

## An update on the Corporate Insolvency Proposals

14<sup>th</sup> January 2002

On 28 November, Melanie Johnson, Minister for Competition, Consumers and Markets, announced further details on the Enterprise Bill and that more information on how we plan to take forward the insolvency proposals would be published soon. She also said that DTI would publish details of its position following the consultation on the White Paper "Productivity and Enterprise: Insolvency – A Second Chance".

The White Paper outlined proposals to modernise the UK's insolvency regime and contained provisions on both personal bankruptcy and corporate insolvency. These included: reducing the discharge period for most bankrupts; reviewing the relevance of statutory restrictions on un-discharged bankrupts; providing a tougher regime for bankrupts whose conduct has been irresponsible or reckless; restricting the right to appoint an administrative receiver; streamlining administration; abolishing Crown preference and modernising the financing regime of the Insolvency Service. A summary of the responses is available on the [Insolvency Service Website](#).

This paper looks at how the proposal to streamline administration has developed, and is the first in a series designed to provide more information on the insolvency proposals now being taken forward by the Enterprise Bill. Together this set of papers will form the Government's response to the consultation.

### *Streamlining Administration*

A vigorous entrepreneurial society is vital to sustaining economic and social development. While businesses will occasionally fail in competitive markets, viable companies should not be allowed to go to the wall unnecessarily. The Enterprise Bill aims to help companies survive and increase entrepreneurship by promoting collective insolvency procedures, in particular through streamlining administration - recognised as an effective tool in encouraging company rescue - and restricting the use of administrative receivership.

We need to strike a balance between the interests of companies and their creditors if we are to promote an effective entrepreneurial society. Therefore, in designing the proposals to streamline administration we are working closely with the finance sector, the small firms lobby and other business groups and insolvency professionals.

### *The White Paper*

The White Paper set out proposals to modernise the UK's insolvency regime, which included plans to promote a collective approach to insolvency and a culture in which companies that can be rescued, are rescued. Administration was recognised as an important tool in providing companies in financial difficulty with the space needed to put together a rescue plan, or alternatively, to provide a better return to all creditors, not just floating charge holders.

The White Paper accepted that administrative receivership was popular with floating-charge holders as cases could be dealt with quickly, and it allowed them to realise their own security easily. It also recognised that while the take up of administration was increasing, it needed to

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be streamlined and many of the current formalities removed if it was to be effective as a major insolvency procedure.

Proposals to streamline administration included a court-based route into administration for floating charge holders without the need for a rule 2.2 report (but with a duty to give at least five days notice to the company and any party presently entitled to receive notice) and a new procedure for interim administration which could be entered into without notice in cases of urgency. In addition, the White Paper suggested shortening the time scale for the administrator to send out a statement of proposals as well as widening the purposes for which an administration order could be made to enable the realisation of the security of a floating-charge holder whilst taking into account the possibility of preserving all or part of the company's business.

## *Consultation*

We consulted widely on the proposals set out White Paper, and the responses have helped further develop them in terms of their practical application. We are continuing to work closely with a range of interested parties on the finer points of detail. This paper provides more detail on the proposals to streamline administration set out in the White Paper, and explains how some of the proposals and other issues identified as a result of comments received in response to the consultation are being taken forward.

## *The Way Forward*

### Main developments since the White Paper

- *Provide out-of-court routes into administration for companies and floating charge holders – this also removes the need for the proposed interim administrator;*
- *Replace the existing 4 purposes of administration with a better-defined 2-stage approach for all administrations rather than introducing an additional purpose as originally proposed.*
- *Remove the need for a Rule 2.2 Report in all cases of administration and not just for floating charge holders as originally proposed;*
- *Extend the powers of administrators to make distributions to secured and remaining preferential creditors in all cases, and to unsecured creditors in some cases – which was raised by respondents to the White Paper consultation; and*
- *Introducing a 3-month cap for most cases of administration - which was raised by respondents to the White Paper consultation.*

### *routes into administration*

For administration to be as widely effective as possible, it needs to be easy to access for companies and their creditors. While respondents to the consultation generally supported plans to promote collective insolvency procedures and the majority agreed with the need to streamline administration, many felt that a court-based procedure could not achieve the necessary speed and flexibility that are seen as strengths of administrative receivership. In addition, there was a view that a substantial increase in the number of administration orders would create pressure

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on, and possibly delay in, the courts. Respondents also raised questions over proposals for an interim administrator.

It is therefore proposed that, as well as being able to apply for administration through the courts, there should be out-of-court routes into administration for floating charge holders and companies. This will allow the courts to focus on cases of dispute and will remove the need for a new interim administration procedure as set out in the White Paper.

Other issues raised relating to the restriction on the appointment of an administrative receiver included the ability of floating charge holders to choose the administrator and the potential impact that any changes might have on lending. We are therefore proposing that floating charge holders who have a valid and enforceable floating charge will be able to appoint as administrator an insolvency practitioner of their choosing without having to apply through the courts and without notice. However, they will need to be able to demonstrate that: they hold a floating charge over whole, or substantially the whole, of the company; the charge has become enforceable; and no winding up order has been made or provisional liquidator has been appointed.

