Chapter 8

Legal Analysis: England and Wales

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8.1 Introduction

Compared with many of its European counterparts, England and Wales has traditionally been viewed as a predominantly creditor-friendly jurisdiction. In recent years, this actual or perceived favouring of creditors has been tempered to a degree by the promotion of a "rescue culture" in which one of the principal functions of English insolvency law is to facilitate the rehabilitation of troubled companies, with the aim of preserving and maximising value for creditors, shareholders, employees and other stakeholders.

The current law derives in large part from the enactment of the Insolvency Act 1986 ("IA 1986"). However, there have also been significant recent developments in English insolvency law, notably following the incorporation of the Enterprise Act 2002 ("EA 2002"), which introduced amongst other things the popular "out-of-court" administration route. In addition, wholesale changes have taken place in the cross-border arena, principally as a result of:

(a) the coming into force of the EC Regulation on Insolvency Proceedings on 31 May 2002 ("the Regulation"); and
(b) the adoption into domestic law of the UNCITRAL (UN Commission on International Trade Law) Model Law through the enactment of the Cross-Border Insolvency Rules on 4 April 2006.

English law features a variety of insolvency processes. This multiplicity of processes means that England and Wales offers a flexible and versatile, but sometimes rather complex, jurisdiction in which corporate debt may be restructured.

The process of corporate debt restructuring in England and Wales was until recently dominated by the so-called "London Approach", in which large and/or complex restructuring transactions would be carried out on a broadly consensual basis and managed by an ad hoc panel of senior bank lenders, often engaging the services of an administrative receiver. In recent years this largely consensual process has been overtaken by the emergence of secondary debt traders and hedge funds, which have taken active and aggressive positions in restructurings. A typical complex restructuring in England and Wales now reflects this changing identity of creditors; there will generally be multiple layers of secured and unsecured bond and bank debt represented by creditor constituencies with diverging and frequently hostile interests.

8.2 Insolvency processes

As stated above, English law features a variety of insolvency processes, which has led to some accusations of unnecessary complexity. In summary there are five main processes:

(a) liquidation;
(b) administration;
(c) schemes of arrangement ("Schemes");
(d) company voluntary arrangements ("CVAs"); and
(e) administrative receivership.

Each of these processes is explained in detail below.

In summary, liquidation and administration are more recognisable formal insolvency processes. In order to initiate a liquidation or administration, it is necessary to show that the company concerned is insolvent. The test to be applied in determining insolvency is the inability of a company to pay its debts as they fall due, either on a cash-flow basis (Section 123(1) IA 1986) or on a balance sheet basis

(Section 123(2) IA 1986). In determining whether an English company is insolvent on a balance sheet basis, Section 123(2) specifically provides that the contingent and prospective liabilities of the company concerned should be taken into account when ascertaining whether its liabilities exceed its assets. In determining when a company is insolvent on a cash-flow basis, the following alternative tests are applied:

(a) a debt in excess of £750 has gone unpaid for more than three weeks following service of a statutory demand (Section 123(1)(a) IA 1986);
(b) an unpaid judgment debt is outstanding (Section 123(1)(b) IA 1986); or
(c) the company's inability to pay its debts is otherwise proved to the satisfaction of the court.

There has been a recent clarification in the application of the cash-flow test. In his decision in the *Cheyne Finance* case,[1] Mr Justice Briggs held that, as with the balance sheet test of insolvency, contingent and prospective liabilities can properly be taken into account when determining whether a company is insolvent on a cash-flow basis.

Administrative receivership is now, except in certain limited cases where specific secured creditors can still make use of the process, an historic and somewhat severe process only available to floating-charge holders.

CVAs and Schemes are effective and versatile compromise procedures which can also be used in the context of a solvent company, by which creditors formally agree to accept an alternative to the full amount of their debt in full and final settlement of their claims.

8.3 Liquidation

There are two types of liquidation. First, there is voluntary liquidation. This is when a company is placed into liquidation at the initiative of

[1] *In the matter of Cheyne Finance Plc (in receivership)* [2007] EWHC 2402 (Ch)

its directors but under the control of its shareholders and/or creditors. There are two further subcategories of voluntary liquidation:

(a) A members' voluntary liquidation, or "MVL", is used for a solvent company, and indeed a statutory declaration of solvency from its directors is required in order for a company to proceed with an MVL.
(b) A creditors' voluntary liquidation, or "CVL", is used for an insolvent company. Where a company is unable to pay its debts as and when they fall due, a CVL is formally initiated by a resolution of the shareholders of the company (convened by its directors). Frequently the liquidator chosen by the shareholders is displaced at the first creditors' meeting in favour of an appointee selected by the creditors.

Second, there is compulsory liquidation, more commonly known as "winding-up". In a winding-up a petition is presented to the court by a qualifying creditor (i.e., a creditor with an unsatisfied statutory demand for an amount in excess of £750 debt or a judgment debt) requesting that the company be liquidated. If the court is persuaded accordingly after a hearing, it will order that a liquidator be appointed to the company concerned in order to wind it up.

Note that there is also a provisional liquidation procedure for use in urgent cases, whereby an insolvency practitioner with limited powers is appointed immediately, typically to ensure the preservation of a company's assets pending the hearing of the winding-up petition.

8.3.1 Purpose

In all types of liquidation, the purpose is the same, namely bringing about the end of the company in question. Liquidation is the appropriate process in such cases to achieve finality where the company has reached the definitive end of its useful life.

Compulsory liquidation is also frequently used for investigative purposes where fraudulent or wrongful trading on the part of current or former directors is suspected by creditors. There may be the prospect of additional recoveries by pursuing such claims in order to force such directors to contribute to and thus swell the estate of the insolvent company. These special remedies against delinquent directors are dealt with in more detail at Section 8.12.1 below.

The purpose of an MVL is generally to wind up a solvent but defunct company in order to "tidy up" its affairs and/or to permit the upstreaming of any residual funds to shareholders.

Finally, liquidation may be of assistance for the purposes of disclaiming an onerous or unprofitable contract to which the company is party. Section 8.13 below sets out some further detail on the ability of a liquidator to disclaim such contracts.

8.3.2 Advantages and disadvantages

As explained above, liquidation is often used in the context of a solvent company. The reason that it is chosen in preference to a strike-off of the company concerned, which is a much less expensive way of closing a redundant company (by formally deleting or "striking" it from the Companies Register), is certainty. Liquidation represents a definite end to the life of the company.

One disadvantage of liquidation is that it is only suitable to be used in circumstances where there are no prospects of recovery of the business of the company concerned. There is no rehabilitation or rescue likely in a liquidation, only an inexorable winding-up.

8.3.3 Entities eligible

"Winding-up by or subject to the supervision of the court" is listed in both Annex A and Annex B to the Regulation. This means that any entity whose "centre of main interests" ("COMI") is adjudged to be within England and Wales is eligible for winding-up under English law as a "main" proceeding. Further, if that entity is found to have an "establishment" in England and Wales, then liquidation may also be commenced as a "secondary" proceeding under the Regulation. *See* Section 8.14 below for further detail on the operation of the Regulation.

Note that an MVL, used to dissolve a solvent company, is not listed in the Regulation, which only seeks to regulate insolvency processes.

8.3.4 Tests to be applied

As stated above, the test to be applied is insolvency, characterised by the inability of the company concerned to pay its debts as they fall due, on a balance sheet (assets less than liabilities) or on a cash flow (unpaid judgment debt/statutory demand) basis. The English court also has a residual discretion, which is rarely used in practice, to put a company into liquidation if it deems that it is just and equitable for it to do so (e.g., in cases of "sham" companies or in circumstances where the company cannot continue to carry out its stated purpose as set out under its constitutional documents).

