decides to make the order or to dismiss the petition a 'moratorium' is imposed on the company's debts. This means the creditors may not:

a) take any steps to enforce any security over the company's property (this does not, however, prevent appointment of an administrative receiver – see 23.2.2.3);

b) repossess goods in the company's possession under a hire-purchase agreement, a conditional sale agreement, a chattel leasing agreement or an agreement under which the vendor has retained title;

c) commence or continue proceedings, execution or other legal process against the company or its property;

d) levy distress against the company's property.

However any of these things can be done with the leave of the court. The object of these rules is to preserve the assets of the company so that if an order is made the administrator will have a better chance of saving the business.

1.2. Critical analysis

One of the aims of administration is to allow companies to be reorganised and refinanced. Once an Order is granted the business enjoys great protection and therefore it can only be applied for if everyone involved is confident that an aim will be achieved. While an administration order is in force, the company cannot go into liquidation and no administrative receiver can be appointed. (Section 11(3) 1A 1986). Where appropriate administrations may also be used to effect a better realisation of assets than liquidation. Administration is often a prelude to a CVA or a Section 425 Scheme whereby creditors agree to compromise their claims.

Despite the need for a court order an administration can be put in place very quickly in response to the urgent needs of a company and its business. The company then has the benefit of a stay on all creditors' actions and the administrator has wide powers to deal with not only the company's assets but also those of third parties subject, in some cases, to the court granting leave for the proposed action.

The administration procedure can be frustrated by the appointment of an administrative receiver by a debenture holder with floating charge (up to the point of the court order). In some cases the debenture holders (banks) are prepared to allow an Administration to go forward despite holding a floating charge thus indicating that they are content with the likely outcome of the procedure.

§ 2. Classification of the procedure among branches of law, competent jurisdictions, overview of the procedure followed before these jurisdictions, implications of private international law

2.1. Description

The legislation applicable to the administration of companies incorporated in England and Wales is Part II of the Insolvency Act 1986 and the Insolvency Rules 1986. Administration is an alternative to winding up and an administration order cannot, therefore be made once the company has gone into liquidation. This means that the passing of a winding up resolution by the company or the making of a winding up order preclude the making of an administration order. Similarly the making of an administration order prevents winding up.

Once an administration order has been made no appointment of an administrative receiver is possible. The rules give a creditor who can appoint an administrative receiver a right to veto administration but if he wishes to do so he must act quickly as the right to veto is lost if no appointment has been made by the time the petition for administration is heard.

2.2. Critical analysis

No additional comments

§ 3. Criteria to benefit from the regime

3.1. Description

The petitioner must show that the company is unable to pay its debts or is likely to become unable to pay its debts. The petitioner must swear an affidavit setting out the grounds for the petition. This may be supported by a report from an independent Insolvency practitioner, which sets out the practitioner's reasons for that at least one of the objectives can be achieved. If no such report is annexed to the petition, the petitioner must explain why none has been produced. In addition to proving inability to pay debts the petitioner must satisfy the court that the making of an administration order would be likely to achieve one or more of the following objectives:

a) the survival of the company, and the whole or any part of its undertaking as a going concern;

b) the approval of a voluntary arrangement or a composition in satisfaction of the company's debts, or a compromise or arrangement between the company and some or all of its members under s.425 CA 1985; or

c) a more advantageous realisation of the company's assets then could be effected on a winding up.

3.2. Critical analysis

In practice a petition not supported by a practitioners report is unlikely to succeed except perhaps in cases of great urgency.

§ 4 Specification of the possible initiators of the procedure

4.1. Description

A petition for the making of an administration order may be presented by the company, or its directors, or by a creditor or creditors (including any contingent or prospective creditor or creditors) or by any or all of those people together. (s. 9(1) IA 1986))

4.2. Critical analysis

No additional comments

§ 5. *Restructuring plan*

5.1. Description

Section 23 IA 1986 requires the administrator to prepare proposals as to how he is going to achieve the purpose for which he was appointed. These proposals must be sent to the Registrar of Companies and to all creditors (so far as the administrator is aware of their addresses) within three months of making the order unless the court extends the period. Copies of the proposal's must also either be sent to all members or the members must be given an opportunity to ask for free copies.

