Contents

A. Insolvency law, policy and procedure 01
B. Insolvency metrics 14
C. Plenary insolvency proceedings 15
D. Ancillary insolvency proceedings 18
E. Trends 22

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The legislative framework underpinning UK insolvency
law is principally provided by the Insolvency Act 1986 ("IA 1986") and the Insolvency Rules 1986 ("IR 1986"), which apply to both companies and individuals. They also apply in modified form to certain forms of partnership. Elsewhere, "special insolvency regimes" apply to certain regulated entities including credit institutions, insurance undertakings and utility companies (see section I vi below).

The IA 1986 and IR 1986 are supplemented by other legislation, such as the Companies Act 2006 (including the statutory provisions relating to schemes of arrangement used in restructurings) ("CA 2006"), the Company Directors' Disqualification Act 1986 ("CDDA 1986") and the Law of Property Act 1925 (which, in some cases, governs the ability of a secured creditor to enforce its security).

In some instances, the procedure will be modified by the Financial Collateral Arrangements (No. 2) Regulations 2003. These regulations implement the EU Directive on Financial Collateral Arrangements, which aims to simplify the process of taking and enforcing financial collateral across the EU. The Regulations disapply a number of provisions of the IA 1986, including the moratorium on enforcement of security in insolvency processes such as administration and company voluntary arrangements ("CVAs") and the order of priority of claims in floating charge realisations.

Finally, the jurisdiction of the English courts to open main insolvency proceedings may be limited by the EC Regulation on Insolvency Proceedings (No. 1346/2000) ("ECIR"). The ECIR is directly applicable in all member states except Denmark, in cases where the debtor's centre of main interests ("COMI") is situated in an EU member state. It imposes a framework of jurisdictional rules governing the opening of all proceedings that fall within its scope and will override the national law of member states where necessary. Certain types of debtor are excluded from the ECIR, the key examples being credit institutions and insurance undertakings which are subject to separate regulations. Where the ECIR applies, main proceedings may only be opened in the UK if the debtor company has its COMI (which is presumed, in the absence of proof to the contrary, to be where the debtor's registered office is located) in the UK. The company does not have to have been incorporated in an EU member state. If the company’s COMI is located in another EU member state, secondary proceedings can be opened in the

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1 The term "UK insolvency law" is used in this chapter to denote the insolvency laws applicable to England and Wales. Similar laws apply, with modifications, to Scotland and Northern Ireland.

2 References to “EU member state” in the remainder of this chapter should be taken to mean an EU member state other than Denmark.

3 Main proceedings for the purposes of the ECIR are defined as "collective insolvency proceedings" and are listed in Annex A to the ECIR. Those relevant to corporate insolvencies in the UK are: winding up by or subject to the supervision of the court; creditors’ voluntary liquidation (with confirmation by the court); administration (including out-of-court appointments) and voluntary arrangements.
UK if the company has an establishment in the UK. Secondary proceedings are listed in Annex B to the ECIR and must currently be in the form of winding-up proceedings. Secondary proceedings opened prior to the opening of main proceedings in another EU member state (known as territorial proceedings) are not limited to winding-up proceedings. Insolvency proceedings opened in an EU member state under the ECIR will be automatically recognised without any formality in all member states, including the UK, from the time the judgment opening the proceedings becomes effective in the EU member state in which the proceedings are opened. Amendments to the ECIR are currently being considered (see section V below).

If the company’s COMI is outside the EU, the ECIR will not apply and the UK, in common with other EU member states, will be free to act in accordance with its existing laws and practice when exercising jurisdiction, opening proceedings and recognising and enforcing proceedings opened within and outside the EU.

1.2 Policy

A little over a decade ago, changes to insolvency legislation were introduced under the Enterprise Act 2002 to facilitate corporate rescue. Key amendments included the streamlining of the administration regime (see section I iv below) and the limiting of the circumstances in which the holder of a qualifying floating charge (broadly defined as a floating charge over the whole or substantially the whole of the company’s property (“QFC holder”)) can appoint an administrative receiver to realise its security. These changes reflect the shift in policy voiced by successive UK governments over recent years in an attempt to make the UK a more debtor-friendly jurisdiction, where entrepreneurship is to be encouraged and where there should be no stigma attached to business failures, in the absence of wrongdoing by the directors of the company.

In the UK, the prevailing approach to treatment of businesses in financial difficulties has generally been to attempt to achieve a consensual solution to keep businesses going. However, the complexity of capital structures, diverse views of different stakeholders and the flexibility of tools such as schemes of arrangement, CVAs and pre-packaged administrations (explained in further detail below) has meant that solutions that are not fully consensual have become more commonplace.

1.3 Insolvency procedures

Introduction – insolvency and rescue procedures

Subject to the applicability of any special insolvency regimes (see para 1.6 below) or any jurisdictional limitations imposed by the ECIR, the processes described below can be used to wind up or rescue a company in the UK. In brief, a company (including an overseas company if its COMI is in England or if the company is otherwise found to have sufficient connection with this jurisdiction) may be placed into voluntary or compulsory liquidation, unless it is subject to a special insolvency regime. Alternatively, it may be made subject to any of three alternative statutory procedures: administration, CVA or receivership. In addition, a company may have its debts rescheduled or compromised by way of a creditors’ scheme.

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4 The purpose of this limitation is to maintain the primacy of the main proceedings. However, proposals for the reform of the ECIR, put forward by the European Commission in 2012, include the suggestion that a wider range of procedures should be recognised in secondary proceedings to facilitate cross-border restructurings (see para 1.7 below).

5 Territorial proceedings may only be opened in two sets of circumstances: either where main proceedings cannot be opened because of the conditions laid down by the law of the EU member state within the territory in which the company’s COMI is situated, or where the opening of territorial proceedings is requested by a creditor who has his domicile, habitual residence or registered office in the EU member state within the territory in which the establishment is located or whose claim arises from the operation of that establishment. If main proceedings are not subsequently opened in the EU member state where the company’s COMI is situated, the territorial proceedings will retain their independent status.

6 See sections 220-221 IA 1986 which allow for the winding up of foreign companies as unregistered companies.
of arrangement ("scheme"). Unlike liquidation, administrations, CVAs and schemes can be used to rescue a company and may form part of a restructuring plan. The IA 1986 also provides for receivership (including administrative receivership), which is a self-help remedy enabling a creditor to recover what it is owed through the realisation of charged assets.

Liquidation

A company may be wound up by way of a "members' voluntary liquidation" ("MVL"), which is a solvent liquidation, or a "creditors' voluntary liquidation" ("CVL"), which can also be used as an exit route from administration. In a CVL, the creditors will have a greater say than in an MVL and are also able to appoint a liquidation committee to supervise certain aspects of the winding up. A company can also be wound up by the court as a compulsory liquidation.

If main proceedings are pending in another EU member state, and the company’s COMI is located in that member state, it will still be possible to commence a CVL in the UK, provided the company has an establishment in the UK, as it is a "winding-up proceeding" for the purposes of Annex B to the ECIR. If, however, main proceedings have already been opened in another EU member state, the English court must stay the secondary proceedings in whole or in part if requested to do so by the liquidator in the main proceedings. The liquidator in the main proceedings can also request that main proceedings previously opened in another member state as territorial proceedings be converted into winding-up proceedings if it is in the interests of creditors in the main proceedings. The English court has the power, however, to request the liquidator in the main proceedings to take any suitable measure to guarantee the interests of the creditors in the secondary proceedings and of individual classes of creditors. Such a request may only be rejected if it is manifestly of no interest to the creditors in the main proceedings.

In cases where a company is incorporated outside the UK and the ECIR does not apply (i.e. the company’s COMI is not located in an EU member state) it may be wound up as an "unregistered company" under the IA 1986 in certain circumstances, including where it is unable to pay its debts or if the court is of the opinion that it is just and equitable to wind it up. There is no statutory guidance as to the criteria that will justify an English court in assuming jurisdiction but case law has identified the following further requirements which must be satisfied before the court will exercise its discretion to make a winding-up order: there must be a sufficient connection with England; there must be a reasonable possibility, if a winding-up order is made, of benefit to those applying for the winding-up order; and one or more persons interested in the distribution of assets of the company must be persons over whom the court can exercise jurisdiction. The sufficient connection test may be satisfied by, for example, the presence of assets within the jurisdiction or finance documents that are governed by English law. The court may also assume jurisdiction where the insolvency procedures in the relevant foreign jurisdiction have been found to be unsuitable or outmoded.

In both a voluntary and a compulsory liquidation, the liquidator is under a duty to collect in and realise the assets of the company for distribution to the creditors. There is no prescribed time limit within which to complete this process. The company will then be dissolved. If the liquidator believes that he or she could achieve a better result for the creditors if the company were placed in administration, then he or she may apply to the court for himself or herself or another person to be appointed as administrator.

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7 The IA 1986 was amended to enable foreign liquidators to apply to convert administration and voluntary arrangements in English proceedings into winding-up proceedings and for foreign companies to be placed into voluntary liquidation as unregistered companies if their COMIs are located in the UK.