Under English law there is no positive obligation to file for insolvency when the company is in a perilous financial position (compare the position in, for example, Germany), but there is a more fluid potential liability for wrongful trading if the directors of the company continues to trade whilst the company is insolvent (*see* Section 8.12 below).

8.3.5 Key players

The key player in a liquidation is the liquidator, who is an independent insolvency practitioner appointed to the company in liquidation by the court upon the request of the person or entity which has initiated the liquidation process. Whilst a liquidation is formally carried out by the court, and the insolvency practitioner reports to the court, in practice there is generally no significant court involvement (although the liquidator is at liberty to request directions from the court to assist and protect him when dealing with more complex matters).

8.3.6 Estimated duration

The duration of a liquidation depends on the complexity of the affairs of the company in question. If the liquidator carries out investigations into the prior dealings of the company and its directors with a view to bringing a wrongful trading or other action, the duration of the liquidation process may need to be extended accordingly. As a very broad guide, the majority of liquidations may last for between six months and two years, which even at its longer end is still generally quicker than equivalent procedures in many other European countries.

8.3.7 *Critical steps*

The first critical step is obviously the commencement of the liquidation itself. In an MVL the directors must each swear a statutory declaration of solvency. In a CVL, a 75 per cent shareholder vote in favour of liquidation is required, then a creditors' meeting must be convened to be held within 14 days. In a compulsory liquidation, the liquidation order is made by the court. The liquidator is formally appointed on the commencement date (although note that in a compulsory liquidation the appointment is backdated to the date that the winding-up petition was originally filed).

The next critical step is that the liquidator takes over the management of the company and begins to sell any assets, with the realisations to be distributed to creditors pursuant to the prescribed order of priority following determination of their respective claims by the liquidator in accordance with the detailed provisions of the Insolvency Rules 1986 (which accompany and complement the provisions of the IA 1986).

At the end of the liquidation process, the company concerned is formally dissolved after the expiry of the period of three months following the filing by the liquidator of his final documentation with Companies House.

8.3.8 *Approvals required (court/creditors/others)*

As explained above, the liquidation is carried out under the supervision of the English court. However, the appointed liquidator has wide powers and can sell the company's assets without the prior approval of the court, the creditors or any other party.

In many liquidations, particularly the larger ones, an informal creditors' committee will be appointed whose function is to act as a sounding board and reporting point for the liquidator.

8.3.9 *Effects (on company/creditors e.g., moratorium)*

In a CVL there is a narrowly delineated statutory moratorium, which imposes a stay on creditor action but does not prevent any enforcement of security. Accordingly, secured creditors remain free to enforce their security in the manner provided for in the underlying documentation.

There is no automatic moratorium in an MVL, but the English court will generally be willing, on receipt of an application accordingly, to grant the company a moratorium from the date of the original shareholder resolution, in order to facilitate the efficient conduct of the MVL process.

In a compulsory liquidation creditors cannot take or continue any action against the company or its property without the leave of the court (*see* Section 130 IA 1986). However, secured creditors may still enforce their security.

In every case, the directors are no longer in charge of the company (*see* Section 8.3.10 below) and the advent of liquidation automatically terminates the contracts of employment of any employees of the company concerned.

The appointed liquidator has the power to "disclaim" onerous or unprofitable contracts. This essentially involves the liquidator unilaterally terminating the contract prior to its scheduled maturity, as explained further at Section 8.13 below.

8.3.10 Management of company (who is in charge?)

In a liquidation the liquidator takes control of the company and the directors cease to hold office. Indeed, one of the automatic effects of the making of the liquidation order is the dismissal of the directors. The liquidator has very wide statutory powers, which permit him to take any action required to realise the assets of the company and make distributions to creditors. The liquidator is vested with the power to continue to temporarily operate the company's business if this will result in a better realisation of assets than an immediate liquidation, but this is rarely the case.

8.3.11 Prospects for recovery

There are no prospects for recovery of a company that has been placed into liquidation. If further assets are discovered after the end of the liquidation, the liquidation process can be reinitiated, but only for the purposes of realising such assets and making a further distribution to creditors. Liquidation is therefore not an appropriate process if a pre-packaged sale of the company's business to its creditors or a third party is envisaged.

8.4 Administration

Administration is the most commonly used insolvency procedure in England and Wales in circumstances where the company in question has an active business and/or where a rescue of the business is possible.

Schedule B1 to the IA 1986 was introduced by the EA 2002. It creates a more flexible and user-friendly regime by which a company can be placed into administration without any court involvement, but rather simply by the completion and filing of a series of straightforward statutory forms.

8.4.1 Purpose

In summary, administration is about the promotion of corporate reorganisation and/or efficient asset realisation under the protection of a strong statutory moratorium. The entry into administration creates a breathing space in which a business can be restructured whilst enjoying a respite from creditor action.

The purpose of administration is clearly set out at paragraph 3(1) of Schedule B1 IA 1986, which states that:

> "The administrator of a company must perform his functions with the objective of –
>
> (a) rescuing the company as a going concern, or
> (b) 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
> (c) realising property in order to make a distribution to one or more secured or preferential creditors".

These three objectives are listed in descending order of importance. In other words, only if it is not possible to rescue the company as a going concern should the administrator look to maximise returns to creditors, and only if this objective is in turn not possible should the administrator focus on favouring the secured or preferential creditors. Importantly, whichever of the three objectives is ultimately pursued, the administrator must always act in the interests of the company's creditors as a whole.

8.4.2 Advantages and disadvantages

The principal advantage of administration is the wide automatic statutory moratorium that it brings with it, which is of great assistance in providing a window of opportunity in which a distressed business may be restructured with the aim of maximising value for all stakeholders involved.

One perceived disadvantage of administration is that it can be a relatively slow process (although on average it is still generally quicker than many comparable insolvency processes elsewhere in Europe and in the US).

8.4.3 Entities eligible

Administration is listed in Annex A to the Regulation as a "main proceeding". This means that any entity which is found to have its COMI located within the borders of England and Wales is eligible for administration.

Since the incorporation of the Regulation, several cases have shown that the scope of administration is not merely limited to English-incorporated companies. For example, in the case of *Re Salvage Association* [2003] EWHC 1028 (Ch) an unincorporated association was placed into administration. In the case of *Re BRAC Rent-A-Car International Inc.* [2003] EWHC 128 (Ch) a US entity was placed into administration. In the case of *Re Collins and Aikman Europe SA and other companies* [2006] EWHC 1343 (Ch), 24 European companies incorporated in 10 different jurisdictions were all placed into English administration proceedings.

8.4.4 Tests to be applied

As with the liquidation process, the threshold test for eligibility for administration is insolvency, measured by the inability to pay debts when due as defined by the tests set out at Section 123 IA 1986.

If the appointment of an administrator is sought to be made by a qualifying floating charge holder (*see* Section 8.4.5 below), then the charge must have become enforceable in accordance with the terms of the charge document.

As with liquidation, under English law there is no statutory duty incumbent on the directors of a company to file for administration, but in practice the potential risk of wrongful trading liability in the event of an ensuing liquidation weighs heavily on their decision-making process as soon as such directors start to trade in the zone of insolvency.

8.4.5 Key players

An administrator can be appointed by the company itself (through its shareholders), by its directors, by a qualifying floating charge holder, or by any other creditor.

The new "out-of-court" route into administration introduced by the EA 2002 is only available to the company, its directors and a qualifying floating charge holder. The more traditional court route must still be followed if the administration application is made by any other creditor or if a court determination of the location of the company's COMI is required (objections may be heard and directions as to conduct of complex cross-border administrations can then be given by the judge – this was the case for example in the Collins and Aikman matter).

Once the administration application is accepted and the administration order made, the key player is the administrator. The administrator is given wide statutory powers to do all that is required to run the business of the company concerned. Indeed, paragraph 59(1) of Schedule B1 IA 1986 provides that: "The administrator of a company may do anything necessary or expedient for the management of the affairs, business and property of the company".