5.2. Critical analysis

The creditors are given a measure of control over the administration process, which balances the risk inherent during the moratorium created by an administration order. The administrator must hold a meeting of creditors within three months of the order (unless the court extends the period) at which the proposals are considered. If the proposals are accepted by the creditors' meeting then the administrator must manage the company in accordance with the proposals. The creditors' meeting may propose modifications to the proposals, but the administrator can reject such modifications.

If the creditors' meeting rejects the proposals the administrator musts go back to court. In such a case the court will probably discharge the administration order but it may also make any other order as it sees fit including a further administration order.

During the course of the administration the administrator may need to revise the proposals which have been accepted by the creditors. If he does so, and the revision appears to him to be substantial, then he must seek approval of the revision from a creditors' meeting (s.25).

§ 6. Administration of the procedure

6.1. Description

The administration order directs that the affairs, business and property of the company are managed by an administrator appointed by the court. The administrator must be a qualified insolvency practitioner.

6.2. Critical analysis

The administrator is given very wide powers to achieve the aims of the administration. He is given the power to do 'all such things as may be necessary for the management of the affairs, business and property of the company' s.14(1)(a)) and specific powers listed in schedule 1. These include power to bring and defend proceedings, sell assets, borrow money, insure and appoint agents. In case of difficulty, the administrator may apply to the court for directions.

§ 7. The degree of protection of the actors implied in the procedure: public investors, creditors (secured and unsecured), shareholders stake holders,…), as well as the way to carry out this protection

7.1. Description

See above points 5.1 and 5.2.

7.2. Critical analysis

See above points 5.1 and 5.2.

§ 8.Termination of the procedure

8.1. Description

The administrator may apply to the court for discharge of the order at any time. He must make such an application when it appears to him that the purpose for which the order was made has been achieved or has become incapable of achievement, or when required to do so by a creditors' meeting.

8.2. Critical analysis

No additional comments

§ 9. Degree of information on the development of the procedure towards creditors (e.g. access to (court) files, etc.)

9.1. Description

A creditors' meeting musts be held within 3 months (s.23(1)(b) of the making of the order. If the creditors decline to approve the administrator's proposals, the court may discharge the administration order and make such consequential provision as it sees fit (including overriding the creditors views).

9.2. Critical analysis

In practice, definitive proposals are often not to the creditors until more then three months after making the order.

§ 10. Costs related to the procedure, if applicable (e.g. fees trustee, receiver etc)

10.1. Description

Administrations have to be initiated by an application to court followed by a court order. Those preliminary steps will in practice involve lawyers in preparing an application to court and this is seen as expensive as is the involvement of the insolvency practitioner administrator (and often his staff) in controlling the company's affairs. The fact that the exit from administration is invariably through another procedure may add to the cost.

10.2. Critical analysis

No additional comments

§ 11. Competence, knowledge and functioning of insolvency (bankruptcy) courts

11.1. Description

The High Court of England and Wales has the power to place a company incorporated in England and Wales into Administration. In certain circumstances it also has the power to place overseas companies into Administration. The court has a discretion as to whether or not it will make an Administration Order. The court can exercise this discretion and refuse to make an administration order in cases where the company is viable even though technically insolvent. The Administration procedure is controlled by the court and the administrators are appointed by the court.

11.2. Critical analysis

No additional comments

§ 12. Publicity conditions, if applicable (e.g. newspaper, official gazette);

12.1. Description

The administrator must publicise his appointment immediately in the following ways:

- advertisement in the *London Gazette*;
- advertisement in a newspaper suitable to bring it to the creditors' attention;
- notice to the company;
- notice to debenture holders and to the Registrar of Companies.
- Notice must also be sent to all known creditors within 28 days of the appointment

Section 12 IA 1986 additionally provides that ‘very invoice, order for goods or business latter which, at a time when an administration order is in force in relation to a company, is issued by or on behalf of the company or the administrator, being a document on or in which the company's name appears, shall also contain the administrator's name and a statement that the affairs, business and property of the company are being managed by the administrator’.

