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Bankruptcy Strategies and Trends in the United Kingdom

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Unique Aspects of Bankruptcy Law in the United Kingdom

Our discussion of bankruptcy law in the United Kingdom focuses predominately on the law in England and Wales. This is because, while the United Kingdom is a member of the European Union, the United Kingdom is itself made up of the constituent countries of England, Scotland, Wales, and Northern Ireland. Ireland is not part of the United Kingdom and is a separate member state of the European Union. In the United Kingdom, only England and Wales share a common form of legal system known as English law. Both the law of Scotland and Northern Ireland, though influenced by English law, are distinct. Thus, our discussion is based on the English law countries of England and Wales, where we are licensed, and references to the United Kingdom and U.K. law shall mean England and Wales, and English law, respectively.

The distinctions above help clarify how our country differs at its core from most of the rest of the European Union. England is the original common law jurisdiction, and English law remains the forerunner of common law legal systems. While there are twenty-seven member states in the European Union, only the United Kingdom and Ireland are common law states. The remaining European Union member states have civil law systems.

In short, the distinction means that in England and Wales, prior decisions of the courts are given greater weight than in civil law jurisdictions, the courts are generally empowered to make law, and the role of the adversarial process is more integral to the determination of disputes. The net result of this is that insolvency and bankruptcy law in the United Kingdom is significantly less codified than in other European Union member states.

Further, the nomenclature presumed in the title of this chapter is potentially misleading in England and Wales. "Bankruptcy" is a term that has been glamorized by U.S. practice, but is not accurately used in the context of insolvent companies in the United Kingdom. Bankruptcies in England and Wales are reserved for individuals and, in some instances, partnerships lacking limitation on liability.

With respect to corporations and other companies, these entities are subject to different insolvency procedures, namely liquidation and administration (administration order and administrative receivership), each described in greater detail below. The term "bankruptcy" is used often in public, non-legal discourse to refer to companies, but it tends to carry with it the connotation of liquidation. The term "bankrupt" is often used interchangeably with "debtor" to refer to the individual or company in bankruptcy or insolvency, as the case may be. Note, however, that the difference is both fundamental and procedural. Bankruptcy and business insolvency actions are administered by separate courts and are pursuant to different procedural rules.

Because an understanding of both bankruptcy and business insolvency makes one better at understanding either individually, we discuss both laws below, but with an emphasis on business law, as this is our practice. One should not lose sight, however, that this is one of the key hallmarks of the U.K. system: different systems for individuals versus companies, each of which has arisen and evolved in unique ways. This is discussed in further detail below.

Business insolvency law in the United Kingdom is not, therefore, generally referred to as *bankruptcy* law. As described in more detail below, businesses (for these purposes, corporations and other companies) have a variety of legal options in this regard, including, but not limited to, company voluntary arrangements/schemes of arrangement, receiverships, administration, and liquidation/winding up.

The core questions in all of these options, and concomitantly in comparing the United Kingdom's various options to those in the European Union or the United States, is the balance of competing interests and presumptions, such as:

1. Balancing creditor versus bankrupt protections
2. Determining whether bankrupts or third parties should take the primary role in determining process and outcome
3. Balancing efficiency versus cost
4. Weighing predictability against flexibility

Compared to the United States, the benchmark against which most bankruptcy systems are measured, the United Kingdom's business bankruptcy laws are less permissive and more creditor-protective. Further, though both systems are based in common law, the U.S. system is more statutorily confined. Codification is a prominent feature of the other states of the European Union. Whereas the United States focuses on providing a fresh start and a clean slate for bankrupts, European insolvency legislation prioritizes the satisfaction of creditors' claims. A bankrupt's property is not protected in the United Kingdom and the European Union in the same way it is in the United States. Creditors therefore have more possibility to enforce their claims, and bankrupts have to give up most of their property to serve creditors' claims.

Compared to the rest of the European Union, however, legislation in the United Kingdom is often considered the most bankrupt-friendly. Of all the European countries, the United Kingdom's bankruptcy legislation most resembles that of the United States, but it is still regarded as being stricter and more creditor-friendly than the United States. In addition to giving up most of their property, European bankrupts typically have to undergo a period of good conduct with a settlement plan to make a contribution to debt service. For example, Irish legislation foresees a waiting period of twelve years before the discharge of consumer debt (c.f., the twelve-month period in the United Kingdom, recently shortened from thirty-six months). This, too, is a hallmark of the U.K. insolvency regime: its overall flexibility (and not uncoincidental ability to do major tasks without court oversight or intervention, as discussed below).

This United Kingdom and European Union divide in part centers on the perception of whether a bankrupt, by being insolvent, has done something "wrong." In Chapter 11 in the United States, which stresses the "fresh start" of bankrupts (and their officers and directors), bankrupts receive a treatment akin to that of innocent victims of economic circumstances. As discussed in more detail below, recent reforms in the United Kingdom have sought to bridge this divide, with moderate degrees of success.

The differing U.S. perception leads to the U.S. approach of debtor-in-possession, a concept that, until recently, was completely foreign to the European Union member states (including the United Kingdom). Traditionally, European Union countries look more askance at bankrupts and their officers and directors in such circumstances. As noted below in more detail, this is changing, albeit in many instances slowly.

Still, as noted above, the United Kingdom is considered to be more permissive than the rest of the European Union. Indebted persons (and businesses) throughout Europe often turn to the United Kingdom to take advantage of its relative leniency. The practice, termed "forum shopping," involves potential bankrupts from other European countries setting up an address in the United Kingdom and filing for bankruptcy, allowing them to be debt-free quicker than in their own country (note the twelve years in Ireland mentioned above, or seven years in Germany). The courts and the Insolvency Service have been, however, working to detect and deter those who would use forum shopping in this manner.

European Union rules mean any bankruptcy ruling in the United Kingdom must be recognized by the other countries in the European Union, thus allowing a foreigner to be declared bankrupt in the United Kingdom, and thus benefiting from the one-year rule upon their return to their own country.

For companies, the issue is complicated by the factor of the center of main interests, whereby such forum shopping should be limited to the one true forum where the business has its nexus. However, determinations of the center of main interests are not without complication. For example, where a multinational corporation has independent business subsidiaries operating in multiple European Union member states, or where competing factors of the center of main interests lead to different results (e.g., a company founded under one member state's laws, headquartered in another, operating in a third, and with significant assets and liabilities in a fourth). The center of main interests also applies to individuals, making it more difficult to employ the tactic discussed above in recent practice.

The History of Bankruptcy in the United Kingdom

Historical Perspective

<u>Statute of Bankrupts 1542</u>

In England, bankruptcy law dates in codified form from the Statute of Bankrupts 1542 (34 & 35 Henry VIII, c. 4), but is certainly much older conceptually, and existed in England as a body of non-codified law prior to that time. It is important to note that, at this early stage, the emphasis of bankruptcy laws was not rehabilitation or discharge, but instead the orderly parsing of debts among creditors. Further, as with this and many subsequent laws, the goal was less to rehabilitate innocent but hapless bankrupts, and more to punish perceived negative behavior. The Statute of Bankrupts 1542 included in it, for example, the power to imprison bankrupts for non-payment of debts, which power arose from the civil enforcement of debt against a non-trader. Longer-term imprisonment for debt in the United Kingdom did not stop until 1869, while short-term imprisonment continued into the twentieth century (in some cases).

<u>The Bankruptcy Act 1571</u>

Under the Bankruptcy Act 1571 (13 Eliz. I, c. 7), commissioners of bankrupts could be appointed to allow a bankrupt to legally discharge his or her debts to creditors by an equitable and independent distribution of the bankrupt's assets, and then begin trading again with his or her outstanding debts wiped out. Further, the Fraudulent Conveyances Act 1571 provided the lord chancellor with the power to redistribute frauds in the aid of equitable creditor recovery.

<u>Statute of Anne Bankruptcy Act 1705</u>

The stated purpose under the Statute of Anne Bankruptcy Act 1705 (4 Anne, c. 17) was, once again, to prevent frauds by bankrupts. In actuality, however, this act had the effect of shifting focus away from the fraudulent presumption of bankrupts by introducing for the first time the concept of a discharge for the bankrupt who cooperated with its creditors ("all and every Person and Persons so becoming bankrupt…shall be…discharged from all Debts by him, her or them due and owing at the Time that he, she or they did become Bankrupt…."). The discharge was effectuated by obtaining a "certificate of conformity" from the bankrupt's creditors (in the requisite number and amount).