For companies in financial difficulty, the moratorium that applies to administration can provide the vital breathing space needed to develop a rescue package. Providing a quick, easy and cheap route into administration will increase the likelihood of companies seeing rescue as an option at an early stage – when a rescue plan is more likely to succeed.

Directors of companies using the out-of-court route will need to give notice to any floating charge holder who has the power to appoint. There will be a notice period during which the floating charge holders may either agree to the proposed appointment or appoint an alternative administrator, although the moratorium will take effect immediately notice is given. If there is no floating charge holder, or they did not respond to the notice of intention to appoint, the Company's appointee will automatically take office after the notice period has lapsed. However, where there is no floating charge holder the unsecured creditors may requisition a creditors' meeting to vote on replacing the appointee if they so wish.

The out-of-court route will not be available to a company if the directors have put the company into administration during the previous 12 months, or if a winding up petition has been presented or a winding up order made.

A company applying for administration will need to demonstrate that it is, or is likely to become, unable to pay its debts and that notice has been given to the floating charge holders and any others entitled to notice. Other creditors can only apply for administration through the courts and will need to demonstrate that the company is, or is likely to become, unable to pay its debts.

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## *making the purpose of administration more straightforward*

The White Paper proposes a widening of the purposes of administration to enable the realisation of the security of a floating charge holder. We have decided to replace the existing 4 statutory purposes of administration under Section 8(3) of the Insolvency Act 1986 with 2 better-defined objectives. The purpose of the new objectives will clearly be to maximise the chances of the company, and as much as possible of its business, continuing in existence; and only if that is not possible, bring about a better return for the company's creditors and members than would result from an immediate winding up of the company, e.g. by allowing the company to trade for long enough to complete a large order. This removes the need for the proposed additional purpose while supporting the Government's aim of encouraging company rescue and, where that is not possible, a better realisation of the company's assets.

## *reducing bureaucracy*

The White Paper proposed removing the requirement for floating charge holders to submit a Rule 2.2 report in applying for administration through the courts. In order to simplify the process for all users of administration, and to encourage companies to consider rescue at an early stage, we further propose replacing the Rule 2.2 report in all cases of administration with a much simpler statutory declaration for the out-of-court route, or a statement filed with the court for the court route. This will have the same effect as a statutory declaration, and any breach will carry appropriate sanctions.

## *powers of the administrator*

A number of the White Paper respondents raised issues over the powers of the proposed interim administrator, but also of the power of the administrator to make distributions, although the latter point was not covered in the White Paper.

Providing out-of-court routes into administration has removed the need for an interim administrator and therefore concerns over the scope of their powers. The administrator will have full power to run the business as set out in Sections 14 and 15 of, and schedule 1 to, The Insolvency Act 1986. In light of responses to the White Paper, the administrator will be given the power to make distributions to fixed charge holders, preferential creditors and floating charge holders without leave of the court. The administrator will only be able to pay unsecured creditors by leave of the court, except where it would be in the interests of all creditors to do so, e.g. where machinery has broken down and the contractors will not make the repair unless their existing debt is paid off. This will be a useful addition to the administrator's powers and will aid company rescue.

If the administrator decides that the company can be rescued, or a better realisation of the assets achieved, they will provide the creditors and the court with a copy of their report, including their proposals, within 28 days. Where there are no funds available from the insolvent estate for unsecured creditors, outside that flowing from the abolition of Crown preference, the administrator will not be required to call a meeting of the creditors. If it is necessary to convene a meeting of the creditors, the administrator will do so on 14 days' notice. While generally only

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unsecured creditors are able to vote on the proposals, secured creditors can vote on the unsecured part of their debt. However, the creditors will not be able to approve proposals that affect the right of a secured creditor to enforce their security (as currently set out in Section 4(3) and 4(4) of the Insolvency Act 1986 in relation to Company Voluntary Arrangements).

If the administrator wants to sell the whole or a substantial part of the business, he or she will need to either: get the consent of the majority of creditors, or in cases of urgency, e.g. where a downturn in the market could result in a sharp fall in the value of the business, the administrator may apply to the court.

### *speeding up the process*

To improve the likelihood of a company rescue, and to provide certainty and transparency, the administration needs to conclude quickly. This was an issue raised as part of the consultation. We are therefore shortening many of the time-scales and introducing a three-month cap on administration. The proposed changes to administration mean that it should be possible to conclude the majority of administration cases within the new timeframe. However, in complex cases, the courts will be able to extend the time-scales and with the creditors' approval one three-month extension will be possible without leave of the court.

### *exit routes*

Although not specifically covered in the White Paper, for administration to be successful it needs to have clear exit routes tied to its objectives. We therefore intend that:

- If the company can be rescued, then the rescue plan will be put into action.
- If it cannot be rescued, then the administrator will aim to achieve a better realisation of the company's assets than an immediate liquidation.
- Where there are no funds available for the unsecured creditors, the administrator will realise the company's assets and make payments to preferential creditors and fixed and floating charge holders and will arrange for the dissolution of the company.
- If there are funds available for the unsecured creditors, the company will be put into voluntary liquidation.

### *Further Information*

The Government's White Paper "[Productivity and Enterprise – Insolvency: A Second Chance](#)" was published in July 2001 and is available from [The Insolvency Service Web Site](#) along with a summary of the responses. For more information on the Enterprise Bill, you can visit the [Enterprise Bill website](#).

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