12.2. Critical analysis

No additional comments

COMPANY VOLUNTARY ARRANGEMENT

§ 1. Comprehensive description of the Regime and its underlying philosophy

1.1 Description

The Insolvency Act 1986 sought to promote agreement between a company in difficulties and its creditors. The directors or (where the company is being wound up) the liquidator or (where an administration order is already in force) the administrator may make proposals to the company and its creditors. These proposals must, if they are to be put into effect under the Act, nominate a qualified insolvency practitioner to implement them. Where the nominee is not the liquidator or administrator, the person making the proposal (that is, the liquidator, administrator or directors) must submit details of the proposals and of the company’s creditors, debts, liabilities and assets to the nominee. The nominee must then submit a report to the court stating whether or not he thinks that meetings of members and creditors should be called to consider the proposals.

The proposals may be as simple or as complex as the situation of the company demands. In practical terms, the creditors are usually offered something definite as an alternative to what they might obtain if the company was, for example, to be wound up.

If more than 75% of creditors who vote support the proposals, and any modifications, then all those unsecured creditors who were notified of the creditors’ meeting have to be bound by the terms of the proposals, whether or not they have accepted them. Shareholders only need to vote by majority. Once the proposals are accepted an Insolvency Practitioner becomes a Supervisor instead of being a Nominee. Generally the Supervisor will not run the company but will merely monitor the trading which remains under the directors’ control.

The result of the meeting must be reported to the court. The court can reject the scheme on grounds of unfair prejudice or material irregularity.

1.2. Critical analysis

A Voluntary Arrangement is a very flexible procedure where the company can propose what it wants to creditors and therefore meet its own needs for going forward whilst still giving a better return to creditors than if the company had to stop trading, or enter another insolvency process.

There is no requirement for the company to be insolvent. There is a clear incentive for directors and managers of a company to seek to put a CVA in place as they remain in control of company and its affairs. Because the insolvency practitioner's role is limited to acting as a nominee and supervisor of an agreed arrangement there is no requirement for any reporting under the Company Directors Disqualification Act.

On the other hand the current absence of a stay on creditors' actions means that any creditor can pursue individual remedies and thereby frustrate collective agreement.

However, the government introduced a formal version of the moratorium in terms of ss1-4 and Schedules 1-3 of the Insolvency Act 2000. Schedule 1 of the Act inserts a new s1A into the Insolvency Act 1986, which provides that:

'Where the directors of an eligible company intend to make proposals for a voluntary arrangement, they may take steps to obtain a moratorium for the company.'

However, only if the proposal is made by the directors of the company that the CVA is eligible for moratorium. The provisions do not apply if the proposal is made by the liquidator or administrator of the company, although a moratorium will be in place following such appointment.

Further, the provisions only apply to an 'eligible company', which under the Act is a small company as defined by s.247 (3) of the CA 1985. Please note that these provisions are not yet in effect.

§ 2. Classification of the procedure among branches of law, competent jurisdictions, overview of the procedure followed before these jurisdictions, implications of private international law

2.1. Description

CVA’s are dealt with under Part I of the Insolvency Act 1986.

2.2. Critical analysis

No additional comments

§ 3. Criteria to benefit from the regime

3.1. Description

See above point 1.1. A proposal by the directors cannot be made if the company is subject to an administrator order or is being wound up.

3.2. Critical analysis

No additional comments

§ 4 Specification of the possible initiators of the procedure

4.1. Description

As stated above, the directors or (where the company is being wound up) the liquidator or (where an administration order is already in force) the administrator may make proposals to the company and its creditors. These proposals must, if they are to be put into effect under the Act, nominate a qualified insolvency practitioner to implement them. Where the nominee is not the liquidator or administrator, the person making the proposal (that is, the liquidator, administrator or directors) must submit details of the proposals and of the company's creditors, debts, liabilities and assets to the nominee.

4.2. Critical analysis

No additional comments

§ 5. Restructuring plan

5.1. Description

As stated above, in order to establish a voluntary arrangement a proposal must be prepared by the directors explaining why such an arrangement is desirable and why the creditors may be expected to agree to it.

The proposal is submitted to a 'nominee', who must be an authorised insolvency practitioner, for his consideration and comments. In practice the nominee will have assisted in preparing the proposal. The proposal must contain details of the assets to be included (or excluded) and any assets to be provided by others. Details must also be given of the nature and amount of the company's liabilities and the extent to which there may be claims from secured, preferential and connected creditors and the manner in which they are proposed to be dealt with. The proposal must set out the proposed duration of the voluntary arrangement, when creditors may expect a distribution and how much they may expect to receive. Estimates of the remuneration of the nominee and supervisor must also be disclosed, together with details of the supervisor's role and qualification.

