Lovells

The Most Important Current International Bankruptcy Cases - UK 2002-2003

Jeremy Cole
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A. BACKGROUND

US Scandals - Bankruptcies

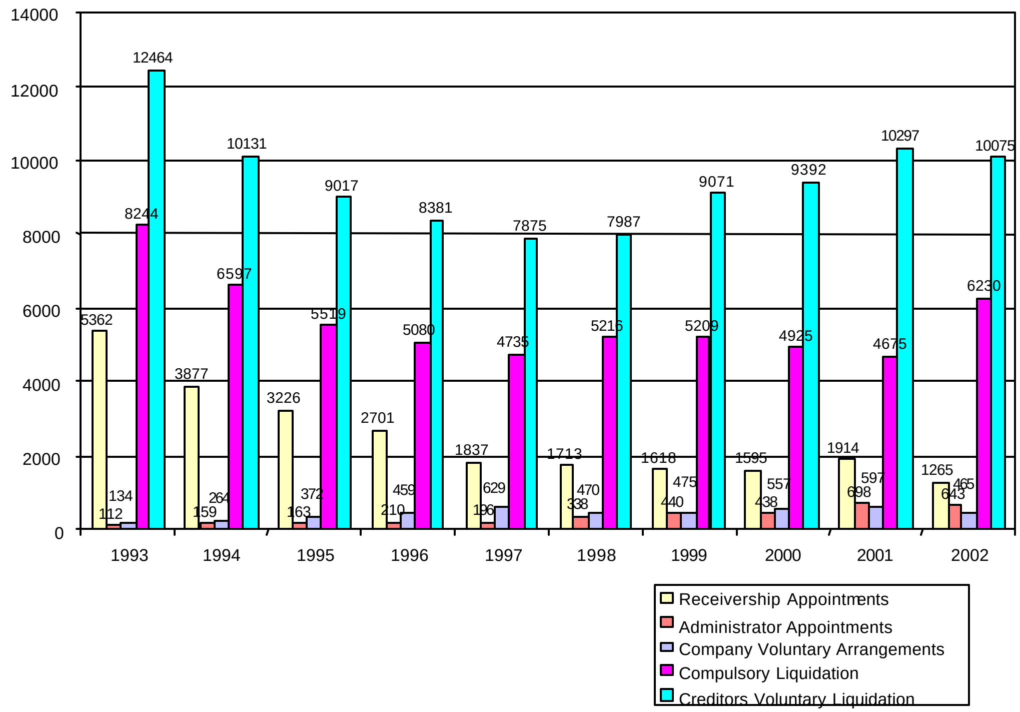
In the US, over the last 18 months there have been numerous notorious financial scandals, a number of which have led to bankruptcies. They include:

Enron	In October 2001, Enron revealed its third quarter results. There appeared to be substantial hole in Enron's accounts. The SEC launched an investigation into the firm. Andersen, Enron's auditors, were implicated in the destruction of relevant documents and on 15 June 2002 a guilty verdict was reached in respect of an obstruction of justice case in the US. Neither Enron or Andersen are still in business.
WorldCom	In April 2002, Bernie Ebbers, WorldCom's founder and chief executive departed having borrowed millions of dollars to underwrite the inflated prices that he had paid for WorldCom shares. In June 2002, WorldCom admitted inflating its profits by $3.8 billion between January 2001 and March 2002. Two months later, WorldCom admitted to inflating its profits by a higher sum, $7 billion.
Xerox	In April 2002, the SEC filed a civil suit against Xerox for misstating four years' profits in the sum of $3 billion. A settlement was negotiated under which Xerox agreed to pay a $10 million fine and to restate four years' trading statements, whilst not admitting (or denying) wrongdoing. The penalty was the largest ever imposed by the SEC in respect of a publicly traded company in relation to accounting issues.
Adelphia	In June 2002, Adelphia, a large telecoms company, filed for bankruptcy. It is now facing regulatory and criminal investigations. It has restated its profits for the last two years and admitted that it did not have as many cable television viewers as it had claimed.
Global Crossing	Global Crossing, another large telecoms company, filed for Chapter 11 bankruptcy on 28 January 2003. Global Crossing's practice of trading network access with other firms may have given a misleading impression of the size of its business, given that revenues may have been booked when in fact no money may have changed hands as between firms involved. More recently, Richard Perle, Chairman of the US Defence Policy Board, has resigned amidst accusations of conflicts of interest over his role in the sale of Global Crossing to Asian investors.
Qwest	Whilst under criminal investigation, Qwest had to restate its profits, admitting that it had improperly accounted for about $1.1 billion in sales of optical capacity on its network, as well as sales of communications equipment.
NY banking scandals	In addition to the above scandals and bankruptcies, a number of news stories have been generated by Eliot Spitzer's investigations into the banking industry in NY and particularly the behaviour of analysts employed by certain banks in NY.

