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The *Insolvency Bill* [H.L]

Bill 173 of 1999-2000

The *Insolvency Bill* completed its passage through the House of Lords on 26 July 2000. It was sent to the House of Commons on 27 July 2000 and has a provisional date for second reading of 24 October 2000. The Bill's main purpose is to assist the rescue of viable businesses which are facing short to medium term financial difficulties. It allows small companies to make voluntary arrangements with their creditors by providing the option of a moratorium to give the company's management time to put a rescue plan to creditors. The Bill also amends the procedure for disqualifying unfit company directors.

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Summary of main points

The *Insolvency Bill* [HL 173] was introduced to the House of Lords on 3 February 2000 and completed its passage there on 26 July 2000. It is provisionally down for Second Reading on 24 October 2000. The Bill adds new provisions to, and amends existing provisions in, the *Insolvency Act 1986* and the *Company Directors Disqualification Act 1986*. It provides for:

- small companies in financial difficulty to make voluntary arrangements with their creditors by providing the option of a moratorium;[1]

- modifications to the existing company and individual voluntary arrangement schemes;

- individuals who are not otherwise authorised to act as insolvency practitioners to act as nominees and supervisors if subject to the rules of a body recognised for the purpose by the Secretary of State;

- the Secretary of State to accept undertakings from unfit directors which would have the same legal effect as directors disqualification orders made by a court;

- reform of the procedure for reporting delinquent company officers;

- the amendment of section 219 of the *Insolvency Act 1986* to ensure it is compliant with the *European Convention on Human Rights*;

- the reform of the insolvency provisions relating to administration of insolvent estates of deceased persons (England and Wales only);

- a power to make regulations on the investment of funds held in the Insolvency Services Account on behalf of bankrupt estates, and the payment of interest on relevant funds; and

- an order-making power to allow the implementation of a Model Law on cross-border insolvency as adopted by the United Nations Commission on International Trade Law.

This Bill applies to England & Wales and, in so far as it shares similar insolvency procedures, to Scotland.[2] It does not apply to Northern Ireland save to a very limited extent.[3]

This Paper also considers other recent insolvency reform initiatives including: the Insolvency Regulation Working Party Review, the Ferris Committee Report, bankruptcy law reform, the Forensic Insolvency Recovery Service and the European Insolvency Regulation.

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[1] A *moratorium* is a temporary stay on certain legal acts and processes from being performed or continued

[2] For example, Scotland has different procedures for bankruptcy and individual voluntary arrangements

[3] Clause 16 states that the Bill, except Part II of Schedule 2 and paragraphs 16(3) and 22 of Schedule 4, does not extend to Northern Ireland.

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I Background

A. Voluntary arrangements under the existing insolvency regime

A review of insolvency law and practice was set up in January 1977 by Mr Edmund Dell, then Secretary of State for Trade and Industry, under the chairmanship of Sir Kenneth Cork. Its remit included consideration of 'less formal procedures as alternatives to bankruptcy and company winding up proceedings in appropriate circumstances'. A report was published in June 1982.[4] Among the proposals considered by the report, were two new or revised procedures: administration and company voluntary arrangements. Both procedures were implemented in the *Insolvency Act 1985*, and subsequently consolidated in the *Insolvency Act 1986* and the *Insolvency Rules 1986.*

In effect the *Insolvency Act 1986* [IA 1986] and the rules made under it now provide the principal statutory regime governing insolvency in the UK. This regime includes mechanisms for company rescue procedures as an alternative to company winding up proceedings. These company rescue procedures include administration and company voluntary arrangements. This Bill is concerned, in part, with amending company voluntary arrangements [CVAs].

CVAs were introduced by Part I of the IA 1986. The CVA is a form of business rescue procedure for companies facing financial crisis; they are an alternative to company winding up proceedings (although a CVA can be proposed even after a company has gone into administration or liquidation). Where a company is wound up, its assets will be liquidated, its affairs put in order, and it will then be dissolved and cease to exist as a legal entity. A CVA enables a company to make a legally binding arrangement with its creditors and members for satisfying its debts.

In summary, the object of a CVA is to rescue the business. A CVA procedure has the following advantages:

- it is easy to put in place;
- there is no requirement that the company should be insolvent;
- the Court has limited involvement;
- an approved CVA binds every person who was given notice of, and was entitled to vote at, the creditors' meeting to consider the proposal (whether or not he was actually present at the meeting); and

[4] Cmnd. 8558

- creditors are often given a better return on their debts than under a compulsory liquidation procedure.

Despite the advantages, government statistics indicate the comparatively low level of use of CVAs. There were 372 CVAs in 1995 compared to a total of 12,757 company winding-up petitions.[5] In 1997, there were 629 CVAs compared to a total of 11,158 winding up petitions.[6] However, in 1998 the number of approved CVAs had fallen to 470 compared to a total of 11,771 winding up petitions. [7]

In accounting for this, it is generally accepted that company rescues can be made more difficult or prevented altogether because of the absence of provision in the IA 1986 for obtaining a short moratorium in the CVA procedure. A moratorium is a temporary stay on certain legal acts and processes from being performed or continued. Under current legislation, the absence of a moratorium means that, until the arrangement is formally approved, any creditor can take legal action against the assets of the company and so jeopardise the prospects of the arrangement succeeding. It is argued that the addition of a moratorium from the outset of proceedings would offer a company's management a short breathing space within which to put together a rescue plan to creditors.

CVA procedure

Under the current procedure, the directors of a company, an insolvency practitioner or an administrator (if the company is in administration) can make a proposal under which a scheme of arrangement or composition with creditors is put before a meeting of creditors for their approval. The proposal may involve, for example, a delay of payment until a certain event happens, payment by instalments, the payment of less than 100p in the pound in full settlement, capital restructuring or an orderly disposal of assets. A licensed insolvency practitioner would supervise the plan of reorganisation. The proposal must contain an explanation why a CVA is desirable and why the company's creditors might be expected to agree to it. The proposal must set out details of the company's assets and liabilities, and how it is proposed to deal with secured and preferential creditors.

Before a CVA can be implemented, it has to be approved by shareholders and creditors; a 75% majority of creditors must be in favour of it. The majority is calculated by reference to the value of the creditors' claims of those creditors present in person or by proxy and voting at the meeting. Shareholders' approval is given by a simple majority.

Once the CVA has been formally approved, no creditor who has been given notice of the creditors' meeting can take any action against the company in relation to his debt. This moratorium applies whether or not the creditor concerned attended the meeting or voted for or against the proposal. If the company is in administration or liquidation, the court may 'stay' (i.e. temporarily stop) the proceedings and give specific directions to facilitate the implementation of the CVA. The winding up of the company is not, however, cancelled but simply suspended. Under a CVA, the company would be able to continue to trade under the control of the directors and the general supervision of a 'supervisor'.

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[5] The Insolvency Service Annual Report and Accounts 1995-96 see also Lord Chancellor' Department press notice No. 345/99, *Company winding up and bankruptcy petition statistics*, 5 November 1999

[6] Ibid.

[7] Ibid. See also Department of Trade and Industry press notice P/2000/076, *Byers gives firms breathing space to survive*, 4 February 2000

B. Reviews of company rescue procedure prior to the *Insolvency Bill*

1. The Conservative Government's approach

In November 1992, as part of a wider review of company law, a working party was set up by the Insolvency Service to examine why company rescue provisions brought into effect by the IA 1986 had been so little used. The working party identified the following eight barriers to the greater use of these provisions:

- Lack of a moratorium on creditors' rights in reaching a CVA.
- Difficulties in raising new money to fund continued activities while a CVA is being negotiated.
- The power of secured creditors (generally banks) to put in an administrative receiver to recover the value of their security.
- Ignorance of the existence of the rescue procedure, among directors and insolvency practitioners.
- The association of rescue provisions with 'insolvency' law.
- The rescue being attempted too late.
- Taxation issues.
- The possibility of 'distress' being levied against a company.

In October 1993, a consultation document, *Company Voluntary Arrangements and Administration Orders*, was published by the Insolvency Service.[8] This document set out proposals intended to 'ease companies' entry into rescue procedures'. Among the proposals considered was the introduction of a short moratorium on creditors' actions to give time for a CVA to be put together. This short moratorium would be brought into effect following a statement by an insolvency practitioner (to be described as a 'nominee') that there was a reasonable prospect of a successful CVA. It would last initially for no more than 28 days, but it could be extended by the agreement of the creditors for a maximum of another two months. If there was no such agreement the company could be put into liquidation or administration or receivership. The proposed moratorium would bind all creditors, included secured creditors, who would be unable to appoint a receiver. It was also proposed that secured creditors be compelled to give seven days notice of an intention to appoint a receiver, so that the directors of a company would be able to prevent it by filing for a CVA. A number of other issues were also

[8] Insolvency Service, *Company Voluntary Arrangements and Administration Orders*, October 1993

consulted on, including the possibility of 'super-priority' to be given to creditors during the moratorium or subsequent CVA.[9]

In April 1995, the Insolvency Service published a summary of responses to its October 1993 consultation document.[10] It also published for further consultation revised proposals for a new CVA procedure.[11] These revised proposals included:

- The 7 day notice of the intention to appoint a receiver was reduced to 5 working days.
- Provisions were proposed to prevent disposal of assets or other abuse by directors during that period of notice, and during a moratorium. This was to answer the banks' concerns that the assets over which they might hold charges might be dissipated.
- A meeting of creditors could not approve a proposal that would affect the rights of secured creditors without the concurrence of those secured creditors.
- The idea of a statutory super-priority was dropped.

In other respects the 1995 proposals broadly followed the proposals set out in October 1993. Responses were sought to twenty-three specific questions. However, the results of this consultation exercise appear not to have been published.

On 27 November 1995, Phillip Oppenheim, then Minister for Company Affairs, announced his firm intention (when parliamentary time allowed) to add the option of a moratorium to the existing CVA procedure.[12] At the time of the General Election in May 1997, consultation on this proposal was still in process.

2. The Labour Government's approach

On 11 February 1998, in a written answer to a PQ on what plans the new Labour Government had to improve current liquidation and bankruptcy procedures, Mr Nigel Griffiths said:

> When Parliamentary time allows, I intend to introduce legislation to improve the efficiency and effectiveness of the procedure for disqualifying unfit company directors. This will make it possible for a person who under the present law is or could be subject to an application for a disqualification order instead to give an

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[9] It is generally accepted that one problem with a CVA is the difficulty in raising new money to continue to fund activities while a CVA is being negotiated. This problem gave rise to the idea of statutory super priority for such lenders.

[10] Insolvency Service, *Company Voluntary Arrangements and Administration Orders: Summary of Responses,* April 1995

[11] Insolvency Service, *Revised Proposals for a new Company Voluntary Arrangement Procedure: A Consultative Document*, April 1995

[12] DTI press notice P/95/839, *Company Voluntary Arrangements*, 27 November 1995

> undertaking to the Secretary of State which would have the same legal effect as a disqualification order made by a court. I also wish to make it easier for firms in financial difficulty to make voluntary arrangements with their creditors by introducing into the existing statutory framework the option of a moratorium to give the company's management a breathing space within which to put a rescue plan to creditors.[13]

On 2 November 1998, Mr Peter Mandelson, as Secretary of State for Trade and Industry, addressed the annual meeting of the Confederation of British Industry (CBI) in Birmingham and restated his commitment to insolvency law reform. This was followed in December 1998, by the publication of *Our Competitive Future: Building the Knowledge Driven Economy.*[14] In this Competitiveness White Paper, the Government announced its intention to:

- legislate for a moratorium on creditors' actions to allow a business in financial difficulties up to three months to come to an agreement with its creditors;
- review arrangements for business rescues and reassess the relative rights of creditors, including possible changes to the Crown's preferential status;
- review whether insolvency law needed to be changed to ensure that it supported enterprise, including whether any of the current restrictions on bankrupts could be eased.