5.2. Critical analysis

See above point 1.2.

§ 6. Administration of the procedure

6.1. Description

The directors and manager's of the company remain in control. The insolvency practitioners role is limited to acting as nominee and supervisor of an agreed arrangement.

6.2. Critical analysis

No additional comments

§ 7. The degree of protection of the actors implied in the procedure: public investors, creditors (secured and unsecured), shareholders stake holders,…), as well as the way to carry out this protection

7.1. Description

As stated above the nominee must submit a report to the court within 28 days of receiving notice of the proposal stating whether, in his opinion, meetings of the company and its creditors should be called to consider the proposal.

Creditors are entitled to vote provided written notice of their claims have been submitted to the chairman either before or at the meeting

Secured and preferential creditors enjoy a veto over the loss of their rights and exert a strong element of control over the process.

A CVA only binds an unsecured creditor if they had notice of the meeting in accordance with the Insolvency Rules (s. 5(2) (b) IA 1986))

7.2. Critical analysis

No additional comments

§ 8.Termination of the procedure

8.1. Description

Once the arrangement has been completed, the supervisor reports on the implementation of the arrangement.

8.2. Critical analysis

No additional comments

§ 9. Degree of information on the development of the procedure towards creditors (e.g. access to (court) files, etc.)

9.1. Description

See above point 7.1.

9.2. Critical analysis

No additional comments

§ 10. Costs related to the procedure, if applicable (e.g. fees trustee, receiver etc)

10.1. Description

Whilst cheaper than Administration a company in difficulties will often find the cost of the procedure a significant drain on scarce resources, particularly given the need to ensure adequate financing for continued trading.

10.2. Critical analysis

No additional comments

§ 11. Competence, knowledge and functioning of insolvency (bankruptcy) courts

11.1. Description

There is a limited amount of court involvement, most of which involves filing various documents at court. Where the nominee is not the administrator or the liquidator he must, within 28 days (or such longer period as the court may allow) after he is given notice of the proposal, submit a report to the court as to whether meetings of the shareholders and creditors should be summoned to consider the proposal. (S.2(2) IA 1986)).

After each meeting, the chairman of the meeting must report the result of the meeting to the court. (s.4(6) IA 1986)). The court is not required by the Insolvency Act or by the Insolvency Rules to do anything other than endorse on the report the date that it was filed in court. There is no court hearing at which the report is considered.

The court can also be involved where creditors and shareholders wish to challenge the decisions of the meetings or are dissatisfied with implementation of the proposals:

- where a creditor or shareholder has challenged the CVA, and the court is satisfied that there has been unfair prejudice or material irregularity, the court has the power to revoke or suspend the approvals given by the meetings (s.6(4) 1A 1986)).

on an application to the court in relation to dissatisfaction over implementation of the proposals, the court may confirm, reverse or modify any act, omission or decision of the supervisor. (s.7(3) IA 1986)).

11.2. Critical analysis

No additional comments

§ 12. Publicity conditions, if applicable (e.g. newspaper, official gazette);

12.1. Description

No additional comments

12.2. Critical analysis

A major advantage of this action is that the Voluntary Arrangement is not advertised in the press.

TITLE 5. LEGAL CONSEQUENCES OF BANKRUPTCY AND POSSIBILITIES FOR A 'FRESH START'

Chapter 5.1. Bankruptcy procedure

Company Insolvency Proceedings

Liquidation or Winding up:

The legislation applicable to the liquidation (both compulsory and voluntary) of companies incorporated in England and Wales is the Insolvency Act 1986 (the Insolvency Act). The most important of the subordinate legislation is contained in the Insolvency Rules 1986. The Company Directors Disqualification Act 1986 (the CDDA 1986) deals with the position of directors of insolvent companies. The Insolvency Bill 2000, which is expected to be enacted in late 2000, will amend both the Insolvency Act and the CDDA 1986.

There are separate provisions in the Insolvency Act dealing with unregistered companies which would apply to unregistered associations (provided they have been formed for gain or profit) and foreign companies (provided they have sufficient connection with the jurisdiction).

