



The Second Forum for Asian Insolvency Reform (FAIR)

Bangkok, Thailand 16 – 17 December 2002

In partnership with

The Government of Japan
and

The World Bank



Hosted by the

The Ministry of Justice of the Kingdom of Thailand



Proposals for UK Insolvency Law Reform: The Enterprise Act 2002
Mr. Stephen Adamson, UK

PROPOSALS FOR UK INSOLVENCY LAW REFORM

THE ENTERPRISE ACT 2002

Sixteen years ago, the insolvency law and practice in the United Kingdom was radically changed with the Insolvency Act 1986 which with other supporting law introduced the role of administrator. This person, who had to hold a licence, is an insolvency practitioner, who is appointed by the Court and under the current law required an ex parte independent report (“the 2.2 report”) to show that the process was capable of achieving one or more of four purposes. Three of these were for rehabilitation purposes, i.e. going concern sale or one of two types of compromises with creditors. The fourth purpose was to achieve a better outcome for creditors than would be achieved in a winding up (i.e. liquidation).

A moratorium was created which allowed the administrator time to prepare proposals and present them to creditors, to whom he/she was responsible.

This process should not be regarded as the same under Chapter 11 of the US Bankruptcy Code as, in the latter, the debtor stays in possession and has the exclusive right to prepare a plan. In the UK, the administrator takes complete control of the assets, can trade the business, remove directors, etc. The difference between the two processes was highlighted by the innovative Protocol which was developed in the case of Maxwell Corporate Communications PLC.

By and large, the administration process has been successful as it allows the practitioner considerable scope in achieving rehabilitation. It was never designed to replace the right of a lender with a floating charge to appoint an administrative receiver.

Some of the largest collapses in the UK have involved corporates which were too large to have granted security and were successfully dealt with by the administrator.

The Cork Committee, under Sir Kenneth Cork, which had reported in 1982 on the first full scale examination of UK insolvency law for 50 years, expressly approved the efficiency of receiverships but it recommended an alternative process to deal with corporates which had not granted floating charges and would otherwise have gone into a liquidation process.

However, all of this thinking and process are now to be radically altered under the provisions of the Enterprise Act of 2002 which only received Royal Assent on 7 November of this year.

In its White Paper, “Productivity and Enterprise: Insolvency – a Second Chance”, the Government presented its proposals to modernise and reform current UK insolvency laws. Invitations to comment on the proposals were invited, culminating in the final provisions.

It is envisaged that these provisions will come into effect in 2004. However, the processes will be deeply affected by new Insolvency Rules which have not yet been published.

It is relevant to consider what prompted the Government to bring forward these proposals. A particularly favourable view on the state of entrepreneurship in the United States led the UK Government to conclude that the insolvency regime did not favour businesses being rescued when they fell into trouble. Also the Government felt that the use of receiverships by lenders cause premature collapse. To a practitioner who has observed how carefully the secured lenders have used their powers, the latter view is definitely challengeable. The work out lenders have been careful in making such appointments.

There are six principal areas where reform has been introduced. Of these, two relate to individual bankruptcy and are not dealt with in this paper. The remaining four are:

- Administrative Procedure
- Administrative Receivership
- Crown Preferential Status
- Insolvency Services Account

The Act can be viewed on www.insolvency.gov.uk.

In summary, the changes that are proposed will affect not only practitioners, but also institutions which extend credit to UK corporates.

The administration process will be significantly changed from that described at the beginning of this paper.

Holders of floating charges will not be able to appoint an administrative receiver except in relation to capital market transactions and for those floating charges in existence at the date that the Act becomes law.

Crown preference (taxes such as income tax, VAT) is abolished and unsecured creditors will be apportioned a sum (as yet undecided) out of the funds that would have been available to the Crown.

Summary of the changes to insolvency included in the Enterprise Act of 2002

THE LAW AS IT IS	THE LAW AS AMENDED
<p>1. <u>Administration</u></p> <p>Court procedure: An application by directors, company or creditors; one of four specified purposes with no hierarchy; administrator's proposals and meeting of creditors called within three months; no time limit as to duration, but court may require reports at various stages; moratorium.</p>	<p>Court procedure: An application by the company and/or directors and/or creditors; Out of Court: appointment by the holder of a qualifying floating charge or the company or the directors; three purposes (hierarchical); emphasis on the rescue of the company (not the business); the administrator to perform his functions in the interests of the creditors as a whole; administrator's proposals within 28 days, creditors' meeting within 6 weeks; time limit of 3 months which can be extended by creditors' consent to 6 months, but further extensions require court sanction; moratorium.</p>
<p>2. <u>Administrative Receivership</u></p> <p>The holder of a floating charge over the whole (or substantially whole) of a company's property may appoint an administrative receiver. The administrative receiver generally only has duties to his appointor; realises company assets to satisfy the charge of his appointor.</p>	<p>Appointment of an administrative receiver prohibited in relation to post-Act changes, except for capital market transactions, public/private partnerships, utility projects, project finance, financial markets and registered social landlords.</p>
<p>3. <u>Crown Preferential status</u></p> <p>HM Customs & Excise and Inland Revenue rank ahead of floating charge holders in relation to realisations of the company's assets.</p>	<p>HM Customs & Excise and Inland Revenue preferential status abolished; a portion of the company's assets ring-fenced for the benefit of unsecured creditors.</p>

A fundamental change is that administrators can be appointed both in and out of Court. However, the administrator will always be an officer of the Court. Out of court appointments can be made by the holder of a qualifying floating charge or by the company or its directors provided that proper notice has been given.