Administration
An administrator can be appointed in cases where a company is or is likely to become unable to pay its debts and the purpose of the administration is likely to be achieved. The purpose is set out as a hierarchy of three objectives. The primary objective is to rescue the company as a going concern, failing which the administrator must seek a better result for the company’s creditors as a whole than would be likely in a winding up. If that is not achievable, the third objective is to realise the company’s property for distribution to secured or preferential creditors.

The second objective may be achieved by disposing of the company’s business or its assets by way of a pre-packaged sale (“pre-pack”), agreed prior to an administrator being appointed. The sale will then be effected immediately (or soon after) he takes the appointment but before the initial creditors’ meeting and without the consent of the unsecured creditors. This has proved to be a useful, if at times controversial, restructuring tool and, in one notable case, has been used by a foreign company, with the court’s approval, after transferring its COMI to England (see para 1.7 below). The court held that the industry guidance on the use of pre-packs provided by SIP 16 had been complied with and expressly gave the administrators liberty to proceed with the pre-pack as, on the evidence, there was no realistic alternative to realising better value for creditors.

Administration is both a “collective insolvency proceeding”, for the purposes of Annex A, and a “winding-up proceeding” for the purposes of Annex B of the ECIR. If the company’s COMI is located in another EU member state where main proceedings are pending, the company can be placed into administration (using the out-of-court or court-based procedure) in the UK if it meets the requirements under the ECIR that allow territorial proceedings to be opened. If it is able to open territorial proceedings, they can be in the form of any of the proceedings listed in Annex A but will be restricted to dealing with the assets of the company situated in the UK. If main proceedings have already been opened in another EU member state, it will not be possible to seek to achieve the primary objective of rescuing the company as a going concern as secondary proceedings must be a form of winding-up proceedings.

An administrator cannot be appointed to a company whose COMI is located outside the EU unless it is registered under the CA 2006 or is incorporated in an EEA state other than the UK. In this respect, the English court’s jurisdiction is narrower than that for liquidations where an overseas company can be wound up if it has sufficient connection with this jurisdiction (see above).

The administration will end automatically after one year unless extended by court order or with the consent of the creditors. Extensions are often required in complex cases.

CVA
A CVA is an informal but binding agreement between a company and its unsecured creditors to compromise the company’s debts, made with the aim of allowing companies in financial difficulties to avoid liquidation.

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9 Hellas Telecommunications (Luxembourg) II SCA [2009] EWHC 3199 (Ch).
10 A Statement of Insolvency Practice (SIP 16 – Pre-packaged Sales in Administration) was introduced to ensure greater transparency of pre-pack sales. It sets out the required disclosures that an administrator must make to creditors of the details of any pre-pack agreement and sale.
11 A pre-pack administration can also be combined with a scheme, as seen in the IMO Carwash and McCarthy & Stone restructurings.
12 But note the exception provided by section 426 IA 1986 that permits the English courts to assist courts having insolvency jurisdiction in other “relevant countries”: in re Dallhold Estates (UK) Pty Ltd [1992] BCC 394 the court acceded to the request of a Western Australian court to grant an administration order in respect of an Australian company with assets in this jurisdiction.
13 For example, extensions have been granted by the court in the administration of Lehman Brothers International (Europe), which commenced on 15 September 2008 and remains ongoing.
If the CVA proposal is approved by three quarters or more (in value) of the company’s creditors, it will bind all creditors who were entitled to vote, whether or not they had notice of the creditors’ meeting. Dissenting creditors and creditors whose votes are required to be left out of account are therefore bound by a resolution of the requisite majority. Secured and preferential creditors will not be bound unless they have given their consent and, therefore, CVAs are less commonly used by companies that have a large amount of secured debt.

A CVA may be used to avoid or supplement other insolvency procedures, such as administration or liquidation, where it can take advantage of the moratorium against creditor action. An optional moratorium is otherwise available for certain small companies. It has the advantage of being a flexible restructuring tool, which can often be swiftly implemented and requires minimal court involvement. It has enjoyed some degree of success in the retail sector since the onset of the global financial crisis as a way for a company to reach agreement with its landlords and other unsecured creditors.

A CVA is listed as a collective insolvency proceeding in Annex A to the ECIR, which means that it can be proposed by any company, wherever incorporated, provided its COMI is situated in the UK. If the CVA is approved then it will be binding throughout the EU and will have the same effect in any other EU member state as it does under English law.

A CVA is not, however, specifically listed as a winding-up proceeding for the purposes of Annex B to the ECIR. Arguably though, if it is not effected within a liquidation or administration, it can be proposed as a means of terminating secondary proceedings on the basis that it amounts to a “composition”. The ECIR provides that closure in this way requires the consent of the liquidator in the main proceedings but, in the absence of such consent, it may become final if the financial interests of the creditors in the main proceedings are not affected by the measure proposed.

Creditors’ scheme of arrangement

A scheme of arrangement is not an insolvency process but falls instead within the ambit of the CA 2006. It is a court-approved compromise or arrangement between a company and its creditors, or any class of them, to reorganise or reschedule the company’s debts. It does not benefit from a moratorium on creditor action but can be implemented in conjunction with formal insolvency proceedings (administration or liquidation), both of which include a formal moratorium. In its simplest form, a scheme may be used to vary the rights of a class of creditors and can bind dissentient creditors if the requisite majority or majorities vote in favour of the proposal. It has been used by companies to amend and extend outstanding loans and implement debt-for-equity swaps, where they have failed to obtain the requisite level of consent under the underlying loan facility. In addition, it is sometimes used as a stick or “plan B” in the context of restructuring negotiations to help achieve a consensual deal.

The scheme process takes time, although once the proposal document has been finalised and circulated, it may be possible to complete the procedure in approximately six weeks, subject to court availability. Unlike a CVA (where the creditors effectively vote as a single class), it may be difficult to achieve a consensus

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14 The CVA becomes effective immediately after the resolution to approve it has been passed at the creditors’ meeting (for which 14 days’ notice is required).

15 See Article 34 ECIR.

16 Note that the English court’s jurisdiction to sanction a scheme hinges on its jurisdiction to wind up the scheme company in question.

17 The court has, however, stayed proceedings for summary judgment in a case where steps to implement a scheme were well advanced and it had a reasonable prospect of success: Re Vietnam Shipbuilding Industry Group [2013] EWHC 2476.
among affected creditors as to the composition of the various creditor classes. Class composition will be considered at the convening hearing if there are outstanding issues as to fairness. However, the fact that it is binding on all members of the relevant class (or classes) of creditors once it is approved by the appropriate majorities, sanctioned by the court and delivered to the registrar of companies, gives it a key advantage over a CVA.

Schemes are increasingly being used by overseas companies, often in circumstances where such companies are unable to obtain the requisite level of approval for the compromise in their own jurisdiction. Sufficient connection has been found in a number of cases on the basis of the underlying facility agreement being subject to English governing law and jurisdiction clauses. The court will be influenced by whether there is a procedure that is equivalent to a scheme available in the relevant overseas jurisdiction and will also want to be satisfied that the effects of the scheme will be recognised in other jurisdictions. The concern is greater where there are local creditors, opposed to the scheme, that may attempt to ignore its terms and bring claims against the debtor or its assets on the basis of the original (pre-scheme) finance documents.

The fact that a scheme is neither a purely informal out-of-court procedure nor a formal, court-based procedure, and that it falls outside the scope of the ECIR, has led to difficulties in relation to its recognition by the courts of certain EU member states.

It is possible that an order sanctioning a scheme might otherwise be recognised under the EU Regulation on Jurisdiction and the Recognition and Enforcement of Judgments in Civil and Commercial Matters (No. 44/2001) (the “Judgments Regulation”), in certain circumstances (see para 1.7 below for further detail). In cases where an overseas court refuses recognition under the Judgments Regulation it may, with the benefit of expert evidence where necessary, recognise a scheme on a conflict of laws basis.

The effectiveness of a scheme may, however, be recognised outside the EU in countries that have implemented the UNCITRAL Model Law on Cross-Border Insolvency in a form which allows for recognition of such processes.

1.4 Starting proceedings

Liquidation

A voluntary liquidation, whether a CVL or an MVL, is initiated by the company’s members passing a resolution (requiring a three-quarters majority vote) that must state either that they are in favour of a voluntary liquidation, in the case of an MVL, or that the company cannot, by reason of its liabilities, continue its business and that it is advisable to wind it up, in the case of a CVL. The directors of the company must give prior notice to any QFC holder and to the appropriate regulator under the Financial Services and Markets Act 2000, if the company is an authorised deposit taker under the Banking Act 2009, of their intention to propose a resolution for voluntary liquidation. The liquidation will commence on the date the resolution is passed. In an MVL, the members appoint the liquidator, while in a CVL, the creditors appoint him. If, during the course of an MVL, the liquidator forms the opinion that the company will be unable to pay its debts in full, together with any interest, the liquidation will be converted to a CVL.

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18 Including those whose COMIs are located in another EU member state. The English courts’ jurisdiction in relation to schemes of foreign companies has been found not to have been fettered by the ECIR: see Re Drax Holdings; Re InPower Ltd [2003] EWHC 2743 (convening hearing: 17 November 2003) and Re DAP Holding NV [2005] EWHC 2092 (sanction hearing: 26 September 2005).