There are three types or winding up: compulsory liquidation and Members and Creditors voluntary liquidation. All three types are designed to bring the existence of a company to an end and to distribute its assets to those entitled to them.

5.1.1 Compulsory liquidation

Compulsory liquidation begins with a petition to the court. A petition can be presented on a number of grounds. By far the most common is that a company is unable to pay its debts (defined in s.123). A company is treated as being unable to pay its debts if:

i. a demand or payment in the prescribed form (a 'statutory demand'), for more than £750 (this figure may be changed from time to time by regulations) has been left at the companies registered office and the company has neglected to pay the debt, or to secure or compound for it (that is agree to a reasonable compromise) to the reasonable satisfaction of the creditor for three weeks; or

ii. execution or other process issued on a judgement, decree or court order is returned unsatisfied

iii. it is proved that the company is unable to pay taking into account the contingent and prospective liabilities; or

iv. it is proved that the value of the company's assets is less then the amount of its liabilities taking into account contingent and prospective liabilities.

Apart from the inability to pay debts there are other grounds on which a company may be wound up. These are, however, rarely used and are not considered in this report.

A petition for compulsory winding up may be presented by the company itself, any creditor or creditors (including contingent or prospective creditors), any contributory or contributories (the term 'contributory' includes members of the company and certain former members), and, in very limited circumstances, by the Department of Trade and Industry. In practice the overwhelming majority of petitions are presented by creditors.

Even where a creditor has proved grounds for winding up, the court have a discretion to refuse to make an order winding up the company. An order will normally be refused where:

i. The petitioning creditor (together with supporting creditors) is owed £750 or less. The is by analogy with the rule whereby a statutory demand for demand can be used as proof of inability to pay debts.

ii. The majority by value of the creditors oppose the winding up of the company.

5.1.2. Voluntary liquidation

Under s.84 IA 1986 a company can be wound up voluntarily if:

i. a special resolution to wind up is passed; or

ii. an extraordinary resolution is passed to the effect that the company should be wound up as in cannot continue in business because of its debts.

The winding up commences from the date of the passing of the appropriate resolution. A notice of the resolution must appear in the London Gazette within 14 days of its being passed.

There are two types of voluntary liquidation; a members' voluntary winding up and a creditors' voluntary winding up.

5.1.2.1. Members' voluntary winding up

This form of liquidation is utilised in the company is solvent. Within the five weeks immediately proceeding the date of the resolution, the directors (or majority of them) make a statutory declaration, setting out the company's assets and liabilities, and stating that they have made a full enquiry into the company's affairs and are of the opinion that the company will be able to pays its debts within 12 months of the commencement of the winding up. The declaration must be delivered to the registrar within 15 days after the day the resolution was passed.

5.1.2.2. Creditors' voluntary winding up

If no such 'declaration of solvency' is filed, the winding up is a creditors' winding up. A meeting of the creditors must be called for a day not later than the 14th day after the day on, which is held the meeting at which the members pass the winding-up resolution. Notice of the meeting must be posted to the creditors at least seven days before the creditors' meeting and the meeting must be advertised in the Gazette and at least two newspapers.

During the course of a members' voluntary winding up, it may become clear that the company will be unable to pay its debts within 12 months of the commencement of the winding up. If this happens the liquidator must report the fact to the creditors, call a creditors' meeting and convert the liquidation into a creditors' voluntary winding up.

For all forms of liquidation, any liquidator appointed must be a qualified insolvency practitioner.

Chapter 5.2. Legal effects of the Initiation of bankruptcy procedures [effects of initiation, suspension of payments etc legal obstacles or incentives to new investments or neutral]

5.2.1 Compulsory liquidation

When a winding-up order is made, the official receiver of the court becomes the liquidator of the company and continues in office until someone else is appointed (s. 136(2)). The official receiver may summon meetings of creditors and contributors with a view to the appointment of a liquidator. He must either do so or give notice that he intends not to do so within 12 weeks of the winding up order and may be required to call such a meeting by one quarter (by value) of the creditors.

Where the meeting of creditors and contributories are held, each meeting may nominate a liquidator. If the same person is nominated by each meeting, he becomes the liquidator. If different people are nominated, the creditors' nominee takes office unless a creditor or contributory successfully applies to the court for the appointment of the contributories' nominee or of some other person.

