

## ADMINISTRATIVE SUPPORT TO THE JUDICIARY IN THE UK INSOLVENCY SYSTEM

Prepared by  
**Mr. Desmond Flynn,**  
Department of Trade and Industry  
London, UK

### Summary

In the UK the court, whilst exercising a nominal controlling jurisdiction over insolvency proceedings, in practice reserves its interventions for the *resolution of disputes* between interested parties to insolvency proceedings. Such interventions are almost invariably not of the court's own motion but rather in response to claims pressed by one of the parties to the insolvency procedure. The administration of all insolvency procedures is almost exclusively the province of public officials or insolvency professionals.

### History

The system of creditors' control of insolvency cases that existed from 1706 to 1831 and from 1869 to 1883 was replaced by a system of joint control, or creditor participation. Since 1883, with the passage of the Bankruptcy Act, **the conduct (and particularly the administration) of insolvencies** has been the province of either officials (civil servants) or private sector insolvency practitioners. The particular civil servants whose role was brought into existence by the Bankruptcy Act 1883 were **Official Receivers**. They are statutory office-holders (previously under the 1883 Act, the 1914 Bankruptcy Act and currently under the successor act, the Insolvency Act 1986 and the Company Directors Disqualification Act, 1986) who have, in discharging their office as official receiver, trustee or liquidator in relation to insolvency cases, a legal personality separate from the Crown and the Secretary of State for Trade and Industry within whose department they are employed. In addition to their position as statutory office-holders, Official Receivers and their deputies are also officers of the courts to which they are appointed. These (in many ways curious) attributes enable Official Receivers to exercise their functions with a considerable amount of independence from political control. Indeed whilst the current insolvency legislation (the **Insolvency Act, 1986**) provides that Official Receivers shall "act under the *general* (my emphasis) directions of the Secretary of State" it is settled law that this does not enable the Secretary of State to give directions to the Official Receiver in relation to specific cases. In other words the Secretary of State may direct how *all* cases are to be administered (within the law) he cannot direct how any *individual* case is to be dealt with. Despite these curiosities in their status Official Receivers and their staffs enjoy (if *enjoy* is the appropriate expression!) the same terms and conditions of employment as all other civil servants.

The dual status of Official Receivers (statutory office holders and officers of the court) enjoys further, practical recognition in the fact that, uniquely in insolvency proceedings, they are able to make reports to the court and the law provides that such reports are *prima facie* evidence of the matters (of fact) contained in them. All other parties (including any other office-holders) seeking the court's intervention must adduce evidence by way of *affidavit* (now called a statement of truth).

### Private sector insolvency practitioners

Despite that the principal impetus for the bringing into being of Official Receivers was the large number of scandals involving legal practice in general and bankruptcy trustees in particular in the period 1830-1860 (for a trenchant insight into the appalling state of affairs of this branch of the law read *Charles Dickens*) private sector insolvency practitioners have always played a major role in the administration of insolvencies and particularly corporate insolvencies. Under current UK insolvency law insolvency procedures may be divided into two classes, those **ordered** by the court (on the petition of the debtor

herself/itself, of a creditor or of a public authority) and those set in train voluntarily by the debtor and her creditors:

<u>Court ordered proceedings</u> (Official Receiver involved)	<u>“Voluntary” proceedings</u> (Official Receiver not involved)
<ul style="list-style-type: none"><li>• <b>Bankruptcy (of individuals)</b></li><li>• <b>Administration of estates of deceased insolvents</b></li><li>• <b>Winding up of partnerships</b></li><li>• <b>Winding up of limited companies</b></li></ul>	<ul style="list-style-type: none"><li>• <b>Corporate and individual voluntary arrangements</b></li><li>• <b>Creditors voluntary liquidation (insolvent)</b></li><li>• <b>Members voluntary liquidation (solvent)</b></li><li>• <b>Administration</b></li></ul>

In practice, even where the court has made the order to initiate an insolvency proceeding, it rarely is (or needs to be) involved to any significant extent thereafter as regards the administration of the insolvency. The insolvency professional involved (be they Official Receivers and their staffs or private sector practitioners) are routinely expected to administer matters without the need to involve the court. The following examples may elucidate the extent to which routine administration is undertaken without recourse to the court:

- In a **bankruptcy** the court will make a bankruptcy order on the petition either of the debtor or of one of her creditors whereupon conduct of the case immediately passes to the Official Receiver attached to the court.
- The Official Receiver will immediately notify all the debtor’s creditors and any other interested parties (e.g. current suppliers of goods and/or services) and will take steps to protect the debtor’s assets.
- If the assets are minimal the Official Receiver will act as **trustee** but in cases where the assets are substantial he will summon a meeting of creditors. If the creditors resolve on the appointment of an insolvency practitioner as trustee in place of the Official Receiver notice of that appointment is simply filed with the court proceedings. Any dispute as to the conduct or conclusion of the meeting of creditors will be determined by the court – but this is very rare.
- Thereafter the trustee will realise the debtor’s assets, agree the claims of creditors and pay any dividends which realisations permit. The court is only likely to be involved in ordering possession of the debtor’s home (where the property has sufficient equity to justify its realisation) in the minority of cases in which the debtor does not give up possession voluntarily.
- If the debtor (or any third party) fails to give proper co-operation to the trustee the court may order such co-operation, and in the case of a recalcitrant debtor, may (on the application of the Official Receiver) suspend *pro tem* the coming into force of the automatic discharge after three years.

In summary, therefore, in the great majority of bankruptcies the court is unlikely to be involved at all after making the initial bankruptcy order and the same is true of court-ordered winding up, **compulsory liquidation**. In the drafting of the Insolvency Act 1986 the opportunity was taken to streamline the administration of, particularly, bankruptcies and compulsory liquidations where the automatic involvement of the Official Receiver (particularly where acting as trustee) was seen to be a guarantee of the proper working of such streamlined procedures which removed the need for the court’s involvement in many aspects of routine administration.

In **voluntary liquidations** the court will not, in most cases, be involved at all. Under this procedure the directors of an insolvent company approach an insolvency practitioner who in turn circulates the company’s creditors with an invitation to a creditors’ meeting together with financial information regarding

the company's affairs. On an appointed day the shareholders meet and formally resolve for liquidation and nominate an insolvency practitioner to be liquidator. The creditors then meet and either confirm the shareholders' choice of liquidator or elect a different one. The creditors may also elect a **liquidation committee** of creditors which can exercise some supervisory functions, grant the liquidator permissions to undertake certain acts and decide on the liquidator's remuneration. If there is no liquidation committee the liquidator must obtain such permissions from the creditors in general meeting or failing that from the court. Otherwise the whole of the liquidation will, in the vast majority of cases, be conducted without *any* reference to the court at all. The same is true of **members voluntary liquidations** where there is a presumption of solvency and the appointment of the liquidator and any supervision of him is in the hands of the shareholders. Again whilst the court is available to resolve disputes such liquidations are routinely undertaken without any reference to the court.

### **Individual and Corporate Voluntary Arrangements - Company Rescue Mechanisms**

The Insolvency Act 1986 was, substantially, an updating and streamlining of existing legislation. The Act did however provide for some 'new' procedures namely individual and corporate voluntary arrangements (IVAs and CVAs) and the Administration procedure. As may be imagined the voluntary arrangement procedures, both individual and corporate, provide for a company or individual to come to an agreement with its creditors to pay its debts, in whole or in part, over a period of time. In the case of an IVA a debtor approaches an insolvency practitioner who puts together a proposal which can be presented to creditors subject to the court agreeing that the matter can proceed. In most cases (nearly all) such agreement is 'rubberstamped'. When the creditors meet a 75% majority is required for acceptance of the proposal which, if accepted, is then supervised by the insolvency practitioner. He will make the realisations provided for in the agreement and distribute the funds realised (minus the expenses of the procedure) to the creditors. The court may be involved in resolving disputes regarding the meeting of creditors and voting on the proposal but, once accepted, the voluntary arrangement is essentially a contract between the debtor and the creditors. The court does have an important role to play in an IVA in that where the debtor and his insolvency practitioner seek approval for the holding of meetings they will also invariably seek an 'interim order' which is effectively a stay on all proceedings by creditors. Again that stay is routinely 'rubberstamped' by the court.