19 See, for example, the decisions relating to Tele Columbus, Rodenstock, PrimaCom, Seat Pagine, Vivacom and Cortefiel.

20 For example Chapter 15 of the US Bankruptcy Code, which implements the Model Law in the US, amended the definition of “foreign proceedings” to include “adjustment of debt” which captures schemes of arrangement.
A compulsory liquidation is initiated by the presentation of a winding-up petition to the court. This will usually be done by the company, the directors or (more often) a creditor. The grounds on which a court can make a winding-up order include where the company is unable to pay its debts and where the court believes it is just and equitable that the company be wound up. The petition must be advertised either by publication in the London Gazette or in another manner deemed suitable by the court, not less than seven days before the hearing. This will provide notice to creditors and other interested parties who may then attend the hearing and bring to the attention of the court material relevant to whether the winding-up order should be made.

If the court is satisfied that the grounds for winding up are met, it will make a winding-up order. The Official Receiver (an officer of the court) will then automatically assume the role of liquidator until another liquidator is appointed. Receivers and administrators are also able to present petitions and any QFC holder who is entitled to appoint an administrator may apply to the court to have the winding-up order discharged and an administrator appointed.

**Administration**

A company is placed in administration either by filing papers with the court to document an out-of-court appointment or by making an application to the court for a court-based appointment. An out-of-court appointment may be made by the company or its directors. It may also be made by a QFC holder although, for reputational reasons, a QFC holder might prefer the application to be made by the directors. This also has the advantage of placing the QFC holder in the position of being able to influence the selection of the administrator. An application for a court-based appointment may be made by the company, its directors or any creditor. A court-based application might be the only route available if a creditor has presented a winding-up petition against the company or if a QFC holder is unable to make an out-of-court appointment because an administrative receiver is in office.

In some cases, it may be expedient to seek a court-based appointment; for example, where the proposed administrator wishes to secure court approval for a proposed pre-packaged sale of the company or its assets that may otherwise be at risk of being challenged, or where there is a cross-border element and there is a concern that the documentation evidencing an out-of-court appointment might not readily be recognised by a foreign court. This form of application might also be used to avoid the risk of a subsequent challenge as to the validity of an out-of-court appointment on the basis of a procedural irregularity.

An interim moratorium on creditor action will arise, in the case of the court-based procedure, where an application has been made and has not yet been granted (or dismissed) or has been granted but the order has not yet taken effect. In the case of the out-of-court procedure, it will arise on the filing of a notice of intention to appoint an administrator but before either the appointment has taken effect or the period of five business days (in the case of a QFC holder), or 10 business days (in the case of the directors or the company), beginning with the date of filing has expired without an appointment having been made. A full moratorium will arise when the appointment takes effect.

A QFC holder is able to seek a court-based or out-of-court appointment if an event has occurred that would allow him to enforce his security (this will typically be a default under a loan agreement or loan notes). This right of appointment may well arise when the company is not insolvent. In all other circumstances, it will be necessary to show that the company is or is likely to become unable to pay its debts and to provide an opinion from the administrator that the purpose of the administration is capable of being achieved.
Where an administrative receiver is in office, the appointment of an administrator must be made by an application to the court. The court will only make an appointment where the appointor of the administrative receiver consents or where the court thinks that the security under which the administrative receiver was appointed is liable to be released or discharged as a preference or a transaction at an undervalue or that the floating charge is voidable for want of new consideration at the time of its creation.

Where a secured creditor retains the right to appoint an administrative receiver, he may use this right to block the appointment of an administrator by appointing an administrative receiver prior to the appointment of an administrator. A person appointing an administrator must give notice of his intention to appoint an administrator to certain persons, including a QFC holder. During the notice period, a secured creditor who retains the right to appoint an administrative receiver may do so or may instead substitute his choice of insolvency practitioner as administrator. A QFC holder who does not have the power to appoint an administrative receiver may substitute his choice of insolvency practitioner as administrator even though he cannot block the appointment of an administrator.

As mentioned above, in some cases, a pre-pack sale will be agreed prior to an administrator being appointed and effected on, or soon after, he takes the appointment.

**CVA**

To enter into a CVA, the directors (or, if the company is in administration or liquidation, the administrator or liquidator), after proposing the CVA to the members and unsecured creditors, will appoint an insolvency specialist (normally an accountant) to act as the “nominee”. The nominee will report to the court whether, in his opinion, the proposal should be put to members and creditors and, if he believes it should, meetings of members and creditors will be called to approve it.

The CVA can be challenged in court by a creditor or member on the grounds of unfair prejudice or material irregularity (or both). This must be done within 28 days of the filing of the notice of approval with the court or, if the applicant did not receive notice, within 28 days of the day on which he became aware that the meeting had taken place. If there is any uncertainty as regards identifying all the company’s creditors the CVA process is unlikely to be favoured as it may carry the risk of a late challenge from “hidden creditors”.

**Creditors’ scheme of arrangement**

The scheme process is usually initiated by the company (or an administrator or liquidator if the company is in administration or liquidation). The company must first apply to the court for an order giving permission for a meeting of the affected creditors to be convened to vote on the scheme. Any creditors unaffected by the scheme (for example, those that are to be paid in full or whose debts are not required to be compromised) can be excluded from the scheme. Dissentient creditors whose rights are affected by the scheme (for example, those that are to be paid in full or whose debts are not required to be compromised) can be excluded from the scheme. Dissentient creditors whose rights are affected by the scheme will be entitled to vote on it along with other creditors in their class but if the requisite majority has been achieved that class will be bound and the minority view can be disregarded. If the voting majorities are achieved, a further application is made to the court for an order sanctioning the scheme. The scheme will become effective and binding on affected creditors when it is delivered to the registrar of companies.

Affected creditors will have an opportunity to challenge the composition of a class and raise other creditor issues at the convening hearing. If objections to the scheme are later raised by a scheme creditor

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21 Practice Statement (Companies: Schemes of Arrangement) [2002] 1 WLR 1345.
at the sanction hearing, the court may reject them and refuse to grant leave to appeal. If, however, the court considers that an appeal against a decision to sanction the scheme has a reasonable prospect of success, it may grant a short-term stay before making the sanction order (i.e. so that the order cannot be given efficacy by being delivered to the registrar of companies for registration)\(^{22}\). The stay then gives the dissentient creditor time to seek permission to appeal to the Court of Appeal. If the order sanctioning the scheme has already been granted, and has been given statutory effect through registration, it cannot be altered or terminated otherwise than as provided for by the scheme itself or by a further scheme. The court may set aside a sanction order in cases where it was obtained by fraud, although it will not do so if it is satisfied that the result would be the same even if the fraud had not been perpetrated.

1.5 Control of insolvency proceedings

The proceedings will be managed by the insolvency office-holder appointed in relation to the company for each insolvency process. In most cases this will be a qualified insolvency practitioner, as required by the IA 1986, who will be subject to a regulatory regime governing their professional conduct\(^{23}\).

In the UK, while a company is solvent, the directors’ duties are owed to the company for the benefit of present and future shareholders and there is no duty to consider creditors’ interests. However, once there is doubt as to the company’s insolvency or it becomes insolvent, the directors must consider and act in the interests of the company’s creditors to minimise the potential loss to them. If a director continues to trade a business after the point at which he has realised, or ought to have concluded, that the company had no reasonable prospect of avoiding insolvent liquidation and he does not take every step to minimise losses to creditors, he may be liable for wrongful trading. Similarly, a director may be liable for fraudulent trading if he allowed a company to incur debt when he knew there was no good reason for thinking that funds would be available to repay the amount owed at the time, or shortly after, it became due and payable.

Directors of companies that operate overseas may also be required to act in accordance with the laws of the relevant foreign state, particularly if secondary proceedings are opened in that jurisdiction.

The IA 1986 confers on the liquidator the power to seek a court order against directors for a contribution to the company’s assets if his investigations reveal incidences of wrongful or fraudulent trading and to set aside transactions at an undervalue, preferences and transactions defrauding creditors. In addition, he is required, under the CDDA 1986, to submit a report to the Secretary of State for Business, Innovation and Skills (“BIS”) on the conduct of the directors and former directors of the company that may lead to their disqualification from acting as directors, or being involved in the management of the company, for a specified period.

An administrator, in contrast, does not currently have the power to bring an action for wrongful or fraudulent trading\(^{24}\). He may, however, set aside transactions at an undervalue, preferences and transactions defrauding creditors in the same way as a liquidator and is also required to submit a report to the Secretary of State on the conduct of the directors and former directors of the company.

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\(^{23}\) An official receiver (appointed in a compulsory liquidation) is not subject to such a regime. He is an officer of the court and responsible directly to it and to the Secretary of State.

\(^{24}\) Note that the Insolvency Service is proposing introducing changes to the law governing insolvency proceedings to allow administrators to bring fraudulent and wrongful trading claims: see Red Tape Challenge – Changes to Insolvency Law to reduce unnecessary Regulation and simplify Procedures (Insolvency Service, July 2013).
As regards the role of the court, its involvement in a voluntary liquidation is minimal, while in a compulsory liquidation it will hear the application for a winding-up order. In an administration, on the other hand, the court’s involvement varies according to whether the process is commenced by way of a court-based or out-of-court application and whether the complexity of the company’s affairs is likely to require the administrator to seek its directions.