Often a creditors' committee is established, to which the administrator must periodically report.

8.4.6 Estimated duration

Under paragraph 76 of Schedule B1 IA 1986, administrations last for a fixed period of 12 months, which may be extended for further periods by application to the court. The rationale for this statutory provision is to encourage the expedient conduct and progress of administrations, and indeed most straightforward administrations are concluded within the initial 12-month period. Some more complex administrations, particularly those with a cross-border element, will require one or more extensions of this time period in order to permit the administrator to deal with the affairs of the company in a proper and orderly manner.

8.4.7 Critical steps

If an out-of-court appointment is sought to be made, five days' notice must first be given to any holder of a qualifying floating charge in respect of the company.

Once appointed, the administrator must call a creditors' meeting within eight weeks, and the initial meeting must be held within 10 weeks of the appointment date.

The administrator then usually runs the business of, and/or sells the assets or business of, the company concerned. Frequently administrations result in the sale of the business to one or more creditors of the company in exchange for the waiver or satisfaction of all or part of the monies owed to them. Indeed, often "pre-pack" administrations are used to facilitate such a sale, which is made immediately upon the entry into administration following extensive preparatory work carried out prior to the filing for administration.

At the end of the administration process, either the company emerges restructured and continues to trade, or if the assets/business have been sold, it enters into an exit mechanism. In circumstances of asset realisation, the chosen exit process may be:

(a) liquidation – which is often chosen as a mechanism by which to agree creditor claims and distribute the realisations made by the administrators during the administration period;
(b) via a CVA/Scheme, which has the same purpose of agreeing and satisfying creditor claims; or
(c) (if there are no assets to distribute) dissolution.

Under the provisions of the EA 2002, it is now possible for the administrators to agree claims and make direct distributions to creditors without the need for a further complementary insolvency process – *see* paragraph 65(1) of Schedule B1 to the IA 1986. However, this process does not compromise claims and, unless it receives full payment, the creditor concerned will still be able to claim the balance of its debt from the company once it has emerged from administration, which may not have the desired rehabilitative effect on the company.

8.4.8 Approvals required (court/creditors/others)

During the administration, the administrator must report periodically to creditors and seek approval for his proposals. However, if such approval cannot be obtained, the administrator can elect to apply to court to obtain sanction as to his preferred manner of conduct of the administration. If a creditor believes that the administration is not being conducted properly, he is entitled to apply to court for the removal of the administrator.

8.4.9 Effects (on company/creditors e.g., moratorium)

Probably the most important effect of administration is the wide-ranging statutory moratorium granted to the company to protect against the commencement of any other insolvency processes or legal proceedings. Further, no secured creditor may enforce his security without the consent of the administrator or the permission of the court (*see* paragraphs 42 and 43 of Schedule B1 to the IA 1986).

8.4.10 Management of company (who is in charge?)

As mentioned above, the administrator is imbued with very wide statutory powers. The administrator effectively replaces the directors as the management of the company concerned and the directors can be dismissed by the administrator at any time. Whilst the directors technically remain in office for the duration of the administration, they have no powers and are completely subject to the control of the administrator. Indeed, paragraph 64(1) of Schedule B1 IA 1986 provides that: "A company in administration or an officer of a company in administration may not exercise a management power without the consent of the administrator."

This parachuting in of an independent manager can be compared with the position under the US Chapter 11 process and similar regimes in other jurisdictions, in which the directors remain in office and continue to exercise their functions, albeit under a degree of supervision.

The wide statutory powers of the administrator are listed non-exhaustively in Schedule 1 IA 1986. This list is often annexed to the administration order itself to assist in evidencing the administrator's authority to conduct the company's business. Notably, Schedule 1 includes the following powers:

(a) "Power to take possession of, collect and get in the property of the company";
(b) "Power to sell or otherwise dispose of the property of the company";
(c) "Power to bring or defend any action or other legal proceedings in the name and on behalf of the company";
(d) "Power to carry on the business of the company";
(e) "Power to make any arrangement or compromise on behalf of the company";
(f) "Power to do all other things incidental to the exercise of the foregoing powers".

8.4.11 Prospects for recovery

The prospects of recovery for a company in administration in any specific case largely depend on prevailing micro- and macro-economic factors. What can be said for certain is that the entry into administration often facilitates such recovery by providing a protective wrapper under which the company has the optimum chance of returning to viability.

The next two processes discussed, CVAs and Schemes, can be used as freestanding mechanisms or in the context of an ongoing administration. In the latter case they operate as an instrument through which to achieve a binding compromise with creditors in order to permit a smooth exit from the insolvency process.

The essential benefit of both CVAs and Schemes is that they permit majority voting. Thus all creditors, even those who are untraced or adverse to the process, may be bound by the decision of the majority (note that in both cases a disgruntled minority creditor may seek to avail himself of the unfair prejudice safeguard available, although this safeguard operates differently in each process).

8.5 Schemes of arrangement

Schemes were formerly provided for by Sections 425 to 427 of the Companies Act 1985. The applicable legislative provisions are now Sections 895 to 901 of the Companies Act 2006 ("CA 2006"), which largely restate the existing law. Interestingly, Schemes are not specifically recognised as an insolvency procedure – and accordingly the provisions of the Regulation do not extend to them – because they can be used in a variety of solvent and insolvent contexts. For example, they are frequently used as a mechanism to consummate a takeover or to facilitate the reorganisation of a corporate group.

8.5.1 Purpose

The purpose of a Scheme, as with a CVA, is the rescue and/or reorganisation of the company concerned by means of agreeing a binding accommodation/arrangement with its creditors (and/or its shareholders).

8.5.2 Advantages and disadvantages

Schemes often require complicated and esoteric documentation, which can result in expense. However, they are still often used in the most complex restructurings (although perhaps this is more due to practitioners' familiarity with Schemes rather than any real advantages over other processes).

The essential benefit of the use of a Scheme is that it permits majority voting. However, issues frequently arise with the required determination of classes of creditors.

8.5.3 Entities eligible

Because Schemes are not recognised as an insolvency process and are therefore not subject to the provisions of the Regulation, only English companies are *prima facie* eligible. However, the English court will approve a Scheme in respect of a foreign company if it can be shown that the company concerned has a sufficient connection with the UK. Accordingly, Schemes have historically been approved in respect of companies incorporated in Australia, Bermuda and Singapore which were determined to have a sufficient nexus with England and Wales.

8.5.4 Tests to be applied

As mentioned above, there is no need to show insolvency. However, the court will need to be satisfied that the terms of the Scheme are fair and reasonable and that the determination made of the various classes of creditors is appropriate.

In the case of *Re Hawk Insurance Co Ltd* [2001] EWCA Civ 241, Chadwick LJ held that when determining the classification of creditors, it is necessary to decide whether the rights affected or granted by the Scheme in question were so distinct from each other that the Scheme had to be interpreted as affecting more than one class of creditor. This analysis of the similarity or dissimilarity of creditor rights will need to be made on a case-by-case basis.

8.5.5 Key players

A Scheme may be proposed by the company itself (through its directors or by an appointed officeholder i.e., an administrator or liquidator) or by a creditor or shareholder.

8.5.6 Estimated duration

Generally a straightforward Scheme can be sanctioned in around three months from the date of the initial application to court, although its actual implementation may take much longer. If the terms of the Scheme are particularly complex, the duration of the approval and implementation process will obviously need to be extended accordingly.