The Government stated its wish to encourage risk-taking and facilitate company rescue when things go wrong. It argued that when fundamentally viable businesses are lost there are consequences for creditors, employees and the wider economy. The Government announced the setting-up of a joint Department of Trade & Industry (DTI) and Treasury working party to review company rescue procedures.[15]

On 2 February 1999, Mr Stephen Byers the new Trade and Industry Secretary outlined the working party's terms of reference in a written answer to a PQ:

> The terms of reference of the review have now been agreed as follows:
>
> To review aspects of company and insolvency law and practice in the UK and elsewhere relating to the opportunities for, and means by which, businesses can resolve short to medium term financial difficulties, so as to preserve maximum economic value; and to make recommendations.
>
> The principal areas of focus for the review should be:
>
> - the further development of the rescue culture;

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[13] HC Deb 11 February 1998 c218W

[14] Department of Trade and Industry, *Our Competitive Future: Building The Knowledge Driven Economy: Government's Competitiveness White Paper*, Cm 4176, December 1998

[15] Ibid, paragraph 2.13

- a re-assessment of the relative rights and remedies of secured and unsecured creditors in insolvencies to include the position of the Crown as a preferential creditor; and

- consideration of the duties of directors in relation to companies experiencing financial difficulties.[16]

Work on the review began in January 1999 and in September 1999 a consultation document, entitled *A Review of Company Rescue and Business Reconstruction Mechanisms*, was published.[17] A principal theme of the document was whether there is a need to shift the balance of the UK insolvency regime from being creditor-friendly to being debtor-friendly. Evidence referred to in the consultation document suggests that the UK is significantly less debtor-friendly than the regimes of other major industrialised countries, France having the most debtor-friendly regime.

The four main areas of change canvassed in the Review were:

(i) an interim moratorium to facilitate CVAs, such a moratorium to be binding, to a qualified extent, on secured creditors;

(ii) the abolition of Crown preferential status as a creditor;

(iii) a single 'gateway' regime for financially distressed companies to avoid a multiplicity of procedures and to save costs; and

(iv) prohibition against investigating accountants subsequently accepting appointments as administrative receivers.

The consultation period ended on 12 November 1999. According to the Insolvency Service, the report of the review group on this consultation is to be published shortly.[18] The Trade and Industry Committee has already recommended that the full report of the company rescue review be published, together with results of commissioned research.[19]

This section has traced the chronology of developments leading to the *Insolvency Bill* and to the on-going review of company rescue and business reconstruction mechanisms. However, a distinction should be drawn between the scope of the *Insolvency Bill* and the remit of the review. The main purpose of the Bill is to fulfil the Government's commitment to introduce a moratorium into the CVA procedure. It also amends the existing provisions concerning directors' disqualification procedures. The remit of the review extends far beyond those two

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16 HC Deb 2 February 1999 c 580W

17 Insolvency Service, *A Review of Company Rescue and Business Reconstruction Mechanisms*, September 1999

18 Insolvency Service on-line register of the progress of its consultation documents, http://www.insolvency.gov.uk/information/con_doc_register/closedindex.htm, 4 October 2000

19 Trade and Industry Select Committee (HC), *Draft Insolvency Bill*, HC 112, 1999-2000, 14 December 1999, paragraph 8

matters to encompass all aspects of company rescue procedures and insolvency law in the United Kingdom.

C. Developments in directors' disqualification procedures prior to the *Insolvency Bill*

In a compulsory liquidation, the Official Receiver has a statutory duty to investigate the affairs and causes of failure of the business and also to investigate the conduct of the directors. The power to disqualify unfit company directors is an important safeguard for shareholders and creditors. Under current law, anyone who holds himself out to be a director can be disqualified, including:

- Executive directors
- Non-executive directors
- De facto directors
- 'Shadow' directors

A director need not be present in the jurisdiction to be disqualified and his company need not be incorporated in the jurisdiction. Moreover, a director need not still be a director when the company becomes insolvent to be disqualified.

Under the *Company Directors Disqualification Act 1986* [CDDA 1986], a director can be disqualified by the court on the basis of:

Section 2 – a conviction for an indictable offence in connection with the promotion, formation, management or liquidation of a company (15 years).

Section 3 – for persistent breaches of company legislation concerned with filing returns (3 defaults in five years) (5 years).

Section 4 – for fraud, fraudulent trading, breach of duty revealed on winding up (15 years).

Section 5 – a summary conviction for breaches of company legislation (i.e. for repeated failure to file documents with the corporate registrar) (5 years).

Section 6 – 'unfitness' to be a director, shown by his conduct as a director of a company which has become insolvent. The disqualification order can be made for between 2 and 15 years.

Section 8 – 'unfitness' to be a director, as evidenced from an inspector's report (15 years).

Section 10 – finding of fraudulent or wrongful trading (15 years).

Once a disqualification order has been made, the person concerned cannot for the period specified in the order, without leave of the court, be:

- a director of a company, or
- a liquidator or administrator of a company, or
- a receiver or manager of a company's property, or
- concerned, in any way, directly or indirectly, in the promotion, formation, or management of a company (this means <u>any</u> company, not just the company from which he was disqualified)

It is a criminal offence to contravene a disqualification order. Civil liabilities may also be incurred in respect of such contravention.

Under the CDDA 1986, most proceedings for a director's disqualification are on the grounds of section 6 'unfitness' (for example, lack of commercial probity; trading while insolvent; 'phoenix' behaviour; or a director claiming excessive remuneration). According to Government statistics, the number of disqualification orders made by the court under Section 6 were 1,359 in 1998 and 1,219 in 1997.[20]

The Insolvency Service announced in its Annual Report Accounts that for the year ending 31 March 2000 a total of 1,540 directors were disqualified compared to a total of 1,284 in the previous year. This represents an increase of twenty per cent.[21]

At present, and for almost all cases, disqualification can only be achieved by means of court proceedings on an application made by the Secretary of State or the Official Receiver. Only in very exceptional cases is an undertaking not to act as a director acceptable in lieu of disqualification (for example, due to the poor state of health or the advanced age of the director).

In giving judgment in the case of *Re Carecraft Construction Co Ltd*, Mr Justice Ferris held that it would be difficult to replace court orders with undertakings of disqualification. This is because there is no scope for the parties to reach agreement, it is the court that must be satisfied as to the unfitness of a director:

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[20] Department of Trade and Industry press notice P/2000/076, *Byers gives firms breathing space to survive*, 4 February 2000

[21] Department of Trade and Industry press notice P/2000/510, *Rogue directors face new offensive*, 29 July 2000

> It was a condition precedent to the making of a disqualification order under s.6 of the 1986 Act that the court was satisfied that the conduct of a director in relation to a particular company or companies made him unfit to be concerned in the management of a company. There was therefore no scope in disqualification proceedings for the parties to reach an agreement and then ask the court to embody their agreement in a consent order, but, on the other hand, the court had no means to control the way in which either party conducted its case, whether in respect of the scope and definition of the changes made or disputed or in respect of the evidence which was presented in order to support or rebut the charges. Accordingly, by analogy with other situations, such as a plea of guilty in criminal proceedings, inheritance proceedings and restrictive trade practices proceedings, in which the court, while needing to be satisfied of certain matters and to exercise its own discretion, could in appropriate cases dispense with a full hearing, the court had justification to deal with an application under s.6 of the 1986 Act summarily without requiring a full trial and without requiring the parties to contest every point, provided some evidence and not merely an assertion of no evidential value or an admission which was unsupported by evidence was presented to the court which established unfitness. [22]

This view was underlined by Lord Woolf MR when giving judgment in a Court of Appeal case, *Re Blackspur Group plc*:

> The purpose of the Act of 1986 is the protection of the public, by means of prohibitory remedial action, by anticipated deterrent effect on further misconduct and by encouragement of higher standards of honesty and diligence in corporate management, from those who are unfit to be concerned in the management of a company.
>
> Parliament has designated the Secretary of State as the proper public officer to discharge the function of making applications to the court for disqualification orders. There is a wide discretion to do so in cases where it appears, in the prescribed circumstances, that 'it is expedient in the public interest that a disqualification order should be made'. In any particular case it may be decided that the public interest is best served by making and continuing an application to trial; or by not making an application at all; or by not continuing a pending application to trial; or by not contesting at trial points raised by way of defence or mitigation. All these litigation decisions are made by the Secretary of State according to what is considered by her to be 'expedient in the public interest'. They are not made by the court or by other parties to the proceedings.
>
> Once proceedings have been brought to trial, it is for the court, not for the Secretary of State or for any other party, to decide whether a disqualification order should or should not be made. A court can only make a disqualification order if it is 'satisfied' on the prescribed statutory matters. As the court must be 'satisfied' of those matters, it is not appropriate for the court to act, or even for the court to be asked to act, as a rubber stamp on a proposed consent order, without regard to its factual basis. We

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22 *Re Carecraft Construction Co Ltd* [1994], 1W.L.R 172, 181 Chancery division (Companies Court)

> agree with the view expressed by Ferris J. in In re Carecraft Construction Co. Ltd [1994]….
>
> *"In disqualification proceedings…there is no scope for the parties to reach an agreement and then ask the court to embody their agreement in a consent order. The court itself has to be satisfied, after having regard to the prescribed matters and other facts which appear to be material, that the respondent is unfit to be concerned in the management of a company; and the court itself must decide the period of disqualification if it decides to make a disqualification order."*
>
> However…this does not prevent the court from taking into account the agreement of the parties in concluding that it is satisfied that the case warrants disqualification and in determining the period of disqualification which is appropriate, thus allowing the issues to be determined by the court to be disposed of summarily.[23]

In fact, over recent years a new 'consent' procedure has been introduced – the so-called 'Carecraft' procedure – under which the parties present an agreed statement of facts and a suggested period of disqualification, which is then ratified by the court. However, the process can still be subject to considerable delay and cost.

In a December 1995 Practice Direction, Sir Richard Scott, then Vice–Chancellor, recommended a change in the law to give disqualification undertakings the same status as a court order.[24] He did not see why time and money should be spent by insisting on bringing a case before a court where the Secretary of State (or Official Receiver) and a director could come to an agreement. The Court of Appeal in *Re Blackspur Group plc*, whilst refusing an undertaking, repeated this recommendation.[25]

However, more recently, Sir Richard Scott has expressed concern that directors were choosing to accept disqualification under the Carecraft consent procedure, rather than test their case in court.[26] This is because directors could not afford the costs of full legal proceedings. He suggested that courts could consider allocating costs using the test applied in criminal cases rather than the loser-pays-all civil litigation formula.[27]

The present Government believes that the procedure for disqualifying unfit directors should be made more efficient and effective, so that the business community and consumers are given earlier protection.

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[23] *In re Blackspur Group Plc* [1998], 1 W.L.R Court of Appeal

[24] Trade and Industry Select Committee (HC), *Draft Insolvency Bill*, HC 112, 1999-2000, 14 December 1999, paragraph 40

[25] *In re Blackspur Group Plc* [1998], 1 W.L.R Court of Appeal

[26] Trade and Industry Select Committee (HC), *Draft Insolvency Bill*, HC 112, 1999-2000, 14 December 1999, paragraph 42, See also HL Deb 4 April 2000 c1267

[27] Under civil law rules, there is a risk that all costs could be awarded against the director

II The *Insolvency Bill*

A. Background

According to evidence collected by the Trade and Industry Committee, the first public indication of a draft *Insolvency Bill* was in late September 1999, when the Insolvency Service circulated 'draft clauses' accompanied by brief explanatory notes headed 'Proposed Insolvency Bill' to a number of professional organisations. Included among those organisations were the Society of Practitioners of Insolvency (SPI) (now renamed the Association of Business Recovery Professionals), the British Bankers Association (BBA), the Institute of Chartered Accountants of England and Wales (ICAEW), the Law Society and the Confederation of British Industry (CBI). The process was described by the Insolvency Service in an accompanying letter as being "a short technical consultation". Responses were sought by 19 October 1999.

In the Queen's Speech on 17 November 1999, it was announced that the Government would introduce legislation to "assist the rescue of viable businesses in short term difficulties, and improve the procedure for disqualifying unfit company directors".

As a pre-legislative scrutiny exercise, the Trade and Industry Committee considered and reported on the draft *Insolvency Bill*.[28] The Committee expressed its unease at the way that this draft legislation had been approached:

> We are left with in [sic] some unease at the way this draft legislation has been handled. If draft clauses were available in 'late July/August' they could have been put out then for proper consultation, however inconvenient the timing from Parliament's point of view. We noted in our recent Report on the draft Electronic Communications Bill, itself produced on 23 July with virtually no notice, that 'draft legislation published with little or no notice…creates unnecessary obstacles to Committee scrutiny'. If the Government is serious about exposing draft legislation to parliamentary scrutiny, it is time that it recognised that such scrutiny is likely to be more useful the more time and notice is given: and that Committee scrutiny can assist the process of legislation at later stages.[29]

The *Insolvency Bill* [HL Bill 28] was introduced in the House of Lords on 3 February 2000. Publishing the Bill, Stephen Byers, Secretary of State for Trade and Industry, said:

> Promoting entrepreneurship and responsible risk-taking in the UK is a key element in fostering a more competitive nation. The new regime proposed in the Insolvency Bill would help to achieve that.