In an out-of-court appointment, the court’s involvement is likely to be limited, in an uncomplicated case, to receiving and stamping the documents which must be filed at court.

In a CVA, court involvement is limited to receiving a report from the nominee whether, in his opinion, the proposed CVA has a reasonable prospect of being approved and implemented and whether it should be put to the creditors and members. Notification of the approval (or rejection) of the proposal must then be filed at court within four business days of the meeting.

1.6 Special regimes

Certain entities are excluded from the general insolvency regime because of the nature of their businesses. They are subject instead to special insolvency regimes which, in some cases, are based on the administration procedure found in Schedule B1 to the IA 1986.

Banks and analogous bodies may be placed into administration without a court order so long as the consent of the appropriate regulator under the Financial Services and Markets Act 2000 ("FSMA 2000") is obtained and filed at court. The regulator is also able to participate in the administration proceedings. In addition, the Banking Act 2009 introduced a special administration regime for failing banks and building societies where government intervention is required25. More recently, a special administration regime was introduced for investment banks26.

Special regimes also exist for insurance companies27; postal services; water or sewerage companies; certain railway companies; air traffic control companies; London Underground public-private partnership companies; building societies and bodies licensed under the Energy Act 2004.

There are no special insolvency rules in English law relating to corporate groups. Instead, each company is treated as a separate legal entity28. Nor are group insolvencies provided for in the ECIR. The lack of a framework to deal with the insolvency of corporate groups is widely viewed as a shortcoming of the ECIR and one that may frustrate plans for a coordinated restructuring of the business of a multi-national group. However, in cases where the COMIs of some or all of the individual group companies have been found to be located in the same jurisdiction29, it has been possible to achieve procedural consolidation of the insolvency

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25 The procedure is to be used only where there has been a transfer of part of a failing bank’s business, assets or liabilities to a bridge bank or a private sector purchaser under the special resolution regime, leaving an insolvent residual entity. It is designed to ensure that essential services and facilities that cannot be immediately transferred to the bridge bank or private purchaser continue to be provided for a period of time.

26 The Investment Bank Special Administration Regulations 2011 (SI 2011/245). These regulations have been supplemented by the Investment Bank Special Administration (England and Wales) Rules 2011 (SI 2011/1301).


28 Note, however, the existence of a number of statutes that do provide for company groups to be considered as one entity in non-insolvency situations, for example the CA 2006 with the concept of group accounting; and taxation legislation with concepts such as “controlling interests” and group taxation and tax relief.

29 Typically, this will be where the COMI of the parent, provided it has “command and control” of the group, will be located. See, for example, Re Daisytek-ISA Ltd [2003] BCC 562 and Re MG Rover España S.A [2006] BCC 599.
proceedings of those companies by placing each of them in an insolvency process in the same jurisdiction (usually that of the parent company’s COMI), where the proceedings are managed by the same insolvency office-holder.

A broadly similar result may be achieved by opening main proceedings in one jurisdiction and effectively preventing the opening of secondary proceedings in other EU member states by agreeing to respect local priorities (thereby achieving the same outcome for local creditors)30 or by postponing the opening of secondary proceedings until a global sale has been completed31.

Notwithstanding the appeal of a single, universal process for group companies, it is acknowledged that this approach could present problems given, for example, the difficulties in defining a group or deciding which entity is to be the lead company for COMI purposes and where proceedings should be opened.

One of the proposals for the reform of the ECIR, put forward by the European Commission in 2012 (see section V below), provides instead for the coordination of insolvency proceedings concerning different members of the same group by obliging the liquidators and courts involved in the different main proceedings to cooperate and communicate with each other. In addition, it gives the liquidators involved in such proceedings the procedural tools to request a stay of the various other proceedings and to propose a rescue plan for the members of the group subject to insolvency proceedings. This proposal has broadly received the endorsement of UNCITRAL which has itself produced a framework for legislation in relation to the insolvency of enterprise groups32.

Another initiative encouraged by UNCITRAL is the use of cross-border protocols to facilitate cooperation between courts and practitioners33. An early example of this approach was seen in the Maxwell Communications Corporation case, where the UK administrators entered into a protocol with the examiners in the US Chapter 11 proceedings. More recently, cross-border protocols have been used in the Lehmans and Madoff insolvencies.

1.7 Cross-border issues

The English court’s jurisdiction in cross-border insolvency cases derives from one of four key sources: the ECIR, the CBIR, section 426 of the Insolvency Act 1986 and the common law34.

As mentioned in section I above, its jurisdiction may be fettered by the ECIR if the company’s COMI is situated in an EU member state, in which case the courts of that member state will have jurisdiction to open insolvency proceedings. Prior to the coming into force of the ECIR, if a foreign company was found to have sufficient connection with England, the court could exercise its discretion to wind up that company as an unregistered company under section 221 of the IA 1985 (see para 1.3 above). That jurisdiction is now precluded by the ECIR35, although the test remains in place for companies that fall outside its scope.

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32 Legislative Guide on Insolvency Law, Part Three: Treatment of Enterprise Groups in Insolvency adopted by UNCITRAL on 5 July 2010 and published on 21 July 2010. Elsewhere, INSOL Europe has recommended the introduction of group proceedings.
33 See the UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation (adopted 1 July 2009).
34 Note, too, Foreign Judgments (Reciprocal Enforcement) Act 1933, which provides for enforcement in England of civil and commercial judgments made in designated jurisdictions, provided that the judgment has been registered under that statute.
35 Article 3(2) of the ECIR.
Re Arena Corporation Ltd\textsuperscript{36}, for example, the English court found that a company incorporated in the Isle of Man but with its COMI in Denmark\textsuperscript{37} had sufficient connection with England (in the form of assets located in England) to enable it to exercise its jurisdiction under section 221 of the IA 1986 to wind up the company. Cases such as these, which do not meet the jurisdictional requirements of main or territorial proceedings, will be subject to the relevant national law and will be recognised by EU member states and non-member states alike in accordance with the rules of private international law.

If the debtor’s COMI is outside the EU, the ECIR will not apply and the UK, like other EU member states, will be free to act in accordance with its existing laws and practice when exercising jurisdiction, opening proceedings and recognising and enforcing proceedings opened in other EU member states. It will not be possible, however, to take advantage of the associated provisions under the ECIR, such as automatic recognition in all EU member states, which are available where main proceedings are opened. This may prove to be a hurdle in group restructurings if some of the debtor companies have substantial connections with one or more member states but fall outside the scope of the ECIR because their COMIs are not situated in an EU member state.

The English courts may otherwise be required to recognise foreign main proceedings and foreign non-main proceedings (the equivalent of main and secondary proceedings under the ECIR) under the CBIR, which implement the UNCITRAL Model Law on Cross-Border Insolvency, regardless of whether or not that country has enacted the Model Law\textsuperscript{38}. Upon recognition, relief by way of a moratorium on creditor action is automatically granted while other appropriate relief may be obtained at the court’s discretion. There is also a requirement for judicial co-operation on the part of the English court “to the maximum extent possible”, where recognition is granted\textsuperscript{39}.

Alternatively, the English courts may offer relief and assistance under section 426 of the IA 1986 which provides for co-operation both between jurisdictions within the UK and between the UK and other designated jurisdictions, which mainly include Commonwealth countries.

In circumstances where the ECIR, the CBIR and section 426 of the IA 1986 are not applicable, the English courts have an inherent jurisdiction to co-operate with foreign insolvency representatives and recognise foreign proceedings. The granting of recognition will depend on whether the foreign office-holder has satisfied the common law principles developed by the English courts. This area was considered in detail by the Supreme Court in Rubin v Eurofinance (see section D below) where an attempt was made to extend the circumstances in which recognition and assistance would be granted by the English courts.

In a number of cases, foreign companies have migrated their COMIs to the UK in order to take advantage of the UK’s established insolvency and restructuring processes. This kind of forum shopping has received judicial support at EU level\textsuperscript{40}, with a clear distinction being made between its use for the purposes of

\textsuperscript{36} Re Arena Corporation Ltd [2003] All ER (D) 277.

\textsuperscript{37} Recital (33) of the ECIR confirms that Denmark, which exercised its opt-out in relation to the ECIR, is not to be regarded as a “member state” for the purposes of the ECIR.

\textsuperscript{38} The English courts may also refuse to provide assistance under the CBIR if it would be manifestly contrary to public policy.

\textsuperscript{39} In cases of conflict between the obligations of the UK under the ECIR and the provisions of the CBIR, the ECIR will prevail. In essence, the CBIR provide an alternative basis for judicial co-operation where the ECIR does not apply, for example where the debtor’s COMI is not situated in an EU member state or where the type of proceeding (or foreign representative) in question is not listed in the relevant annexes to the ECIR, or to the extent that they do not conflict with the ECIR.