8.5.7 Critical steps

First, the English court receives the application for a Scheme from the company (or creditor(s)/shareholder(s)) proposing it. Notices are then sent to convene (on at least 14–21 days' notice) meetings of the various classes of creditors and shareholders involved. The convening notice must attach an explanatory statement setting out the effect of the Scheme. This is often referred to as the "Scheme Statement" or "Scheme Circular" and is frequently a weighty and complex document. The Scheme is then voted on and approved by such stakeholders. Finally, the Scheme is formally sanctioned by the court and the court order is registered at Companies House, at which point the Scheme becomes effective.

8.5.8 Approvals required (court/creditors/others)

In order to be validly implemented, the terms of a Scheme must be approved by a simple majority in number representing at least 75 per cent in value of the persons present and voting in each relevant class of creditors/shareholders.

The court has the responsibility to supervise the Scheme in its various stages. It must give its sanction to the Scheme before it becomes effective, and in determining whether or not to grant such sanction the court will consider whether creditors have been dealt with fairly and verify that the prescribed procedure has been scrupulously adhered to.

8.5.9 Effects (on company/creditors e.g., moratorium)

A Scheme does not feature any automatic moratorium or other protection against creditor action, so in practice it is frequently coupled with an administration order.

Once the terms of a Scheme are approved, the Scheme is binding on all creditors as well as on the company itself.

At the consummation of the Scheme, the company concerned reverts to its former status as amended by the Scheme (e.g., the Scheme may have been used as a mechanism to implement a debt-for-equity swap).

8.5.10 Management of company (Who is in charge?)

Unless the terms of the Scheme provide to the contrary, the directors remain in charge of the company's business.

8.5.11 Prospects for recovery

In winding-down scenarios, the use of a Scheme can often result in a more efficient and less expensive outcome than if a more time-consuming liquidation procedure was used. For this reason Schemes are frequently chosen as the appropriate method for winding-up the affairs of defunct insurance companies.

8.6 CVAs

A Company Voluntary Arrangement is a rescue procedure for a company in financial difficulty provided for by Part I of the IA 1986.

8.6.1 Purpose

The purpose of a CVA is the rescue of the company concerned. The objective is the avoidance of liquidation for the company in difficulty by means of a contractual compromise with its creditors, promoted by the company's liquidator or administrator.

If the company concerned is not already in an insolvency process, the CVA may be promoted by an independent insolvency practitioner brought in specifically to perform this role.

8.6.2 Advantages and disadvantages

One of the principal advantages of a CVA is that, provided it is approved by the requisite majority (on which *see* further below), its terms bind all unsecured creditors (although not secured or preferential creditors), even if such creditors are opposed to or unaware of the CVA. In other words, it permits majority voting and "cram-down". A CVA can also be tailored to the demands of a particular case.

A CVA, being relatively informal and subject to minimal court involvement, is frequently less expensive than other insolvency processes.

However, a CVA does not have any effect on the rights of secured or preferential creditors unless they agree to the proposals contained therein. CVAs have also proved difficult to implement in practice, often failing through a lack of support from secured/preferential creditors, and are accordingly not a popular choice.

A further disadvantage of CVAs is that they do not impose any automatic moratorium on creditor action against the company. Frequently the proponent(s) of a CVA therefore choose to apply for administration to act as a protective overlay under which the terms of the CVA may be implemented. However, "small companies" (those that meet two of the following tests: (a) turnover no greater than £6.5 million; (b) balance sheet total of not more than £3.26 million; (c) maximum 50 employees) now benefit from the ability to apply to court for an optional moratorium in order to save the cost of having to apply for administration to provide the requisite respite from creditors. However, to date the right to apply for such a moratorium has been seldom employed in practice.

8.6.3 Entities eligible

Annex A to the Regulation includes a reference to "Voluntary arrangements under insolvency legislation". Therefore, potentially any company whose COMI is adjudged to be located in England and Wales is eligible for a CVA.

8.6.4 Tests to be applied

As with a Scheme, it is not necessary to show that the company concerned is insolvent (although this will generally be the case in practice).

8.6.5 Key players

A CVA can be commenced by the directors of a company or by an officeholder (liquidator/administrator) appointed in respect of the company.

The promoter of a CVA is known as the "nominee" until the CVA is approved and the implementation phase starts, at which point (usually) the same person becomes the "supervisor". This person is always a licensed insolvency practitioner.

The court is not heavily involved in the CVA process; it simply acts as the filing point for various documents.

8.6.6 Estimated duration

As with a Scheme, the duration of a CVA often depends on the complexity of its terms. Given the requirements of notices and reports to creditors and shareholders, three months is an approximate guideline timing for the process to run its course.

8.6.7 Critical steps

The nominee generally summons meetings of the company's creditors and shareholders to review the terms of the proposed CVA. The creditors and shareholders then vote on whether to approve such terms. If approved, the terms are implemented and the supervisor reports back to the shareholders and creditors upon consummation of the CVA.

8.6.8 Approvals required (court/creditors/others)

A CVA is binding on all creditors if it is approved by:

(a) a simple majority exceeding 75 per cent by value of such company's creditors; and
(b) a simple majority of the company's shareholders.

Given that it is a mechanism for the compromise of debts, the need for shareholder approval appears a little incongruous. This anachronism is tempered in practice by the fact that in the event of a dispute between the shareholders and the creditors on the approval of the terms of the CVA, the creditors' vote prevails.

A CVA can be challenged in court on grounds of unfair prejudice or material irregularity.

8.6.9 Effects (on company/creditors e.g., moratorium)

The CVA supervisor takes control of the company's assets upon the implementation of the CVA.

In the event that the CVA fails through insufficient creditor support the CVA supervisor may petition for the liquidation or administration of the company (if it is not already in such a process).

Provided that the requisite approval percentages are obtained, a CVA binds all creditors even if such creditors are unaware of or opposed to such proposals.

The usual effect of the proposals in a CVA are a rescheduling or reduction in the company's debts and/or a debt-for-equity swap.

Once the terms of the CVA are implemented and the full process has run its course, the company concerned reverts to its former status (whether fully active or in an ongoing insolvency process).

As explained above, since 1 January 2003 "small companies" have been entitled to apply to court for an optional moratorium.

8.6.10 Management of company (Who is in charge?)

The CVA supervisor/nominee is in charge of the implementation of the CVA itself, but (unless the terms of the CVA provide otherwise) the directors remain in control of the company, and may continue to trade and undertake the company's business uninterrupted by the CVA process, subject to a degree of monitoring by the nominee.

8.6.11 Prospects for recovery

The prospects for recovery are generally good if the buy-in of secured and preferential creditors to the terms of the CVA can be obtained.

8.7 Administrative receivership

This is a severe remedy formerly available to secured creditors. Recourse to this remedy has now been abolished in respect of almost all charges created on or after 15 September 2003.

Administrative receivership was historically the dominant procedure for the realisation of the trading assets of companies that still had a continuing business (and in respect of whom, therefore, liquidation was not an appropriate outcome). However, it was perceived that this procedure gave senior banks too much power, and that the exercise of such power was not in tune with the rescue culture which English law was seeking to facilitate. Indeed, the perception was that the operation of administrative receivership was eviscerating too many businesses which could otherwise have been saved with a little intensive care (e.g., through administration).

Administrative receivership is now only available:

(a) for holders of floating charges that were created prior to 15 September 2003; and
(b) in certain limited and clearly delineated cases, for example PFI and capital markets arrangements (including structured investment vehicles or "SIVs").

Administrative receivership has accordingly been dying out as a remedy since 2003. However, this blow was softened for the banks by:

(a) the availability of the new streamlined out-of-court administration procedure under Schedule B1 of the IA 1986 (*see* above); and
(b) the abolition of crown preference as a super-priority claim in the order of priority between creditors applicable in an insolvency (*see* Section 8.10 below dealing with order of priority).

Interestingly, administration (and particularly the relatively new out-of-court route) has proved so popular that whilst administrative receivership is still available as a method of recourse for holders of pre-September 2003 floating charges, in practice such creditors now habitually choose to use the administration procedure. This has contributed to the decline of the London Approach referred to at Section 8.1 above.