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28 Trade and Industry Select Committee (HC), *Draft Insolvency Bill*, HC 112, 1999-2000, 14 December 1999

29 Ibid.

> This Bill strikes the right balance of protecting the rights of consumers and creditors, improving the insolvency system and allowing financially troubled firms some breathing space in an increasingly competitive business world.
>
> To help stop fundamentally viable businesses going to the wall, this Bill introduces a moratorium for firms in financial trouble using Company Voluntary Arrangements (CVAs). This means that managers of around 500 small firms a year could have the breathing space needed to put a rescue plan to creditors without fear of legal action.
>
> This will benefit the management, workers, creditors, suppliers and the wider economy.[30]

Commenting on the way the Bill also proposes changes to the way directors are disqualified, Stephen Byers said:

> At present there can be lengthy delays while the courts disqualify someone from being a director. The Bill will introduce a fast-track system where, if the director agrees, disqualification can be done administratively rather than through the courts.
>
> Some 1,500 unfit directors were disqualified last year after a company failure and, with only 10 per cent of cases contested and going to a full court hearing, there is obviously a great deal of scope to reduce the burden on the courts, free up more of their time to deal with other issues and to save costs.
>
> Our commitment to disqualifying unfit directors and protecting the public is unequivocal – our improvements to the disqualification system prove that.[31]

B. Notice of receivership proposal abandoned

Initially, it was proposed that the Bill would introduce a new restriction on the appointment of an administrative receiver. It was proposed that a floating chargeholder (i.e. a debenture holder, normally a bank) would be required to give the company a warning notice of a prescribed minimum period before appointing an administrative receiver. However, the Government decided not to proceed with this proposal. Mr Byers said:

> Following consultation on the proposed changes, and listening to the views of the Trade and Industry Select Committee, that proposal is not included in the Bill.
>
> There was concern that company rescues might be thwarted where, for example, a bank acted over-hastily and appointed administrative receivers before a voluntary arrangement could be agreed. Views suggested that in practice, receivers are only appointed following discussions with the company and attempts to rescue it, or where there is a well founded fear of fraud or malpractice. However, I will be looking to

[30] Department of Trade and Industry press notice P/2000/076, *Byers gives firms breathing space to survive*, 4 February 2000

[31] Ibid

> banks and other financial institutions to make sure that any such problems do not occur in future.[32]

C. Consultation on landlord's right to the peaceable re-entry of business premises during a moratorium

During the passage of the *Insolvency Bill* through the House of Lords the Insolvency Service undertook a brief consultation to obtain views on an additional measure:

> …that landlords should not be able to effect peaceable re-entry (without consent or leave of the court) whilst a company or individual is the subject of a statutory moratorium in an insolvency procedure.[33]

The background to this consultation is as follows. Until 1997 a landlord's right to peaceable re-entry of premises was considered by the courts to be a security interest for the purpose of the *Insolvency Act 1986*. Accordingly, a landlord was not permitted peaceably to re-enter the premises of a tenant subject to an administration order unless the administrator or the court consented. However, this view was overturned in the case of *Razzaq v Pala* in 1997.[34] In this case the court held that peaceable re-entry was not a security interest for the purposes of the *Insolvency Act 1986.*

Unless the decision in *Razzaq v Pala* is reversed, business rescues attempted by a CVA moratorium (as set out in the *Insolvency Bill*) could be prejudiced (as, indeed, could those being attempted by the Administration or Individual Voluntary Arrangement procedures).

This point was originally raised by a number of professional bodies giving evidence to the Trade and Industry Committee.[35] In determining the extent of the moratorium, the draft Bill appears to borrow the wording from the administration provisions of the IA 1986.[36] In doing so, the Bill replicates a gap in the earlier legislation whereby there is no freeze at all upon a landlord's right to repossess leasehold premises occupied by the company. It was argued variously that the unfettered right of a landlord to take possession peacefully could in itself destroy a rescue attempt:

> The CBI [confederation of British Industry] wrote that the unfettered right of a landlord to take possession peacefully could single-handedly kill off an otherwise perfectly viable rescue attempt. The BBA [British Bankers Association] described this as an anomaly and the SPI [Society of Practitioners of Insolvency] suggested that

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[32] Ibid
[33] The Insolvency Service online register to the progress of its consultation documents: http://www.insolvency.gov.uk/information/con-doc-register/closedindex.htm, 4 October 2000
[34] *Razzaq v Pala* [1997] W.L.R 1336
[35] Trade and Industry Select Committee (HC), *Draft Insolvency Bill*, HC 112, 1999-2000, 14 December 1999
[36] Section 11(3)(d) *Insolvency Act 1986*

> ‘the company should also be protected against peaceable re-entry by a landlord during a moratorium’. [37]

The consultation period closed on 7 July 2000. According to the Insolvency Service, it is expected that Government amendments will be tabled to the *Insolvency Bill* which will remove a landlord’s right to effect peaceable re-entry.[38]

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[37] Ibid. Paragraph 39

[38] The Insolvency Service on line register on the progress of its consultation documents, http://www.insolvency.gov.uk/information/con_doc_register/closedindex.htm, 4 October 2000

III The main provisions of the *Insolvency Bill*

As outlined in the Explanatory Memorandum that accompanies it, the Bill deals with the following matters:

- Clauses 1 – 3 and Schedules 1 – 3 deal with voluntary arrangements.
- Clause 4 deals with the qualification and authorisation of nominees and supervisors in voluntary arrangements.
- Clauses 5 – 8 and Schedule 4 deal with disqualification.
- Clause 9 deals with the reporting of suspected offences.
- Clause 10 deals with the restriction on use of answers obtained under compulsion.
- Clause 11 deals with deceased insolvents.
- Clause 12 deals with the interest on sums held to the credit of bankrupts' estates in the Insolvency Service Account.
- Clause 13 deals with the model law on cross-border insolvency.

An outline of the main provisions of the Bill is set out below. This outline relies, in part, on the interpretation given to the provisions in the Bill's own Explanatory Memorandum.[39]

A. Voluntary arrangements, moratorium and nominees

Clause 1 introduces Schedule 1 to the Bill. Schedule 1 provides the directors of a small company with the option to apply for a short moratorium where the directors intend to put a proposal to the company and its creditors for a CVA under Part I of the IA 1986.[40]

A small company is defined by section 247(3) of the *Companies Act 1985*. Specifically, a company is small if it can satisfy two or more of the following criteria:

- Turnover – not more than £2.8 million.
- Balance sheet total – not more than £1.4 million.

[39] Explanatory Notes on the *Insolvency Bill* (HL), Bill 173 - EN

[40] A moratorium is a temporary stay, or in Scotland a *sist,* on certain legal acts and processes from being performed or continued

- Number of employees – not more than 50.

In effect, the directors of a small company will have the right to apply for a moratorium lasting for an initial period of 28 days, although this period can be extended by a further two months with the support of the creditors. To obtain a moratorium, first, the directors will have to obtain a statement from a nominee to the effect that he is of the view that the proposed voluntary arrangement stands a reasonable prospect of being agreed and implemented. The nominee will oversee the moratorium. Subject to the agreement of the creditors, he will also become the supervisor and will oversee the implementation of the voluntary agreement if one is agreed.[41]

The moratorium will come into force automatically upon the filing of certain documents with the court, but no court order is needed. The moratorium will be binding on all parties. It will have the same consequences as a moratorium flowing from an administration order. The directors of the company will remain in full control of the company's affairs, but they may only dispose of assets in the 'ordinary course of business'.

During the moratorium the nominee is expected to monitor the company's activities. If it appears to him that, because of new developments, the proposal is no longer likely to be acceptable to the creditors, he will have to withdraw. This will bring the moratorium to an immediate end.

Clause 2 introduces Schedule 2 to the Bill. The Schedule makes various technical amendments to the existing CVA procedure in Part I of the IA 1986 and to the *Building Societies Act 1986*.

Clause 3 of the Bill simply introduces Schedule 3 to the Bill, which makes various technical amendments to the existing Individual Voluntary Arrangements (IVA) procedure. IVAs provide a means for individuals in financial difficulties to reach a legally binding agreement with their creditors in satisfaction of their debts or a scheme of arrangement of their affairs.[42]

Clause 4 of the Bill amends Part XIII of the IA 1986, which deals with insolvency practitioners and their qualifications. An insolvency practitioner is a person who has the conduct of an insolvency procedure (for example, a liquidator in a winding up of a company). At present, only a person qualified to act as an insolvency practitioner under section 388 of the IA 1986 may act as a supervisor.

Clause 4(2) of the Bill extends the meaning of 'to act as an insolvency practitioner' so as to include a person who acts as a nominee in relation to a company or individual voluntary arrangement. **Clause 4(3)** inserts a new subsection (1A) to section 389 of the IA 1986. The

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[41] See p.16 for a detailed explanation of how a nominee acting under the Bill differs from an insolvency practitioner

[42] In England & Wales only

amendment means that it will not be an offence to act as a nominee or supervisor whilst unauthorised to act as an insolvency practitioner provided that the individual is authorised to act as a nominee or a supervisor under clause 4(4) of the Bill.

Clause 4(4) introduces a new section 389A to the IA 1986, which provides for persons to act as nominees and supervisors if authorised to do so by a body recognised by the Secretary of State for that purpose. The Secretary of State may only recognise a body (by way of an order), if it appears to him to meet specified criteria. For instance, the body should ensure that its members are 'fit and proper persons' to act as nominees or supervisors and that they meet acceptable requirements as to education, training and experience and have appropriate bonding in place.

The Secretary of State may revoke an order recognising such a body if, in his view, it no longer meets the requirements for recognition.

The power given to the Secretary of State is specific and limits what he can do by way of delegated legislation. It is also subject to the negative resolution procedure.

B. Disqualification Orders and undertakings of unfit directors

The Bill builds upon both the *IA 1986* and the *CDDA 1986*.

Clauses 5(1) to **(3)** of the *Insolvency Bill* are technical amendments dealing with disqualification orders. **Clause 6** of the Bill deals with disqualification undertakings. The Bill provides that where there is agreement between the Secretary of State and an unfit director, disqualification can be achieved by an undertaking without legal proceedings.

Clause 5(1) amends section 1 of the CDDA 1986 by providing that an individual who is the subject of a disqualification order cannot obtain the leave of the court to act as an insolvency practitioner. This is to make it consistent with section 390(4)(b) of the IA 1986, which provides for an absolute ban on an individual acting as an insolvency practitioner if he is subject to a disqualification order.

Clause 5(2) further amends section 1 of the CDDA 1986 and provides that any period of disqualification begins 21 days after the date on which the disqualification order is made unless the court directs otherwise.

Clause 5(3) defines the term 'receiver' for the purposes of the CDDA 1986.

Clause 6 amends the CDDA 1986 so that instead of making a court application, the Secretary of State may accept from an unfit director an offered undertaking for a period to be agreed between the parties. The period of disqualification would be for a maximum of 15 years and a

minimum of 2 years[43]. This undertaking would have comparable force to a disqualification ordered by a court.

In effect, clause 6 establishes a 'fast track' procedure for the disqualification of unfit directors. However, it must appear to the Secretary of State that it is **expedient in the public interest** to accept an undertaking instead of applying for or proceeding with a court application for a disqualification order.

The following points should be emphasised:

- Disqualification undertakings will only apply in relation to sections 7 and 8 of the CDDA 1986, based on unfit conduct under section 6 of the CDDA 1986 in relation to an insolvent company.

- Breach of the terms of an undertaking will have the same criminal and civil consequences for the individual as the breach of a disqualification order. Accordingly, it is the government's view that undertakings will provide the same protection for business and the public as a disqualification order.

- The existing court procedure will remain in place to be used as an alternative to disqualification undertakings. This means that if a director does not agree that he should be disqualified, the Secretary of State will still be able to make an application to the court to disqualify that person and the director will be able to defend those disqualification proceedings in court.

Clause 6(5) of the Bill has the effect of inserting a new section 8(A) into the CDDA 1986. This new section 8(A) provides that the disqualified person may subsequently apply to the court to vary the undertaking he has given:

> 8A.-(1) The court may, on the application of a person who is subject to a disqualification undertaking –
>
> (a) reduce the period for which the undertaking is to be in force, or
>
> (b) provide for it to cease to be in force.
>
> (2) On the hearing of an application under subsection (1), the Secretary of State shall appear and call the attention of the court to any matters which seem to him to be relevant, and may himself give evidence or call witnesses.

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[43] The minimum of two years applies in the case of an undertaking under Section 7 of the *Company Directors Disqualification Act 1986*, as amended by Section 6 of the *Insolvency Bill*

1. Effect of Northern Irish directors disqualification

Disqualification of unfit directors in Northern Ireland is governed by the *Companies (Northern Ireland) Order 1989*. This Order makes similar provision for disqualification in Northern Ireland to that made in Great Britain by the *CDDA 1986*.