<u>Insolvent Debtors (England) Act 1813</u>

Under the Insolvent Debtors (England) Act 1813 (53 Geo. III, c. 102), the ability to imprison debtors for *de minimis* amounts was curtailed (raising the minimum amount to forty shillings). Still, creditors continued to rule the process and could often determine the length of a bankrupt's prison sentence. Famously, John Dickens, the father of novelist Charles Dickens, was imprisoned in 1824—accompanied by his wife and three youngest children (not including Charles), as was common practice at the time—at the infamous Marshalsea Prison for non-payment of a £40 debt. Though John was released three months later after using a legacy to satisfy the debt, Charles's visits to Marshalsea are thought to have influenced some of his writings.

The Bankrupts (England) Act 1825

The Bankrupts (England) Act 1825 (6 Geo. IV, c. 16) was not, as some have reported, the beginning of voluntary bankruptcies in the United Kingdom (that instead happened in 1869), though it is true that it introduced for the first time an ability of bankrupts to cooperate with friendly creditors for the bankrupt to be declared insolvent. The act also introduced for the first time the concept of composition (a formal system whereby creditors could agree among themselves how to divvy up the bankrupt's assets without resorting to the courts).

Joint Stock Companies Act 1844

It is important to note that, during most of this period, the concept of insolvency for businesses was hopelessly intertwined with the bankruptcy of the principals of the business. It was not until the enactment of the Joint Stock Companies Act 1844 (7 & 8 Vict. 1844) that incorporation became available on a wider basis in the United Kingdom. While the concept of limited liability would not be implemented until 1855, when incorporation become more widely available and with respect to the underlying legal principle that corporations have a separate, legal existence from their principals, more fulsome insolvency rules for incorporations were unsurprisingly more in demand. Parliament anticipated this, and with the 1844 Companies Act, enacted the Joint Stock Companies Winding-Up Act 1844.

Limited Liability Act 1855

As noted above, the Limited Liability Act 1855 (18 & 19 Vict., c. 133) referred to in the vernacular as the "Rogues Charter" by *The Law Times*, brought U.K. practices with respect to corporations more into line with the other states of Europe. Nonetheless, it is the codified origin of limiting the liability of corporation principals to their principal stake.

Companies Act 1862

In the Companies Act 1862 (25 & 26 Vict., c. 89), the general governance of companies and the winding up of companies were combined into a single statute. From this point forward and continuing for more than one hundred years, as a general rule of thumb, companies' insolvency rules were contained in the currently applicable Companies Act, and personal bankruptcy rules were contained in the currently applicable Bankruptcy Act.

Note, however, given the fact that bankruptcy law pre-dated the wide use of corporations in the United Kingdom, the laws pertaining to insolvency by corporations evolved independently and have an independent existence (noting also, however, that their remains sometimes overlap when it comes to partnerships).

The Three Bankruptcy Acts of 1869

A trio of acts in 1869 implemented the most major shift in focus in U.K. individual insolvency law to that date. The Bankruptcy Act (England) 1869 (32 & 33 Vict., c. 71) consolidated existing but fractured bankruptcy laws into a single statute, and introduced for the first time an entirely voluntary petition by the bankruptcy for liquidation by arrangement. The Debtors' Act (England) 1869 (32 & 33 Vict., c. 62) abolished in a general sense debtors' prisons, though permitted imprisonment on terms set forth in the concomitant Bankruptcy Act. The Bankruptcy Repeal and Insolvent Court Act (England) 1869 (32 & 33 Vict., c. 83), together with the concomitant Bankruptcy Act, eliminated the existing Insolvent Debtors' Court in favor of a system of Bankruptcy Courts both in and outside of London.

Insolvency Acts of 1985 and 1986

The preceding system of codification through numerous partially applicable laws continued until late in the twentieth century. In response to the report of the Insolvency Law Committee known as the "Cork Report," Parliament attempted to combine the fractured sources of law in this arena into a single statute known as the Insolvency Act 1985, and then in the Insolvency Act

1986. Nonetheless, it remains the case, as is noted above, that remedies for individuals versus companies are administered by different courts and under different procedures.

A Modern Perspective

The preceding history gives one a better understanding of the difference between business insolvency law and bankruptcy in the United Kingdom, and an appreciation for the fact that business "bankruptcy" in the United Kingdom has been, and to some degree is still today, governed by multiple sources of statutory and judicial precedent.

Looking forward to today, the major statutes governing bankruptcy and insolvency in the United Kingdom are the:

- Companies Act 2006
- Insolvency Act 1986
- Insolvency Rules 1986
- Insolvency Act 1994
- Insolvency Act 2000
- Insolvency (Amendment) (No. 2) Rules 2002
- Council Regulation (EC) No. 1346/2000
- Insolvency (Amendment) (No. 2) Regulations 2002
- Tribunals, Courts, and Enforcement Act 2007
- Enterprise Act 2002
- Insolvency (Amendment) Rules 2003 (SI 1730/2003)

It is probably more helpful, rather than to parse the aforementioned statutes (and keeping in mind that numerous other statutes may affect outcomes), to consider the options at a meta level. Other than doing nothing (or evading debts), the relief available to both individual and corporate insolvents may be parsed into useful, general categories. They are:

1. Informal, unsupervised remedies

    a. Unstructured settlements (individuals or companies)
    b. Forbearance/refinance (individuals or companies)

   c. Workouts (companies)

2. Formal, minimally supervised remedies

   a. Individual voluntary arrangements (individuals)
   b. Company voluntary arrangements (companies)
   c. Administrative receivership (companies)
   d. Administration (companies)
   e. Liquidation by a creditors' voluntary winding up (companies)

3. Formal, court-governed remedies

   a. Bankruptcy (individuals)
   b. Schemes of arrangement (companies)
   c. Liquidation by a compulsory winding up (companies)
   d. Dissolution (companies)

Each is discussed briefly in turn below. However, it is important to note that, given the number of substantial changes to the relevant laws in recent times, commentators do not seem to be able to reach agreement even as to the foregoing classification. Are schemes of arrangement still a major tool, for example? Is a company voluntary arrangement an independent tool or an aspect of administration? These are questions best left to be debated another day. The breakout contained herein is as we perceive the state of the law.

Categories of Bankruptcy Relief in the United Kingdom

Informal, Unsupervised Remedies

It is difficult to track the prevalence of unsupervised, out-of-court remedies, as they are, by their nature, non-public. Some commentators have argued that such remedies make up the bulk of insolvent remedies in the United Kingdom, while others argue that such remedies are seldom used. As virtually every known bankruptcy system has, as its foil, a less formal alternative, the use of such informal remedies must certainly have its place.

It seems, however, that such informal remedies—at least for companies—are less often used in the United Kingdom than in other jurisdictions. This is because, unlike countries such as the United States, which has both formal bankruptcies and informal workouts but nothing of substance in between, the United Kingdom has what is essentially three tiers of remedies with a middle tier that balances formality and oversight. In the United States, where the choice is more binary, those seeking to avoid the harsher realities of the Bankruptcy Code are forced to craft their own out-of-court remedies. In the United Kingdom, the middle ground is well trodden, thus intuitively requiring less from the more informal alternatives in this category.

In addition to frequency of use, the success of such strategies can be measured in large part by this same availability of the alternative remedies. When, as has been the case in the United Kingdom, the alternative schemes are almost entirely creditor-friendly, the net result is dysphasic. Parties seeking the less formal alternatives may be motivated to do so out of a desire to avoid the aforementioned bias. At the same time, however, such informal remedies tend to reflect the same bias existing in the alternative remedies, as parties negotiate in part with an eye on their perceived chances of success should an alternate remedy be required.

Success in this regard is measured first by the lens applied to the situation (i.e., are we representing the creditor or the debtor?), and then by the ability to shape outcomes that are viewed favorably through that lens (i.e., what, in light of the foregoing, is our goal?). Further, because, by their nature, voluntary negotiations are most easily accomplished with a limited number of parties, and the logical choice for such a subset of creditors is those creditors with the largest or most sophisticated obligations, the use of workouts as a remedy tends to favor such large, often institutional creditors. Thus, success viewed through the creditors' lens may be a relative matter.