Once an order for compulsory liquidation has been made, no action can be started or proceeded with unless the leave of the court is obtained (s.130 IA 1986). In addition, at any time between presentation of the petition and the making of the order, the company, or any creditor or contributory, can apply to have any action pending against the company stayed (s.126 IA 1986). Furthermore, any execution, attachment, sequestration or distress started after the commencement of a compulsory liquidation is void. However, if the attachment or execution was begun before the presentation of the petition, it can only be avoided by the liquidator if it was completed after commencement of the liquidation.

5.2.2. Creditors' voluntary winding up

A meeting of the creditors must be held within 14 days of the meeting (of the members) at which the winding up resolution was passed. The creditors may nominate a liquidator at their meeting. He will then become liquidator of the company but any other director, member or creditor may apply to the court for the appointment of the members' nominee or some other person.

The members will often have appointed a liquidator at the meeting at which the resolution for creditors' winding up was passed. Such a liquidator is entitled to act until the creditors' meeting is held but during that period his powers are restricted to collecting the company's property, disposing of perishable goods or other goods which may decline in value and take other steps to protect the company's assets.

The liquidator, any creditor or member, may apply to the court to have actions started after the commencement of the liquidation process stayed. Such a stay is not granted automatically although, if the action is begun after the date of passing the resolution to wind up an insolvent company it will be granted. Any execution, attachment, sequestration or distress started after the commencement of a compulsory liquidation is void. However, if the attachment or execution was begun before the presentation of the petition, it can only be avoided by the liquidator if it was completed after commencement of the liquidation.

5.2.3 Members' Voluntary winding up

The liquidator is appointed by the members in general meeting.

The liquidator, any creditor or member, may apply to the court to have actions started after the commencement of the liquidation process stayed. Such a stay is not granted automatically although, if the action is begun after the date of passing the resolution to wind up an insolvent company it will be granted. Any execution, attachment, sequestration or distress started after the commencement of a compulsory liquidation is void. However, if the attachment or execution was begun before the presentation of the petition, it can only be avoided by the liquidator if it was completed after commencement of the liquidation.

Chapter 5.3. Legal effects of bankruptcy as such

Liquidation is designed to bring the existence of a company to an end and to distribute its assets to those entitled to them. The effect of liquidation is that the company ceases to exist as a commercial entity. When the liquidation is over the company is 'dissolved, that is it ceases to exist as a legal entity.

The compulsory liquidation of a company by the court is deemed to commence at the time of the presentation of the petition rather than at the date of the order. (s. 129 (2) IA 1986) Any disposition of the company's property and any transfer of shares made after the commencement of the winding-up is, unless the court orders otherwise, void. (s.127 1A 1986) Once the order has been made, no action can be started or continued against the company without the leave of the court. (s. 130(2) IA 1986) The directors' powers will also cease at that date. In addition, the business of the company ceases except to the extent necessary for it to be wound up.

A voluntary liquidation commences at the time of the passing of the shareholders' resolution for the winding up of the company. (s.86 IA 1986) The directors' powers will also cease at that date. (s.91(2) IA 1986) In addition, the business of the company ceases except to the extent necessary for it to be wound up.

When a CVL is commenced, there is no automatic moratorium on proceedings against the company. The liquidator or any creditor or shareholder may, however, apply to the court for a stay of any proceedings. Such a stay will not be granted automatically, but will usually be granted where proceedings were commenced after the shareholders' resolution.

Chapter 5.4. 'Excusability' following bankruptcy

Research by the UK Association of Business Recovery Professionals (R3), highlights the fact that many company directors are unaware that when a company goes into an insolvency procedure, the Insolvency Practitioner is required by law to file a report on the conduct of the directors and must do so as soon as he is aware of any malpractice. An adverse report could lead to the directors being disqualified from holding office for between 2 and 15 years. Research by the Association of Business Recovery Professionals shows that more then 50% of directors did not realise that non-executive directors owe the same duty of care to shareholders and creditors as executive directors. Two thirds did not know that their exposure could increase if they have a greater than average level of experience and expertise.

For the self-employed at least, the Enterprise Bill, currently going through the UK Parliament could mean that bankruptcy will not necessarily preclude further enterprising initiatives.