Clause 7(1) of the Bill provides that a disqualification order made under Northern Irish legislation will have the same effect in Great Britain as one made under the *CDDA 1986*.

Disqualification of unfit directors is a devolved matter in Northern Ireland. The Northern Ireland Assembly may, or may not, wish to bring in legislation for disqualification undertakings. If it should make such provision the purpose of **clause 7(2)** is to enable effect to be given to the undertakings in Great Britain.

2. Reporting of suspected offences

The Government has taken the opportunity of this Bill to make other technical amendments to the CDDA 1986 to improve its effectiveness.

At present, section 218 of the IA 1986 requires a liquidator of a company wound up in England or Wales to report to the Director of Public Prosecutions suspicions of criminal misconduct by company officers or shareholders. The Director may then refer such reports to the Secretary of State for investigation. It is the Government's view that it would be better for those reports to be made directly to the Secretary of State.

Clause 9 amends section 218 of the IA 1986. It provides that in the winding up of a company by the court, the court may direct the liquidator to report apparent criminal misconduct by company officers or members of the company to the Secretary of State rather than to the Director of Public Prosecutions.

The Clause also requires a liquidator in a voluntary winding up to report suspicions of criminal misconduct by company officers past or present or members to the Secretary of State rather than to the Director of Public Prosecutions.

The Clause further provides that the Secretary of State may exercise powers under the *Companies Act 1985* when investigating the alleged misconduct. In the case of a winding up in Scotland, such misconduct will still be reported to the Lord Advocate.

Commenting on this Section, the Trade and Industry Committee said:

> While there is no outright opposition to this change, we note the comments reported by the ICM [Institute of Credit Management] from a member of the Institute which suggests that these provisions not only have always been a mess but that the opportunity for a rather more thorough tidying–up maybe being missed. The Institute quotes this member as declaring that "s218 has been the subject of correspondence and discussion between the DPP and DTI for at least nine years…", and his comment that s218 remains silent on the duties in this respect of officeholders under

> administration. The IOD [Institute of Directors] also expressed some concern at the absence of clear procedures. We hope that the opportunity offered by clause 9 will be taken to tidy up other gaps in insolvency law relating to the duty to report suspected offences to the authorities.[44]

3. Restriction on use of answers obtained under compulsion

Clause 10 of the Bill amends section 219 of the IA 1986 so that answers given by an individual under a power of compulsion (conferred by section 218 (5) of the IA 1986) cannot be used against him by the prosecution in subsequent criminal proceedings except in very limited circumstances.[45]

C. Insolvent estates of deceased persons

Clause 11(4) of the Bill is a technical amendment of some importance. It amends section 421 of the IA 1986. It states:

> **11.**-(4) At the end of the section there is inserted –
>
> "(5) For the purpose of determining what is comprised in the insolvent estate of a deceased person where-
>
> > (a) the provisions of this Act specified in an order under this section apply (by virtue of such an order) with or without modifications to the administration of the estate, and
> > (b) on the day on which he died, he was beneficially entitled to a joint tenancy in any property,
>
> the deceased person is to be treated in relation to that property as if he had been adjudged bankrupt immediately before that day (so that his severable share is part of that estate)".

In effect, section 11 provides that a deceased debtor's share of property held on a joint tenancy is available to creditors in insolvency proceedings, as it would have been in the debtor's lifetime. This makes it consistent with the rest of the deceased debtor's estate.

Clause 11 reverses a 1994 Court of Appeal decision in the case of *re Palmer deceased (A Debtor).*[46] In that case the Court of Appeal ruled that the secondary legislation made under section 421 of the IA 1986, the *Administration of Insolvent Estates of Deceased Persons Order 1986* – was ineffective since it went beyond the parent Act. The case concerned a

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[44] Trade and Industry Select Committee (HC), *Draft Insolvency Bill*, HC 112, 1999-2000, 14 December 1999, paragraph 46

[45] Section 219 of the *Insolvency Act 1986* currently allows answers obtained by use of compulsory power to be used in evidence. That is contrary to the decision of the European Court of Human Rights in the case of *Saunders v. the United Kingdom* [1996] 23 EHRR 313

[46] *In re Palmer deceased (A Debtor)* [1994] Ch.316

solicitor, Gavin Palmer, who died insolvent in November 1990. In 1991 an insolvency administration order was made against his estate. Mr Palmer and his wife held a joint tenancy of a property near Leeds. On his death Mrs Palmer became absolute and beneficial owner of the property as the surviving joint tenant. The question before the court was whether creditors could 'reach back' to Mr Palmer's share of the tenancy. The Court of Appeal concluded that:

> …if Parliament had intended that the interest of a deceased debtor in property held jointly should be treated as forming part of his estate for the purposes of its administration in bankruptcy, it could have expressly so provided: section 9 of the *Inheritance (Provisions for Family and Dependants) Act 1975* is an example of how this can be done and, more particularly, of the appreciation by Parliament of the problems to which the existence of a beneficial joint tenancy can give rise in circumstances similar to those of the present case.[47]

In effect, the Court took the view that prior to the IA 1986 the whole interest in a joint tenancy would have accrued to Mr Palmer's widow and would not have been accessible to his creditors. There is no evidence to suggest that the Government at the time of introducing the IA 1986 intended to change that situation, otherwise, it could have expressly so provided. Consequently, the Court decided that the debtor's interest, on the day of his death, in his share in property held on a joint tenancy does not become available to the trustee to distribute between the creditors of a deceased insolvent.[48]

The purpose of Clause 11 is to ensure that the property of a person who dies insolvent is treated in the same way as that of a live insolvent. It provides that an order made under section 421 of the IA 1986 may now provide that all property, ownership of which was vested in the deceased debtor immediately prior to his death (including his share in property held on a joint tenancy), be available to creditors in insolvency proceedings where the insolvency order was made after the debtor's death. Section 421 of the IA 1986 applies only to England and Wales.

In considering this clause, the Trade and Industry Committee concluded:

> There is a genuine policy question as to whether the interest of a deceased debtor in property held jointly should be treated as forming part of his estate for the purpose of its administration in bankruptcy. This deserves to be addressed explicitly rather than by merely referring back to the apparently underlying policy in the 1986 Act; it remains for Ministers to make a positive case for amending the law in this way.[49]

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[47] Trade and Industry Select Committee (HC), Second Report on *Draft Insolvency Bill*, HC 112, Session 1999-2000, 14 December 1999, paragraph 44

[48] The *trustee* is the person appointed to realise the assets of a deceased individual and distribute the proceeds to the creditors

[49] Ibid page xxvi

D. Bankruptcy: interest on sums held in Insolvency Services Account

Clause 12 of the Bill enables the Lord Chancellor, with the concurrence of the Secretary of State, to make rules relating to the investment of bankruptcy funds held in the Insolvency Services Account and the payment of interest on those funds.

Briefly, the Insolvency Services Account is an account kept by the Secretary of State at the Bank of England. All money received in a bankruptcy by the trustee has to be paid into this account. The requirement to do so is set out in the *Insolvency Regulations 1994*.[50] The central Accounting Unit of the Insolvency Service administers the account on behalf of the Secretary of State and controls all payments in and out of the account.

E. Model law on cross-border insolvency

1. Background

One effect of the increasing globalisation of companies is that if they become insolvent there is often a cross-border insolvency issue. For example, company assets may be located abroad. In the absence of an international convention regulating international insolvency, procedures are governed by rules of private international law, which will regulate the disposal of the assets in the event that no rescue scheme is possible. Mr Justice Hoffmann identified the problem with this arrangement in the case of *Barclays Bank plc v Homan and Others* [1993]. He said:

> As the Vice Chancellor said in *Paramount Airways*, the only satisfactory solution to the possibility of jurisdictional conflicts in cross-border insolvencies would be an international convention. In the absence of such a convention, the only way forward is by the discretionary exercise of jurisdictional self-restraint. But one cannot expect every jurisdiction to exercise that discretion in the same way.[51]

The United Nations Commission on International Trade Law (UNCITRAL) has promulgated a Model Law on cross-border insolvency. This Model Law was formally adopted in May 1997. It is hoped that it will facilitate the rehabilitation and reorganisation of businesses.

The preamble to the Model Law states:

> The purpose of this Law is to provide effective mechanisms for dealing with cases of cross-border insolvency so as to promote the objectives of:
>
> a) co-operation between the courts and other competent authorities of this State and foreign States involved in cases of cross-border insolvency;

[50] SI 1994/2507

[51] *Barclays Bank plc v Homan and Others* [1992] B.C.C 757 and [1993] B.C.L.C 680

b) greater legal certainty for trade and investment;

c) fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested persons, including the debtor;

d) protection and maximisation of the value of the debtor's assets; and

e) facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.[52]

The guide to Enactment of the UNCITRAL Model Law states:

1. The UNCITRAL Model Law on Cross-Border Insolvency, adopted in 1997, is designed to assist States to equip their insolvency laws with a modern, harmonised and fair framework to address more effectively instances of cross-border insolvency. Those instances include cases where the insolvent debtor has assets in more than one State or where some of the creditors of the debtor are not from the State where the insolvency proceeding is taking place.

2. The Model Law reflects practices in cross-border insolvency matters that are characteristic of modern, efficient insolvency systems. Thus, the States enacting the Model Law…would be introducing useful additions and improvements in national insolvency regimes designed to resolve problems arising in cross-border insolvency cases. Not only jurisdictions that currently have to deal with numerous cases of cross-border insolvency but also those that wish to be well prepared for the increasing likelihood of cases of cross-border insolvency will find the Model Law useful.[53]

It is clear that the intention is for the Model Law to be accepted by States by modifying their existing national insolvency regimes. The fact that the text is written as a Model Law rather than as a Convention affirms this intention; a Convention would have to be adopted wholesale.

Arguably the most important Article of the UNCITRAL Model Law on cross-border insolvency is: Article 21. This states:

> Article 21 – relief that may be granted upon recognition of a foreign proceeding:
>
> 1. on recognition of a foreign proceeding, whether main or non-main, where necessary to protect the assets of the debtor or the interest of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief including:…

[52] *UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment*, United Nations, December 1998, p.3

[53] Ibid. p.19

> …(d) Providing for the examination of witnesses, the taking of evidence or the delivery of information concerning the debtor's assets, affairs, rights, obligations or liabilities.

2. The Bill's implementation of the UNCITRAL Model Law

Clause 13(1) of the Bill provides that the Secretary of State may by regulations, made with the agreement of the Lord Chancellor in England and Wales and in Scotland with the agreement of the Scottish Ministers, make any provision that he considers necessary or expedient for the purpose of giving effect, with or without modifications, to the Model Law. Specifically, clauses 13 (1) to (6) state:

> **13.**-(1) The Secretary of State may by regulations make any provision which he considers necessary or expedient for the purpose of giving effect, with or without modifications, to the model law on cross-border insolvency.
>
> (2) In particular, the regulations may-
>
> a) apply any provision of insolvency law in relation to foreign proceedings (whether begun before or after the regulations come in to force).
>
> b) modify the application of insolvency law (whether in relation to foreign proceedings or otherwise);
>
> c) amend any provision of section 426 of the Insolvency Act 1986 (co-operation between courts),
>
> and may apply or, as the case may be, modify the application of insolvency law in relation to the Crown.
>
> (3) The regulations may make different provision for different purposes and may make-
>
> a) any supplementary, incidental or consequential provision, or
>
> b) any transitory, transitional or saving provision,
>
> which the Secretary of State considers necessary or expedient.
>
> (4) In this section –
>
> "foreign proceedings" has the same meaning as in the model law on cross-border insolvency,
>
> "insolvency law" has the same meaning as in section 426(10)(a) and (b) of the Insolvency Act 1986,
>
> "the model law on cross-border insolvency" means the model law contained in Annex 1 of the report of the 30th session of UNCITRAL.

> (5) Regulations under this section are to be made by statutory instrument and may only be made if a draft has been laid before and approved by resolution of each House of Parliament.
>
> (6) Making regulations under this section requires the agreement –
>
> (a) if they extend to England and Wales, of the Lord Chancellor,
> (b) if they extend to Scotland, of the Scottish Ministers.

In effect, Clause 13 provides that the regulations may apply any provision of insolvency law to foreign proceedings (modified as appropriate) and amend any provision of section 426 of the IA 1986. This section provides for co-operation between courts exercising insolvency jurisdiction.