The position is somewhat different in CVAs because the Insolvency Act 1986 makes no provision for a stay on creditors actions in relation to the CVA procedure. (This has been advanced as one of the reasons why the CVA procedure has not been adopted in greater numbers since its inception.) Again the court must be notified of the terms of proposal and can direct that a creditors meeting should not be held where, for some reason, it feels the proposal to be inadequate. In practice creditors meetings are invariably held where a proposal has been put the court. Again once approved by a 75% majority of the creditors the voluntary arrangement becomes a contractual matter between the debtor company and its creditors with the realisation of assets provided for in the agreement being supervised by the insolvency practitioner who also undertakes the distribution in due course to creditors. As with IVAs the involvement of the court is, in practice, limited to resolving disputes about the creditors meeting and terms on which the voluntary arrangement was accepted. In practice such disputes are rare.

[Readers may care to note that the absence of a moratorium in connection with a CVA will shortly be cured when the Insolvency Act 2000 is brought into force later this year. This provides that a company seeking to reach an agreement with its creditors may, if wishes, have the benefit of a short moratorium – initially 28 days and thereafter extendable with the consent of creditors to a maximum of three months – provided an insolvency practitioner is involved. It is hoped that this will make the CVA procedure more attractive, particularly to smaller companies, and that this will in turn lead to an increase in the number of creditor company rescues.]

Clearly corporate voluntary arrangements are entered into in order to enable the debtor company to reach an agreement with its creditors and thereby to survive and continue trading. The other 'company rescue mechanism' introduced by the 1986 Insolvency Act was **Administration**. This procedure, arguably, provides a framework which may permit of consideration court involvement in the procedure.

**Forum for Asian Insolvency Reform**  
**Prepared by Mr. Desmond Flynn,**

Where a company is or is likely to become insolvent it may apply to the court for an order of its affairs, business and property should be managed by an administrator appointed by the court. The court would need to be persuaded that one of the statutory ‘purposes’ of making such an order will be achieved these being:

- The survival of the company, in whole or in part, as a going concern;
- The approval of the voluntary arrangement;
- The sanctioning of a scheme of arrangement under Section 425 of the Companies Act 1985; or
- A more advantageous realisation of the company’s assets than could be achieved in a winding up.

The potential for court involvement is not a product of the drafting of the law creating a scheme of Administration but rather of the fact that administration has often been used in relation to very large companies whose affairs are invariably complex and often with an international dimension. Certainly the powers granted by the legislation to an administrator are very wide indeed and give him (as well as the court) leave to consent to a number of actions by creditors in breach of the stay. The courts have made it clear that they expect the Administrator to exercise his professional and commercial judgment in deciding such matters so as to obviate as far as possible the need for such applications to be made to the court. In very substantial and complex Administrations (e.g. Olympia and York, Barings and Maxwell Communications) administrators have actively involved the court in promoting their strategies for the survival, in whole or in part, of those companies and their businesses and some of the success in those and other cases can be attributed to a high (and unusual!) degree of judicial inventiveness and innovation.

#### **Applications for Directions by the Insolvency Office Holder**

Another variation of the court’s function of dispute resolution is to respond to requests by office-holders seeking the court’s direction that they act in a certain way in situations in which there is inevitably going to be some trade-off between the rights of parties. Such an application for directions can, in such circumstances, be seen to anticipate the bringing of proceedings by one or more dissatisfied parties with the office-holder taking the initiative in bringing the relevant facts and the details of the parties in interest to the attention of the court in a strictly neutral way. Such neutrality as to the facts of any situation does not prevent the office-holder recommending what in his or her judgement would be the best outcome in the circumstances, indeed the court will rely on the professional experience and expertise of the office-holder to a considerable degree. Indeed in instances where the courts have felt that what they were being asked to decide was, essentially a commercial issue, they have declined to do arguing that such matters are properly left to the exercise of the commercial judgement of the office-holder. (In response to a relatively recent application by an office holder for an order that he take a particular course of action in relation to the business of the company with which he was dealing, the courts declined to make any order observing that the court “was not a bomb shelter” to provide comfort to office-holders in the exercise of their commercial judgement.