8.7.1 Purpose

The purpose of administrative receivership is to enable the holder of a floating charge to appoint an insolvency practitioner to take control of the company and its assets. Accordingly, the administrative receiver is appointed for the sole purpose of realising the company's assets, exclusively to satisfy the indebtedness owed to the floating charge holder.

8.7.2 Advantages and disadvantages

The advantages and disadvantages of administrative receivership depend on the perception/identity of the person you ask. From the perspective of the floating charge holder, administrative receivership is a useful tool for getting their money back quickly and cheaply, with little risk, whilst retaining control of the process. However, from the point of view of the other creditors, the company, other stakeholders (and perhaps the impartial observer), administrative receivership seems to be a fairly value destructive process not attuned to the interests of all parties.

8.7.3 Entities eligible

Any English company over which a valid floating charge created prior to 15 September 2003 is in force can be subject to administrative receivership. So can an entity falling within one of the limited exemptions set out in Sections 72B to 72GA of the IA 1986 (e.g., certain project finance and capital market arrangements).

8.7.4 Tests to be applied

The floating charge must be enforceable in accordance with the terms of the document under which it is constituted.

If the floating charge was created after 15 September 2003, the holder must show that one of the exemptions set out in Sections 72B to 72GA of the IA 1986 applies.

8.7.5 Key players

The administrative receiver is the key player. He must be a licensed insolvency practitioner.

8.7.6 Estimated duration

There is no fixed time limit. Obviously in the ordinary course the administrative receiver seeks to realise the secured assets and distribute the proceeds of sale to the appointing creditor as quickly and efficiently as possible.

8.7.7 Critical steps

The administrative receiver is appointed and immediately turns his attention to the sale of the company's assets.

8.7.8 Approvals required (court/creditors/others)

None.

8.7.9 Effects (on company/creditors e.g., moratorium)

The appointment of an administrative receiver blocks the appointment of an administrator and crystallises the floating charge under which the appointment has been made.

8.7.10 Management of company (Who is in charge?)

The administrative receiver is in charge.

8.7.11 Prospects for recovery

Generally poor. The purpose of administrative receivership is the settlement of the debt owed to the qualifying floating charge holder, not the rescue of the company, and indeed frequently administrative receivership has precisely the opposite effect.

8.8 Restructuring alternatives

Informal restructurings are fairly commonplace in England and Wales, perhaps as a result of the perceived cost and complexity of using an English insolvency procedure. Frequently, different groups of creditors realise that their interests are better protected supporting an out-of-court process than via a formal insolvency. Accordingly, in practice often a restructuring starts with the formal institution of contractual standstill arrangements to give comfort that the creditors standing still will not employ their contractual rights of enforcement. This creates a consensual window of opportunity in which restructuring discussions can take place. The outcome of these discussions may be:

(a) the waiver/forbearance of all or part of the debt owed; and/or
(b) the exchange of this debt for an equity stake in the existing business.

Alternatively, the business may be transferred to a newly incorporated company in which the creditors of the old company take an equity stake (and frequently also further debt).

8.9 Types of security

There are two principal ways to take security over real property (i.e., land and buildings): by way of mortgage and by way of fixed charge.

8.9.1 Mortgage

A mortgage involves the transfer of ownership in the land to secure the payment of a debt (or discharge some other obligation). The debtor has a right of redemption, pursuant to which the creditor must transfer title back to the debtor upon repayment of the debt.

8.9.2 Fixed charge

A fixed charge is a form of security which is usually taken over a specific, valuable asset (e.g., land, machinery, ships or aircraft). Unlike a mortgage, title and possession remain with the borrower. However, until the debt is fully repaid the borrower typically cannot dispose of the asset without the permission of the lender. This causes practical difficulties in circumstances where the asset in question is subject to daily variation in the borrower's business (e.g., accounts receivable from debtors), so floating charges are often used in these cases (*see* Section 8.9.3 below).

A lender with a fixed charge is entitled to take possession of the relevant asset by way of recourse if the borrower defaults under the loan. The lender can then sell the asset itself or appoint a fixed-charge receiver to do so on its behalf (which is frequently the case due to concerns regarding potential lender liability). There is also an implied power under the Law of Property Act 1925 ("LPA") to appoint a receiver on enforcement of a legal mortgage.

Upon such a sale arising from the enforcement of a fixed charge the lender has a priority claim over the proceeds. Accordingly, a fixed charge is often considered to be the best form of security available, as it gives its holder a proprietary interest in the asset involved ahead of the costs and expenses of any officeholder appointed, as well as over the claims of floating-charge holders, preferential creditors and unsecured creditors (*see* Section 8.10 below).

If the proceeds of sale are insufficient to satisfy the fixed-charge holder's claim, the balance of his claim ranks *pari passu* with the claims of ordinary unsecured creditors. If the proceeds of sale are more than sufficient, the surplus must be returned to the debtor.

8.9.3 Security over other types of assets

For other types of assets the principal form of security are as follows:

(a) Mortgage/fixed charge: *see* above.
(b) Floating charge: this is a unique English legal concept. It involves a charge taken over a variety of assets, fluctuating from day to day (e.g., cash in an operating account). A floating charge refers to assets generically and is usually taken over a debtor's entire business (in tandem with fixed charges over specific identifiable assets). It "floats" over all such assets but "crystallises" on specific assets upon the occurrence of a default as specified in the constituting charge document.

Accordingly, in comparison to a fixed charge, unless and until a default occurs a floating charge allows the borrower to deal with the charged assets in the ordinary course of business without reference to the charge holder. If a default does occur, as explained above, the floating charge effectively becomes a fixed charge in respect of the assets over which it previously "floated". At this point the borrower may no longer freely deal with the charged assets without the charge holder's consent.

For many years there was a degree of uncertainty as to whether a charge over book debts took effect as a fixed charge or floating charge under English law. The case of *Spectrum Plus Ltd., Re: National Westminster Bank Plc* v *Spectrum Plus Ltd* [2005] UKHL 41 is now authority for the proposition that such a charge can only take effect as a fixed charge if the book debts are paid into a specified "blocked" account over which the charge holder has control. Otherwise, the security taken will be characterised as a floating charge. The implication of this characterisation is important because it determines the creditor's position in the order of priority applicable in a corporate insolvency (*see* Section 8.10 below).

8.9.4 Other forms of security

Other forms of security are as follows.

8.9.4.1 Quasi-security (e.g., security assignments)

Security can be taken over receivables by way of a legal and/or equitable assignment of the benefit of the entitlement to such receivables.

8.9.4.2 Pledges

A pledge involves the delivery of the asset subject to security to the lender. The lender has the right to possess the pledged asset and sell it if the debtor defaults. The "delivery" of the pledged assets to the creditor may be actual (i.e., physical delivery) or constructive (e.g., the delivery of share certificates representing shares).

8.9.4.3 Liens

A lien is the right to retain possession of another person's property until a debt is settled. It differs from a pledge in that a lien does not automatically confer on its beneficiary a right to dispose of the property subject to the lien if the debt in question is not paid.

Liens can be created by contract. They also arise automatically in certain commercial relationships (e.g., that between a solicitor and a client, between a haulier and the consignor of goods and between dry cleaners and their customers).

8.9.5 Formalities of registration

The precise formalities of registration depend on both the nature of the asset over which security is to be granted and the form of the security interest to be taken (charge, assignment, etc.)

For the purposes of certainty and evidentiary value, security documents are often executed as a deed by more than one signatory (or by the affixing of the company seal).

In order to be fully valid and unopposable, a charge must be registered at Companies House within 21 days of its creation, by the completion and filing of a Form 395.