A special note should be made with respect to workouts, which is the most formal of the informal remedies. While the term "workout" in the United States connotes a free-form, completely un-predetermined process, in the United Kingdom workouts tend to be almost exclusively with banks, and they tend to follow a set pattern, which is known as the "London approach" and was primarily used prior to 1997. Under such workouts, the company seeking to propose the informal solution to its difficulties first approaches its banks and requests both a voluntary moratorium on enforcement and a continued availability of credit during the process (akin to the forbearance and waiver process in the United States). During the voluntary moratorium period, an independent accountant generally investigates the company. Once this has been achieved, the company will, with one or more of the banks acting in representative capacity for the whole, negotiate a restructuring of existing obligations.

The net result may be similar to that obtainable in a company voluntary arrangement or another, more formal remedy, but at least in theory the workout both avoids the attendant time and costs of a more formal remedy and keeps secret for the most part the terms of the agreement. The downsides of this approach include that the moratorium is entirely voluntary, and that the restructuring requires unanimity among the affected banks. Further, at least one commentator has observed that the cost of workouts can be immense. Though recent commentators have asserted that the London approach in and of itself is dead (due to the reduction in related authority of the Bank of England), workouts continue to be employed. With respect to individuals, there has been a rise in the use of debt management plans, which are unregulated and unregistered.

Formal, Supervised Remedies

<u>Individual Voluntary Arrangements</u>

An individual voluntary arrangement is a voluntary agreement between the bankrupt and its creditors, in which the bankrupt makes a proposal that sets out how it intends to repay its creditors, usually over a period of five years. As opposed to the preceding, less formal remedies, an individual voluntary arrangement has formal elements that must be set up by a licensed insolvency practitioner and remain on the public register for two years after the date of either completion or termination of the arrangement.

These agreements afford a level of protection against creditors. The bankrupt puts together a plan of action and payment, upon which the bankrupt's creditors vote (75 percent approval is required). In so doing, the bankrupt can moot extant bankruptcy proceedings if such a voluntary arrangement is approved, but such creditors may reapply for individual bankruptcy for the individual voluntary arrangement proponent should the agreement fail.

Company Voluntary Arrangements (CVAs)

One step further removed from an out-of-court workout for businesses is a CVA, an insolvency procedure that allows a financially troubled company to reach a binding agreement with its creditors about payment over an agreed period of time of all or part of its debts.

CVAs are a relatively new creature of U.K. jurisprudence (dating from the 1980s), but they continue a longer practice relating to arrangements and schemes of arrangement. CVAs have no need for direct court oversight, though they may be combined with administration in order to invoke, for example, such a procedure's moratorium protections.

A CVA may be proposed by the directors, administrators, or liquidator of the company, but cannot be proposed by creditors or shareholders. As noted above, CVA proposals may be combined with administration in order to obtain a moratorium. Further, if the debtor is qualified, an application may be made to the court for a moratorium without need for an administration. Under such rules (see, however, the discussion below on recent developments), the subject of a CVA may receive such a moratorium preventing creditors from taking action against the company or its property for up to twenty-eight days if the company is a "small company." The CVA moratorium, even where applicable, only operates from the submission of the proposal. If the company wishes to have a moratorium during the negotiations that lead toward the CVA, it will normally first invoke an administration procedure (as described below). If an administrator is in office, the company will be covered by the moratorium arising from the administration.

When the CVA has been proposed, a nominee (who must be an insolvency practitioner) reports to court on whether a meeting of creditors and shareholders should be held to consider the proposal. The meeting decides whether to approve the CVA. If 75 percent of the creditors and 50 percent

of the shareholders agree to the proposal, it is binding on all creditors who had notice of the meeting and were entitled to vote. All creditors who had notice of the meeting are bound by the terms of the arrangement. If the meeting of creditors and shareholders approves a CVA, the nominee (or other insolvency practitioner) becomes the supervisor of the CVA.
Once the CVA has been carried out, the company's liability to its creditors (who had notice of the meeting of creditors) is cleared in the manner set forth in the CVA.

CVAs are the closest mechanism in the United Kingdom to the U.S. concept of debtor-in-possession, complete with (as applicable) the automatic stay equivalent: the moratorium. The company can continue trading during the CVA and afterwards. CVAs are a key element to the rescue culture currently being promoted by the government, banks, and large creditors.

With that said, given their relatively informal nature, they can be used in a manner that causes creditors to be aggrieved. For example, in the recent Powerhouse Ltd. CVA, the High Court found the CVA to be "unfairly prejudicial" to landlords in its attempt to deny those landlords the right to pursue third-party guarantees. *Prudential Assurance Co. Ltd. v. PRG Powerhouse Ltd.* [2007] EWHC 1002 (Ch).

Further, a major limitation in the use of CVAs is that they may only be used to bind unsecured creditors.

<u>Administrative Receivership</u>

Administrative receivership is a remedy under English law available to creditors with secured interests in property (floating charges, but not generally fixed charges). Since the nineteenth century, these creditors have the right, in lieu of their existing and much older right to take possession of their collateral, to appoint a receiver over the assets in question, if and when the debtor has violated the terms of the applicable debenture. It is also possible for a receiver to be appointed under the independent authority of a court.

It is fair to say that, prior to the Enterprise Act 2002 coming into effect on September 15, 2003, administrative receivership was the preferred remedy for secured lenders in enforcing their security in the United Kingdom. Among other things, such receiverships led to quick results, as the receiver was under neither an obligation to rescue the business nor an obligation even to attempt to rescue it.

The Enterprise Act 2002, however, continues the trend in the United Kingdom toward a "corporate rescue" culture both by severely curtailing the practice of receiverships and by implementing new duties on the receivers. As to the former, secured lenders may now appoint administrative receivers in only a limited number of circumstances, and the right is virtually nonexistent for debentures executed after the effective date of the act. With respect to the latter, changes implemented by the Act require administrators to perform their duties with respect to the creditors as a whole and impose a duty to consider rescue opportunities.

It has been observed that these changes are at odds with one of the principal prior uses of receivership, namely the quick sale of the assets in question. This is unquestionably true. When, as noted above, the administrator in the receivership is obligated to first consider the rescue of the company before invoking or enforcing alternate remedies, a conflict arises between the duties imposed by the Enterprise Act 2002 and the duty to quickly realize upon the assets through a prearranged sale. Compare this to the discussion of pre-pack administrations below.

Administration

As with administrative receivership, administration proper is a form of trusteeship, with the primary conceptual differences being that the administrator (a licensed insolvency practitioner) takes receivership over the entire company (upon appointment of the court, appointment by one or more qualified secured creditors, or appointment by the company or its directors), as opposed to a receiver taking receivership over specified assets (upon appointment by one or more qualified creditors, as discussed above).

As noted above in the discussion of CVAs, administration is often used as a tool of facilitation rather than a means to an end itself, although recent changes to the laws pertaining to administration have expanded administrators' powers to effect creditor repayment schemes.

Recent changes to the laws of both receivership and administration have made administration a more viable remedy than receivership for secured creditors seeking to enforce their charge. This is reflective of the shift to rescue culture in U.K. statutes as a whole, as the goal of an administrator is much more targeted at rescue than has been that of a receiver (in fact, the actions of administrative receivers in realizing upon the collateral within their trust have all too often led to the subsequent liquidation of the company).

Because of these changes and the overall flexibility of the mechanism, administration is the most common form of non-terminal insolvency relief sought in the United Kingdom.

Administration is a mechanism designed to protect companies from their creditors (and in turn, creditors from each other) while a restructuring plan is completed, and it is similar in many respects to Chapter 11 under the U.S. Bankruptcy Code (but for, as noted above, the fact that only CVAs in the United Kingdom come close to the concept of debtor-in-possession contained in Chapter 11; administration is more akin to a trusteeship in Chapter 11). For example, as is the case under Chapter 11 in the United States, an administration may be "pre-packaged" (where the essential elements of the relief sought are defined and agreed to by the major constituents prior to making the request for relief).