UK Insolvencies

Whilst the news in the UK has not been as exciting as in the US, the number of companies going into insolvent processes has risen almost back to the levels seen in the early 1990s (particularly when one looks at the number of companies going into compulsory liquidation): see the statistics below from the Department of Trade and Industry.

DTI STATISTICS ON INSOLVENCY IN ENGLAND AND WALES 1993 – 2002



Year	Receivership Appointments	Administrator Appointments	Company Voluntary Arrangements	Compulsory Liquidation	Creditors Voluntary Liquidation	TOTAL
1993	5,362	112	134	8,244	12,464	26,316
1994	3,877	159	264	6,597	10,131	21,028
1995	3,226	163	372	5,519	9,017	18,297
1996	2,701	210	459	5,080	8,381	16,831
1997	1,837	196	629	4,735	7,875	15,272
1998	1,713	338	470	5,216	7,987	15,724
1999	1,618	440	475	5,209	9,071	16,813
2000	1,595	438	557	4,925	9,392	16,907
2001	1,914	698	597	4,675	10,297	18,181
2002	1,265	643	465	6,230	10,075	18,678

There have also been several significant companies in serious financial difficulties, some of which have had to enter into insolvency processes:

British Energy	In September 2002 the UK government announced that it had made available an emergency facility of £650 million to British Energy, a nuclear power station operator which supplies about one fifth of UK electricity. In November 2002 a rescue plan was put in place and on 14 February 2003 a standstill agreement was negotiated with British Energy's creditors which enabled the UK government to extend its loan (though the amount was reduced) until September 2004. The European Commission later approved the state aid provided by the UK government under EU law. In April 2003, AEG, a US electricity company which owns the UK's largest power station, the Drax power station, announced that it has asked the European Court to rule on whether the European Commission should have permitted the UK government's aid to British Energy under EU law. AES argues that under EU law the rescue package for British Energy should have included measures to compensate other electricity producers which have also been affected by the slump in power prices. It believes that the assistance provided to British Energy, which was justified by the UK government on safety and security grounds, will force other electricity generators into insolvency.
TXU Europe	In November 2002, six of the companies in the TXU Europe group of companies went into administration. These six companies included TXU Europe Group plc, the holding company for a large number of businesses in the UK, Germany and in the Nordic region. Most notably, TXU Europe owned the old Eastern Electricity and Norweb businesses, and, from March 2002, the Amerada Hess business. Various other companies within the TXU Europe group have since gone into insolvency. The shortfall in the assets of TXU Europe is about £2.5 billion.
ITV Digital	In March 2002, ITV Digital went into administration in the UK. It had paid £351 million for the rights to broadcast Football League games, which proved to be an excessive sum when the TV audiences and advertising revenues ITV Digital had expected did not materialise. The service offered by the administrators to subscribers was seriously reduced on 1 May 2002, after the administrators had failed to find a buyer either for the business as a going concern or for various of its assets. Following various failed legal battles by the Football League to recover the £179 million it was owed, ITV Digital went into liquidation. In April 2003, liquidators offered its 200,000 creditors only two pence in the pound for the £1.3 billion outstanding to creditors.
Federal - Mogul	The Federal-Mogul Corporation whose shares are listed on the New York Stock Exchange, carried on business as automotive and vehicle parts manufacturers in some 295 locations in 53 different countries. As a result of a massive rise in asbestos related claims, the trading companies went into Chapter 11 proceedings in the USA, with 133 companies also entering administration in the UK. A global rescue plan is in the process of negotiation.

In addition to these headline stories, the difficulties faced by Equitable Life, Independent Insurance and Swissair have provided plenty of work for insolvency lawyers in the UK.

B. LEGAL DEVELOPMENTS

1. THE REACTION TO ENRON AND OTHER DEVELOPMENTS

Derek Higgs' report entitled "Review of the role and effectiveness of non-executive directors" was published on 20 January 2003. Its recommendations are generally regarded as sensible measures for the proper regulation of the unitary boards of directors of UK companies and taken on their own are scarcely controversial. However there is a view that, if applied with full rigour, they are likely to lead to a considerable shift in board power from the executive to the non-executive members of the boards of listed companies. Indeed the top UK companies have been reported as having expressed widespread disapproval of the proposals - a recent survey by the CBI has shown that more than 80 per cent. of Britain's largest companies are opposed to a number of the proposals, in particular the ban on company chairmen heading nominations committees and the proposal for non-executive directors to be able to attend meetings with major shareholders. Although the companies understand that the proposals are based on a "comply or explain" regime so that any company would be free to explain why it does not think it a good idea to follow the recommendations, the fear is that, given the box-ticking approach of certain institutional shareholders, the regime will quickly become "comply or else".