\textsuperscript{40} See the opinions of Advocate General Colomer, delivered to the European Court of Justice in Case C-1/04 Staubitz Schreiber [2006] ECR 1-701 and Case C 339/07 Seagon v Deaky Martin Belgium NV [2009] ECR 1-767.
ensuring that the COMI is located in the best place to reorganise the company and its group for the benefit of creditors and, possibly, other stakeholders (“good” forum shopping), as opposed to its use where the company acts for selfish motives to benefit itself or its shareholders or directors at the expense of creditors (“bad” forum shopping).

The decision in Hellas Telecommunications (Luxembourg) II SCA, where a Luxembourg entity moved its COMI to England three months before entering administration, is significant for its consideration of what is required to effect a successful migration. The court heard that, at the same time as moving its head office, the company also informed creditors of the change in address to London, made a press announcement that its activities were moving to London, opened a London bank account, registered at Companies House as a foreign company and appointed UK-resident individuals as directors of the English company that became its general partner. The court found that, on the evidence presented to it, the presumption in the ECIR that the company’s COMI was in Luxembourg was rebutted. It noted that the purpose of the COMI was to enable creditors in particular to know where the company was located and where they would be dealing with it, finding “one of the most important features of the evidence” to be that all negotiations between the company and its creditors had taken place in London.

The European Commission has suggested, in its proposal for the reform of the ECIR, measures to restrict the scope of bad forum shopping by creating an express obligation on the part of the court, when considering opening proceedings, to examine the grounds on which jurisdiction to open proceedings is claimed. This obligation would be met by the insolvency office-holder in cases where proceedings are opened without a court decision.

A cross-border issue also arises in situations where foreign companies, without migrating their COMIs to the UK, make use of an English law scheme of arrangement to compromise or amend the terms of their debt documents. The key issues to be considered include whether the English court has jurisdiction over the foreign company and whether the scheme will be recognised in the foreign jurisdiction. For example, in such cases, there remains some uncertainty as to the extent to which the EC Judgments Regulation may have an impact on the English court’s jurisdiction to sanction the scheme. The judges presiding over these cases have avoided reaching a firm conclusion as to whether that regulation applies to schemes, having been satisfied, on the facts of each case, that even if the regulation were to apply, one or more of the exceptions to the general rule would also apply so that the English court had jurisdiction. In most cases this was possible only because the relevant finance documents contained a clause conferring jurisdiction on the English courts (most were one-way exclusive jurisdiction clauses but in one case a non-exclusive jurisdiction clause was found to be sufficient). There is also some ongoing debate over the meaning of the term “judgment” in Article 32 of that regulation in relation to schemes. Despite the wide scope that the term is given by Article 32, some commentators have argued that the procedure for implementing an English scheme is not adversarial in nature and that the sanction order is not therefore a judgment and should not be granted recognition under that regulation.

There is likely to be further English and European case law on this topic as schemes remain a popular restructuring tool.

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41 An early example of “good” forum shopping can be seen in the Schefenacker restructuring, where the holding company of a German automotive supplier moved ownership of its assets and liabilities to a new, English-registered holding company so that it could enter into a CVA.


43 A key reason for the COMI shift was to facilitate a pre-pack of the company’s main asset, its shares in the main trading telecoms company, to a new group company leaving behind subordinated lenders as creditors of a company with no assets.
B. INSOLVENCY METRICS

The UK economy has been showing some signs of recovery in 2013 with a small amount of growth in the first two quarters that is expected to continue. Reports suggest that it may average approximately 1% over the entire year, and reach 2% in 2014.

There are signs of increased activity in the corporate debt markets. Loan volumes are expected to rise further as the economy expands, notwithstanding the impact of new capital and liquidity charges resulting from regulatory changes to the banking industry. Currently, the lending is often to refinance existing facilities, sometimes on more favourable terms to the borrower. There have also been certain acquisition finance transactions and some investors are taking advantage of opportunities to acquire distressed or non-core assets (or both), often from banks. In addition to refinancings, the loan markets have also continued to see repricings, dividend recapitalisations and agreements to amend and extend existing loans in return for higher margins and fees. The refinancing and amend and extend activity has contributed to a reduction in the number of loans due to mature over the next few years.

While banks were showing a reluctance to lend, an increase in activity in the high-yield bond market became evident and issuances in all currencies by European companies were standing at record levels in August 2013. It is anticipated that European issuers, that have been active in the US markets, may gradually return to their local markets as economic conditions improve. There has also been an increase in non-bank lending.

It is thought that ongoing macroeconomic difficulties are causing corporate default rates to remain elevated in comparison with the position before the onset of the global financial crisis. Some of the largest formal defaults have been in consumer-dependent sectors, such as retail, and it is estimated that it is likely to be some time before formal default numbers return to pre-crisis levels. However, the Bank of England’s Credit Conditions Surveys show that rates may have peaked in 2012 and that more positive signs were visible in the first and second quarters of 2013, with the default rates showing little or no increase in large and medium-sized companies.

The statistics relating to insolvencies in England and Wales for the second quarter of 2013 show a 6.5% decline in company liquidations and a 0.6% decline in CVLs on the corresponding quarter of 2012, although the number of CVLs is now on the increase. In addition, there has been a decrease of 25.6% in other corporate insolvency procedures (receiverships, administrations and CVAs) on the same period a year ago although the CVA figures for this quarter have been distorted by the large number of CVAs entered into by companies within one healthcare group.

The statistics do not give an indication of the size or types of businesses involved and may include an element of double-counting as it is not possible to identify companies that have been through multiple procedures. Nor do they distinguish between processes opened as main proceedings and those opened as secondary proceedings. It is possible that this data may be available in the future, in respect of proceedings opened in EU member states, if the European Commission’s proposal requiring member states to publish court decisions in cross-border insolvency cases in an interconnected electronic register is eventually adopted.

44 Junk in vanguard of move away from banks; news analysis (Financial Times, 23 August 2013).
45 These are compiled by the Insolvency Service and are based on data obtained from Companies House - see: Statistics release: insolvencies in the second quarter 2013 (Insolvency Service, 2 August 2013).
46 See section V.
C. PLENARY INSOLVENCY PROCEEDINGS

This section discusses two key insolvency decisions handed down by the English Supreme Court in the last 12 months: Eurosail and the joint Nortel Networks/Lehman Brothers appeals.

The significance of the Eurosail case\(^47\) lies in the court’s detailed consideration of section 123(2) of the IA 1986, which describes the balance sheet test for insolvency, and how it should be applied\(^48\). Section 123(2) states that a company will be deemed unable to pay its debts “if it is proved to the satisfaction of the court that the value of the company’s assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities”.

Eurosail is an English-incorporated special purpose vehicle and the issuer of notes under a securitisation programme. It entered into currency and interest rate swaps with other entities from the Lehman Brothers group to hedge its obligations under the notes. The swaps were terminated after those entities entered Chapter 11 proceedings in the US in October 2008. As a result, Eurosail lost its protection from currency and interest rate fluctuations. It submitted a claim against the estates of the relevant Lehman entities for approximately $221 million but did not replace the swaps. Its audited accounts for the year ending 30 November 2009 recorded a substantial net liability of £74.557 million although the company continued to meet its obligations as they fell due. Certain noteholders argued, on the basis of its net liabilities, that Eurosail should be deemed unable to pay its debts within the meaning of section 123(2) of the IA 1986, which was an event of default under the terms and conditions of the notes. This led to an application to court by the security trustee to determine whether Eurosail was balance sheet insolvent.

The Supreme Court unanimously upheld the decision of the lower courts that Eurosail should not be deemed unable to pay its debts within the meaning of section 123(2) IA 1986, as incorporated into the terms and conditions of its note issuance.

The guidance to be distilled from the judgment is that, first, while a company which falls within section 123(2) of the IA 1986 is often said to be “balance sheet insolvent”, that expression must not be taken literally because a company’s statutory balance sheet may omit some of the company’s contingent assets or contingent liabilities. The question of whether the company has “reached the point of no return because of an incurable deficiency in its assets” (as suggested by the Court of Appeal) is not the applicable test. Rather, the court must be satisfied, on the balance of probabilities, that a company has insufficient assets to be able to meet all its liabilities, including prospective and contingent liabilities (discounted for contingencies and deferment).

The court noted that the test is far from exact and that whether it is satisfied will depend on the available evidence as to the circumstances of the particular case. In Eurosail there was no certainty that there would eventually be a deficiency, given that the issuer’s liabilities could be deferred for over 30 years and that currency and interest rate movements during that time (which would affect its financial position) could not be predicted with any confidence.

As regards the interaction between the balance sheet test and the cash flow test, which is met if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due\(^49\), approval was

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\(^{47}\) BNY Corporate Trustee Services Ltd & Ors v Neuberger [2013] UKSC 28 (9 May 2013).

\(^{48}\) The balance sheet test in section 123(2) IA 1986 is one of the two key tests for insolvency in English law (there is no definition of insolvency in the IA 1986, the key question is whether a company is able to pay its debts).

\(^{49}\) See section 123(1)(e) of the IA 1986.
voiced for an earlier case\textsuperscript{50} that found that the cash flow test is concerned not only with debts that are immediately payable but also those falling due in the reasonably near future.