There are also specific registration requirements for certain categories of assets (e.g., land/shares/intellectual property/ships/aircraft), such as registration of the charge in a particular formal register.

8.9.6 Methods of security enforcement

The specific mechanism for the enforcement of a charge depends on the terms of the applicable security documentation. As mentioned above, in the interests of minimising the risk of liability for the enforcing lender, the documentation will frequently provide for the appointment of a receiver to sell the property on behalf of the secured lender.

As described above, until 2003 the prevailing method of enforcement of a floating charge was via the appointment of an administrative receiver. Nowadays the only route available to the charge holder is through the appointment of an administrator. Whilst an administrative receiver only ever acts in the interests of the appointing creditor, an administrator must act for the benefit of all creditors. This change in law both reflects and seeks to promote the rescue culture which now pervades English insolvency law.

8.10 Order of priority

Subject to certain mandatory conditions (e.g., the priority of secured and preferential creditors in a CVA), in a Scheme and CVA the specific contractual terms govern the precise waterfall of payments applicable.

In a formal corporate insolvency process (administration or liquidation), statute provides for the order of priority set out below. Note that constituents of each category must be paid in full before creditors in the category below can receive any money. Within the categories creditors rank *pari passu* amongst themselves.

In descending order of priority, the applicable order is as follows:

1. Debts secured by a mortgage/fixed charge. These are paid from the proceeds of sale of the secured assets (net of the costs of realisation). As explained above, if there is a surplus this must be returned to the debtor company, whilst any unsatisfied portion of the debt will rank *pari passu* with ordinary unsecured debts (*see* below). Often, the fixed-charge holder will also hold a floating charge so, even in the event of a dispute regarding the fixed charge, this creditor will still be paid in priority to ordinary unsecured creditors.
2. Preferential debts. The categories of preferential creditors have been curtailed in recent years, partly as a concession to floating-charge holders as compensation for the loss of the right to appoint an administrative receiver. They now mainly consist of employees with employment-related claims (e.g., unpaid wages and contributions to occupational pension schemes). Crown preference in respect of monies owed to Her Majesty's Revenue and Customs has now been abolished.
3. Costs of the insolvency proceedings. There are two subcategories of such costs, with their own internal order of priority. First, sums due under contracts adopted by or entered into by the insolvency practitioner must be paid, e.g., amounts owed to an employee who has been retained in the business post-insolvency. Second, the fees and expenses of the insolvency practitioner involved must be paid. This includes both their own fees plus the fees of any legal and other advisers engaged.

   The ranking of officeholders' fees and expenses is currently subject to proposed legislative reform.

4. Debts secured by a floating charge. These are paid from the proceeds of sale of the asset(s) subject to the floating charge. Since the effective date of the EA 2002 (15 September 2003) a "prescribed part" of such sale proceeds is no longer available to

the floating-charge holder and is instead ring-fenced for the benefit of the ordinary unsecured creditors. The prescribed part is calculated as 50 per cent of net floating charge realisations up to a cap of £10,000 (i.e., maximum £5,000), then 20 per cent of the remainder of the realisations. The maximum quantum of the prescribed part is limited at £600,000.

5. Ordinary unsecured creditors. This category, typically the largest by way of membership and aggregate quantum, is generally made up of ordinary trade creditors and other counterparties who have not taken security over the assets of the company concerned. Notably, it also includes amounts owed to related companies under shareholder and affiliate loans as English law does not recognise the concept of equitable subordination.

   Note that, whilst fixed and floating charge holders may claim as ordinary unsecured creditors for the balance of their claim (if any) still due after application of the proceeds of the enforcement of their security, they are not entitled to "double dip" by sharing in the amounts comprising the prescribed part to so make up any shortfall in their security.[2]

6. Interest. Interest incurred on all debts following the date of entry into the insolvency process is then paid (any accrued interest up to the date of entry into administration/liquidation forms part of the principal claim).
7. Shareholders' equity. The residual value (if any) is distributed to the shareholders in accordance with the respective rights attaching to their shares.

8.11 Other remedies/recovery mechanisms

8.11.1 Mechanisms to secure unpaid debts (e.g., liens/retention of title clauses)

8.11.1.1 Liens

See Section 8.9.4.3 above.

[2] *Re Permacell Finesse Limited (in liquidation)* (not yet reported, 30 November 2007); *Thorniley* v *HMRC* [2008] EWHC 124 (Ch) (5 February 2008).

8.11.1.2 Retention-of-title clauses

These are used by trade creditors to effectively secure unpaid debts by inserting specific terms into the relevant sale contract. They are the main practical mechanism by which trade creditors secure amounts owed to them.

A typical retention-of-title clause provides that title in goods will not pass from the trade creditor to the buyer until the trade creditor has received full payment for the goods supplied. The clause may relate to amounts owed in respect of the delivery of specific goods or (more commonly) be drafted as an "all monies" clause (i.e., providing that no title to any goods passes until the trade creditor is fully paid everything it is owed by the debtor).

Retention-of-title provisions are sometimes referred to as "Romalpa" clauses from the name of a well-known case on the subject.

Difficulties can arise when the goods which are subject to a retention-of-title clause are mixed with other identical or similar goods or converted in a manufacturing process. In order to avoid identification difficulties if the retention-of-title clause is triggered and the trade creditors seeks to recover its goods, a well-drafted retention-of-title clause will provide for the goods to which it relates to be kept separately and clearly identified to the extent possible whilst they remain in the debtors' possession, and not to be transferred or sold to a third party.

8.11.2 Other recovery mechanisms (e.g., summary judgment equivalent)

8.11.2.1 Court judgment

This is a relatively quick, court-based mechanism for the recovery of amounts owed. If the debt in question is not disputed, summary judgment can be sought, which is an even more expedient route. The creditor must make an application to court against the debtor seeking an order that the defendant should pay the debt due.

If and when judgment is obtained, the judgment creditor has various methods of enforcement open to him. He may seek to enforce the judgment by applying for:

(a) a charging order over the debtor's property, which will give him the right to have such property sold and the realisations used to satisfy the debt owed to him;
(b) an order requiring a third party to pay an amount owed to the debtor to him instead (known as a garnishee order, and frequently used in respect of bank accounts); or
(c) an application for the seizure of the debtor's assets by a bailiff.

8.11.2.2 Statutory demand

A statutory demand is a formal document served on a debtor in order to evidence a debt in excess of £750. It can then be used as grounds for the commencement of a liquidation proceeding by that creditor against the debtor in question if no payment is made within 21 days following service of the formal request for payment. Although it is not strictly designed for such a purpose, a statutory demand can be an effective debt recovery mechanism, as the threat of a winding-up petition being presented if no payment is made within the required timeframe may persuade the debtor to pay the debt, even if the debtor has competing obligations to fulfil.

8.11.2.3 Freezing order

This is a particular form of interim court order which prevents a party from disposing of assets (or removing them from the jurisdiction) pending resolution of a dispute. Freezing orders can have a severe commercial effect and are accordingly rarely granted in practice.

8.11.2.4 Receivership

Receivership is an out-of-court method of enforcement available to secured creditors. As described in detail above, there are two main types of receivership under English law:

(a) administrative receivership, which except in certain limited cases has now been abolished in respect of charges granted post-15 September 2003; and
(b) fixed charge and LPA receivership, whereby a person (who, unlike an administrative receiver, need not be a licensed insolvency practitioner) is appointed pursuant to the terms of a fixed charge document following the occurrence of a default in accordance with its terms. The receiver's role is then to realise the

property subject to the fixed charge and to turn the net proceeds over to the secured creditor in question.

Note that a receiver of any kind does not owe duties to the body of creditors as a whole, unlike a liquidator or administrator. Instead, the receiver's sole duty is to realise the charged assets for the benefit of his paymaster, the appointing chargee.