The principal recommendations contained in the report are as follows:

1. Composition of Board: At least half the members of a board, excluding the chairman, should be independent non-executive directors. A definition of "independence" is to be included in the existing Hampel Combined Code on corporate governance - this addresses not just matters that could affect objectivity but also those that could appear to do so. There should also be a strong executive representation on the board. Guidance on roles of chairman, non- executive directors and principal board committees to be annexed to Combined Code. The annual report should include a statement describing how the board operates and specifying the number of board and committee meetings held and attendance by individual directors.

2. Chairman: At the time of appointment the chairman should meet the test of independence. No individual should chair the board of more than one major company. A chief executive should not become chairman of the same company. The division of responsibilities between the chairman and chief executive should be set out in writing and agreed with the board.

3. Non-executive directors: The non-executive directors should meet as a group at least once a year (without chairman or executive directors) and annual report should include a statement on whether such meetings have occurred. Full time executive directors and senior management just below board level should be encouraged to take one (but not more than one) non-executive director position on a non-competitor board.

4. Relationship with shareholders: The senior independent director should be available to shareholders if they have concerns that have not been resolved through contact with the chairman or chief executive. The senior independent director should attend a sufficient number of the regular meetings of management with major shareholders to understand their concerns and should communicate these matters to the non-executive directors. Other non-executives should be able to attend meetings with major investors if they choose. On appointment, meetings should be arranged for non-executive directors with major investors. A company should state in its annual report what steps it has taken to ensure that the members of the board, and in

particular the non-executive directors, develop a balanced understanding of the views of major investors. The company secretary should act as a conduit for contacts between major shareholders and non-executive directors.

5. Professional development: The performance of the board, its committees and its individual members should be evaluated at least once a year - the report includes a guidance note on the questions that need to be considered. The annual report should state whether such reviews are taking place and how they are conducted.

6. Board committees: The nomination committee should consist of a majority of independent non-executive directors. It may include the chairman but should be chaired by an independent non-executive. The remuneration committee should comprise at least three members all of whom should be independent non-executive directors. It should have published terms of reference. The Higgs Report welcomes the recommendations contained in the Smith Report on audit committees, also published on 20 January 2003. They include recommendations that the audit committee should include at least three independent non-executive directors; the chairman of the board should not be a member; no one other than the audit committee's chairman and members should be entitled to be present at meetings; at least one member should have significant, recent and relevant financial experience (e.g. as an auditor or finance director of a listed company); the committee should be provided with written terms of reference; and there should be procedures to ensure the independence and objectivity of the external auditor annually. As a matter of good practice the company secretary, or his or her designee, should act as secretary to all board committees. Furthermore the company secretary should be accountable to the board through the chairman on all governance matters. The appointment or removal of the company secretary should be a matter for the board as a whole.

7. Non-executive directors - recruitment and appointment: Non-executives should be drawn from a wider pool. A group of business leaders and others is to report to the DTI on identification of appropriate individuals from the non-commercial sector. Professional advisers to be encouraged to allow suitable candidates to act as non-executives. When an appointment is put to shareholders for approval, the board should explain why they believe the relevant individual should be appointed and how the individual meets the requirement of that role. A comprehensive induction programme should be provided to new non-executive directors. Non-executives should normally serve two three year terms. There should be annual re-election after nine years. Non-executives should not be considered independent after ten years. There is to be no limit on the number of non-executive positions any individual can take but non-executives are to undertake that they will have sufficient time, taking into account their other commitments, and annual performance evaluation should be used to assess whether sufficient time is being spent. Non-executive directors' fees should be more clearly built up from an annual fee, meeting attendance fees and an additional fee for chairmanship of committees or role as senior independent director. There is some merit in non-executives having the opportunity to take part of their fees in the form of shares, but they should not hold options over the shares of their company. Insurance is to be regarded as the basic protection for non-executive directors against suits by third parties and companies should arrange appropriate insurance cover in respect of legal action against its directors.

8. Small listed companies (outside FTSE 350): The same requirements should apply (save that an individual should be free to sit on all three principal board committees), but it may take more time for these companies to comply fully with the revised Code and some of the Code's provisions may be less relevant or manageable.

9. Effective date for proposed changes: Most of the recommendations require changes to be made to the Combined Code, a revised version of which is set out in the report. The changes are to be introduced as soon as possible for reporting years starting on or after 1 July 2003.

Notwithstanding that the reaction of the business community to the Higgs Report has been mixed, the Chancellor of the Exchequer has stated that the UK Government will press ahead with the Higgs reforms. In addition, in January 2003 the Trade and Industry Secretary unveiled new measures to protect against business malpractice. These include the setting up of a single authoritative regulator with responsibility for setting accounting and auditing standards and a new independent audit inspection unit to monitor the audits of listed companies, major charities and pension funds.