As one of the presiding judges has subsequently suggested, the most obvious consequence of the Eurosal decision is that “the chances of a company which can still pay its debts as they fall due, but whose current balance sheet does not look that good, being wound up under section 123(2) are a bit less than they were before”\textsuperscript{51}. Of itself, this is an important development. However, the judgment has far-reaching implications because the cash flow and balance sheet tests for insolvency are central to English insolvency law. They are relevant not only when considering the grounds for placing a company into administration or liquidation but also in relation to the duties of directors and the pursuit of certain claims by insolvency practitioners. They are also commonly included as a termination event or event of default in commercial agreements and financing documentation, as was the case in Eurosal, although the precise drafting of such provisions varies.

While it is helpful to have guidance from the Supreme Court on these important tests, a number of areas of uncertainty remain. For example, the Supreme Court did not consider how future and contingent liabilities are to be “discounted for contingencies and deferment”. It is therefore conceivable that, although the highest court in the UK has considered these tests, particularly the balance sheet insolvency test, in some detail, Eurosal will not be the last word from the English courts on the matter. The guidance from the Supreme Court also confirms that the analysis will depend on the nature of the relevant business (and its assets and liabilities), and that it will remain important to consider the tests on a case-by-case basis.

The conjoined Nortel and Lehman Brothers appeal\textsuperscript{52} also provides some clarification on a key area of English insolvency law, this time on the categorisation and treatment of potential pensions liabilities on insolvency.

The case arose following the financial collapse of two multinational groups: Nortel Networks, a major supplier of telecommunications and computer network equipment, and Lehman Brothers, the investment banking group. Both had final salary pension schemes that were in substantial deficit (£2.1 billion in the case of Nortel and £120 million in the case of Lehman). A number of the English companies in both groups were placed into administration.

The Pensions Regulator (“TPR”) decided to use its discretionary powers to issue a financial support direction (“FSD”), requiring certain companies connected or associated with the pension scheme employer companies (the “targets”) to put in place reasonable financial support for the schemes in deficit. It served notice on the administrators within each group notifying them to that effect. The administrators appealed against the notice, which had the effect of staying proceedings by TPR, and applied to court for a determination on whether an FSD or a contribution notice (“CN”)\textsuperscript{53}, issued after the target has gone into administration or liquidation (an “insolvency event”), imposes any obligation on the target and its insolvency office-holders and, if so, how that obligation would rank in the target’s insolvency.

The four possibilities presented to the Supreme Court as to how the cost of complying with an FSD (or CN)

\textsuperscript{50} Re Cheyne Finance Plc [2007] EWHC 2402 (Ch) (17 October 2007).
\textsuperscript{51} Speech by Lord Hope at the Banking and Financial Services Law Association, Gold Coast, Australia: “A light at the end of the tunnel? – BNY in the UK Supreme Court” (29 August 2013).
\textsuperscript{52} Re Nortel Companies & Ors [2013] UKSC 52 (24 July 2013).
\textsuperscript{53} A CN requires specific payment to be made to a scheme, and can be issued by TPR if the relevant company fails to comply with the FSD. It may also be issued on a standalone basis.
issued after an insolvency event should rank were
that: (i) it would be an expense of the administration
or liquidation; (ii) it would be an ordinary provable
unsecured debt within rule 13.12 IR 1986 (which
defines “debt” and “liability”), ranking pari passu with
other unsecured debts falling within that category;
(iii) it would be payable (if at all) only out of any
surplus available after payment in full of all unsecured
creditors (i.e. not a provable debt); or (iv) if the third
possibility is correct, the court could and should direct
the administrators to vary the statutory ranking of
liabilities in order to treat the liability more favourably.

The lower courts had reluctantly concluded that
the liability was an expense of the administration,
thereby elevating it to super-priority status, payable in
priority to claims of floating charge holders, unsecured
creditors and the administrators in respect of their
remuneration.

The Supreme Court held unanimously that such a
liability was a provable debt which arose by reason of
an obligation incurred before the date on which the
company entered the relevant insolvency procedure.
In so doing it overruled the decisions of the lower
courts and earlier, long-standing decisions on personal
insolvencies that the lower courts had felt they were
bound to follow. While expressing a reluctance to lay
down a universally applicable formula to determine
whether such an obligation had been incurred, the
court suggested a three-stage test: the company
must have taken, or been subjected to, some step or
combination of steps which (a) had some legal effect
(such as putting it under some legal duty or into
some legal relationship), and (b) resulted in it being
vulnerable to the specific liability in question, such
that there would be a real prospect of that liability
being incurred. If these two requirements are satisfied,
it would then be relevant to consider (c) whether it
would be consistent with the regime under which
the liability is imposed to conclude that the step
or combination of steps gave rise to an obligation
incurred before the company went into administration
or liquidation54.

The finding that an FSD liability ranks as a provable
debt significantly widens the ambit of rule 13.12(1)
(b) IR 1986. This may have implications outside the
sphere of pensions legislation and raises the question
of how, in practice, the three-stage test will be
applied. Inevitably, some uncertainty remains and the
decision opens the way to future debate on whether
an obligation has been incurred for the purposes of the
rule, how the liability that may result from it should be
measured and whether, based on the language used in
the judgment, it extends beyond liabilities created by
statute.

The decision also clarifies, to some extent, how the
insolvency rules relating to administration expenses
should operate. While not an absolute rule, the general
principle, as outlined by the court, is that a liability
should only be an administration expense if it either:
(a) arises out of something done in the administration
(normally by the administrator or on the administrator’s
behalf) and is therefore an expense incurred by the
administrator in the course of the administration, in
order to do their job; or (b) is imposed by a statute
whose terms make it clear that the liability to make
the disbursement falls on an administrator as part of
the administration, either because of the nature of
the liability or because of the terms of the statute.
This means that a liability that is not incurred by an
administrator but that simply arises while he or she
is in office, should not amount to an administration
expense, unless expressly required by statute. This part
of the decision may also have wider implications as to
how insolvency expenses are treated, for example on
the issue of when rent is payable as an administration
expense, which is currently under judicial scrutiny in
proceedings relating to the administration of companies
in the Game group.

54 Pursuant to rule 13.12(1)(b) of the IR 1986.
**D. ANCILLARY INSOLVENCY PROCEEDINGS**

One of the most significant decisions handed down in the past year involving foreign companies subject to main proceedings in other jurisdictions is that of the Supreme Court in respect of the *Rubin v Eurofinance* and *New Cap Reinsurance* cases. In a conjoined appeal, the Supreme Court considered the circumstances in which an order or judgment of a foreign court (here, the US Bankruptcy Court and the New South Wales Supreme Court) in proceedings to adjust or set aside vulnerable transactions would be recognised and enforced in England. In both appeals the parties against whom the judgments were made were neither present in the foreign country nor had they knowingly submitted to the jurisdiction. Since both judgments were *in personam*, the essential issue was whether the existing common law principles were applicable or whether the court should adopt separate rules for such judgments in avoidance proceedings, where the judgments were central to the purposes of the insolvency proceedings or were part of the mechanism of collective execution.

*Rubin v Eurofinance* concerned a business trust that operated primarily in the US and Canada where its customers were based. It had been set up by a company owned by an individual who, along with his two sons, were the defendants in this case. All were UK residents. In October 2005, the trust was placed into Chapter 11 proceedings in New York, having already been subject to multiple actions for fraud in the US and Canada. In December 2007, the legal representatives ("receivers") appointed to administer the trust brought proceedings in the New York Bankruptcy Court against the defendants for fraud and unjust enrichment, among other counts. In July 2008, the trust, acting by the receivers, obtained a default and summary judgment in the New York proceedings against the defendants for an amount in excess of $10 million. The receivers applied to the English High Court for an order recognising the proceedings as "foreign proceedings" for the purposes of the CBIR and enforcing the judgment against the defendants as if it were a judgment of the English court against them.

The defendants contested the application, contending that the judgment was not enforceable against them as they had played no part in the US proceedings: they had not been present when the court in New York gave judgment against them and had not submitted to the jurisdiction of the US court. Therefore, the common law principles providing the basis on which a foreign court had jurisdiction to give a judgment *in personam*, were not applicable and the New York judgment could not be enforced against them in England. They further argued that was nothing in the CBIR that modified or excluded the common law principle that the judgment was not enforceable in circumstances where the defendant had not participated in the relevant foreign proceedings.

The Court of Appeal had accepted that the judgment was an *in personam* judgment but decided that the common law rule did not apply to foreign judgments in avoidance proceedings because they were central to the collective enforcement regime in insolvency and were governed by special rules by treating judgments determining insolvency rights i.e. rights which arise during and only in the course of an insolvency as a special category of judgment. Applying the concept

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56 Under English common law, in order for a foreign court to have jurisdiction to give a judgment *in personam*, capable of recognition and enforcement against the person whom the judgment was given, that person must (i) be present in the foreign court when proceedings were instituted; (ii) be a claimant (or make a counterclaim) in the foreign proceedings; (iii) submit to the jurisdiction of the foreign court by voluntarily appearing in the proceedings; or (iv) agree to submit to the jurisdiction of the foreign court before the commencement of the proceedings.