The Insolvency Service has justified the drafting of this section as follows:

> By taking a power in primary legislation to implement the Model Law by enacting it through secondary legislation – rather than the Bill itself- it will be possible for the precise form of that legislation to be settled following consultation with interested parties.
>
> Since the precise form in which the Model Law will be enacted and the required modifications of existing insolvency law are not yet settled, the Insolvency Service feels it appropriate that there should be an opportunity for Parliament to debate the contents [of] any regulations made under this power. The Insolvency Service, therefore, considers that the regulations made under it should be subject to Parliamentary control by way of the affirmative resolution procedure.[54]

In response, the Select Committee on Delegated Powers and Deregulation said:

> "The memorandum states that it is thought right that Parliament should have the opportunity to debate the contents of any regulations and so affirmative procedure is provided by subsection (5). The Committee considers that this is the appropriate way to implement this international agreement and welcomes the provision of the affirmative procedure for this Henry VIII power".[55]

F. Commencement

A power is included in the Bill to bring its provisions (with the exception of Clause 13) into force by way of statutory instrument rather than bringing it into force on Royal Assent or on a

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[54] Delegated Powers and Deregulation Select Committee (HL), *Insolvency Bill* (HL), HL 35, 1999-2000, 16 February 2000

[55] Ibid. Annex 'Memorandum by The Insolvency Service', page 4

date (or dates) specified in the Bill. **Clause 13**, which confers a power to make regulations, comes into force when the Act is passed.

Finally, **Clause 16** provides that, apart from amendments made by the Bill to provisions which apply to Northern Ireland, the Bill does not apply to Northern Ireland.

G. Schedules to the Bill

There are five schedules to the Bill. The purpose of each schedule can be summarised as follows:

Schedule 1 – Moratorium where directors propose voluntary arrangement.

Schedule 2 – Company voluntary arrangements.
- **Part I** – Amendments of the Insolvency Act 1986
- **Part II** – Amendments of the Building Societies Act 1986.

Schedule 3 – Individual voluntary arrangements.

Schedule 4 – Minor and consequential amendments about disqualification of company directors.
- **Part I** – Amendments of the Company Directors Disqualification Act 1986.
- **Part II** – Consequential amendments of other enactments.

Schedule 5 – Repeals.

The schedules are largely technical in nature, making amendments to the IA 1986 and the CDDA 1986. An outline of each schedule is set out below. This outline relies, in part, on the interpretation given to a particular provision in the Bill's own Explanatory Memorandum.[56]

1. Schedule 1

Paragraphs 1, 2, 3 and 4 of Schedule 1 make a number of amendments to the IA 1986 the major amendment being the addition by paragraphs 2 and 4 of a new section 1A and schedule A1 to the IA 1986.

The remaining paragraphs 5 to 12 of Schedule 1 make consequential amendments to various parts of the IA 1986.

a. New Schedule A1

Schedule A1 consists of five parts. **Part I** is the introductory part of the new Schedule.

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[56] Explanatory Notes on the *Insolvency Bill* [HL] [Bill 173 – EN]

Paragraphs 2 to 4 of Part I define the conditions that have to be satisfied if a company is to be eligible for a moratorium. [57] The present policy is to limit eligibility to small companies as defined in section 247(3) of the *Companies Act 1985*.[58]

However, paragraph 5 permits the Secretary of State to amend, by Regulations, the eligibility criteria. When this provision was first drafted, it was argued that the Secretary of State would effectively be given a new power to make delegated legislation that went beyond the normal routine powers reserved for him. Commenting on this, the Insolvency Service said:

> Experience of use of the new moratorium procedure may indicate that the eligibility criteria require amendment in the future. This power provides the flexibility to do that if it is considered necessary.
>
> This power is specific and constrains what the Secretary of State can do by way of delegated legislation. Therefore, the Insolvency Service considers it appropriate for it to be subject to the negative resolution procedure.[59]

Unconvinced by this reasoning, the Select Committee on Delegated Powers and Deregulation made the following recommendation:

> While it is possible to modify those qualifications without making a textual amendment to paragraph 3(2)(a), the power can be seen as, in substance, a Henry VIII power. Parliamentary control over powers in the new Schedule is provided by paragraph 42. Subparagraph (3) of that paragraph makes it clear that any regulations may amend or repeal any enactment and sub-paragraph (4) applies negative procedure.
>
> When the House of Commons Trade and Industry Committee reported on the draft bill it commented 'Regulations extending eligibility for a moratorium to larger companies should require further consultation so that the results of experience to date can be factored into the decision; and the secondary legislation should require affirmative resolution'.[60] Clearly that recommendation did not lead to changes to the draft bill…
>
> The Committee wishes to draw this recommendation to the attention of the House. In our view, the appropriate level of control for a Henry VIII power is a matter of judgment for the House, and perhaps the chief issue affecting that judgment is the

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57 Insurance companies, certain banks, companies which are parties to market contracts or any of whose property is subject to market change or companies which are 'participants' or any of whose property is subject to a collateral security change are ineligible for a moratorium

58 Paragraph 3(2)(a) of Schedule A1. For a full definition of a small company pursuant to section 247(3) of the *Companies Act 1985* see pages 18 to 19 of this Paper

59 Delegated Powers and Deregulation Select Committee (HL), *Insolvency Bill* (HL), HL Paper 35, 1999-2000, 16 February 2000, Annex 'Memorandum by The Insolvency Service', page 4

60 Paragraph 24 of the Trade and Industry Committee's report

> importance of the change to be made and whether it is controversial. In considering paragraph 5 of the new Schedule, the House will no doubt wish to bear in mind the comments of the House of Commons Trade and Industry Committee. For our part we consider that the impact upon the rights of creditors is potentially such as to warrant the affirmative procedure.[61]

Although the Bill contains other Henry VIII powers, the Committee was of the view that they did not need to be drawn to the attention of the House.[62] The Committee was only concerned about the power in paragraph 5 of the new Schedule A1. With regard to this power, the Committee recommended "that the bill should be amended to provide for the affirmative resolution procedure. There is nothing else in the Bill which the Committee wishes to draw to the attention of the House".[63]

In response to this recommendation by the Select Committee on Delegated Powers and Deregulation, the Insolvency Service said:

> We are grateful for the Committee's view on the issue. We have noted its concerns and propose to accept the Committee's recommendation. Instructions will be sent to Parliamentary Counsel to seek the appropriate amendment.[64]

Part II of the new Schedule A1 deals with obtaining a moratorium where directors propose a voluntary arrangement.

Paragraphs 6 to 11 deal with the requirements for obtaining a moratorium.

The purpose of paragraph 6 is to place a duty upon the directors seeking a moratorium to provide information to the nominee. They must give the nominee a document setting out the terms of the proposed CVA and another containing details of the company's assets, debts and other liabilities, together with any additional information the nominee may request. If the nominee considers the CVA proposal has a reasonable prospect of being approved, that sufficient funding is available and that meetings of the company and the creditors should be held, he must provide a statement to the directors to that effect.

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61 Delegated Powers and Deregulation Select Committee (HL), *Insolvency Bill (HL)*, HL 35, 1999-2000, 16 February 2000

62 The powers of the Bill which enable regulations, rules or orders to be made by statutory instrument are to be found in the provisions made by Clauses 4(4), 7(2), 11, 12, 13 and 15, Schedule 1 paragraph 4 (see paragraphs 5, 7(4), 8(7), 16(4), 30(7), 39(9), and 42 of Schedule A1), paragraph 10 and Schedule 4 paragraph 13(5)

63 Ibid

64 The Insolvency Service's response dated 23 February 2000, to the recommendations of the Delegated Powers and Deregulation Select Committee (HL), *Insolvency Bill (HL),* HL 35, 1999-2000, 16 February 2000

Paragraph 7 simply outlines the documents the directors must file at court in order to obtain a moratorium. Paragraph 7(4) allows the Secretary of State to amend, by regulations, the list of documents to be filed at court.

Paragraph 8 sets out the duration of the moratorium. Under this provision, a moratorium comes into force automatically when all the relevant documents are filed at court. It will automatically end after 28 days. However, a meeting of the company and creditors held within the initial period may decide to extend the period of the moratorium by up to a further two months.[65]

The moratorium may be brought to an end by a decision of the meeting of creditors and the company to approve a CVA having effect under paragraph 36. Alternatively, the moratorium may be ended:

- by a decision of the court;
- by the withdrawal by the nominee of his consent to act;
- by a decision of the meetings of creditors and company;
- on the expiry of the initial moratorium period of 28 days if both the first meetings of the company and creditors have not taken place; or
- if there is no decision by the meetings to extend it.

Paragraph 8 (7) enables the Secretary of State, by order, to increase or reduce the initial 28-day period of the moratorium. The apparent reason for this is that experience of use of the moratorium procedure may indicate in the future that a longer, or shorter, period is more appropriate and this power would give the flexibility to change the period. This power given to the Secretary of State is also subject to the negative resolution procedure.

The purpose of paragraph 9 is to place a duty on the directors of the company to notify the nominee that a moratorium has come into force. When a moratorium comes into force, and when it ends, the nominee must advertise that fact and also notify the registrar of companies.[66] When a moratorium comes into force the nominee must also notify any creditor who has petitioned for the winding up of the company.

Part III of new Schedule A1 deals with the effects of a moratorium upon parties, other than the company.

Specifically, paragraph 12 states that during a moratorium:

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[65] Paragraph 32 Schedule A1

[66] Paragraph 10 to 11 of Schedule A1

- no insolvency proceedings can be commenced against the company;
- except with the leave of the court, no steps may be taken to enforce any security over the company's property or repossess any goods in the company's possession under a hire-purchase agreement;
- no other proceedings, execution or other legal process may be commenced or continued or distraint levied;
- no meeting of the company may be held or requisitioned without the consent of the nominee or the court;
- where a petition (other than an excepted petition) for the winding up of the company has been presented before the beginning of the moratorium, proceedings on the petition are stayed (i.e. stopped) during the moratorium.[67]

Paragraph 13 provides that whilst a moratorium is in force, a floating charge is prevented from crystallising.

Paragraph 14 is important because it provides that any security given over a company's assets during the moratorium will be unenforceable unless at the time it was granted there were reasonable grounds for believing it would benefit the company.

Paragraphs 16 to 23 are concerned with the legality of transactions entered into by the company during a moratorium. It should be emphasised, however, that under paragraph 15 even if a company enters into a transaction in contravention of paragraphs 16 to 22 it does not make that transaction void or unenforceable against the company.

Paragraph 16 provides that on all headed paper, invoices and orders on which the name of the company appears, there must also be stated the name of the nominee and reference should be made to the fact that a moratorium is in force. If this provision is breached, the company and any officer of the company who, without reasonable excuse, authorises or permits the breach, commits an offence.

Paragraph 17 provides that during a moratorium, a company may not obtain credit of £250 or more from a person who has not been informed that a moratorium is in force in relation to the company. If this provision is breached the company and any officer of the company who knowingly authorises or permits the breach commits an offence. Paragraph 17(4) gives the

[67] An excepted petition is a petition presented by the Secretary of State pursuant to section 124A of the *Insolvency Act 1986* on the grounds that it is in the public interest to wind up the company or pursuant to section 72(1)(b) of the *Financial Services Act 1986* or section 92(1)(b) of the *Banking Act 1987* on the grounds that it is just and equitable that the company be wound up.

Secretary of State the power to increase or decrease the sum specified in paragraph 17 under new section 417A of the IA 1986.

Paragraphs 18 and 19 deal with the disposal of company property. During a moratorium, the company may only dispose of any of its property or make any payment of a debt which existed at the start of the moratorium if there are reasonable grounds for believing that the disposal or payment will benefit the company and it is approved by the moratorium committee, or, if there is no such committee, by the nominee. An offence is committed if the company or if an officer of the company makes a disposal or payment contrary to these provisions (otherwise than in pursuance of a court order).

However, paragraphs 20 to 22 permit a company during a moratorium to dispose of charged property and any goods which are in the possession of the company under a hire-purchase agreement if the court or the holder of the security or owner agrees.[68] An offence is committed if the company or an officer of the company breaches these provisions, without reasonable excuse.

Paragraph 23 provides that when a moratorium is in force, a company commits an offence if it enters into a market contract, grants a market charge, gives a transfer order or provides any collateral security.[69] Again, an offence is committed if the company or a company official without reasonable excuse breaches this provision.[70]

Part IV of new Schedule A1 is concerned with the monitoring of a company's activities by the nominee.

Paragraph 24 is important because it imposes a duty on the nominee to monitor the company's affairs during the moratorium in order to form an opinion on whether or not the proposed CVA has a reasonable prospect of being approved. The nominee must also assess whether the company is likely to have sufficient funds to enable it to continue its business through the moratorium.