The main objective of administration is to rescue the company as a going concern. In so doing, this objective primarily seeks to achieve a better result for the creditors than a winding up of the company, and to realize efficiently upon property so as to make better distributions to secured and preferential creditors. With that said, it has been said that actual company rescue seldom occurs (c.f., commentators in the United States who argue that Chapter 11 reorganization is rarely successful at saving a troubled company).

The filing of a notice of administration will bring into effect an interim moratorium on insolvency proceedings and other legal processes being taken against the company.

The administration proposal normally contains full details relating to the administrator's appointment, the circumstances leading up to administration, details of how the administrator proposes to achieve the administration, information about how the administration will end, and a statement of the company's general affairs. Included in each creditor's copy of the proposal will be an invitation to the creditors meeting, which must be held within ten weeks of the date the business entered administration. Details of the creditors meeting will ordinarily be included as part of the proposal.

Proposals can be accepted, modified and then accepted, or rejected. If they are rejected, the administrator is required to report to the court to seek further directions, and is required to send a report of the outcome of the meeting to the court. If accepted, the administrator manages the company's affairs, business, and property in accordance with the proposals that have been agreed upon by the creditors.

Administration is a useful tool to control the company and ensure survival of the business. It is possible for the administrator to appoint directors or managers to run the company, but irrespective, the existence of an administration will normally shield existing directors from accusations of wrongful trading during the course of the administration. The moratorium affords the company and its administrator a reasonable timeframe to negotiate a deal with all parties, including their creditors.

On the other hand, administration is a much more open and public remedy than that of a CVA. Directors also cede a portion of control of the business to the administrator, which may not be desirable. Costs are often high for this procedure, and financing can be difficult. This latter point is addressed in the current developments discussion below.

A subset of administrations that has received much attention recently are the so-called "pre-packed sales" or "pre-packed administrations." These refer to the same procedure, where a sale of a company's assets or business (in whole or in part) is arranged prior to the commencement of an administration, and the sale is consummated immediately or shortly after the commencement. According to the government, in 82 percent of pre-pack cases, 100 percent of jobs are saved.

While such practice is rooted in established law in the United Kingdom (permitting such rapid sales if the circumstances warrant it), it has been the subject of criticism based mainly on the lack of transparency to unsecured creditors. Further concerns are that such rapid solutions fail to address long-term challenges, and that sales may be for less than appropriate value.

The government has recently announced a consultation on "Improving the Transparency of, and Confidence in, Pre-packaged Sales in Administrations," and will likely enact new rules—potentially requiring additional disclosure or heightened court scrutiny—as a result.

<u>Liquidation by a Creditors' Voluntary Winding Up</u>

Liquidation and winding up are essentially synonymous in the United Kingdom, and they come in two primary flavors: creditors' voluntary winding up and compulsory winding up (a third variety known as members' voluntary winding up is discussed *infra*).

Despite the name, a creditors' voluntary winding up is a form of liquidation that is not instituted by creditors, but rather by the company itself. Creditors seeking to wind up a company must do so through the compulsory winding up process.

This form of liquidation is generally chosen by a company if it is insolvent and does not wish to pursue a course of rescue. If the company wishes to wind up and dissolve but is solvent, it would ordinarily invoke the members' voluntary winding up mentioned above, which is a form of administration that may only be invoked by solvent companies.

Other than solvency, the key difference between a creditors' voluntary winding up and a members' voluntary winding up is that in the former, as the name may imply, the creditors are ceded control of the liquidation.

Ordinarily, a company pursuing a creditors' voluntary winding up will resolve to commence the winding up and concomitantly appoint a liquidator to govern the winding up. Regardless of whether a liquidator or the members of the company remain in control after the resolution, the resolution will have the initial effect of limiting such controlling party's powers until a meeting of the company's creditors is held.

Within two weeks of the resolution, such a meeting should be held. At the creditors meeting, a number of things are likely to happen. Of particular interest is that the creditors may choose a different liquidator or appoint one if one was not previously appointed. Absent a court order to the contrary, the creditors' choice prevails. Qualified creditors act in the creditors meeting by majority vote determined by monetary amounts owed.

After the administrative aspects of the liquidation are determined in the creditors meeting (if and as adjourned) and any subsequent meeting of creditors, the liquidator shall proceed to liquidate the assets of the company for the benefit of the creditors, to be distributed according to their relative priorities (and *pro rata* among creditors of the same priority). Once the creditors' voluntary winding up is completed, the liquidator will commence a dissolution action to terminate the company's existence.

Formal, Court-Governed Remedies

<u>Bankruptcy</u>

Bankruptcy is a formal, court-governed process available to individuals in the United Kingdom. Bankruptcy petitions are usually presented either in the High Court in London or in a County Court near to where the individual lives or trades. A court will only make a bankruptcy order after a bankruptcy petition has been presented.

It is usually presented by either an individual themselves (a debtor's petition) or one or more creditors who are owed at least £750 (a creditors' petition). The bankrupt's acknowledgement or agreement is not a prerequisite to the order.

In the case of creditor-instigated bankruptcies, the first act is generally a statutory demand by the creditor, which is usually served on the bankrupt within seven days of having been made. From this date, a debtor has eighteen days to apply to have it set aside, and then twenty-one days in which to make a payment or payment proposals. A creditors' petition will be issued once the time limit expires and there has been no application to set aside.

The petition can be presented against an individual even if they are not present in the United Kingdom, providing they normally live in, or have a recent residential or business connection with, the United Kingdom. A hearing date will be listed two to three months after issue of the statutory demand. (See also the discussion of individual voluntary arrangements and the timing with respect thereto, *supra*.)

Because the process is more formal, it has the potential to be more costly. Disputes should be settled quickly and as far as possible before the bankruptcy order is made, as doing so afterwards is usually difficult and expensive.

At the hearing, the court can do one of four things, namely:

1. Stay the proceedings if, for example, the court needs further information
2. Dismiss the petition if, for example, an administration order would be more appropriate on the facts presented
3. Appoint an insolvency practitioner if, for example, the court believes an individual voluntary arrangement would be more appropriate
4. Make a bankruptcy order

The official receiver, a civil servant in the Insolvency Service and an officer of the court, deals with individual bankruptcy. The official receiver is responsible for administering bankruptcies, and they will act as a trustee of the individual's estate unless a private-sector insolvency practitioner is appointed. One of the official receiver's main duties is to investigate the individual's financial affairs both before and during the bankruptcy period. The official receiver is then responsible for the disposing of the individual's assets and making payments to the creditors, subject, of course, to those assets being permitted to be retained so as not to leave the individual indigent.

A relatively new (implemented in April 2009) form of individual bankruptcy-like relief has arisen out of the Tribunals, Courts, and Enforcement Act 2007: debt relief orders. Because these have the effect of a bankruptcy for those with low levels of debt, assets, and income, we classify debt relief orders as a type of bankruptcy. This may not be strictly accurate, as one might more accurately think of them as an alternative to bankruptcy—available in limited circumstances. In a debt relief order, the bankrupt applies directly to the Insolvency Service for relief, at approximately 20 percent of the cost of a formal bankruptcy petition. If granted, the order provides a moratorium from creditor action during a period of repayment, followed by a discharge of remaining, applicable debts upon successful completion of the terms of the debt relief order.

Schemes of Arrangement

Prior to the creation of the CVA mechanism, the primary tool for companies seeking to enter binding, voluntary arrangements with their creditors was a scheme of arrangement under the applicable Companies Act. Because schemes of arrangement arise under the Companies Act, insolvency is not a prerequisite. For this reason, such schemes are often referred to as "solvent schemes" for short.

Following the publication of the Cork Report in 1982 and the subsequent statutory revisions in 1985 and 1986 (which introduced, among other changes, CVAs), schemes of arrangement have seen a marked decline in usage (except in special circumstances such as insurance companies). While schemes of arrangement still exist as an independent remedy (arising under the Companies Act as opposed to the Insolvency Act), CVA practice has almost entirely supplanted them. This is, in part, a result of one of their essential differences: schemes of arrangement are a court-governed process, while CVAs are not. The absence of court oversight appears to be perceived as a positive step, allowing parties more flexibility. It is further a reflection of both the attendant costs and the fact that schemes of arrangement lack the moratorium protections of other mechanisms. As

CVA practice has been refined through use and statutory amendment, more of the perceived advantages of schemes of arrangement (other than the direct, judicial oversight) have disappeared.