#### **The Authorisation and Regulation of Insolvency Practitioners**

The other principal area of innovation of the Insolvency Act 1986 was the creation of an insolvency practitioner profession through the medium of delegated regulation. The Act (Section 389) makes it an offence to act as an insolvency practitioner without being qualified to do so. Two methods of qualification are provided for in the Act the first, membership of and authorisation by a professional body recognised by the Secretary of State (Section 391) or, direct authorisation by a ‘competent authority’ for the time being the Secretary of State.

Historically insolvency practice in the UK has been the province of accountants and, to a lesser extent, lawyers. The idea of insolvency practice as a pre-eminent (rather than subsidiary) profession grew from the early 1960s with the formation of what was to become the Insolvency Practitioners Association. However at the time of the coming into force of the Insolvency Act 1986 the majority of those practising insolvency were not members of the Insolvency Practitioners Association but one of the accountancy or legal bodies. Thus it was that seven bodies were recognised by the Secretary of State as being able to authorise their

**Forum for Asian Insolvency Reform**  
**Prepared by Mr. Desmond Flynn,**

members to act as insolvency practitioners, a number which may seem very large in view of the fact that there are only some 1,800 practitioners in total of whom only 800 regularly take insolvency appointments. The recognised bodies are:

- The Institute of Chartered Accountants in England and Wales
- The Institute of Chartered Accountants in Scotland
- The Institute of Chartered Accountants in Ireland
- The Law Society (England and Wales)
- The Scottish Law Society
- The Association of Chartered Certified Accountants
- The Insolvency Practitioners Association

The majority of those who regularly take insolvency appointments are members either of the Institute of Chartered Accountants (England and Wales) or the Insolvency Practitioners Association.

There are two levels of monitoring in pursuit of authorisation. The first, the Secretary of State monitors the recognised professional bodies to ensure that they keep their rules up to date, that those rules are applied efficiently and effectively to those of their members they have authorised to act as insolvency practitioners and that their disciplinary arrangements function so as to ensure that high standards of technical, commercial, professional and ethical conduct are maintained. At a second level, the individual recognised professional bodies monitor their individual members ensuring compliance with insolvency legislation, the rules of the recognised body and agreed best practice across the profession. The Secretary of State directly licenses some 130 individuals who are subject to ongoing monitoring and inspection by officers from the Insolvency Service.

Each recognised professional body has the capacity under its own rules to discipline licence holding members and, in extreme cases, to remove those licences. Similarly the Secretary of State may remove someone's licence (or decline to re-new it) on the grounds that they are unfit although the exercise of this discretion by the Secretary of State is subject to appeal to an independent Insolvency Practitioners Tribunal. Some 6/8 insolvency practitioners have their licences revoked or not renewed each year and a number of others are subject to monitoring in respect of undertakings they have been asked for in relation to future behaviour.

To say that the 'professionalisation' of insolvency practice has been a success is to invite, no doubt, the wrath of the gods but by and large standards of professional behaviour in this area have risen substantially since the coming into force of the 1986 Act. There are very few cases of fraud, corruption or other criminality amongst insolvency practitioners and even fewer amongst Official Receivers and their staffs. That is not to say that there are not complaints about the way in which individual insolvency practitioners deal with individual cases or, more generally, about the level of fees, costs and charges in insolvency cases.

### **Conclusion**

The scheme of the Insolvency Act 1986 was very much to leave Official Receivers and insolvency practitioners to deal with as much of the routine and administration of insolvency cases as possible and indeed in "voluntary" proceedings to leave it to the insolvency professionals in its entirety. The long history of public service of Official Receivers and their staffs and, latterly, the effective regulation of insolvency practitioners as a profession have underpinned confidence in their capacity to administer insolvencies in a fair, efficient and objective way. It is clear from a number of recent pronouncements that the courts would not wish to have any larger role in case administration than at present.