Paragraph 25 provides that a nominee must withdraw his consent to act if, at any time during the moratorium:

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68 Charged property (or secured property) is defined in the Bill's Explanatory Memorandum as property on which a creditor has a specific claim (e.g. a mortgage) in respect of money owed to him.

69 Part VII of the *Companies Act 1989* applies to market contracts of which there are 3 classes: contracts made by members of exchanges; contracts made by recognised exchanges; and contracts made by clearing houses

70 There are 4 classes of market charge defined by the *Companies Act 1989.* In relation to each class, a 'charge' is defined as any form of security (s. 190(1) of the 1989 Act) and includes a floating charge but expressly excludes a charge on land or any interest in land. The 4 classes of market charge are: charges in favour of an investment exchange, charges in favour of the Stock Exchange, charges in favour of clearing houses, charges relating to the transfer or allotment of specified securities. The *Financial Markets and Insolvency (Money Market) Regulations 1995* created a fifth class of market charge: the money market charge.

- he considers that the CVA proposal (or, if he has received notice of modifications, the proposal as modified) no longer has a reasonable prospect of being approved or implemented;

- he considers that the company will not have sufficient funds to enable it to continue to carry on its business through the moratorium; or

- he becomes aware that on the date of filing the company was not eligible for a moratorium; or

- the directors do not provide him with necessary information which he requests.

Once the nominee has withdrawn his consent to act the moratorium comes to an end. Paragraph 25 also provides that a nominee may not withdraw his consent to act in other circumstances. Where the nominee does withdraw his consent to act he must give notice of that fact to various parties and failure to do so without reasonable excuse is an offence.

Paragraph 26 is also important as it provides that the court may be asked to confirm, reverse or modify any decision or act of the nominee and give directions to the nominee or make any order it sees fit, either during or after the moratorium. An application to the court can be made by any creditor, director or member of the company or any other person affected by the moratorium who is dissatisfied by any decision or act of the nominee.

Paragraph 27 sets out the course of action creditors may take if there are reasonable grounds for believing that the company has suffered a loss as a consequence of any act, omission or decision of the nominee, but the company does not propose to take any action. If the court concludes that the act of the nominee was unreasonable it may order the company to pursue a claim against the nominee or authorise a creditor to do so or make any other order it sees fit.

Paragraph 28 provides that in certain circumstances the court could replace the nominee. For example, if it is a complex matter and it is impracticable or inappropriate for the nominee to continue to act, the court may direct that another person with the necessary qualifications replace the nominee.

Part V of new Schedule A1 is concerned with the implementation of a CVA.

The nominee may call meetings of the creditors and of the company whenever he thinks fit. Paragraphs 29 and 30 provide for the summoning, conduct and reporting to the court of the outcome of such meetings.

Paragraph 31 provides that the meetings summoned by the nominee under paragraph 29 shall decide whether or not to approve the proposed CVA, with or without modifications. But such modifications may not, without the specific agreement of the creditors concerned, affect the right of a secured creditor to enforce his security or the rights of preferential creditors to be paid in priority to other debts.

Paragraphs 32 to 34 permit the initial period of the moratorium to be extended for a maximum period of up to two months provided certain conditions are satisfied. Where a moratorium is extended, paragraph 35 provides for a moratorium committee to be set up. This committee can exercise functions conferred on it by the meetings held under paragraph 29, where those meetings have approved an estimate of the expenses to be incurred in carrying out the committee's functions.

Paragraph 36 provides that in the case of a conflict, the decision of the creditors' meeting is to prevail subject to the right of any company member to apply to court for an order that the decision of the company meeting should prevail instead.

Paragraph 37 provides that a decision approving a CVA binds all creditors of the company owed money at the start of the moratorium including unknown creditors. 'Unknown creditors' means persons who were not given notice of the meeting at which the CVA was approved but who would have been entitled to vote had they had notice of it. If unknown creditors surface after the CVA has been completed they can still claim the amount they would have received from the company.

Paragraph 38 permits the decision approving a CVA to be challenged on the ground that it unfairly prejudices the interests of a specific person or because there has been some material irregularity in the conduct of a meeting held under paragraph 29 of Schedule A1. This challenge has to be made formally, by an application to the court. In considering such an application, the court may revoke or suspend the decision approving the CVA or direct that new meetings be held to consider any revised proposal.

Paragraph 39 provides for the implementation of an agreed CVA, and for the person who is carrying out the functions of the nominee to become the supervisor of the CVA. It also enables people who are dissatisfied with any act or omission of the supervisor to apply to the court and sets out what the court can do in such circumstances. It also enables the supervisor to apply to the court for directions or to petition for the winding up of the company or an administration order.

Part VI of new Schedule A1 sets out provisions to challenge a company director's actions.

Paragraph 40 permits any creditor or member of the company to apply to the court if he considers that the company's affairs have been or are being managed in a way that is unfairly prejudicial to the interests of creditors or members. A court application can also be if an actual or proposed act or omission by a director is or would be so prejudicial. The paragraph only applies in relation to the acts or omissions of the directors during the moratorium.

Paragraph 41 sets out a series of actions that will amount to offences if committed by an officer of the company in the 12 months prior to the start of the moratorium. One of these actions involves a specific monetary limit; that is the fraudulently removal of any part of the company's property to the value of £500 or more. This paragraph also provides defences that may be raised in relation to the offences.

Under paragraph 42 it is also an offence for an officer of the company to seek to obtain a moratorium, or an extension of it, by making a false representation or fraudulently doing, or failing to do, anything.

Paragraph 43 provides that any provision in a floating charge is invalid if its purpose is to provide for the obtaining of a moratorium to be an event causing the charge to crystallise or restrictions to be imposed on the disposal of the property. Similarly, any provision in a floating charge is invalid if its purpose is to use the obtaining of a moratorium as grounds for appointing a receiver. [71]

2. Schedule 2 - Company Voluntary Arrangements (CVAs)

Part I – Amendments of the IA 1986

Part I of Schedule 2 makes amendments to the relevant sections of the IA 1986 relating to CVAs so to provide for a moratorium.

Under paragraph 3 of Schedule 2, the nominee has a duty to state in his report to the court whether in his opinion the proposed CVA has a reasonable prospect of being approved and implemented. Amendments are also made to the circumstances in which the court may replace a nominee in line with the new moratorium procedure.

Paragraph 5 provides that a decision by the creditors' meeting to approve a proposed CVA is to prevail where this conflicts with the decision by the meeting of the company, subject to the right of a company member to challenge this decision on an application to the court.

As a consequence of paragraphs 6 and 7, the CVA will bind all of the company's creditors including unknown creditors.

It is an offence under paragraphs 8 and 12 for an officer of a company to seek to obtain the approval of its members or creditors to a proposed CVA by making a false representation or fraudulently doing, or failing to do, anything. The nominee or supervisor is required to report suspected offences to the Secretary of State (England & Wales) or to the Lord Advocate (Scotland).

Schedule 2 also deals with consequential amendments resulting from Clause 4 (qualification of insolvency practitioners).

Part II – Amendments of the *Building Societies Act 1986*

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[71] A floating charge is a charge upon present and future assets of a debtor (used particularly by banks as a means of security for the provision of a loan), while leaving a company free to deal with its assets in the ordinary course of its business without reference to the creditor

Part II of Schedule 2 deals with the interaction of the CVA procedure with the *Building Societies Act 1986*. In brief, it prevents a building society from using the CVA moratorium procedure.

3. Schedule 3 - Individual Voluntary Arrangements (IVAs)

Schedule 3 makes amendments to the provisions of the IA 1986 relating to IVAs.

Paragraph 2 states that except with the leave of the court, distress may not be levied during the period of the moratorium. An example of levying distress is where a landlord seizes goods for outstanding rent.

Paragraph 5 states that the nominee must state in his report to the court whether he considers that the proposed IVA has a reasonable prospect of being approved and implemented. It also amends the circumstances in which the court may replace a nominee in line with the new procedure.

Paragraphs 6 and 7 permit an individual to put a proposal for an IVA to his creditors without first having to obtain an interim order as is currently the case.

Paragraphs 9 and 10 provide that an IVA will bind all of the individual's creditors including unknown creditors. However, if an unknown creditor appears after the IVA has been completed, he can still claim from the individual the amount he would have received by making an application to the court.

It is an offence under paragraphs 11 and 14 for an individual to seek to obtain approval of an IVA by making a false representation or fraudulently doing, or failing to do, anything. The nominee or supervisor has a duty to report suspected offences to the Secretary of State.

Schedule III also deals with consequential amendments resulting from Clause 4 of the Bill, relating to the qualification of insolvency practitioners.

4. Schedule 4 – directors' disqualification

All the provisions in **Part I** of Schedule 4 make technical amendments to the CDDA 1986.

Paragraph 5 makes provision as to which court an application for a director's disqualification order under section 6 of the CDDA 1986 can be made. However, proceedings are not invalidated because of their being taken in the wrong court.

Paragraphs 8 and 10 provide for Section 13 (criminal penalties for breach of disqualification order) and Section 15 (personal liability for company's debts where a person acts while disqualified) of the CDDA 1986 to apply in relation to disqualification orders in Northern Ireland.

Paragraph 12 makes provision as to which court can give a disqualified person leave to act as a director or as a receiver of the property of a company or be concerned in the promotion, formation or management of a company. The implication of this provision is that if a person is subject to a disqualification order made by a court having jurisdiction to wind up companies, that person is required to make his application to that court. If a person is subject to a disqualification undertaking, the application for leave has to be made to a court to which the Secretary of State could have applied had he not accepted the undertaking.

Section 18 of the CDDA 1986 provides for the maintenance of a register of directors' disqualification orders. Paragraph 13(5) of Schedule 4 permits Regulations to be made for Northern Irish disqualification orders to be recorded in this same register.[72]

Part II of Schedule 4 provides for consequential amendments to be made to other Acts. Specifically, provisions in the *IA 1986*, the *Police Act 1996* the *Housing Act 1996* and the *Law Reform (Miscellaneous Provisions) (Scotland) Act 1990* make reference to disqualification orders under the CDDA 1986. The purpose of Part II is to make consequential amendments to those provisions so as to give disqualification undertakings and Northern Irish disqualification orders the same effect in the context of each of those Acts, as a disqualification order made under the CDDA 1986. The *Police Act 1997* is modified but only in respect of disqualification undertakings.

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[72] Note: disqualification undertakings proposed in the Bill would also be registered and any breach of the undertaking would carry the same sanctions as the breach of a disqualification order

IV The debate in the Lords

The Bill was debated at some length in the Lords where a number of Members made substantial contributions including: Baroness Buscombe (Opposition Spokesman on Trade & Industry), Lord Kingsland (Opposition Spokesman on the Treasury), Lord Razzall (the Liberal Democrat Spokesman on Trade & Industry) and Lord Sharman another Liberal Democrat peer. The Government's position was explained by Lord McIntosh of Haringey, Government Spokesman for Trade & Industry.

The stages were:

First Reading – 3 February 2000

Second Reading - 4 April 2000

Committee consideration – 15 June 2000

Report Stage – 11 July 2000

Third Reading – 26 July 2000.

The proposals of the Bill that provoked some of the liveliest discussions included those to:

- Provide companies with the option of a moratorium before a CVA, to enable the company's directors to put a rescue proposal to creditors.

- Permit those who are not otherwise authorised to act as insolvency practitioners to act as nominees and supervisors of voluntary arrangements.

- Provide an out of court procedure for disqualifying directors and its effect on the European Convention of Human Rights.

A. Moratorium

The voluntary arrangements and moratorium provisions of the Bill were among the most important areas of debate.