With that said, the court oversight of schemes of arrangement should not be overlooked. In *Re Bluebrook Limited and other companies (IMO)* [2009] EWHC 2114 (known as *IMO Car Wash*), the High Court demonstrated why such oversight can be invaluable. In *IMO Car Wash*, the company proceeded with a scheme of arrangement with their senior lenders, but did not include their junior, institutional creditors in such arrangement. The net effect of the arrangement was to leave those sub-debt holders behind with claims against an empty, corporate shell while allowing the senior lenders claims against the emergent company and its assets.

Not surprisingly, the sub-debt holders challenged the scheme, arguing that the scheme eviscerated their rights. The company and senior lenders, however, argued that the scheme was net neutral to their rights, as all such parties had, prior to the scheme, were rights extant in the company *after* the senior creditors had been satisfied. The argument centered on the value of the company, and whether the sub-debt needed be consulted if such value showed they were "out of the money."

In short, the High Court agreed with the company. It found the company's valuation compelling, that the sub-debt was therefore out of the money, and therefore that the sub-debt need not have been consulted as part of the scheme of arrangement.

While the logic appears tautological, *IMO Car Wash* underscores why, in instances of controversy, parties may revert to the scheme of arrangement to have the court oversight necessary to quell disputes.

In addition, as noted above, schemes of arrangement remain preferable to CVAs where there exists the need to bind multiple creditor and/or member classes, as CVAs may only at present be used to bind unsecured creditors.

Liquidation by a Compulsory Winding Up

As noted above, liquidation and winding up are essentially synonymous in the United Kingdom. Compulsory winding up is the counterpart to the creditors' voluntary winding up discussed previously.

Unlike creditors' voluntary winding up, compulsory winding up is a court-governed process. The relief may be petitioned for by the company, its directors, or its creditors, and in some instances, it may be sought by various government authorities. Creditors might, in certain instances, bring the petition to derail an existing voluntary winding up, though it is unlikely that will succeed if the voluntary mechanism is already sufficiently advanced.

When commenced by a creditor, a statutory demand is usually served on the debtor within seven days after having been made. From this date, a debtor has eighteen days to apply to have it set aside, and twenty-one days to make payment or payment proposals, or else a petition will issue. Note that the winding-up petition is listed two to three months after issue.

The court is vested with the authority to accept or reject the petition; the former commencing the winding up via a winding-up order, and the latter, in the case of a petition brought by a creditor, potentially subjecting such creditor to damages in tort (for example, in the factual example discussed in the preceding paragraph).

On the making of the winding-up order, an official receiver is appointed. As noted above with respect to individual bankruptcies, the official receiver is both a civil servant in the Insolvency Service and an officer of the court. The official receiver may act as receiver, or may call a meeting of creditors to appoint a licensed insolvency practitioner as liquidator of the company. While the receiver enjoys the powers of answering directly to the court (and being able to seek assistance therefrom), its liquidation of the company will proceed in much the same manner as that of a liquidator in a creditors' voluntary liquidation. Even if a separate liquidator is appointed, the official receiver retains the duty to investigate the company's affairs.

Note that this form of liquidation may be preceded by provisional liquidation, where an administrator is appointed to marshal the company's assets and affairs immediately, pending the actual liquidation. This ordinarily only happens where there is a risk of dissipation of the assets, as it is a very invasive remedy.

Dissolution

Following a liquidation, or in some cases following receivership or administration, a company may seek dissolution as its final act. If the preceding act was a voluntary liquidation (either a members' voluntary winding up or a creditors' voluntary winding up) or an administration, the dissolution occurs after a waiting period following the conclusion of the preceding act. If the preceding act is a compulsory winding up, the dissolution is automatic unless stayed by the court.

Note that dissolution is not, as it is in other jurisdictions, a winding up mechanism. That process should be completed prior to the dissolution occurring. Any property left in the possession of the company escheats to the Crown upon dissolution.

The Impact of Ownership Structure on the Bankruptcy Process

Heretofore, the discussion of companies' remedies has been generic as to the form of company. Clearly, however, the structure and ownership of an entity has an impact in the bankruptcy process. Unlike a sole trader or partnership, a limited liability company has the benefit of being a separate legal entity from its directors and shareholders, with the concomitant limitations on liability relating thereto.

In general terms, company directors have a duty of care to the company, its shareholders, employees, and creditors. A company director is not personally liable for the company's debts, even when the company is insolvent. However, they can be personally liable for:

1. Personal unpaid levies associated with employment (e.g., National Insurance and Pay as You Earn deductions)

2. Unpaid personal income tax as a result of "cash drawings"
3. Personal guarantees given to banks, finance companies, landlords, and so on
4. "Wrongful trading"—liabilities incurred as a result of insolvent trading prior to the company ceasing to trade resulting in a benefit from the transaction at an undervalue and/or preference and any liability resulting from fraudulent trading

As to the latter point, note that a company is technically insolvent when it cannot pay its debts as they fall due (a cash flow test) or where the liabilities exceed the value of its assets (a balance sheet test).

This is different from partners' liability when winding up a partnership. Absent an administration or voluntary arrangement (in the case of a limited liability partnership) or a bankruptcy (in some cases for strict partnerships), a partnership is treated much like an unregistered company and is wound up in the same way as a company. The tasks of the liquidator are therefore to:

1. Realize the assets in the partnership, including any deficiencies due on the partner's individual capital accounts (the partners will have to pay such deficiencies if required). All debtors, property, and other assets will be collected by the liquidator.
2. Investigate the conduct of the "officers of the partnership" just as the liquidator in a company liquidation must do.

    a. The liquidator can initiate actions against the partners to seek to disqualify them as partners in a partnership (Insolvent Partnerships Order 1994).
    b. The liquidator must also ascertain whether any transactions have taken place that put the partners (individually or collectively) into a better position than they should be in such transactions (known as preferences or transactions at undervalue). If such transactions have been completed before the winding up, they can be undone. The court can order that the partners reverse the transaction.

3. The liquidator completes his or her work by making payments (called distributions) to the creditors in order of priority (if any distributions can be made).

Where the partners have decided that the partnership has no viable future or purpose, a decision may be made to cease trading and wind up the partnership. Clearly, such a decision should not be taken lightly.

There are two basic ways the partnership can be wound up: the creditor's petition and for a partner's petition:

1. *Creditor's petition.* A creditor can petition to wind up the partnership but not issue bankruptcy petitions against the individual partners; or the creditor can issue a petition to wind up the partnership concurrently with a bankruptcy petition against one or more of the individual partners.
2. *Partner's petition.* The partners can petition to wind up the partnership but not issue bankruptcy petitions against the individual partners; or the partners can issue a petition to wind up the partnership concurrently with a bankruptcy petition against the individual partners.

By initiating such action themselves, the partners as individuals may avoid the disqualification of the partners and company directors; however, this will depend on their actions prior to the failure and whether they had acted at all times correctly and in the creditor's interests.

Further, an insolvency practitioner must be appointed where the winding up process is used. Sometimes this may ensure better return, investigation into the officers' conduct pre-insolvency, and the knowledge that the partnership will not increase its debts. In rescue and restructuring work, the partnership can quickly terminate leases and contractual liabilities. On the other hand, as with all liquidations, assets of the business may have a lower realized value than if the business continued.

As noted above, in the case of strict partnerships (as opposed to limited liability partnerships), there exists a possibility that the lack of limitation on partners' liability will result in bankruptcy, as opposed to insolvency.

Recent Changes to the United Kingdom's Bankruptcy Rules

Insolvency and bankruptcy must constantly evolve and modernize to keep pace with changes in business culture and practice. The United Kingdom's corporate insolvency regime is highly regarded by commentators outside the United Kingdom and ranked well when compared to other international regimes. Clearly, the United Kingdom's regime (as are all such statutory schemes worldwide) is being tested in the current economic downturn. Most commentators are of the opinion that it is performing well. Notwithstanding this, the government appears to be seeking further development of the regime by making targeted changes.
For example, recently proposed and, in some cases, implemented changes show that the government continues toward giving those involved in the rescue of struggling companies a better chance of establishing a rescue package. Company rescue, which has been mentioned numerous times throughout this treatise, has been seeing increased attention since the concept was first emphasized in the Cork Report of 1982.

