NOTES ON NEW INSOLVENCY LEGISLATION

?? **Insolvency Act 2000**

Most of this came into force in April 2001 and one very significant part came into force on 1st January 2003. This part of the Act contains provisions for a moratorium on legal process against a com pany, including the enforcement of security, without the commencement of administration proceedings which would normally be required to introduce the moratorium protection. The moratorium would be for a period of 1 month which may be extended to 3 months. The purpose is to encourage directors of a company to propose a company voluntary arrangement to creditors, which would involve a compromise of creditors' claims. If the proposals receive the necessary majority approval from creditors, they will bind th e creditors and the intention will be that the company then becomes solvent and can continue in operation.

These new moratorium provisions only apply to small companies, which is a definition taken from the Companies Act 1985 and is based on a finance and employee test. The Government has power to make these provisions apply to larger companies and it is likely that this will happen in time, depending on how successful these provisions are.

The directors of a company may not have time to prepare propos als to send to creditors as certain creditors may take steps to enforce security, to wind up the company or take other action which would lead to formal insolvency proceedings, for instance receivership. An administrator may put forward a voluntary arrang ement but this involves the process of appointing an administrator with all the cost and time this may involve, as well as the company having to be run under the stigma of administration.

There are a number of exceptions to these moratorium arrangements, for instance in respect of securitisation and other financing transactions for which special purpose vehicle companies are used and which would fall within the small company test. There are at present a relatively small number of company voluntary arrang ements put forward by directors and it is hoped that the new regime should encourage this and therefore encourage the rescue of companies outside formal insolvency proceedings.

?? **Enterprise Act 2002**

This Act, which is expected to come into force later this year, introduces radical changes to the current insolvency regime for companies, in particular so far as secured creditors are concerned. A bank or other creditor which holds a floating charge will no longer be able to appoint an administrative receiver but will be able to appoint an administrator through an out of court process. The intention is not to stop the bank enforcing its security, but to permit this to take place by the administration route, as the administrator has duties to creditors generally, rather than is the case with an administrative receiver whose duties are principally to the bank which appoints him. There are a number of exceptions to the restriction on appointing administrative receivers, in respect of a number of financing transactions, for instance capital markets fundraising transactions and public private partnerships.

The process for appointing an administrator is considerably simplified and the directors and the company will also be able to appoint an administrator without going through the current court process. The purposes of an administration will also be changed to try to encourage the rescue of companies and the whole or part of their business if at all possible. The statute also provides for a speedier process, in particular that administration can only last for 3 months, although this may be extended by the court or by agreement with creditors.

After many years of discussion, the rule that certain liabilities to the Crown rank as preferential claims and ahead of a floating charge is to be abolished. These are principally PAYE and VAT. Another significant change is that part of the assets of the company which would otherwise be the subject of a floating charge will be released and available for unsecured creditors.

The overall effect will be to reduce the value of the floating charge, encourage greater recognition of unsecured creditors and streamline the administration process.

?? **European Regulation on Insolvency Proceedings**

This Regulation came into force on 31st May 2002 and effects insolvencies throughout the European Union (save for Denmark). It provides for EU wide recognition of an administrator and a liquidator appointed in the UK, so that they will be able to apply the rules of their home jurisdiction in any other EU country, subject to issues of public policy in that country. Equally, there will be reciprocal recognition in the UK of insolvency officers of other EU countries. The test for establishing in which country the proceedings commence is where the company has "its centre of main interests". There could be a dispute as to where this is in particular cases. There is also the possibility of having a local liquidation in another country. There are a number of exceptions to the application of the law of the home jurisdiction in other EU countries, for instance in respect of enforcement of security, set-off rights and retention of title.

This is a complicated area and still somewhat unchartered from the practitioner's point of view. However, it is likely that the Regulation will have a considerable bearing on formal insolvencies of companies incorporated in one EU country, which have assets in other EU countries. The intention is to give more coordination in insolvencies within the EU, for the benefit of creditors.

?? **UNCITRAL**

UNCITRAL, which stands for United Nations Commission for International Trade Law, developed model legislative provisions in respect of certain aspects of cross-border insolvency. Unlike the EU Insolvency Regulation which automatically applies to domestic legislation in each EU country, the UNCITRAL model provisions have to be adopted by each country.

The Insolvency Act 2000 includes a provision whereby the Secretary of State can adopt these provisions into UK domestic law and make appropriate amendments to the existing regime. It is likely that the model law will be adopted by this country, as it has been by certain other countries. The purpose is to promote co-operation between the courts and office holders in one country with those in overseas countries involved in cross-border insolvency, and also to give greater certainty for trade and investment and fair and efficient administration of such insolvencies to protect the interests of creditors and other parties. It is also intended to promote the protection and maximisation of the value of the debtor's assets in the rescue of financially troubled businesses. An overseas insolvency representative may apply to the court in the relevant country to obtain relief under its law, including the opening of proceedings in that country. The foreign representative may participate in the insolvency proceedings in their country, giving foreign creditors rights in the insolvency. The court in the relevant country and the local insolvency representative must co-operate to the maximum extent possible with the foreign courts and foreign representatives. This includes communication of information and overall co-ordination.

The proposals contain a number of provisions which could be of considerable assistance in cross-border cases, for recognition of overseas representatives and commencement of ancillary proceedings and other matters.

- **Other issues where there are developments currently taking place**

  - The possible use of Chapter 11 moratorium and restructuring regime from the US is likely to have a greater place in restructurings of English companies which have interests, for instance subsidiaries, in the US. It may be possible to put an English company into Chapter 11 in the US as part of restructuring arrangements.

  - So-called debt traders, principally from the US, have been involved in buying bonds of UK listed companies and exerting considerable influence in restructuring negotiations. In the past, restructurings and insolvencies have been mainly led by the banks which have secured or unsecured rights, but now unsecured bondholders are exerting much more influence in the process.

  - There is a greater prevalence of conversion of debt into equity so that banks and bondholders convert part of their debt into shares and take over most of the share capital of the company, leaving the former shareholders with very little interest.

  - The greater use of turnaround specialists, which is a development from the traditional company doctor idea, with restructuring specialists taking board positions and bringing in a team with them who have expertise in this area.

The overall effect of all this is likely to encourage the restructuring of companies and, if formal proceedings are required, that these be carried out in the greater interest of all creditors. In addition, there will be greater consolidation and understanding in cross-border insolvencies, for the benefit of creditors as a whole, rather than the more fragmented basis as at present, although there are some very effecti ve cross-border co-operation techniques available.

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April 2003