2. FLOATING CHARGES AND SECURITY RIGHTS:

The Privy Council case of *Agnew and Another v The Commissioner of the Inland Revenue and Another* [2001] BCC 252 (on appeal from the New Zealand Court of Appeal in *Re Brumark Investments Ltd*) advanced the law on fixed charges over book debts. It decided that where a charge over the uncollected book debts of a company leaves the company free to collect and then use the proceeds for its own benefit in the ordinary course of business, the charge is inevitably a floating charge[1] and not a fixed charge, whatever the debenture might say. The case has led to many insolvency practitioners holding onto book debt realisations and not paying them to chargeholders except where there is a court order or clear, irrevocable indemnity against subsequent claims by preferential creditors.

As Philip Wood has pointed out[2], the decision has its drawbacks in the context of large contracts in major financings such as project financings (the banks have a charge over the construction contract, the concession, the supply contract and the off-take contract), aircraft financings (the bank has an assignment over the lease or charterparty), and securisations (the bondholders have charges over the receivables, the sale contract and the administration contract).

The *Brumark* case may have marked the turning of the tide against the efficacy of the floating charge on insolvency, given caselaw this year and legislative developments:

Re Leyland Daf Ltd	Court of Appeal	[2002] 1 BCLC 571	The reference to a "company's assets" in sections 115 and 175(2) IA 1986 when read together with the definition of a floating charge in section 251 of IA 1986 include assets comprised in a floating charge which has crystallised prior to the commencement of the winding up of the company. Accordingly, liquidators may have recourse to such assets for the payment of expenses properly so incurred in priority to the claims of the chargee in so far as such property remains undistributed.
Flightline Ltd v Edwards	Court of Appeal	[2003] BCC 361	A freezing Order preventing a party from dealing with certain assets does not create a security interest over the assets from time to time subject to it, because it did not impose an obligation on the part of the respondent to satisfy any judgment debt out of those assets. In order for an equitable charge to be created over a specific fund it is necessary to find not merely a restriction on disposal but also an obligation on the debtor to pay the debt out of the fund. Flightline has argued that the Court should permit them to continue their action on the grounds that a specific sum had been set aside from the liquidation for the settlement of their claim. Permission to appeal was overturned by the Court of Appeal.

[1] Under English law, the concept of the floating charge is that of a charge over a revolving class of assets which the company is free to deal with in the ordinary course of business until an event occurs which entitles the creditor to intervene and assert his security rights over the assets then held or subsequently acquired by the company ("crystallisation"). Until crystallisation, the chargee has merely a security interest in a fluid fund of assets. The floating charge is vulnerable to subsequent fixed charges on insolvency (and certain other preferential payments).
[2] [2001] CLJ 472

The Enterprise Act 2002 received Royal assent in November 2002. The corporate insolvency provisions of this Act are currently due to come int o force in August 2003. Those provisions include:

1. Administrative receivership[3] to be abolished for new floating charges (apart from the few prescribed statutory exemptions, which include, importantly, capital market transactions, public-private partnerships, utilities projects, and certain financial markets transactions). The right to appoint an administrative receiver was previously one of the most useful protections for a floating chargeholder, since the administrative receiver's principal aim is to recoup his chargeholder's debt and his duties are owed primarily to the chargeholder.

2. Qualifying floating charges created before the appointed date to be "grandfathered".

3. New out of Court procedure for appointment of an administrator[4] (who has duties to all creditors, c/f the position of an administrative receiver) by either a floating chargeholder (2 business days' written notice to prior floating chargeholders) or the directors of the company (or the company itself) (5 business days' written notice to floating chargeholders).

4. Abolition of the Crown preference[5] in respect of various employment taxes (PAYE and NICs) and Value Added Tax.

5. Ring-fenced fund for unsecured creditors. Current indications are for 50% of the first £10,000 and 20% thereafter, up to a maximum of £600,000 (i.e. a maximum of £123,000).

6. Holders of grandfathered floating charges to receive a windfall. They will not be subject to the ring-fencing above, but they will obtain the benefit of the abolition of the Crown preference. The holders of a grandfathered charge should not agree to postpone their charge after a more recently created non-grandfathered charge.

It remains to be seen whether, and if so to what extent, the Enterprise Act will fundamentally change the methods and approach to finance and workouts taken by banks and other financial institutions. In macro terms, the Enterprise Act may accelerate the move away from traditional overdraft financing towards asset backed and receivable-based lending.

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[3] An administrative receiver is a receiver or manager of the whole (or substantially the whole) of a company's property appointed by or on behalf of the holders or any debenture which as created was a floating charge, or by such a charge and one or more other securities; or a person who would be such a receiver or manager but for the appointment of some other person as the receiver of part of the company's property.

[4] Administration is a procedure introduced by the Insolvency Act 1986. The heart of the administration process is a statutory moratorium and the suspension of the rights of creditors and security holders, in order to afford the company an opportunity to address its solvency problems with a view to rescuing the company and avoiding liquidation. An administration order directs that "during the period for which the order in is force, the affairs, business and property of the company shall be managed by a person [the administrator] appointed for the purpose by the Court". The administration order will specify one of the statutory purposes for which it may be made and, once appointed, it is the duty of the administrator to formulate and, if approved, implement, proposals for achieving the purpose of the administration.