Recently, the Insolvency Service, on behalf of the government, announced a consultation on "Encouraging Company Rescue," with the following key areas identified:

Moratoria for Company Voluntary Arrangements

The first proposal relates to moratoria for CVAs. Only small companies facing financial difficulty may at present, while pursuing the CVA, obtain a moratorium on creditor action (and whereby the existing management stays in place—akin to the debtor-in-possession concept mentioned above). It has been proposed that the size limitation be modified, so that viable large and medium-sized companies would have the same opportunity for a moratorium while trying to come to an agreement with their creditors. It has been further suggested that a court-based route for securing a moratorium of up to three months would also be a useful addition to the bankruptcy regime.

The attendant costs of the court-governed procedure may, as a presumably unintended consequence, however, make it less likely for small companies to avail themselves of this relief. Thus, while this proposal is in line with the rescue culture discussed *infra*, the implementation of such a proposal is in question.

Increased Security for Repayment of post-CVA Monies

Second, greater security has been proposed for the repayment of monies loaned post-CVA or administration, thus ensuring that new secured lenders are protected (while affording existing secured lenders adequate protection as well). The government's stated intention is that banks, other financial institutions, and trade and services suppliers should be encouraged to provide finance or supply credit to allow the company to trade its way out of its difficulties. It is proposed that "rescue finance" should rank in front of other administration expenses, that there should be a greater ability to create new security in both an administration and a CVA, and that certain asset-based lending arrangements should cease on administration or a CVA. This is akin to the U.S. procedure of super-priority, debtor-in-possession loans.

Modernizing and Streamlining the Insolvency Legislation

Last, the government's third proposal involves the reform of the insolvency procedure in its entirety: modernizing, streamlining, and making easier some processes. The stated aim is to reduce the burdens on users of insolvency law, thus increasing returns to creditors.

With respect to this consultation, the initial responses received were mixed. A number of respondents professed confusion on how such super-priority financing would integrate into the existing system of priorities, and others were fearful of such integration. The common agreement was that any such mechanism would need to be court-governed, so that the court could balance the dilutive effect of such financing against the potential increase of recoveries to creditors that continued trading might produce. It seems then, that any such mechanism, if implemented, would not be available in CVAs, but rather in administration or schemes of arrangement. It is unclear whether such proposals will receive further attention after upcoming elections.

In addition to the foregoing, note the previous discussion regarding pre-pack administration and the ongoing consultations relating thereto.

Insolvency (Amendment) Rules 2010

In addition to the foregoing, the Insolvency (Amendment) Rules 2010 is a major piece of insolvency legislation, with the first changes with respect to advertising having actually predated the amendment and come into force in April 2009. The government's stated aim is to "ensure the most effective delivery of measures to provide added flexibility of communication with insolvency processes and other measures to reduce burdens on users of the legislation, providing further savings in the cost of administering insolvencies for the benefit of creditors." The main changes include:

- Delivery of notices by electronic means (with the consent of the recipient)
- Using Web sites to send bulky reports and other documents to creditors
- Ability to provide for the authentication of documents sent electronically
- Replacing the need to have certain documents sworn by a statement of truth
- Making provisions for the court to limit disclosure of addresses, voluntary arrangements, and bankruptcies for victims of violence
- A limited reduction in the requirement to file documents at court

As the stated intention behind the program is to complete the modernization of insolvency procedures by the end of April 2010 and to allow those changes to settle before bringing the new Insolvency Rules into force in April 2011, such changes are—as of the date of this writing—in the midst of implementation.

UNCITRAL Model Law

In August 2005, the government issued a consultation paper entitled "Implementation of UNCITRAL Model Law on Cross-Border Insolvency in Great Britain" to implement the United Nations Commission on International Trade Law (UNCITRAL) Model Law on cross-border insolvency. The model law was, not uncoincidentally, implemented that same year as Chapter 15 of the Bankruptcy Code in the United States. The model law provides a mechanism for dealing with cases of cross-border insolvency, including cases where the debtor has assets in more than one country or where some of the creditors of the debtor are not from the country where the insolvency proceeding is taking place. Applications under the model law are dealt with by the specialist Chancery District Registries as well as the High Court's Chancery Division in London.

There were several key drivers for these changes. As noted *infra*, for the past thirty years, the government has been emphasizing rescue culture. Since the publication of the Cork Report in 1982, the United Kingdom's procedures have moved more toward a U.S.-inspired style of corporate reorganization.

At the same time, the existing economic climate in the United Kingdom cannot be ignored as a factor. In addition to the current recession in the United Kingdom and worldwide, we face an unprecedented level of bank failures and fraud in the financial markets. These factors lend themselves well to creative thinking in an effort to preserve value.

Navigating the U.K. Bankruptcy Process

Communicating with Clients and Other Professionals

The foregoing demonstrates that the restructuring and insolvency schemes extant in the United Kingdom are complex. In addition to the statutes and rules in place, the common law nature of the system means that debtors and creditors alike must also understand those existing guidelines in light of the court rulings on the same. This is, bar none, the single most common cause of vexation for non-U.K. legal professionals seeking assistance in the United Kingdom.

As a result, it is common that initial meetings with professionals and clients alike are spent educating the parties on the quirks and confines of the various mechanisms. This is, in part, why we have structured this response to provide detailed background and explanation behind the U.K. systems.

Further, non-U.K. professionals are often confused by the various agencies governing, and trustee-like roles involved in, each mechanism. Those from the United States, in particular, are used to acting more unilaterally in seeking relief, and not accounting for the need to coordinate action with liquidators, receivers, and other roles played by specialist insolvency practitioners (discussed *infra* and specifically in more detail below).

Given how the facts surrounding the mechanism shape the outcome, with respect to debtor companies as clients, the initial discussions must really be devoted to fact enquiries. While practically speaking, the choices between the various insolvency and restructuring mechanisms can be fairly cut and dried, the right facts are necessary to make those decisions.

With this in mind, one of the most challenging but most crucial steps in advising any company seeking to avail itself of the alternatives is to know the company, warts and all. A questionnaire that may assist in better understanding the company is included as Appendix C. Note that the questionnaire cannot, by its very nature, be all-encompassing. It is a starting point for asking further, more in-depth questions. Nonetheless, it has proven useful in understanding the various factors that underlie choices between the mechanisms, as well as obtaining the core level of information needed to meet the requirements of each.

In some instances, the information evinced by the questionnaire will immediately help narrow and refine options. For example, the form of the company and whether the company is insolvent are each factums that define available relief, as discussed above. Further, such information may be useful in understanding the center of main interests for extraterritorial venue (see UNCITRAL discussion above) considerations as well as intra-territorial venue issues.

Communicating to Creditors via Public Media

The Insolvency Service has been working on a project for some years to simplify and modernize insolvency legislation in England and Wales. One such change is, as noted above, the change to advertising rules relating thereto. The statutory requirement of newspaper advertising in all insolvency proceedings is moving to a less prescriptive set of rules.

The Legislative Reform (Insolvency) (Advertising) (Requirements) Order 2009 No.864 amends Sections 95 and 98 of the Insolvency Act 1986 as they apply to England and Wales by:

- Removing liquidator's requirement in a members' voluntary liquidation and in creditors' voluntary liquidation to advertise notice of the creditors meeting (which is required to be summoned under those sections) in a newspaper in addition to the *London Gazette*
- Replacing this requirement with a discretion to undertake additional advertising
- In cases where that discretion is exercised, permitting the advertisement to be effected by means other than an advertisement in a local newspaper

Thus, while the requirement to publish notices in the *London Gazette* remains (and some additional publishing requirements have been introduced), additional publicity is now the decision of the insolvency practitioner appointed as liquidator, depending on the circumstances of each individual case. Further newspaper advertising need not be done if the insolvency practitioner thinks it will not benefit the creditors, but where the insolvency practitioner feels that additional publicity is necessary, such publicity may now be given by methods other than newspaper if the insolvency practitioner believes the cost/benefit ratio is favorable and the alternate method would better reach creditors.

Key Players in Various Mechanisms

There are several key players involved in processing bankruptcies in the United Kingdom.