The Bill is designed to remove the stigma surrounding failure and seek to ensure another chance is possible for those who go bankrupt without fault. The most severe sanctions, will be applied only to those who act dishonestly, or with incompetence and recklessness. This legislation should contribute to creating a less punitive culture for the small business debtor by assuring there is less shame in failure and further opportunity to restart economic activities following bankruptcy.

Chapter 5.5. Responsibility of the Company's management in case in bankruptcy of a limited liability company.

Chapter X of Part IV of the IA 1986 on the winding up of companies registered under the companies Acts,– deals with malpractice before and during liquidation; penalisation of companies and company officers; investigations and prosecutions.

The Chapter makes the offences of fraud, misconduct, material omission and false representation and provides for summary remedies against directors and officers of a company

The company's directors and officers can be held personally liable to contribute to the assets of the company for any one of the following reasons:

- misfeasance or breach of any fiduciary or other duty (s. 212 IA 1986);
- fraudulent trading: Section 213 provides that where it appears that any business of the company has been carried on with intent to defraud creditors or for any fraudulent purpose the court may declare that any persons who were knowingly parties to the carrying on of business in that manner are liable to contribute to the company's assets. This section is not limited to directors and officers but applies to anyone who has been involved in carrying on the business of the company in a fraudulent manner. It is necessary to prove actual dishonesty; and
- wrongful trading: Section 214 applies only to directors, former directors and 'shadow directors' and only where such a director continues to trade after a time when he knew, or ought to have concluded, that there was no reasonable prospect of the company avoiding liquidation.

The company's officers can also be criminally liable under Sections 206-211 of the Insolvency Act for fraud, misconduct, falsification of the company's books, material omissions from statements and false representations. They are also liable to disqualification from being a director of any company for up to 15 years under the CDDA 1986. The Insolvency Act 2000 has introduced a more streamlined directors' disqualification procedure.

Company Directors Disqualification Act 1986

In 1986 the Company Directors Disqualification Act (CDDA): brought together all the previous disqualification legislation; and introduced new, tougher rules against those involved in the failure of a company and whose conduct called into question their fitness to be a director.

From April 2001, the Insolvency Act 2000 has also enabled the Secretary of State to accept disqualification undertakings from directors. These have the same effect as disqualification orders, but do not need a court to be involved.

A disqualification order can be made under the CDDA where

- certain criminal offences connected with the Companies Acts legislation have been committed,;
- wrongful trading (such as trading while insolvent;
- failure to comply with filing requirements under the Companies Act Legislation;
- unfit conduct in insolvent companies.

Where unfit conduct has been found the liquidator, administrative receiver, administrator or Official Receiver has a duty to send the Secretary of State for Trade and Industry a report on the conduct of all directors who were in office in the last 3 years of the company's trading. The Secretary of State has to decide whether it is in the public interest to seek a disqualification order against a director.

Examples of the most commonly reported conduct include; allowing the company to continue to trade when it was unable to pay its debts; failure to keep proper accounting records; failure to prepare and file accounts or make returns to Companies House; and failure to submit returns or pay the Crown any tax due.

Proceedings are brought by the Secretary of State for Trade and Industry or, usually in compulsory winding-up cases, by the Official Receiver at the direction of the Secretary of State. The matter is heard, and decided by the court, unless the Secretary of State accepts a disqualification undertaking from a director.

The minimum period of disqualification is 2 years and the maximum 15 years. A disqualification order usually carries with it an order to pay the costs and expenses of the Secretary of State or the Official Receiver or both.

Unless he or she has court permission, the person is disqualified for the period stated in the order or undertaking from:

- being a director of a company;
- acting as receiver of a company's property;
- directly or indirectly being concerned or taking part in the promotion, formation or management of a company; or
- being a member of or being concerned or taking part in the promotion, formation or management of a limited liability partnership.

He or she is also absolutely disqualified during the disqualification period from acting as an insolvency practitioner.

TITLE 6. PROSPECTS AND RECEOMMENDATIONS

Since the wide reaching review of UK insolvency legislation and the publication of the Cook report in the mid 1980's a great deal of legislative change has been undertaken to alter the perceived negative effects and public perception of insolvency in the UK.