8.12 Liability

8.12.1 Directors (e.g., wrongful trading)

A breach of their fiduciary duties or some other misconduct occurring in the period before insolvency may give rise to various claims against directors once in insolvency. Liability can apply to current directors, former directors and shadow directors (e.g., a vocal and influential shareholder). Amongst the penalties such directors risk are disqualification (for a period of between two and 15 years), fines, imprisonment and personal liability to contribute to the assets of the company concerned.

The principal heads of liability are as follows.

8.12.1.1 Misfeasance/breach of fiduciary duty
Under Section 212 of the IA 1986, a liquidator or any creditor of, or contributory to, the company can bring proceedings under this provision against any officer or director or indeed anyone involved in the management of the company.

8.12.1.2 Fraudulent trading
Under Section 213 of the IA 1986, a person who is or was knowingly party to the carrying on of business by a company with the intent to defraud its creditors may be held liable to contribute to that company's assets on a subsequent insolvency.

Fraudulent trading is also a criminal offence which may result in liability even if the company in question is solvent.

8.12.1.3 Wrongful trading

Under Section 214 of the IA 1986, a director of a company may be found personally liable to contribute to the insolvency estate if he allows a company to carry on its business in circumstances where he knows (or ought reasonably to have known) that there was no reasonable prospect of the company avoiding insolvent liquidation. The director involved may escape liability if he can show that he took all steps required to minimise the potential loss to creditors from the point at which wrongful trading liability would otherwise be triggered (i.e., as soon as the company was trading insolvently).

Liability for wrongful trading also extends to shadow directors, that is, persons in accordance with whose instructions the directors are accustomed to act. There has been some recent discussion as to whether the wide scope of this potential liability is too much of a deterrent or disincentive to attracting turnaround professionals to assist troubled companies when they are trading in the zone of insolvency.

This provision only applies in a liquidation and only the liquidator has standing to bring proceedings under Section 214 of the IA 1986. Those found liable under this provision may be required to make a personal contribution to the estate of the insolvent company in order to swell the assets available for distribution to creditors.

8.12.1.4 Director disqualification

Under the provision of the Company Directors Disqualification Act 1986 ("CDDA 1986"), an order may be made or undertaking extracted (which has the same effect in practice) preventing a delinquent director from holding office in any English company for a period of between two and 15 years (depending on the gravity of the relevant misconduct). Officeholders appointed to an insolvent company have a statutory duty to make reports (known as "D Notices") on directors who have shown unfitness for office in the period leading up to insolvency.

The matters determining unfitness are set out at Schedule 1 to CDDA 1986. This provision remains formally unaffected by the coming into force of the CA 2006.

8.12.1.5 Transactions at an undervalue/preferences

See Section 8.13 below. If transactions are determined to breach the provisions relating to such objectionable antecedent transactions, a director who has benefited can be required to make a contribution to the insolvent estate of the entity involved.

8.12.1.6 Miscellaneous discrete offences

Under Sections 206 to 211 IA 1986, directors can be found liable for a number of specific offences of fraud/misconduct (e.g., the falsification of company records).

8.12.1.7 Personal guarantees

Note that in practice a director will frequently give a personal guarantee (secured on his own assets) of the company's liabilities. Upon insolvency, this guarantee may be called upon.

8.12.1.8 New provisions of CA 2006 dealing with directors' duties

The new provisions of CA 2006 have sought to promote the concept of "enlightened shareholder value" by making directors' duties the subject of statutory codification for the first time. The new statutory duties are set out at Sections 170–177 CA 2006. They are as follows:

(a) Duty to act within powers (Section 171 CA 2006).

(b) Duty to promote success of company (Section 172 CA 2006). This is the critical provision which has generated much commentary. Section 172(1) requires the director in question to have regard to, amongst other things:

   (i) "the interests of the company's employees";

   (ii) "the need to foster the company's business relationships with suppliers, customers and others"; and

   (iii) "the impact of the company's operations on the community and the environment".

   The wording of this new provision has caused some commentators to speculate how these considerations tie in with the requirement to consider or act in the interests of creditors when the company concerned is in the zone of insolvency. However, Section 172(3) CA 2006 specifically provides that the duty to promote the success of the company is subject to "any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company".

   However, the other duties set out by CA 2006 are not subject to such a qualification.

(c) Duty to exercise independent judgment (Section 173 CA 2006).
(d) Duty to exercise reasonable care, skill and diligence (Section 174 CA 2006).

The following duties are scheduled to come into effect in October 2008:

(a) Duty to avoid conflicts of interest (Section 175 CA 2006).
(b) Duty not to accept benefits from third parties (Section 176 CA 2006).
(c) Duty to declare a personal interest in a proposed transaction or arrangement (Section 177 CA 2006).

8.12.2 Shareholders

Absent circumstances of shadow directorship, shareholders are generally only liable in an insolvency to the extent of the value of any unpaid share capital.

However, the Pensions Act 2004 introduced an important new regime under which related companies could be obliged to contribute to underfunded pension schemes of affiliates in certain circumstances. The regime operates by the service of a financial support direction on the relevant entity by the appointed watchdog, the Pensions Regulator, which if not complied with can result in the service of a contribution notice requiring the company concerned to make a contribution to its underfunded affiliate.

8.12.3 Others

In general solely in cases where shadow directorship is characterised can a third party be subject to liability in an insolvency context (e.g., liability for wrongful trading under Section 214 IA 1986). It is very rare in practice.

However, lenders are conscious that they do not want to risk an action in tort for damage to the business of the company occasioned upon the enforcement of their security. Therefore, rather than enforce the security themselves, charge documents will often provide for the appointment of a receiver to "do the dirty work" on the secured lender's behalf.

8.13 Antecedent transactions (including clawback)

There are certain actions that may be taken by an administrator/liquidator appointed to an insolvent company to compensate the estate by challenging transactions that the company has been party to in the time leading up to its insolvency. The overriding goal is to restore the company to the position it would have been in had the improper transaction not occurred.

There are four main categories of antecedent transactions that may be challenged/set aside by application to the court by the officeholder involved:

(a) Transactions at an undervalue: under Section 238 IA 1986, the court is entitled on application to set aside a transaction entered into by a company for which no consideration was paid by the counterparty or for which the consideration paid was considerably less than market value.

The clawback period for a transaction at an undervalue claim is two years prior to the onset of insolvency.

It is a defence to show that:

(a) the company entered into the transaction in good faith and for the purpose of carrying on its business; and
(b) at the relevant time there were reasonable grounds for believing that the transaction would benefit the company.

Finally, note that the company concerned must be insolvent at the "relevant time" or become insolvent as a result of the dubious transaction. This requirement is not necessary when characterising a transaction defrauding creditors (*see* (c) below).

(b) Preferences: in accordance with Section 239 IA 1986, a transaction may be subject to being unwound by the court as a preference on application by an officeholder if the transaction has preferred a creditor, surety or guarantor (i.e., that creditor or other party has, as a result of the relevant transaction, been put in a better position than would otherwise be the case on a hypothetical insolvent liquidation of the company in question).

In order to set the transaction aside as a preference, the court must be satisfied that the company concerned was influenced by a desire to prefer the relevant counterparty.

The clawback period is six months preceding the onset of insolvency. This period may be extended to two years if the transaction counterparty is determined to be "connected" to the company.

Finally, note that the company concerned must be insolvent at the "relevant time" or become insolvent as a result of the dubious transaction. As with a transaction at an undervalue, this requirement can be compared with the criteria for characterising a transaction defrauding creditors (*see* (c) below).

(c) Transactions defrauding creditors: under Section 423 IA 1986, on the application of an officeholder the court may make an order to unwind a transaction if it is satisfied that the aim of the transaction was to defraud creditors by putting assets of the company outside the insolvency estate and therefore beyond their reach.