Insolvency Practitioners

In the United Kingdom, only a licensed insolvency practitioner can be appointed and is licensed to advise on, and undertake appointments in, formal insolvency procedures for individuals and businesses. Insolvency practitioners are subject to oversight and inspection by the DETI Insolvency Service acting for the secretary of state for trade and industry and the DETI Insolvency Service acting for the secretary of state. Note that insolvency practitioners are generally accountants, not lawyers. For this reason, insolvency is often viewed more as an administrative process than a judicial one.

Insolvency is a regulated profession under the Insolvency Act 1986, and anyone who wishes to practice as an insolvency practitioner needs to pass three examination papers set by the Joint Insolvency Examination Board and meet the authorizing body's insolvency experience requirements. Licenses are issued by certain recognized professional bodies such as the Law Society and the Institute of Chartered Accountants in England and Wales.

As a "competent authority" under the Insolvency Act 1986, the secretary of state for business, enterprise, and regulatory reform authorizes insolvency practitioners. The Insolvency Service, an executive agency of the Department for Business, Enterprise, and Regulatory Reform discussed below, oversees insolvency regulation, and each authorizing body is represented on the Joint Insolvency Committee, which aims to develop and maintain insolvency standards and best practice guidance, largely by means of statements of insolvency practice.

The Insolvency Service

The Insolvency Service is an executive agency that administers and investigates the affairs of bankrupts, companies, and partnerships wound up by the court, and establishes why they became insolvent. In addition, it:

- Acts as trustee/liquidator where no private-sector insolvency practitioner is appointed
- Acts as nominee and supervisor in fast-track individual voluntary arrangements
- Takes forward reports of bankrupts' and directors' misconduct
- Deals with the disqualification of unfit directors in all corporate failures
- Deals with bankruptcy restrictions orders and undertakings
- Authorizes and regulates the insolvency profession
- Assesses and pays statutory entitlement to redundancy payments when an employer cannot or will not pay its employees
- Provides banking and investment services for bankruptcy and liquidation estate funds
- Advises ministers and other government departments and agencies on insolvency, redundancy, and related issues
- Provides information to the public on insolvency and redundancy matters via its Web site, publications, and the central enquiry line and redundancy payments helpline

Success Rate for Client Insolvency Strategies in the United Kingdom

The success rate for client insolvency strategies depends on how one measures success. CVAs appear to be beneficial to businesses that have experienced trading difficulties since start-up and need time to prove their business model, and those that want to avoid the stigma of liquidation and require time to restructure themselves. This model is sometimes used by companies that wish to wind down trading in an orderly fashion or wish to close down over a certain period of time.

The business must be viable for a CVA to work. Further, a CVA must offer the creditors more money than would be received if the company went into liquidation, or the creditors will not support the rescue process. It is therefore advantageous for the company directors to canvass support of the creditors in advance of the CVA.

Recent statistics, however, show that CVAs are not being used as frequently as the government would probably prefer. According to Companies House, in the year from April 2005 to March 2006, CVAs were utilized at their lowest point in five years, despite the mounting recession at the time (which peaked in the United Kingdom in 2008—2009). In this same year, administrator appointments reached a number nearly four times what it had been five years previously. During this same period, liquidations remained relatively flat.

These statistics seem to provide evidence that the government's focus on rescue culture is succeeding (though not by way of the government's preferred vehicle). However, liquidations themselves appeared to number nearly four times that of all non-terminal matters combined. That ratio is down somewhat, as five years previously liquidations outnumbered non-terminal matters by a factor of nearly six.

Further, while the use of administrations may be growing more recently at a lower rate than that of CVAs, over the past twenty years, the increase has been relatively similar. There were, according to the government's Insolvency Service, thirty-four times as many CVAs in 2009 as there were in 1987, as opposed to an approximate increase of thirty-two times for administrations over the same period.

Conclusion

As noted above, the relief available to company debtors and creditors is varied and often conditional in the United Kingdom. Strategic decisions are rarely as simple as the venue choice discussed above.

A typical choice might be how to restructure a company in the common "debt for equity" swap used to deleverage highly leveraged companies. If 100 percent agreement of affected creditors and stockholders can be obtained, and the company is not listed, a CVA is a logical choice.

With less than 100 percent agreement, the choice becomes more complex. While CVAs are favored by the government, as noted above, one downside of CVAs is that such out-of-court remedies do not automatically protect large companies from creditor actions taken prior to the implementation of the CVA itself. With less than 100 percent agreement, the stay against action is crucial. Another downside is the inability to bind secured creditors.

Combined with an administration, the moratorium protection may be achieved, but the question of overall enforceability on recalcitrant creditors remains, as such creditors may still challenge CVAs on the basis of unfair prejudice, even if the requisite votes are obtained, and are only bound if their claims are secured. The result of a successful challenge in this regard is potentially disastrous, as it occurs at the point when the company and the majority of its constituents are fully vested in the process.

As with *IMO Car Wash*, in such instances, it may pay to consider proceeding by a scheme of arrangement. In schemes of arrangement, the challenge process is fully engaged as part of the mechanism itself, and may be used to draw out early recalcitrant creditors.

Such decisions, however, are not taken lightly and without the advice of those experienced in insolvency matters. The authors of this treatise, for example, rarely proceed in providing advice to clients in this realm without first consulting with an insolvency practitioner.

It may seem clichéd, therefore, but the best guidance that can be given to lawyers in this field is to, after assimilating the information contained herein and the facts available from the client and elsewhere, consult with and obtain advice from a specialist in this field. In the United Kingdom, perhaps more than in any other jurisdiction, the success of any applicable strategy is contingent upon the availability and use of such advice.

Additional Resources

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APPENDIX A

SAMPLE INSOLVENCY CHECKLIST

Country	Legislation	Purpose	Eligibility	Extra-judicial settlement
USA	Bankruptcy Code (11th Chapter of the United States Code)	Firstly, to give an honest debtor a 'fresh start' in life by relieving the debtor of most debts, and secondly, to repay creditors in an orderly manner to the extent that the debtor has property available for payment	**Chapter 7** Individual, partnership, corporation or other business entity, irrespective of the amount **Chapter 13** Any individual as long as unsecured debts are less than $336,900 and secured debts are less than 1,010,650; corpor-ations and partner-ships are not eligible	Not compul-sory, not common

France	Code de la consum-mation	To address the situation of over-indebtedness of natural persons	Any well-intentioned debtor who cannot meet his personal debts	Depends on the applied insolvency procedure. Renego-tiations are compulsory with the mostly applied procedure
Germany	Insolvenz-ordnung	To satisfy creditors' claims, while giving the honest debtor the opportunity to have remaining debts discharged	Any debtor who is (or is about to be) insolvent	Yes, compulsory
Ireland	Bankruptcy Act of 1988	To satisfy creditors' claims by selling debtors' assets	Any debtor who has assets available that are sufficient to produce at least €1,900	Very common, not compulsory
Spain	Ley 22-2—4, de 9 julio, Concursal	To satisfy creditors' claims while protecting the debtor from the consequences of over-indebtedness	Any debtor who is (or is about to be) insolvent	Not compulsory

England and Wales	Insolvency Act Rules of 1986	To free the debtor from overwhelming debt, while making sure that the assets are shared out fairly among the creditors	Any debtor who is insolvent	Not compulsory

APPENDIX B

OVERVIEW OF INSOLVENCY LAWS IN SELECT EUROPEAN COUNTRIES

Extract taken from the CEPS Working Document No. 318/July 2009 (Maria Gerhardt)

	Negotiated agreement with creditors	**Debt reorganization /consolidated loan**	**Debt Management Plan (DMP)**	**County Court Administration Order (CCAO)**	**Individual Voluntary Arrangement (IVA)**	**Debt Relief Order (DRO)**	**Bankruptcy**
Automatically free of the debt?	No	No	No	No, unless the court makes an order for this	Yes, when you have completed the terms of the IVA	Yes, debts are 'discharged' at the end of the 12 months, subject to certain exceptions. But you will still have to pay debts that are not allowed in a DRO, listed later	Yes, when you are 'discharged, subject to certain exceptions, listed later. But you will still have to pay debts that are not allowed in bankruptcy, listed later