57 See section A, para 1.7 above.
of modified universalism\footnote{The principle of modified universalism, described by Lord Hoffman in \textit{Re HIH Casualty & General Insurance Ltd} [2008] UKHL 21 as “the golden thread running through English cross-border insolvency law since the 18th Century”, requires the English courts, so far as it is consistent with justice and UK public policy, to co-operate with the courts in the country of the principal liquidation to ensure that all the company’s assets are distributed to its creditors under a single system of distribution. Accordingly, any proceedings opened by courts of other states where the debtor has assets are ancillary to the main proceedings and those courts will collaborate with the main proceedings.} as propounded in the \textit{Cambridge Gas} case\footnote{\textit{Cambridge Gas Transport Corporation v. Official Committee of Unsecured Creditors of Navigator Holdings plc} [2006] UKPC 26, where the Manx court was prepared to recognise a US bankruptcy.}, the Court of Appeal had taken the view that the judgments were to be categorised neither as \textit{in personam} nor \textit{in rem} but rather were a separate category as part of the mechanism of collective execution inherent in the insolvency process.

The Supreme Court rejected the reasoning of the Court of Appeal by a four to one majority and allowed the appeal, holding that there should not be special rules for avoidance judgments and that \textit{Cambridge Gas} was wrongly decided as there was no basis for recognition in that case. In so doing, it appears to have dealt a blow to the further development of the principle of modified universalism in the English courts, unless this part of the decision can be viewed as simply limiting the scope of the principle only in relation to the recognition and enforcement of foreign avoidance judgments.

In the \textit{New Cap} case, an Australian reinsurance company had paid sums by way of commutation of its liabilities to members of a Lloyd’s syndicate that had placed reinsurance with it. When the company went into liquidation the liquidator brought proceedings in New South Wales to set aside and recover the payments made to the syndicate as a preference, on the basis that New Cap had been insolvent when they were made. The syndicate did not accept service of the proceedings, nor did its members submit to the jurisdiction of the New South Wales court by agreement or take part in the proceedings, although they made points which seemed to them relevant in correspondence with the liquidator’s solicitors and they had taken part in the liquidation by, for example, submitting proofs of debt. The court allowed the proceedings to continue against the syndicate on the basis of an order for substituted service. It found that New Cap was insolvent at the relevant time and, on evidence adduced by the liquidator, declared that the payments were voidable transactions under the relevant legislation. It then ordered the relevant syndicate members to pay two sums to New Cap, with interest. It also ordered the sending of a letter of request to the English court, asking it to exercise its jurisdiction under section 426 of the IA 1986\footnote{Section 426 of the IA 1986 provides for co-operation between courts in designated territories exercising jurisdiction in relation to insolvency (see section A, para 1.7 above).} to assist the New South Wales court, primarily by ordering that the syndicate should pay to New Cap the sums of money ordered respectively by the relevant part of the New South Wales order. Alternatively, it asked that the liquidator be allowed to bring proceedings in the English court to set aside the payments as preferences, those proceedings to be determined according to Australian law or for the English court to give such other relief as it might consider just. The liquidator and New Cap itself then issued proceedings in the High Court seeking the relief indicated in the letter of request, originally pursuant to section 426 alone, and then by amendment alternatively under common law.

The Supreme Court dismissed the appeal in \textit{New Cap Reinsurance} on the basis that the syndicate had submitted to the jurisdiction of the New South Wales court by filing proofs of debt and participating in creditors’ meetings (also, the liquidator had admitted the syndicate’s claims). It was the view of the court that the company should not be allowed to benefit from the insolvency proceeding without the burden of
The decision potentially has significant consequences for cross-border insolvencies on the question of the ability to recognise and enforce judgments in England (and other common law jurisdictions) that have been given in the course of a foreign insolvency. In cases where a foreign party has not submitted to the relevant foreign jurisdiction, it will be necessary to bring a separate claim in the English court against that party, necessitating a review of the merits of the case.

Another case that is exciting some interest, but has yet to reach the Supreme Court, is Olympic Airlines. It is primarily concerned with the meaning of "establishment" in the ECIR for the purposes of opening secondary (winding-up) proceedings. Olympic Airlines was a state-owned airline company that had its COMI in Greece. Following a finding that it had been in receipt of illegal state aid, the company ceased operations and was placed in "special liquidation", which is a main proceeding for the purposes of the ECIR, by the Greek state. The company had three offices in the UK from which it conducted its business and had 27 employees who were all members of the company’s pension and life assurance scheme. The liquidator in the Greek proceedings gave instructions for the UK branches to close.

The pension scheme had a deficit of £15 million and the pension scheme trustees petitioned for the winding up of the company as an unregistered company under section 221 of the IA 1986, based on the orders made in that proceeding. The Foreign Judgments (Reciprocal Enforcement) Act 1933 applied to the New South Wales judgment and enforcement should be by way of registration under that Act.

Lord Collins gave the lead judgment which held that the rules at common law governing the recognition and enforcement of foreign judgments apply to judgments given in transaction avoidance proceedings forming part of a foreign insolvency and that there is no different rule governing the recognition and enforcement of such judgments (nor should the courts extend existing law to accommodate one). As a matter of policy, the court did not agree that, in the interests of the universality of insolvency and similar procedures, there should be a more liberal rule for judgments given in foreign insolvency proceedings for the avoidance of transactions. It considered that the restricted scope of the existing rules reflects the fact that there is no expectation of reciprocity on the part of foreign countries while expanding the principal would also be detrimental to UK businesses without any corresponding benefit. Nor would any serious injustice result from adhering to the traditional rule.

The court noted there were several other avenues open to office-holders: Rubin v Eurofinance, for example, could have been founded on proceedings by trustees in England for the benefit of creditors under an express trust, and, in New Cap Reinsurance, avoidance claims by the liquidator of an Australian company could have been made the subject of a request by the Australian court under section 426 of the IA 1986.

The court also confirmed that the recognition and enforcement of foreign judgments cannot be effected either under the CBIR or (obiter) under section 426 IA 1986 as neither were concerned with the enforcement of foreign judgments.

The decision potentially has significant consequences for cross-border insolvencies on the question of the ability to recognise and enforce judgments in England
its inability to pay the pension scheme debt. Their interest in the litigation was that English insolvency proceedings were necessary to trigger assessment for entry into the Pension Protection Fund (“PPF”)\textsuperscript{\footnote{The Pension Protection Fund was established to pay compensation to members of eligible schemes where there is an insolvency event (as defined in the Pensions Act 2004) in relation to the employer company and where there are insufficient assets in the pension scheme to cover Pension Protection Fund levels of compensation.}} which would then assume responsibility for the company’s pension scheme as the proceedings would amount to an “insolvency event” for the purposes of the Pensions Act 2004. However, the petition was opposed by the liquidator on the basis that the company was already being wound up in Greece and that, at the date the petition was presented (i.e. the relevant time at which the issue had to be determined), it did not have an establishment in the UK.

The issue for the English court to consider was whether the UK company, which was in a state of wind-down at the time the application to open secondary proceedings was made\textsuperscript{\footnote{The company had ceased commercial operations in the UK, had no remaining assets in the jurisdiction and no contact with customers. It had dismissed all but two of its staff who were there to assist the Greek liquidator.}}, constituted an “establishment”, in which case it would have jurisdiction to open winding-up proceedings. The High Court found that the fact that the company was in the process of being wound up in Greece was not incompatible with the possession of an establishment in the UK and that it was not necessary for the company to have engaged in “on the market” (i.e. external) trading at the time of the request for the requirements of an establishment to be met: the requisite factors were present at the relevant time.

The decision was reversed by the Court of Appeal, which found that the lower court had not placed sufficient emphasis on the Virgos-Schmit Report\textsuperscript{\footnote{The Virgos-Schmit Report was prepared as a commentary on the European Convention on Insolvency Proceedings. The ECIR is based on the Convention, and the commentary is considered by the judiciary and practitioners alike to be relevant to interpreting the ECIR.}}\textsuperscript{\footnote{Interedil Srl (In liquidation) v Fallimento Interedil Srl [C-396/09] [2012] Bus LR 1582 (EC), 1st Chamber.}}, which indicated that the economic activities contained within the definition of establishment required them to be exercised “externally”. Simply winding down the business did not count as an external activity for these purposes. The decision is being appealed to the Supreme Court.

The case highlights the importance of there being actual "operations" as opposed to a “presence” in a jurisdiction in order to found an "establishment" and provides helpful guidance on the judicial interpretation of “establishment” for the purposes of the ECIR. In particular, dormant branches and ones that have ceased economic activity will not suffice to found jurisdiction for secondary insolvency proceedings. It also suggests that, as with the concept of COMI under the ECIR, external activity and actual business operations ascertainable by third parties will be useful in satisfying the definition.

The case builds on the decision of the Court of Justice of the European Union in Interedil\textsuperscript{\footnote{Interedil Srl (In liquidation) v Fallimento Interedil Srl [C-396/09] [2012] Bus LR 1582 (EC), 1st Chamber.}}, which decided that the term “establishment” must be interpreted as requiring the presence of a structure consisting of a minimum level of organisation and a degree of stability to pursue an economic activity, finding, in that case, that the presence alone of goods in isolation or bank accounts did not, in principle, meet that definition.