Most recently the Insolvency Act 2000, certain provisions of which came into force in 2001 had the aim of giving small companies in financial difficulty the option of a moratorium within which to put a rescue plan (a Company Voluntary Arrangement (CVA)) to their creditors. The Act also seeks to improve the efficiency and effectiveness of the procedure for the disqualification of unfit company directors.

The Enterprise Bill currently before parliament in turn aims to

- Alter the current situation where all bankrupts (regardless of fault) are automatically discharged in three years, provided only that they co-operate with the trustee. The Enterprise Bill will provide those bankrupts who have failed through no fault of their own with a second chance and thus reduce the stigma of bankruptcy. A bankrupt who has been found not guilty of irresponsible conduct towards his creditors will be discharged as soon as it practical. This could potentially be in a matter of months or even weeks. However, if found guilty, a bankrupt may well be subject to a 'bankruptcy restrictions order' (i.e. subject to all the disabilities attaching to a bankrupt) for up to 15 years
- Ensure that companies in financial difficulty do not fail unnecessarily. This will be facilitated by restricting the use of administrative receivership - which places effective control in the hands of a single secured creditor. The reasoning behind the Bill is that it is wrong to let a single secured creditor control an insolvency process under the terms of a contract entered into by the borrower years earlier, when insolvency was not an issue. Court controlled procedures will instead be promoted. The balance will be shifted in favour of administration, which has been recognised as an effective tool in encouraging company rescue, and which takes account of the interests of all creditors, including small firms. The administration procedure will be improved - becoming quicker, more flexible, easier to access and fairer.
- abolish the Crown's preferential rights to recover unpaid taxes ahead of other creditors, bringing real benefits to unsecured creditors, including many small businesses.
- modernise the financial regime of the Insolvency Service, simplifying the fee structure and bringing increased transparency and simplicity, and improving the investment return on insolvent estates thereby benefiting creditors.

Through the Enterprise Bill the Government is seeking to build a stronger enterprise culture in Britain. The Bill provides a range of measures to enhance enterprise through strengthening competition, transforming the current approach to bankruptcy and corporate rescue, and empowering consumers.

TITLE 7. STATE OF KNOWLEDGE

Textbooks:

Berry, Bailey and Schaw Miller on Personal Insolvency

Butterworths Insolvency Law Handbook

Scott Slorach & Jason Ellis, Business Law

White Papers:

Productivity and Enterprise: Insolvency: A Second Chance July 2001

Summary of Responses to White Paper (28 November 2001)

(All texts are available at the following web site www.insolvency.gov.uk)

Regulatory Impact Assessment:

Regulatory Impact Assessment for insolvency provisions in Enterprise Bill as introduced to House of Commons on 26 March 2002. The Enterprise Bill insolvency provisions – regulatory impact assessment

(All texts are available at the following web site www.insolvency.gov.uk)

Government Reviews and Documents:

A Review of Company Rescue and Business Reconstruction Mechanisms: The review was set up by agreement between the Chancellor of the Exchequer and the Secretary of State for Trade and Industry.

Bankruptcy: A fresh Start

A Review of Company Rescue and Business Reconstruction Mechanisms: Report by the Review Group (Department of Trade and Industry, Insolvency Service and from HM Treasury)

An update on Bankruptcy Proposals (26 March 2002)

(All texts are available at the following web site www.insolvency.gov.uk)

Legislation:

Insolvency Act 1986 (the *Insolvency Act*)

The Insolvency Rules 1986 (the *Insolvency Rules*).

Insolvency Act 1994

Insolvency Act (No 2) 1994

Companies Acts of 1985 and 1989 (the *Companies Acts*

Insolvency Act 2000

Entreprise Bill (Published 26 March)

Company Directors Disqualification Act 1986

Council Regulation 1346/2000/EC on insolvency proceedings

Articles

The Implications for British Business of the latest Insolvency Statistics - James Thurston November 2001 Association of Business Recovery Professionals. http://www.r3.org.uk/

Corporate debt restructuring: Key stages: *Michael Castle and Daniella Siretz, Allen & Overy (Practical law Company).*

Annual company and personal insolvency surveys 2001 Association of Business Recovery Professionals.

Research and Surveys

Association of Business Recovery Professionals - It was established, (originally as SPI), in 1990. SPI was the Society of Practitioners of Insolvency. http://www.r3.org.uk/