[5] Under Insolvency Act 1986 (s 386 and Schedule 6), on the winding up of a company c ertain debts are paid in preference. Those debts include sums owed to the Inland Revenue, to Customs and Excise, and sums owed in respect of Social Security Contributions (the "Crown preference").

On 1 January 2003 the last provisions of the Insolvency Act 2000 entered into force. The most important of these provisions (the Company Voluntary Arrangement moratorium) offers small companies in financial trouble a better chance of survival by preventing a single creditor from taking legal action against the assets of the company whilst a rescue proposal is formulated and put to creditors. An initial moratorium of 28 days is available simply by filing the required documents at Court. This is limited to "small companies" (which have any two of the following characteristics (a) turnover of less than £2.8 million, (b) balance sheet total of not more than £1.4 million, or (c) not more than 50 employees). Floating chargeholders are also bound by the moratorium, unless they have appointed an administrative receiver first.

3. LIQUIDATION EXPENSES

In addition to the *Leyland Daf* case mentioned above, there has been another significant case concerning liquidation expenses:

Kahn v Commrs. of the Inland Revenue	House of Lords	[2002] 1 WLR 671	The heads of what constitutes a liquidation expense (and is therefore payable in preference to other debts on insolvency) which are set out in the Insolvency Rules 1986 are a definitive statement and are not subject to any implied qualification that the expense incurred must have been for the benefit of the liquidation. That qualification applies only to those expenses incurred before the liquidation.

4. DISCLOSURE OF DOCUMENTS

There have been some significant cases this year relating to document dsclosure, both within insolvency processes (ie under section 236 Insolvency Act 1986) and in the context of normal litigation disclosure:

Three Rivers District Council and others v Bank of England	Court of Appeal	[2003] EWCA Civ 474.	After BCCI's collapse, Lord Justice Bingham was appointed by the Bank of England and HM Treasury to carry out an inquiry into the manner in which BCCI had been supervised. The Bank gave extensive evidence to the Inquiry. The Governor of the Bank appointed three Bank employees, the Bingham Inquiry Unit ("BIU"), to deal with all communications between the Bank and the Inquiry. The BIU had a great deal of contact with solicitors for the Bank and the Bank's Counsel. The Bank claimed legal advice privilege in respect of BIU documents other than communications directly with the Bingham Inquiry team. Both the Bank and the liquidators agreed that documents emanating from or prepared by independent third parties which were then given to the Bank's solicitors for the purpose of obtaining advice were not privileged. The liquidators did not seek disclosure of documents passing between the BIU and the Bank's solicitors or vice versa, nor any of the Bank's solicitors' internal memoranda or drafts. However, the did seek disclosure of documents prepared by the Bank's employees or ex-employees on the basis that such documents were simply the "raw material" on which the BIU would thereafter seek advice from the Bank's solicitors. The Bank claimed that any document prepared with the dominant purpose of obtaining a solicitor's advice was privileged, under the legal advice privilege head, irrespective of whether it was actually communicated to a solicitor. However, the Bank accepted that this general principle was subject to the exception that document sent to or by an independent third party (even if created with the dominant purpose of obtaining a solicitor's advice) would not be covered by legal advice privilege. The Court of Appeal conducted an extensive review of case law on legal advice privilege. Those authorities established that legal advice privilege did not apply to documents communicated to a client or his solicitor for advice to be taken on them, but only the communications passing between the client and his solicitor (whether or not through any intermediary) and documents evidencing such communications. Later authorities did not change this position. Accordingly, the Court of Appeal overturned the Judge's decision, and held that the Bank was not entitled to claim privilege in any of the documentation or internal memoranda of the Bank's employees. The Court of Appeal turned down permission to appeal. The Bank has indicated that it will seek leave to appeal from the House of Lords.