Court appointments will be made in a similar way to the present regime but will not require the expenses of preparing an independent 2.2 report (see above). Some criticism has been made as these reports have become "over engineered" and hence the costs of entering administration have been too high.

The purposes of an administration have been reduced from the present four under section 8(3) IA 86 to three. Under paragraph 3 of Schedule 16 to the Act:-

"The administrator of a company must perform his functions:

- with the objective of rescuing the company, or
- where it is not reasonably practicable to rescue the company, with the objective of achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being in administration), or
- where it is not reasonably practicable to rescue the company or achieve the result mentioned in paragraph (b), with the object of realising property in order to make a distribution to one or more secured or preferential creditors."

A part of the fundamental thinking behind the new Act is that the company should be saved if at all possible as opposed to its business. Under the administrative receivership regime, the lender would have the right of almost immediate appointment upon a default. The administrative receiver could then take charge of the business and sell the assets from out of the company and, with certain obligations to the unsecured and preferential creditors, attempt to repay the lender its debt.

The administrator is required to act in the interests of the creditors as a whole or, where realising a secured asset, he/she has to avoid unnecessarily damaging the interests of the creditors as a whole. The holders of a qualifying floating charge may apply to the Court to have a specified person as administrator if the company or its directors (who have to give five days written notice) intend to appoint an administrator of their choice out of Court.

The administrator must now convene a meeting of creditors within eight weeks as opposed to currently having to hold a meeting within three months.

Administrations will automatically cease after a limited period but with the consent of all the secured creditors and more than 50% of the unsecured creditors, the administration can be extended for three months; the Court must approve any further extension.

The Act prevents the holders of a floating charge from appointing an administrative receiver, except in cases involving capital market transactions, or where the floating charge in question was created prior to the new Act coming into force.

As stated above, the Crown will give up its preferential status in relation to PAYE (Income Tax) and VAT when the Act comes into effect. An amount, as yet undecided, will be ringfenced for the unsecured creditors and will be taken out of the funds that would otherwise have been payable to the Crown. Employees will continue to have preferential status.

The Insolvency Services Account has long been a bete noire of insolvency practitioners in that the law required, in certain insolvencies, for funds to be paid into this account which is maintained by the Insolvency Services Agency, a part of Government. Creditors of the insolvent estates have effectively had to suffer the fees charged by the Agency. Full details of the new charges are not available but the intention is to simplify the process.

Whether it is right or not, the Government believes that administrative receiverships did not assist the rehabilitation of companies and were not sufficiently “transparent” or acceptable to creditors.

The Government also believes that administrative receivership causes the unnecessary failure of companies, does not maximise economic value and is not transparent and accountable to all creditors. The new streamlined administration procedure is intended to address the perceived shortcomings of administrative receiverships, but at the same time reassure lenders that they have some form of protection in the event of default and maintain a stable cost of lending by matching the flexibility and cost effectiveness of an administrative receivership with the inclusiveness of an administration. The Government believes that the new procedure should ensure:

- a better alignment of incentives;
- survival of viable companies;
- better returns for creditors;
- the preservation of value in the economy.

Full consideration of the checks and balances, which must always be present to ensure equity between the various classes of creditors, the directors and the shareholders, can only be given when the supporting legislation to the Enterprise Act 2002 is published. Experience tells me that when altering one part of the process, there is usually an unforeseen and adverse effect. However, it is to be hoped that the new Act will

achieve the aims of its promoters in preserving value for creditors and giving a troubled corporate every chance to be rehabilitated.

The author is indebted to John Verrill of Lawrence Graham, London, for the use of the tables shown above and attached.

Stephen J L Adamson
London, UK
December 2002

**SUMMARY OF THE INSOLVENCY PROVISIONS
OF THE ENTERPRISE ACT**

	SECTION IN NEW ACT	PROVISIONS	HOW PROVISIONS AFFECT EXISTING INSOLVENCY LEGISLATION
1	s243-244; Sch16; Sch 17	New administration procedure and requirements.	Replaces Part 2 of the Insolvency Act 1986 (“IA86”) in its entirety; inserts Sch B1 after Sch A1 of IA86.
2	s245; Sch.18	Prohibits the appointment of administrative receivers except in certain circumstances.	Inserts Chapter IV in Part III of IA86; inserts Sch 2A in IA86
3	s246 and s247	Abolition of Crown preferential status and the ring-fencing of a part of the assets of the company for the benefit of unsecured creditors.	Paragraphs 1, 2, 3 to 5C, 6 and 7 of Sch 6 of IA86 cease to have effect.
4	s251 to s255; Sch 19; Sch 20; Sch 21	Reduces the automatic discharge period from 3 years to 12 months; introduces bankruptcy restriction orders.	Replaces s279 IA86; Inserts s281(a) IA86; substitutes s289 IA86; amends s310 IA86; inserts s310(a) IA86; Inserts Sch 4A IA86.
5	s256	Generally the bankrupt’s interest in his home ceases to be part of his estate three years from the date of the commencement of the bankruptcy.	Inserts s283A IA86; amends s313 IA86; inserts s313A IA86.
6	s259; Sch 22; Sch 23	The Official Receiver may be the nominee and/or supervisor of an individual voluntary arrangement proposed by a bankrupt using the fast track procedure;	Substitutes s261 IA86; inserts s263A-G IA86; inserts s389B IA86.
7	s265 to 267	Reform of the Insolvency Services Account and the fees charged thereon.	Inserts s415A IA86; inserts paragraph 16A in schedule 8 IA86; inserts paragraph 21A in schedule 9 IA86; s405 IA86 ceases to have effect; substitutes s408 IA86
8	s268 to 276	Supplementary provisions dealing with interpretation; consequential amendments; commencement and short title	