Both the Select Committee on Delegated Powers and Deregulation and the Trade and Industry Committee had recommended that the exercise of the power for the Secretary of State to modify the eligibility criteria for a moratorium should be subject to the affirmative resolution procedure. Lord McIntosh of Haringey accepted this recommendation.[73]

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[73] HL Deb 4 April 2000 c 1250

During the Second Reading of the Bill, Lord McIntosh of Haringey expressed concern that the moratorium on creditors' rights contained in the Bill may not be fully effective against a possible action by the holder of a floating charge. A floating charge is a form of charge over the assets for the time being of a company which is often taken by banks to secure their lending. Consequently, the Government had decided to bring forward amendments to the Bill. The purpose of the amendments was to ensure that certain provisions that might be included in charge documents (perhaps to crystallise the charge into a fixed charge or to impose restrictions on the company's ability to deal with assets covered by the floating charge) cannot be triggered during, or because of, a moratorium.[74]

However, on Report, and during the Bill's Third Reading, Lord Kingsland suggested that floating charge holders might be severely prejudiced if they could not appoint an administrative receiver during the moratorium. He said:

> In my submission it would be more appropriate to leave a floating charge holder with the right to appoint an administrative receiver during the moratorium. It will then be up to the nominee or the directors to persuade the floating charge holder not to appoint an administrative receiver. They should try to do that by putting forward sensible arguments. That procedure has worked as regards administration orders because, as the Minister told us, recent research has shown that in some 50 per cent of administrations a floating charge was in existence but the floating charge holder agreed – or at least did not veto – an administration order.
>
> I therefore reaffirm the point that I made in Committee: these provisions rewrite the bargain between the floating charge holders and companies and will deter lenders from making loans to small companies. That will be to the detriment of the lenders and small companies. In contrast, there is no real benefit in delaying a floating charge holder appointing an administrative receiver.[75]

During the Third Reading of the Bill, Lord McIntosh of Haringey answered these criticisms as follows:

> We see no good reason why a floating charge holder – which will often be a bank – should be exempted from the general stay. But let us look at the arguments that have been urged on us. On Report, the noble Lord, Lord Kingsland, suggested that floating charge holders might be severely prejudiced if they could not appoint an administrative receiver during the moratorium. We do not agree. Quite apart from the fact that the moratorium does not have any effect on security rights other than to stay them, the nominee has to be satisfied that a voluntary arrangement is likely to be agreed and implemented before a moratorium can be obtained. If the nominee is able to reach that conclusion, I simply cannot understand why the noble Lord, Lord Kingsland, thinks that things will deteriorate so badly during the moratorium.

[74] Ibid.
[75] HL Deb 26 July 2000 c 487

> If at some point during the moratorium the nominee concludes that a voluntary arrangement is not likely to be agreed, he is obliged immediately to withdraw his consent. The noble Lord returned to this point today: he said that the nominee might not bring the moratorium to an end and there would therefore have to be a costly application to the courts. The nominee has no choice in the matter. He would have to withdraw if he became aware that the charge holder fully intended to appoint a receiver at the end of the moratorium and he thought that that would scupper implementation of any agreed voluntary arrangement.[76]

He went on to argue:

> Then there is the question of the fate of the other stakeholders when an administrative receiver is appointed. The noble Lord, Lord Kingsland, seems to be content to leave that in the hands of the bank, but let us be clear about the role of an administrative receiver. He is appointed by the charge holder. His duty of care is primarily to the charge holder. His job is to get the best price for the assets and to pay the lender, regardless of where that leaves the company's employees, other creditors, directors or shareholders. Sometimes he will sell the company's business but it is rare for him actually to save the company. So if a plan can be agreed for the rescue of a company by means of a voluntary arrangement we are firmly of the view that this is more likely to result in a better outcome for all concerned than a receivership. We do not wish banks to be the ultimate arbiters of whether a company should be saved.[77]

The duration of the moratorium and the importance given to the wishes of company's creditors in comparison to the wishes of company members was also discussed. On Report, although not in Committee, the Government recognised that the bill as drafted could lead to a perverse outcome. During the Third Reading, Lord McIntosh of Haringey explained the problem as follows:

> If the creditors' meeting met and decided to extend the moratorium and the company met but decided not to, the moratorium would be extended against the express wishes of the shareholders – unless, of course, the court ordered otherwise under paragraph 35.
>
> But if the company meeting had not met, the moratorium would come to an end. In other words, the creditors would not have their wish even though no one even turned up for the company meeting. That is certainly a perverse outcome. We consider it important that both the creditors and the members are offered the opportunity of a meeting within the first 28-day period of the moratorium and, if they are not offered that opportunity the moratorium should end after the 28-day period. I recognise the validity of the thinking behind the amendment but it does not provide the important safeguard that members of a company are able to have their say. On Report, I said that we would bring forward amendments to deal with the concern that the noble

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[76] HL Deb 26 July 2000 c 488
[77] HC Deb 26 July 2000 c 489

> Baroness, Lady Buscombe, raised. We did not expect them to be ready for Third Reading. They will be tabled in another place. I am sorry that they are not ready today, but I repeat the assurances that I have given you.[78]

In Committee, Lord Kingsland had argued that there should be a time limit on the ability of a member of a company to go to court if the decision of a creditors' meeting – which takes effect under paragraph 35 of Schedule A1 or paragraph 5 of Schedule 2 – differs from that made by the company meeting. The Government rejected the amendment on the basis that the timing of any application by a member of a company was not critical for the nominee or supervisor. However, at Report the Government acknowledged that there might be an advantage to having a cut-off point beyond which such applications could not be made. The matter was raised again during the Third Reading. Lord McIntosh of Haringey replied:

> …We still take the view that that will normally be self-regulating. But we can see that there is an advantage in there being a cut-off point beyond which applications cannot be made. We shall be amending the Bill in another place to that purpose. We think that seven days is too short a period for a member to consider his position and make any application to the court which he considers appropriate under this paragraph. We think that a 28-day period would be more appropriate. However, I hope it will be thought that the coming together of minds is sufficient for the noble Lord to withdraw his amendment.[79]

Another concern was the implication of the Bill on third party rights. The Bill provides that in all voluntary arrangements, those bound by the arrangement will include not only those who were entitled to vote at the meeting, but also those who would have been so entitled if they had had notice of it. This is designed to avoid the problem of a previously unknown creditor emerging at a later date with the ability to upset the arrangement. However, Lord Sharman argued that the provision raised problems in connection with those who have claims under the *Third Parties (Rights Against Insurers) Act 1930*. In the case of *Sea Voyager Maritime Inc. v Bielecki* [1999] it was held that a voluntary arrangement unfairly prejudiced a creditor who wished to claim under the 1930 Act because the compromise of his debt prevented him from proceeding against the debtor.[80] Lord Sharman asked the Minister to consider the effect of these provisions on those who have claims under the 1930 Act.[81]

During the debate in the Lords, concerns were also expressed that bona fide third parties should not have to check that certain preconditions had been met before dealing with a company which is subject to a moratorium.

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78 HC Deb 26 July 2000 cc 485-486
79 HC Deb 26 July 2000 c 494
80 *Sea Voyager Maritime Inc. v Bielecki* [1999] 1 All ER 628
81 HL Deb 4 April 2000 cc 1261-1262

B. Nominees

Clause 4 of the Bill permits an individual, who is not otherwise authorised to act as an insolvency practitioner, to act as a nominee and supervisor in a voluntary arrangement if subject to the rules of a body recognised for the purpose by the Secretary of State. This provision was criticised in the Lords.

During the Second Reading, Baroness Buscombe argued that because a person authorised by new section 389A of the *Insolvency Act 1986* will be authorised only to act as a nominee and supervisor, he would inevitably be tempted only to recommend a voluntary arrangement. She said:

> The new procedure for a moratorium cuts out the role of the court. Under the existing law, a company can obtain a moratorium if it petitions the court for an administration order. The petition is usually heard within five days. The court can then continue the moratorium by making an administration order. An individual can obtain a moratorium if an interim order is granted by the court. Again, the court is closely involved at an early stage. That is an important safeguard, because a moratorium imposes extreme conditions on creditors. The Courts therefore police such moratoria carefully.
>
> The new proposals dispense with that important safeguard. A company or an individual will be able to obtain a moratorium without any involvement by a court. That is dangerous enough, but to allow authorised persons who may not even be licensed insolvency practitioners to be the only real safeguard is, in our view, unacceptable. It is essential that there should be public confidence in the integrity and competence of those who will exercise such power to impose a moratorium on creditors. [82]

Lord Sharman also expressed his concern about the qualification of nominees. He said:

> At present persons who are authorised to act as insolvency practitioners are authorised to take all types of appointments under the 1986 Act. They have to be judged to be fit and proper persons to undertake such appointments by their authorising body. Their examination regime requires candidates to demonstrate a knowledge of all types of insolvency.
>
> The provision in Clause 4, which enables the Secretary of State to recognise bodies solely for the purposes of acting as nominees or supervisors, but not otherwise to take appointments, has the potential to create some very difficult problems. That is particularly important because a moratorium may not be the only alternative that a company is considering. One is faced with a situation where there could be a number of alternatives that the directors could choose. They will need advice on that. They will need advice from people who have experience of that position. I see potential

[82] HC Deb 4 April 2000 cc 1255 -1256

> difficulty in first taking advice from an insolvency practitioner about the options available and then perhaps shopping around for someone who is prepared to sign the necessary statement. That leaves me with a residual worry as to whether the directors we would want to take advantage of this procedure, and potential nominees, will regard it as too risky to bother with and opt for other alternatives.[83]

In responding to these concerns, Lord McIntosh of Haringey said:

> A major issue was the question of the qualification or authorisation of nominees and supervisors. I certainly agree that insolvency practitioner advice is required at the outset when the company is in difficulty and it needs to have the whole range of options assessed. But the appointment of supervisors provides that there is somebody who is more expert in rescue mechanisms than in the details of administration and insolvency. Indeed, the Society of Practitioners of Insolvency, now called the Association of Business Recovery Professionals, has recognised that by voting to allow those who have business rescue experience to join their organisation. It may be that this is experience in running businesses rather than the legal and accountancy aspects of not running them – in other words, running them out.[84]

The qualification of nominees was a subject that was raised again in Committee. During the Third Reading of the Bill, Baroness Buscombe also argued:

> We believe that any authorised person should be licensed to be an office holder in bankruptcies, administrations and liquidations. If he is not so licensed and if he is asked for advice as to which insolvency procedure is appropriate, he will be less likely to recommend bankruptcy, administration or liquidation. Because an authorised person will only be authorised to act as a nominee or supervisor, he is most likely to recommend a moratorium or a voluntary arrangement. If he recommends the former, he will not be remunerated. If he recommends the latter, he will be remunerated. Human nature is such that he will find it difficult to resist the recommendation that leads to remuneration rather than no remuneration.
>
> To suggest that clause 4 will not give rise to that danger is unrealistic.[85]

In reply, Lord McIntosh of Haringey said:

> I return to the assertion that prospective nominees will be tempted to recommend a voluntary arrangement when it is not appropriate. On a practical level, we cannot see how it would be good for business continually to recommend procedures that did not work. But the assertion ignores the fact that the authorising body will be monitoring its members. Those are the conditions laid down in Clause 4. The kind of conduct

[83] HL Deb 4 April 2000 c 1260
[84] HL Deb 4 April 2000 c 1271
[85] HL Deb 26 July 2000 c 482

> about which the noble Baroness, Lady Buscombe, speculates would almost certainly lead to a revocation of authorisation.[86]

C. Disqualification of directors

There was general support in the House of Lords for Clause 6 of the Bill, which amends the CDDA 1986. Clause 6 confers a power to accept undertakings on the Secretary of State with the consequence that if such undertakings are accepted, disqualification of directors can be achieved without any significant involvement of the courts. However, during the Second Reading of the Bill, Baroness Buscombe warned that Clause 6 would only save court time and costs if the new procedure were free of detailed preconditions and requirements, such as a Carecraft statement. She said:

> It should also result in a saving of costs to the director concerned, who may well have been impoverished by the collapse of the company of which he was director and beyond legal aid. Clause 6 will save the director from having to contest disqualification proceedings or going through the Carecraft procedure if he accepts that he ought to be disqualified. That procedure involves the agreeing of a fairly lengthy Carecraft statement which the court considers before disqualifying him from acting as a director.
>
> The negotiation and preparation of that Carecraft statement is a significant expense in what would otherwise be a fairly straightforward and cheap procedure where a director effectively pleads guilty, albeit that disqualification proceedings are not criminal in nature. If the procedure, whereby undertakings are accepted instead, does not involve the preparation and negotiation of a similar statement, considerable expense will be saved. It is important that this expense is saved because we must encourage directors to take advantage of the new procedure.
>
> If there is nothing in it for them, they might as well contest the proceedings and there will be no saving in court time. It is therefore important that the new procedure does not become unduly cluttered with detailed preconditions and requirements, such as a Carecraft statement. We hope that the Lord Chancellor will not use his rule-making powers to introduce the necessity for such a statement in his new streamlined procedure. Subject to that one point, we support the new procedure for giving undertakings proposed in Clause 6.[87]

In its pre-legislative scrutiny of the Bill, the Trade and Industry Committee also saw merit in a ‘fast-track’ disqualification procedure for unfit company directors:

> This procedure has been generally welcomed, not least because of recognition by the courts that, despite the introduction over recent years of a consent procedure – the so-called ‘Carecraft’ procedure – under which the parties present an agreed statement of

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[86] HL Deb 26 July 2000 c 484