Re RBG Resources Ltd	Court of Appeal	[2003] 1 WLR 586	Section 236 Insolvency Act 1986 gives insolvency officeholders very wide powers to apply to Court for an order that any officer, any person known or suspected to have in his possession any property of the company in an insolvency process, or any person who the Court thinks capable of giving information concerning the promotion, formation, business, dealings or affairs or property of the company appear before the Court for examination on oath. Alternatively, the Court can order the production of documents by any of those persons. In this case, the Court of Appeal considered the factors relevant to the exercise of its discretion to order a private examination of directors under section 236 in circumstances where liquidators had already commenced proceedings against directors of the company in liquidation. The Court of Appeal noted that it had to balance the liquidators' reasonable requirements for information to carry out his functions, against any potential oppression which making the order might cause to the director. The fact that the person against whom the order was sought was a director, who had a duty to co-operate with the liquidator, under section 235 IA 1986, made the case for ordering an examination stronger, but it did not necessarily outweigh any oppression arguments. It would be oppressive to make a section 236 order requiring a person accused of serious wrongdoing, against whom proceedings had been or were to be brought by the liquidator, effectively to provide pre-trial depositions and to prove the case against himself on oath. The Judge having erred, the Court of Appeal had to exercise its discretion afresh. The Court should not assume that the examination would be conducted unfairly or oppressively when exercising its discretion, given the procedural safeguards contained in the Insolvency Rules 1986. Nor was it required to assess the risk of any possible derivative use of answers given in the examination. On balance, the legitimate requirements of the liquidators to obtain speedy information outweighed the oppression to the first and third defendants. The relevant factors in favour of this conclusion were first, the estimated deficit in the liquidation was very large (over $350 million). Second, the liquidators wanted to obtain quick answers so that they could act to recover outstanding receivables and missing moneys (trial was unlikely to occur for at least 12 months). Third, the company's records were seriously deficient and there was an allegation that relevant documents from the company's transaction files may have been destroyed in the period after PricewaterhouseCoopers resigned as auditors to the company (on the grounds that the directors could not satisfy them as to the genuineness of various transactions). Fourth, the directors had disclosed their personal assets as £2.5 million gross, which was a small sum in comparison with the deficit of the company. The House of Lords dismissed a petition for leave to appeal.

Highberry Ltd v Colt Telecom Group plc (No 1)	High Court	[2003] 1 BCLC 290	Highberry, a hedge fund forming part of the Eliott Associates Group in the US, had acquired £75 million of Colt publicly issued bonds at a discount and presented a petition for administration on the basis that Colt was likely to become insolvent on both a cash-flow and balance sheet basis and that creditors' interests would be better served by an administration. The bonds were not in default and were not due for payment until 2006. Since there would be a dispute as to the solvency of Colt at the hearing of the petition, Highberry sought disclosure of documents and information by Colt and the cross-examination of witnesses, including expert witnesses to the petition for administration. The Court dismissed Highberry's petition. Administrative petitions would normally be heard on written evidence, however the Court did have power to order disclosure or cross-examination under rule 7 Insolvency Rules 1986. It was plain that the nature of purposes of an administration order, the nature of the enquiry of the Court and the usual urgency of the application made it inevitable that only very exceptional circumstances would justify an order for disclosure or cross-examination. Highberry should not be permitted access to sensitive and confidential information which was not available to other investors for the purpose of trying to second guess the expectations of Colt. Highberry did not need the information to understand and evaluate Colt's position. Its requests were also far too wide and vague and it would be wrong to treat the hearing of an administration petition as a mini-trial. The Court merely had to be satisfied as to insolvency and would not be trying the matter.
Re Trading Partners Limited	High Court	[2002] 1 BCLC 655	A letter of request seeking the assistance of the English Court was issued by the Court of the British Virgin Islands ("BVI"). An application was made by the BVI liquidators pursuant to section 426 Insolvency Act 1986 to have their status as liquidators recognised in England and Wales and, in that event, to seek an order under section 236 IA 1986 against the receivers of two associated English companies (the companies being the subject of an SFO fraud investigation). The receivers had objected to the BVI liquidators' request for them to produce their working papers for the last 20 months and certain litigation documents, their concerns being not to lead the liquidators to claims to assets claimed by the debenture holder who had appointed the receivers. The Court held that the policy behind section 426 was to recognise the appointment of a foreign liquidator unless the only purpose of such recognition was to permit the liquidator to operate within the jurisdiction in a manner which the Court recognised as impermissible. Section 236 was designed to enable officeholders to obtain information both from documents and from other records which were the property of the company itself and form other persons who had relevant information, and it included documents and information which came into existence after formal insolvency as part of the conduct of a liquidation, administration or receivership. The Court had jurisdiction to make an order in respect of the records and information sought. The working papers should be produced, subject to a right to redact any references which were either privileged or contained a commentary which was regarded as confidential.

5. ADMINISTRATORS' POWERS AND ROLE

Since May 2002, the administration process has been opened up to be available to insurance companies in the UK, under the Financial Services and Markets Act 2000 (Administration Orders Relating to Insurers) Order 2002. In addition, there have been two significant cases in this area:

Re TXU UK Limited	High Court	[2002] EWHC 2784 (Ch)	The Court has an inherent jurisdiction to authorise an administrator to exercise his powers for the benefit of creditors even where that exercise is not a step towards the fulfilment or any of the statutory purposes for which the administrator is appointed. The administrators proposed to make a payment as part of a three-way compromise to which the third party was contributing and which was likely to be in the interests of creditors. The statutory purposes for which the administrators were appointed go only to what the administrators should be trying to achieve and do not limit the powers of the administrators once they are appointed. However, the Judge considered that the administrators would be unwise to exercise their powers in this way without Court approval.
Re Colt Telecom Group plc	High Court	[2002] EWHC 2815 (Ch)	This was the hearing of the administration petition referred to above. The Judge dismissed the petition. Highberry had alleged that Colt was "likely to become unable to pay its debts". Highberry had to show that this was more probable than not. A company should not be put into administration where there was only a "real prospect" or insolvency. The experts for both parties agreed that there was no binding New York authority on whether the no-action clause contained in the New York law Indenture governing the bonds prevented Highberry from bringing a petition for administration. However, given that the no-action clause stated that a holder of the bonds could not pursue "any remedy with respect to the Indenture or the Notes" unless certain conditions were satisfied, the Judge considered that Highberry could not bring an administration petition. Highberry argued that the clause should be struck out as contrary to public policy: the right of a contributory to petition cannot be abrogated or restricted by provisions in the constitutional documents of a company and this principle should be extended to contracts made by companies with their creditors. The Court rejected this argument. Unusually in this case, the Court ordered that those who had provided the Rule 2.2 Insolvency Rules 1986 reports in support of the application for an administration Order should be cross-examined. In respect of that cross-examination, the Court commented that the rules contained in the Civil Procedure Rules Part 35 (eg as to independence of experts) applied to those who provided evidence in support of an administration petition. Where the petition is likely to be contested then the author of the Rule 2.2 report ought to re-read the Rules and the Code governing expert evidence before writing the report. Further, the insolvency practitioner asked to give evidence to support such a case should not propose himself as an administrator. However, this did not apply to petitions initiated by directors. Where, in contested creditors' petitions, the author of a Rule 2.2 report has a direct interest in the outcome of the proceedings, then he

			should make an express and full statement to that effect in the report, because the existence of a conflict of interest has an effect on the weight to be attached to the evidence in the report. Where evidence in support of a petition is opinion evidence, and not within the expertise of the insolvency practitioner, then individuals who are "true experts" should give evidence. It is not expert evidence to state that "I know a man who knows and he has explained it to me".

6. EUROPEAN DEVELOPMENTS

The most significant development, from a European perspective, has been the entry into force of the European Regulation on Insolvency Proceedings on 31 May 2002 (in all EU Member States except Denmark). Briefly, the most important provisions of this Regulation are:

1. The introduction of the new concept of one set of "main proceedings" and potentially numerous "secondary proceedings" in Member States. The main proceedings dictate the insolvency proceeding of the debtor (whether an individual or a company), wherever the debtors assets are situated, unless and until secondary proceedings are opened, whose effects are restricted to assets situated in the Member State in which the secondary proceedings are situated.

2. Both the main and secondary proceedings must be recognised by all Member States; the applicable law of the main proceedings is the law of the Member State in which the main proceedings are opened. The applicable law of the secondary proceedings is the law of the Member State in which the secondary proceedings are opened.

3. In the UK, members' voluntary liquidations and receiverships are excluded from the scope of the Insolvency Regulation. Secondary proceedings are limited to compulsory liquidation, creditors' voluntary liquidation and bankruptcy (loosely "winding up proceedings"). Neither administration nor voluntary arrangements are available in secondary proceedings.

4. Jurisdiction to open main proceedings depends on the centre of the debtors' "main interests", which must be in the EU for the Regulation to apply. The "centre of main interests" is not defined in the Insolvency Regulation. The Regulation provides for a rebuttable presumption for companies that it will be the location of the registered office, but the Preamble to the Regulation states that it will be where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties.

5. Main proceedings have universal scope, encompassing all of the debtors' assets worldwide and all creditors (subject only to secondary proceedings). The law of the Members State in which the main proceedings have been opened will govern the opening, closing and conduct of the insolvency. Any judgment opening the main proceedings will be recognised in all other Member States and shall produce the same effects in those other Member States as under the states of the main proceedings (again subject only to secondary proceedings).

6. The liquidator of the main proceedings can exercise in all Member States those powers which he enjoys in the Member State of the main proceedings (subject to the opening of secondary proceedings). He can remove assets from the territory in which they are situated subject to certain specific exceptions (third party rights in rem, rights of set-off, reservation of title claims, contracts relating to immovable property, contracts of employment and the law governing payment systems and financial markets). These exceptions are likely to encourage the liquidator to apply for secondary proceedings to be opened.

7. Secondary proceedings deal with assets located in that Member State and run in parallel with the main proceedings. They can only be opened if the debtor has an "establishment" within that Member State. An "establishment" is "any place of operations where the debtor carries out a non-transitory

economic activity with human means and goods". Secondary proceedings can be requested by the liquidator in the main proceedings or by any other person who would be entitled to request the opening of insolvency proceedings in that Member State.