Whilst the characteristics of a transaction defrauding creditors are similar to those found in a transaction at an undervalue, for a transaction defrauding creditors there is no set clawback period or need to show insolvency at the relevant time. On the other hand, the required element of fraud is generally difficult to prove in practice.

(d) Unlawful floating charges: under a provision that is relatively rarely used in practice, floating charges that are created by an insolvent company in the year preceding insolvency are deemed to be invalid, except to the extent that valid consideration was provided to the company concerned in exchange for the granting of the floating charge in question.

If the beneficiary of the grant of the floating charge is a "connected" person, the vulnerable period is extended to two years.

As with transactions at an undervalue and preferences (but unlike transactions defrauding creditors) it is necessary to show that the company was insolvent at the time that the impugnable floating charge was granted or became insolvent as a result.

The relevant provision is Section 245 IA 1986.

In addition, the following two provisions should be noted:

(a) Disclaimer by liquidator: under a provision specific to liquidations, Section 178 IA 1986, a liquidator can elect to unilaterally repudiate "onerous property" of the company. This is defined as any unprofitable contract or any other property which is unsaleable/not readily saleable or which may give rise to a liability to pay money or perform any other onerous act.

    Accordingly, in circumstances where the performance of future obligations under a contract will prejudice the liquidator's obligations to realise the property of the company and pay a resulting dividend to creditors within a reasonable time, the liquidator can disclaim the contract, thus obviating the need for future performance under such contract.

    The purpose of this powerful provision is:

    (i) to protect the interests of unsecured creditors by relieving the company of the adverse impact on the company's assets of the continuing performance of obligations under an onerous contract; and
    (ii) to enable the liquidator to carry out his duties to realise property and make a distribution to creditors at the earliest practicable time.

(b) Dispositions after start of winding-up: any disposition of property made after a liquidation has started is void unless the court orders otherwise. The enforcement of this provision can cause difficulties in practice, as the start of a compulsory liquidation is backdated to the date on which the winding-up petition is originally presented.

    The relevant statutory provision is Section 127 IA 1986.

8.14 International

The two most significant recent reforms in English insolvency law have been the coming into effect of the Regulation in May 2002 and the implementation of the UNCITRAL Model Law through the adoption of the Cross-Border Insolvency Rules 2006. This reflects the increasing globalisation of the restructuring market and the reaction of English law to this globalisation.

8.14.1 Recognition of foreign processes

8.14.1.1 Under the Regulation

The Regulation came into force on 31 May 2002.

In accordance with the Regulation, "main" insolvency proceedings may be commenced in respect of a company registered in England and Wales if it is adjudged by the courts of another European jurisdiction bound by the Regulation that the company in question has its "centre of main interests" in that jurisdiction.

If such proceedings are commenced in respect of an English company in another European jurisdiction, in accordance with Article 16 of the Regulation the English court must automatically recognise them.

8.14.1.2 UNCITRAL Model Law

The UNCITRAL Model Law on Cross-Border Insolvency 1997 was implemented in England and Wales with effect from 4 April 2006 by the coming into force of the Cross-Border Insolvency Regulations 2006. These Regulations provide specific rules governing the recognition of foreign proceedings and foreign officeholders and the provision of assistance to such foreign officeholders.

The aim of the Model Law is to promote certainty and fairness in cross-border insolvencies. The Cross-Border Insolvency Regulations accordingly seek to facilitate access to English courts and English insolvency procedures by foreign insolvency practitioners and creditors ("foreign representatives").

Under the Cross-Border Insolvency Regulations, the foreign representative must make a direct application to the English court:

(a) to commence and/or participate in English insolvency proceedings; and/or
(b) to seek recognition of his foreign proceedings.

The stated aims of the UNCITRAL Model Law are to promote:

(a) cooperation between the courts and competent authorities involved in cross-border insolvencies;
(b) the fair and efficient administration of cross-border insolvencies to protect the interests of all creditors and other stakeholders (e.g., debtors);
(c) the protection and maximisation of the value of debtors' assets; and
(d) the rescue of financially troubled businesses.

8.14.2 Cooperation with foreign courts

8.14.2.1 Under the Regulation

The Regulation contains specific provisions dealing with the harmonious interrelationship and co-existence of concurrent main and secondary proceedings.

See Article 31 of the Regulation.

8.14.2.2 English court will grant assistance on request

Section 426 IA 1986 provides a statutory framework for the reciprocal cooperation of the courts of England and Wales with the courts of a number of present and former Commonwealth countries.

When considering whether to provide assistance, the English court may elect to apply the substantive provisions of English insolvency law or the provisions of the law of the relevant foreign jurisdiction to the extent that these are consistent with English insolvency law.

The English courts have also shown themselves willing to exercise their wide discretion to apply common law principles to provide bespoke assistance to proceedings in foreign courts on request. The rationale behind this is to promote the proper implementation of foreign insolvency processes in the interests of judicial comity. Notable recent examples of this are the *Cambridge Gas/Navigator* and *HIH Insurance* cases.[3]

However, it remains to be seen whether this common law jurisdiction will in the future largely be superseded following the implementation of the Cross-Border Regulations.

[3] *Cambridge Gas Transport Corporation* v *The Official Committee of Unsecured Creditors (of Navigator Holdings plc and Others)* [2006] UKPC 26; *McGrath and Others* v *Riddell and Another* [2008] UKHL 21 (*Re HIH Insurance*).

8.14.2.3 Cross-border Protocols

These are case-specific contractual documents which have historically been drawn up in circumstances where courts in more than one jurisdiction are dealing with a large and complex cross-border insolvency and restructuring process, given that prior to the implementation of the UNCITRAL Model Law there was no framework for such cooperation.

The first known example was in the *Maxwell Communications* case in the 1990s, but a protocol between the US and English courts was also implemented in the more recent *Federal-Mogul* and *Collins and Aikman* cases, where in each case the US Group was in US Chapter 11 proceedings and the European Group was in English administration proceedings.

8.15 Other

8.15.1 Funding

Generally priority is given to new money invested. It is normally a contractual term of the provision of such "new money" that it is repaid in priority to "old money" (i.e., existing debt). However, in practice it can be difficult to effectively prime the holders of secured debt, who will remain entitled to enforce their security.

In England and Wales, unlike in the US, there is no well-established "debtor in possession" loan market.

8.15.2 Creditor protection versus cram-down

As stated above, one of the principal benefits of using the compromise mechanisms of CVAs and Schemes is that they both permit majority voting. Accordingly, subject to the safeguard of an unfair prejudice action available to disgruntled creditors, all creditors can be bound by the approved terms of such a CVA or Scheme.

The case of *Prudential Assurance Co Ltd and others* v *PRG Powerhouse Limited and others* [2007] EWHC 1002 (Ch) has buttressed the unfair prejudice protection available to creditors. It held that a CVA which released the recourse that landlords had against the parent company guarantor of the tenant company subject to the CVA was unfairly prejudicial. A CVA cannot be used indiscriminately to "strip away" the rights of a group of creditors with the benefit of parent company guarantees, even though it may improve the position of a larger group of unsecured creditors.

The former ability of listed companies to delist their shares in order to escape the application of the specific voting rules of the UK Listing Authority (and thus avoid the need for a separate shareholder vote, a strategy notably employed in the British Energy restructuring) has been restricted by amendments to the Listing Rules which require delisting itself to be approved by a majority of the shareholders in the company concerned.

8.15.3 Proposed reforms (if any)

The staged incorporation of the Companies Act 2006 has had, and will continue to have, an indirect effect on English insolvency law. For example, the codification of directors' duties is set out in Sections 170–177 CA 2006 (*see* above). Certain of these statutory duties came into effect on 1 October 2007 and certain others will come into effect on 1 October 2008.