	Negotiated agreement with creditors	**Debt reorganization /consolidated loan**	**Debt Management Plan (DMP)**	**County Court Administration Order (CCAO)**	**Individual Voluntary Arrangement (IVA)**	**Debt Relief Order (DRO)**	**Bankruptcy**
Automatically binding on all unsecured creditors?	No	Only on creditors paid in full	Only on creditors paid in full	Yes	Yes, if accepted by creditors owed more than 75% of your unsecured debts who vote on your proposal	Yes, but only on creditors included in your application form	Yes
Automatic protection from action by unsecured creditors?	No	Only from creditors paid in full	No	Yes	Yes	Yes	Yes
Protection from action by unsecured creditors?	No	No	No	No	No	No	No
Length of time?	No fixed time	No fixed time	No fixed time	Until last payment made	Usually up to 5 years	Usually 1 year	Usually 1 year but you may have to make payments from your income for up to 3 years

	Negotiated agreement with creditors	**Debt reorganization /consolidated loan**	**Debt Management Plan (DMP)**	**County Court Administration Order (CCAO)**	**Individual Voluntary Arrangement (IVA)**	**Debt Relief Order (DRO)**	**Bankruptcy**
Effect on employment?	Probably none	Probably none	Probably none	Probably none	Possibly	Possibly	Possibly
Home at risk?	No, but you need to keep up mortgage/ rent payments	No, but you need to keep up mortgage/rent payments, which may be more difficult unless you take out a secured loan	No, but you need to keep up mortgage/rent payments	No, but you need to keep up mortgage/rent payments	Can be avoided if you can raise an amount equal to your share of the net worth of your home, for example by remortgaging or getting a loan from a relative	No, homeowners will not qualify for a DRO	May be avoided if your spouse/partner or a relative can by your share of the net worth of your home
Minimum or maximum amount owed?	No	No	None	Anything up to £5,000. You must have at least 1 judgment debt	None	Maximum amount owed in total is £15,000, subject to exceptions (see later)	No minimum if it is your own petition (£750 if the petition is by a creditor)

	Negotiated agreement with creditors	**Debt reorganization /consolidated loan**	**Debt Management Plan (DMP)**	**County Court Administration Order (CCAO)**	**Individual Voluntary Arrangement (IVA)**	**Debt Relief Order (DRO)**	**Bankruptcy**
What types of unsecured debts are allowed?	Any	Any	Any	Any	Any, but in practice debts excluded in bankruptcy are usually excluded from IVAs	Any, with certain exceptions, such as fines, student loans and maintenance payments	Any, with certain exceptions, such as fines, student loans and maintenance payments
Credit rating affected?	Yes	Possibly	Yes	Yes	Yes	Yes	Yes

APPENDIX C

DILIGENCE QUESTIONNAIRE

UNITED STATES	UNITED KINGDOM
I. CORPORATE STRUCTURE	
Details of the debtor's incorporation and each of its affiliates (together, the "Company").	Details of the debtor's incorporation and each of its affiliates (together, the "Company") through Companies House.
Perform credit check and confirm corporate good standing of the Company.	Perform credit check on the Company and confirm Companies House filings are up to date.
Review the organizational structure of all subsidiaries, affiliates and parent of the debtor, and determine whether any entities should also file for bankruptcy.	Review the organizational structure of all subsidiaries, affiliates and holding company(s), and determine whether any entities should also file for bankruptcy.
All names used by the Company in the last eight (8) years.	Confirm all previous trading names used by the Company.
Structure of the Company's board of directors; confirm identities of all directors.	Confirm the identities of all directors of the Company.
Confirm all officers and authorized signatories of the Company.	Confirm all officers and authorized signatories of the Company.
Summary of assets and liabilities of the Company and their location.	Summary of assets and liabilities of the Company and their location.
All states in which the Company conducts business or has assets, and location of principal assets (one location only).	Details of all territories the company conducts business and any assets therein.

Tax identification number of the Company; confirm all taxes have been paid.	Confirm with HMRC that all taxes and VAT have been paid.
Securities and Exchange Commission filing number.	Confirm any filing number with Crest / Clearstream.
II. EQUITY STRUCTURE	
Number of shares and number of holders of common stock.	Confirm with Companies House and/or the Company Secretary details of all shareholders, type of shares issued (including part paid) and individual share holdings.
Number of shares and number of holders of preferred stock, broken out by series.	
List all shareholders who directly or indirectly own or control 5% or more of the voting securities of the Company.	List all shareholders who directly or indirectly own or control 5% or more of the voting shares in the Company.
Determine whether there are outstanding options or warrants.	Determine whether there are outstanding options or encumbrances over any shares.
List of names and addresses of all equity security holders.	[List of names and addresses of all equity security holders].
III. DEBT STRUCTURE	
Review debt documents: credit agreements, indentures or trust documents, notes, letters of credit, guarantees or performance bonds, capital leases, pledge agreements and securitization documentation.	Review debt documents: credit agreements, indebtedness or trust documents, notes, letters of credit, guarantees, bonds, leases, options and security documentation.
Holders of individual tranches of debt under the foregoing agreements, and any agents appointed with respect thereto.	Confirm and review any debt instruments and agreements.

Summarize and review key provisions of foregoing agreements, including any unanimity requirements for actions, court and venue requirements, and rights upon breach.	Summarize and review key provisions of debt agreements, including any consents required for actions, court and venue requirements, and rights upon breach.
Review any prior bankruptcy cases filed by the Company within the last eight (8) years.	Review any priority filed by the Company.
Updated balance sheet, income statement, and statement of cash flows, excluding intangible assets such as goodwill, but including:	Updated balance sheet, income statement, and statement of cash flows, excluding intangible assets such as goodwill, but including:
Total fixed liquidated secured debt and approximate number of holders.	Total fixed liquidated secured debt and approximate number of holders.
Total disputed, contingent or liquidated unsecured debt and approximate number of holders.	Total disputed, contingent or liquidated unsecured debt and approximate number of holders.
Names and addresses of the twenty (20) largest unsecured creditors of the Company, and indicate the nature of each claim and the total amount owed to each creditor.	Names and addresses of the twenty (20) largest unsecured creditors of the Company, and indicate the nature of each claim and the total amount owed to each creditor.
IV. BUSINESS QUESTIONS	
General description of the Company's business.	General description of the Company's business.
Determine the status of all pending litigation and arbitration, including the location of the litigation, case names, parties involved, and counsel for all parties.	Determine the status of all pending disputes going to litigation and arbitration, including the location of the litigation, case names, parties involved, and counsel for all parties.

Determine whether the Company owns or possesses any property that poses a threat of imminent and identifiable harm to public health and safety.	Determine whether the Company owns or possesses any property that may not comply with all health and safety requirements (HSE).
Determine the status of all environmental matters and any resultant liability.	Determine the status of all environmental matters and any resultant liability.
Determine the status of all tax filings, claims and refunds.	Determine the status of all the Company's tax/VAT filings, claims and refunds.
Estimate number of employees, and review labor documents: collective bargaining agreements, employment contracts, retiree programs, employee benefit plans, extraordinary employee agreements, bonus agreements and stock option plans.	Estimate number of employees, and review labor documents, including employment contracts, pension schemes, benefit plans, bonus agreements and share option plans.
Estimate number of employees, and review employment source contracts, collective bargaining agreements, employment contracts, consultancy agreements, pensions, bonus and employee benefit plans.	Estimate number of employees, and review employment source contracts, collective bargaining agreements, employment contracts, consultancy agreements, pensions, bonus and employee benefit plans.
Review leases / executory contracts and any other material agreements.	Review leases / contracts and any other material agreements.
Order UCC, tax lien and judgment search for all states in which the Company does business or has property.	Details of tax dispute, disagreement, claim, judgment or other such matter in any country the Company operates.
Conduct title search for all real property.	Conduct title searches with the Land Registry for all real property.

Conduct patent and trademark lien search.	Conduct Intellectual Property searches including Patents/Trademark/Domain Names/Database Rights.
V. MISCELLANEOUS	
General business description of the circumstances leading to the bankruptcy filing, including any other restructuring efforts.	General business description of the circumstances leading to the bankruptcy filing, including any other restructuring efforts.
Determine whether any company information should be filed under seal.	

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