8. The Regulation requires reciprocal collaboration and exchange of information between main and secondary liquidators.

9. The liquidator of the main proceedings can apply to have the secondary proceedings stayed, in whole or in part, for up to 3 months (this period can be extended). Such an application cannot be rejected unless it is manifestly not in the interests of the creditors in the main proceedings. The Court in the secondary proceedings can require the liquidator in the main proceedings to guarantee the interests of the creditors in the secondary proceedings.

There have already been cases concerning the Regulation. They include:

Re BRAC Rent-a-Car Inc	High Court	[2003] 2 All ER 201	Section 8 of the Insolvency Act 1986 ("IA 1986") gives the court the power to make an administration order in relation to a company. Because "company" is not otherwise defined, the general definition in the Companies Act 1985 ("CA 1986") is applied by section 251 IA 1986, to include only companies registered under CA 1985 or an earlier Companies Act. Therefore, prior to the European Insolvency Regulation, administration orders could not made over a foreign company other than pursuant to a request from the court of a relevant country or territory under section 426 IA 1986. The Regulation provides at Article 3(1) that: "The courts of the Member State within the territory of which the centre of a debtor's main interests is situated shall have jurisdiction to open insolvency proceedings. In the case of a company or legal person, the place of the registered office shall be presumed to be the centre of its main interest in the absence of proof to the contrary". The company in question was incorporated in Delaware, with a registered office in the United States. However, it had never traded in the United States and its operations were conducted almost entirely in the United Kingdom, with a trading address in England. It was registered under the Companies Act as an overseas company. Its employees worked in England, with contracts of employment governed by English law. Its trading activities were carried out by way of contracts with subsidiaries and franchisees which were also governed by English law. The company petitioned for an administration order. For reasons related to an Italian arbitration award, the creditors wished to contend that the court had no jurisdiction to make an administration order. The creditors argued that a legal measure of the European Union should not be presumed to apply to entities which were not incorporated in a Member State, and that the Regulation should not be read as having extra-territorial effect outside the E.U. The English court ruled that it had jurisdiction to make the administration order sought. The Regulation did not state that only debtors incorporated in a relevant Member State should be affected by it. According to a literal reading of the Regulation, the only test for the application of the Regulation in relation to a given debtor was whether the centre of the

			debtor's main interests was in a relevant Member State, and not where a debtor which was a legal person was incorporated.
Enron Directo SA	High Court	Unreported, 4 July 2002	A petition for an administration order was presented to the English Court in respect of a Spanish incorporated Enron company trading in Spain but whose headquarters functions were carried out in London. The Judge found that on the evidence of the centre of main interests of the company was in England and accordingly an administration order would be made as a main proceeding under the EC Regulation.

7. OTHER LEGAL DEVELOPMENTS

Money Markets International Stockbrokers Ltd (in Liq) v London Stock Exchange Ltd	High Court	[2002] 1 WLR 1150	This case concerned the English law rule against deprivation provisions triggered by the onset of insolvency. MMI, a company in liquidation, and a former member of LSE, sought reinstatement as a member of LSE or compensation for the loss of its share in LSE. Under LSE's articles of association a member of LSE was required to acquire a "B" share, to surrender that share on ceasing to be a member and that on a member becoming bankrupt it had to transfer its B share back to LSE. Shortly after MMI had transferred its B share back to LSE, LSE had demutualised and the share had a value of about £3 million. MMI argued that the provision in LSE's articles was contrary to the rule that a contract which provided that property would remain in a person until their bankruptcy and thereafter transfer to another, thus depriving a bankrupt's creditors was invalid. Having extracted some general, albeit piecemeal, rules from the authorities, the Judge decided that it could not be said that prior to demutualisation the ownership of a "B" share amounted to the ownership of a free standing asset. A "B" share could only be held by member firms of LSE and it was for LSE's directors to decide who to elect as member firms. Whilst demutualisation had been under contemplation at the time that MMI had been required to transfer the "B" share back to LSE, the date at which that decision was formally taken was after the share had been transferred back to LSE. It followed that there had been no infringement of the general rule against deprivation provisions.
Morphites v Bernasconi and others	Court of Appeal	(2003) 147 SJLB 300 [2002] EWCA 289 (Ch)	Section 213 Insolvency At 1986 (carrying on business with intent to defraud creditors) is satisfied by showing that one creditor was defrauded on one occasion. However, it will not be the case that whenever a fraud on a creditor is perpetrated in the course of carrying on a business, it will necessarily follow that a business was carried out with an intention to defraud creditors. Although not necessary for its determination of this case, the Court of Appeal commented that there must be a nexus between the loss caused to the company's creditors generally (by the conduct in question) and the requisite contribution. Where the conduct of the defendants did not lead to any assets of the company being misapplied or to any claim against the company that would not otherwise have been available, no contribution should be ordered. Finally the Court also considered that, as a matter of statutory construction, there appears to be no basis under section 213(2) for adding a punitive element to any contribution that the Court may order those involved in fraudulent trading to make to the assets of the company.