From an English law perspective, the case also highlights a lacuna in the pensions legislation, in that it demonstrates that the protection of the PPF will not always be available to employees based in England.
should their employer become insolvent in another EU member state: in the absence of an establishment in the UK, the English court will not have jurisdiction to commence the secondary insolvency proceedings needed to provide a trigger for the scheme to be considered for entry into the PPF. UK-based employees of companies that do not fall within the ambit of the ECIR will also need to invoke the UK court’s insolvency jurisdiction to gain assessment for entry into the PPF, although the test for satisfying the jurisdictional requirements will not then be based on the existence of an establishment in the UK.

E. TRENDS

Whether there will be an increase or decrease in insolvency activity during the coming year is difficult to predict, given such factors as the ongoing uncertainty generated by the eurozone crisis, reduced economic growth in China and India, instability in the Middle East and possible further increases in global commodity prices.

It seems possible that the number of corporate insolvencies may decrease further, although the downward trend in formal insolvencies seen over the past year may stall if the predicted collapse of certain “zombie companies”, that are near to the point of insolvency but currently able to survive because of low interest rates, occurs. Also, lenders that have already written down investments may be more inclined to consider enforcement action that will lead to the eventual winding up of the affected companies.

The Governor of the Bank of England confirmed in August 2013 that the Bank is unlikely to raise its base rate (currently 0.5%) until the jobless rate has fallen to 7% or below, which requires the creation of approximately 750,000 jobs and could take three years. This announcement may lead to greater confidence on the part of the banks to lend. Recent reports already indicate that banking confidence is growing, apparently buoyed by improving results and growing customer activity, and that building societies are showing a greater willingness to lend, as they benefit from increasing business and revenues. At the same time, retail and commercial non-performing loans are expected to decline during the second half of 2013.

The Bank of England expects to see a greater desire on the part of corporates to borrow now that it has confirmed that the base rate is unlikely to change: they are also likely to increase their use of any existing cash funds they may have to start investing in their businesses again and to either expand their workforces or give more work to part-time employees in cases where reduced hours were introduced to avoid staff redundancies.

As regards industry trends, the problems created by slow economic growth and the subsequent decrease in demand for industrial goods and manufacturing have been compounded by higher production costs (which are expected to continue to rise), risk-averse investors and falling commodity prices. In the mining sector, many companies are reported to have been left with poor cash reserves and exploration companies, in particular, which rely heavily on equity markets to provide funding for their activities, are expected to find fundraising more difficult in the coming months. Some companies in the sector have been placed into administration, while others, such as Britain’s largest coal producer, UK Coal Plc (now renamed Coalfield Resources plc), have taken steps to restructure their operations. It is possible, therefore, that there will be a further increase in insolvency and restructuring activity in this area in the coming months.

Other industries that have been affected by the downturn are broadly to be found in the construction,
hotels, sports and leisure sectors. The renewable energy sector is also experiencing difficulties which are partly attributable to the reduction in investment in wind, solar and other green energy ventures, particularly in the EU and US markets.

The shipping sector, which is dependent on a vibrant global economy, has also experienced difficulties, largely as a result of a continued decline in demand linked with over-capacity, which may eventually give rise to more restructurings and possible insolvencies.

One noticeable trend in the UK in terms of how corporates are dealing with financial difficulties has been the use of the English law scheme by foreign companies. In these cases jurisdiction has been based on the “sufficient connection” test, discussed above. Sufficient connection has usually been accepted on the basis that the company has entered into agreements governed by English law and submitted to the jurisdiction of the English courts.

Certain European jurisdictions (for example, Spain) still do not have a means to cram down secured creditors, and therefore schemes are likely to remain attractive in some situations. Foreign companies in some jurisdictions are also showing a growing inclination to have debt governed by English law to preserve the option of a scheme and it will be interesting to see whether they push the boundaries further, for example, by attempting to change the governing law of the underlying finance agreements to English law by using a majority lender vote before commencing a scheme.

The need for a plan B or stick (such as the threat of a scheme, CVA, pre-packaged administration or a potential COMI shift (or a combination of any of these)) has also been necessary in complex restructurings in order to improve the prospects of achieving a consensual deal.

In terms of borrowing trends, the rise of the high-yield markets has meant that borrowers are sometimes achieving longer maturities, which reduces the need for short and medium-term refinancing or restructuring. In addition, an increasing number of English companies sometimes have a mix of English and US law governed debt in their capital structure which means that future restructurings may be more complex, since companies may need to weigh up the advantages and disadvantages of UK, US or parallel restructuring processes from a process and recognition perspective.

As regards legislative developments in the UK, a number of consultations have been published by government bodies, which may lead to changes in insolvency law during the coming year or soon after. These include (i) a BIS paper aimed at enhancing the transparency of UK company ownership and increasing trust in UK business which includes several insolvency-related matters to strengthen the disqualification regime and promote better redress for creditors where misconduct has occurred (the Insolvency Service has announced a review of pre-packs in connection with this paper); (ii) a consultation issued by the Insolvency Service in response to the Government’s Red Tape Challenge, which aims to simplify current procedures and reduce unnecessary regulation; and (iii) a call for evidence on the Draft Deregulation Bill, published on 1 July 2013. The Bill proposes a number of substantive amendments to the IA 1986, including changes to clarify the procedure for the appointment of administrators. All of these papers contain proposals

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69 Although the number of sports clubs and facilities entering formal insolvency procedures has fallen 33% in the year since the 2012 “Olympic” summer, according to research by R3 (also known as the Association of Business Recovery Professionals).

70 Transparency and trust: enhancing the transparency of UK ownership and increasing trust in UK business (BIS, July 2013).

71 The Red Tape Challenge – changes to insolvency law to reduce unnecessary regulation and simplify procedures (Insolvency Service, 18 July 2013).
that would have an impact on the regime applicable to directors of companies in distress.

In addition, in December 2012 HM Treasury commissioned an independent review of the investment bank special administration regime, as required by the Banking Act 2009. An interim report was published in April 2013 which provides details of the provisional conclusions and recommendations. The Treasury has accepted the conclusion that the regime should be retained and that changes will be necessary if the regime is to be better able to fulfil the objectives set for it. The results of the second phase of the review are expected to be published later in 2013.

Elsewhere, following several consultations over recent years relating to the modernisation of the IR 1986 that have resulted in a number of amendments being introduced in 2009 and 2010, the Insolvency Service has been working to produce a full consultation draft of a new set of rules to restructure and entirely replace the IR 1986. The draft was due to be published during 2013 but has been delayed because the rules form part of insolvency legislation that is being reviewed under the Government’s Red Tape Challenge. It is possible that the proposed implementation date (October 2014) will be further delayed.

The Insolvency Service also launched a call for evidence on the impact of the proposed changes to the ECIR\(^2\) and published the responses in April 2013. This coincided with the announcement from the Government, confirming that it has exercised its right under the EU Treaty to opt in to the revised version of the ECIR and that it will participate fully in negotiations and implementation of the regulation in its final form. The key amendments under consideration include revising the definition of insolvency proceedings to include (i) hybrid and pre-insolvency proceedings; (ii) clarifying the jurisdiction rules and improving the procedural framework for determining jurisdiction (including, by the addition of new language in relation to the determination of COMI: (a) enabling the court to postpone or refuse the opening of secondary proceedings if this is not necessary to protect the interests of local creditors; (b) abolishing the requirement that such proceedings must be winding-up proceedings; and (c) extending the co-operation requirements by obliging courts of the main and secondary proceedings to cooperate between themselves and by obliging liquidators and courts to co-operate with each other); (iii) requiring member states to publish court decisions in cross-border insolvency cases in publicly accessible interconnected electronic registers; and (iv) including specific rules in relation to the insolvency of multi-national groups of companies (but maintaining the entity-by-entity approach). The proposal is currently with the European Parliament and Council for negotiation and adoption.

Finally, and also at EU level, the European Commission’s proposals for an EU recovery and resolution framework for credit institutions (applicable to banks and building societies in the UK) and investment firms should be noted. In June 2012 it published a draft legislative proposal for the Recovery and Resolution Directive (“RRD”) establishing the framework. The proposals are a direct response to weaknesses in the existing law and regulation for the resolution of banks that became apparent during the global financial crisis. The stated aim of the proposals is to put in place a framework that will allow a bank to fail, whatever its size, while ensuring the continuity of essential banking services, minimising the impact of that failure on the financial system and avoiding costs to the taxpayer. The Commission intends member states to finalise their implementing measures for the RRD by 31 December 2014 at the latest and to apply those measures from 1 January 2015. As an exception to this, the provisions on the proposed bail-in tool

(a process of internal recapitalisation triggered when a firm reaches the point of non-viability) should be applied by 1 January 2018. The UK regulators, the Prudential Regulation Authority and the Financial Conduct Authority, intend to publish final rules for recovery plans and resolution packs in the third quarter of 2013. These rules will take into account the proposed RRD and the guidance of the Financial Stability Board on resolution regimes.