[87] HL Deb 4 April 2000 cc 1254-1255

> facts and a suggested tariff for ratification by the court, the process is still open to unacceptable delay and high cost.[88]

However, the Trade and Industry Committee did question the need for an agreed statement of fact on the basis of which the disqualification undertaking was sought and given. A statement of fact might help to guide both the court and director, should the director seek the court's permission to return to business:

> The DTI in evidence emphasised that the Department would still go through the whole process of investigation and production of full documentation, and only at the point at which they would normally issue proceedings would a decision be taken on whether to seek an undertaking from directors. The Bill provides for the Secretary of State to be able to appear and present evidence in case of an application to vary or quash an undertaking. We consider that there could usefully be explicit provision for a statement of fact on which the undertaking was based to be available to the court in the event of subsequent proceedings.[89]

The Committee also expressed its concern at the full implications of the proposal:

> There is some concern at the implications of the new procedure, which in effect gives the Secretary of State powers unchecked by the court, and where the DTI acts first as the investigator: then as the prosecutor: and then, within a culture of plea-bargaining, as a judge. It is all too easy to imagine an errant director, however strongly convinced of innocence, being advised to give an undertaking rather than risk the hassle and delay of a court case, with the risk that all costs would be awarded against them (hearings being held under civil law rules). Sir Richard Scott was recently reported as having expressed his concern that directors were choosing to accept disqualification under the Carecraft procedure because they could not afford the potentially ruinous costs of a legal battle, and his doubts about the sincerity of the admissions of unfitness sometimes made. He suggested that courts could consider allocating costs using the test applied in criminal cases rather than the loser-pays-all civil litigation formula. There should be clear, public and objective criteria for deciding whether to offer the option of a disqualification undertaking, and whether to accept one, on the lines of similar procedures used by the Inland Revenue, to avoid any suspicion of the DTI either doing directors a favour or bearing down on individuals unduly harshly, using the threat of expensive legal proceedings to force a director to give an undertaking. It is also important to recognise that there will be cases where the public interest demands a public hearing, for example in the wake of some collapse where public confidence in commercial undertakings is at risk, and where justice must be seen to be done.[90]

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[88] Trade & Industry Select Committee (HC), *Draft Insolvency Bill*, HC 112 1999-2000, 14 December 1999, paragraph 40

[89] Ibid paragraph 41

[90] Ibid paragraph 42

The Trade and Industry Committee considered whether the disqualification undertakings proposed in the Bill would be in breach of the European Convention on Human Rights:

> Recent concern has been expressed over the extent to which the *current* system of director disqualification may be found to infringe the European Convention on Human Rights, for example, as a result of the use of compelled evidence arising from insolvency cases or company inspection. These concerns arise even if the proceedings are viewed in European jurisprudence as civil. The application of relatively severe penalties and the fact that initiation of proceedings is reserved to the Crown suggests however that, although civil proceedings in a UK sense, they may be regarded as falling within the ambit of Article 6 on the right to a fair trial. This [the proposal for disqualification undertakings] could not but increase the risks of the system being found to be in breach of the Convention. IOD [Institute of Directors] also suggested that there could be problems with Article 14 on prohibition of discrimination, since it is suggested that the period of disqualification proposed could relate to the wealth of the director. We recommend that the certificate from Ministers of compliance with the ECHR to accompany the Bill should be accompanied by a memorandum exploring the compatibility with the Convention of the new provisions for an executive system of offering directors the option of giving a disqualification undertaking.[91]

Lord Razzall raised the Human Rights issue again during the Second Reading of the Bill. Clause 10 of the Bill provides that answers given by an individual under a power of compulsion under section 218 of the IA 1986 cannot be used against him by the prosecution in subsequent criminal proceedings. Lord Razzall argued that this protection should also be extended to company disqualification proceedings under the CDDA 1986:

> …I raise the point with which the Minister is now intimately familiar as the result of the progress of the Financial Services Bill through the House; that is whether, in full-scale directors' disqualification proceedings, the real character of the trial is not really civil but criminal. If that is so, the Saunders-proofing that has been provided in Clause 10 ought to be extended to the CDDA.
>
> Perhaps the Minister will reflect on what occurs in directors' disqualification proceedings. The proceedings are brought for the protection of the public and, at the end of the day, a director suffers disqualification. They are initiated after a long period of investigation by a team with special powers. The penalty of disqualification is severe: not only does it lead to the loss of a job, but it also leads to the loss of social status and a heavy cost burden.
>
> These procedures are criminal in character and, therefore, should attract all the protections laid down in the European Convention on Human rights. The Minister has

[91] Trade & Industry Select Committee (HC), *Draft Insolvency Bill*, HC 112 1999-2000, 14 December 1999, paragraph 43

> certified that this Bill conforms with that Convention; but, in my submission, clause 10 does not go nearly far enough to make that so.[92]

[92] HL Deb 4 April 2000 c 1267

V Views of the Business community

There has been criticism that the *Insolvency Bill* has been introduced in Parliament before the conclusion of the final Review of Company Rescue and Business Reconstruction Mechanisms. The editorial of *Tolley's Insolvency Law and Practice*, a professional journal, expressed this criticism as follows:

> To a certain extent, it is inevitable that reforms will come on a piecemeal or patchwork basis. However, the inter-relationship between the draft Insolvency Bill and the Review of Company Rescue and Business Reconstruction Mechanisms is so strong that it makes sense to consider them together and to have a single piece of legislation enacting the elements of both. This would ensure co-ordination and consistency and avoid anomalies. Yet, due to the fortuitous availability of a limited parliamentary time-slot, the Insolvency Bill is stealing a march over all the other initiatives, particularly the Review.
>
> We do not believe that there is any real need for such a rush to push the Insolvency Bill on its own through Parliament, without waiting for the wider picture to emerge from the Review.[93]

Tolley's editorial further argues:

> The Select Committee considers the availability of funding during the CVA to enable trading to be continued as essential to the success of a Company Voluntary Arrangement. This question is not addressed at all in the draft Bill, but views on that question have been canvassed in the Review, one of the possibilities being to accord to the provider of the 'rescue finance' a 'super priority' over all other creditors, including secured creditors.
>
> Another pertinent possibility raised in the Review is the abolition of the preferential status of Crown creditors, which often significantly erodes the bank's floating charge and/or return to the ordinary creditors.
>
> We regard these issues as an integral part of successful moratorium and CVA regimes. If the Bill went ahead without waiting for decisions being reached on these issues following a thorough consultation on the Review, and without incorporating those decisions in the Bill, we would regard it as a sloppy piece of legislation. Even the select Committee considers that ideally the legislation be deferred until it can be merged with the results of the Review, but, recognising that the world is not ideal and that opportunities for insolvency legislation are not frequent, it is happy for the Bill to proceed, but not as a vehicle on which to tag other bits of insolvency law reform as it passes through Parliament.[94]

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[93] *Tolley's Insolvency Law and Practice*, volume 16 Number 1 2000, Editorial page 1
[94] Ibid.

The Government sought to answer such criticisms during the Bill's Second Reading in the Lords, when Lord McIntosh of Haringey stated the position as follows:

> Here we are today: we are carrying out a review to deal with the very important questions dealt with by noble lords this evening – funding, debt for equity, super-statutory priority and so on. All of those issues raise fundamental difficulties and will take a considerable time to resolve. We have a moratorium which everyone to whom we have spoken agrees is necessary and can be proceeded with in a relatively small Bill, and yet we are criticised for proceeding with what we can do and not waiting for what we could do in due course. [95]

According to the DTI, responses received to consultations show a broad consensus that the introduction of an interim moratorium to CVA procedures along the lines proposed in the Bill would be useful. The Association of Business Recovery Professionals (R3), (formerly known as SPI, the Society of Practitioners of Insolvency) has, albeit with some reservations, welcomed the new *Insolvency Bill*.

> The Bill will significantly improve the prospects of success for CVAs, as, with the benefit of a stay, the company will be granted a limited period in which to put a rescue together, free from the fear of the threat of winding-up. As you know from our submissions, we do not believe the Bill is perfect. Our submissions are on R3's website. However, it would be churlish not to work with the Government in making this as good as possible, as the profession has been calling for a stay within CVAs ever since CVAs were introduced in 1986.
>
> With regard to directors' disqualification, whilst there has been a great deal of attention given to the Government focus on the area of rescue and turnaround, less attention has been given to the drive to clamp down on those who abuse limited liability. Given that the level of business failures has been relatively static in recent times, the 800 plus disqualifications in March to September last year, a 35% rise from the same period in 1998, may at first sight seem somewhat alarming. However, it is more reflective of the time taken to bring cases to court. Currently a court order is the only means to obtain a disqualification, whether the case is defended or not. As a result, a significant backlog and administrative burden on both the DTI and the practitioners involved, has built up. Whilst the Government is committed to encouraging the entrepreneur by introducing legislation to support the rescue culture, they remain committed to clamping down on unfit directors. Therefore the proposal to introduce a 'fast track' disqualification, without court involvement, through directors' undertaking not to act, should prove a positive step towards freeing up more time to prosecute defended cases. Clearly, this is likely to be dependent on how many unfit directors are willing to opt for this possibility, with the benefit of a reduced term of disqualification. The profession will watch developments with interest.[96]

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[95] HL Deb 4 April 2000 c 1268

[96] "Legislation", *Recovery*, a publication by the Association of Business Recovery Professionals (R3), March 2000, page 3

President Alan Bloom of R3 has said:

> I am relieved government has acted to improve the Company Voluntary Arrangement (CVA). Allowing small businesses to obtain a stay on creditor action for a period of 28 days in order to put a rescue plan to creditors for approval should mean that fewer small businesses will go to the wall. The move is an accurate reflection of changing attitudes throughout the business community in dealing with the financial problems of small companies. Indeed, the change in attitudes is precisely the reason that R3 has evolved from SPI – so that we can welcome business rescue professionals who are not licensed insolvency practitioners.[97]

However, Mr Bloom voiced the profession's concern at the proposal that people other than licensed insolvency practitioners would be permitted to supervise CVAs:

> There is a danger that applying the term 'insolvency practitioner' to those only qualified to practice one insolvency procedure (CVAs) would make them appear far more qualified than is the case, recommending a perhaps unsuitable procedure from an apparently impartial position. Businesses would be placed at risk and creditors could lose out. Directors must be able to confidently seek advice from regulated professionals who are capable of advising on all insolvency and informal options. Currently the only people regulated to do that are licensed insolvency practitioners, but part of R3's function is to encourage the qualifications and regulatory environment that will enable directors to have confidence in many more rescue, recovery and renewal practitioners.
>
> The other provision the Bill makes is for the quicker disqualification of directors by the DTI, which must be welcomed. The process has almost always taken too long in the past and, provided that the DTI remains able to distinguish between the culpable and the merely unfortunate, provides an appropriate flip side to the new-found protection offered by the moratorium.[98]

R3 also see a potential conflict in the role of the nominee:

> In the case of the new moratorium procedure, the Bill would allow the company or other affected parties to challenge the nominee's actions by application to the court. In the view of the GTC there is a contradiction in the Bill between two views of the role of the nominee: that of an independent officeholder with a duty to the general body of creditors and that of a professional adviser with a duty of care to his client, and concerns have been expressed that the Bill might encourage directors to sue a nominee for doing his statutory duty. Although the Bill contains a provision allowing the courts to excuse a nominee if it is satisfied that his conduct was reasonable in all

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97 The Association of Business Rescue Professionals (R3), press notice, *Profession Comments on Insolvency Bill,* 4 February 2000

98 Ibid.

> the circumstances, this does not of itself address the fundamental issue of where the nominee's duty lies.[99]

There is also concern that some company directors may abuse the proposed moratorium provision. The House of Commons Trade and Industry Select Committee has advocated a workable balance between recognition that the moratorium may be urgently needed to allow the nominee to work out the proposals with the directors and others, and a limitation on the right to a moratorium on demand. It has suggested some external controls to prevent directors from trawling through insolvency practitioners until one is found who will make the necessary declarations for obtaining a moratorium.[100]

In its trade journal, *Recovery*, R3 has also discussed the *Insolvency Bill* in the context of current administration procedures:

> The development of a new procedure for a short initial moratorium for small companies (with a turnover of not more than £2.8m and less than 50 employees) has been cautiously welcomed by the interested trade bodies, including representatives from banks whose right to appoint receivers should not, as a result of the Bill, be restricted by any requirement of giving notice. It is always possible that this issue and others rehearsed at the Select Committee will be raised again as part of the wider DTI review.
>
> One important consideration I believe should be borne in mind during these reviews is that the administration procedure has developed in its flexibility and sophistication since its introduction in 1986. There has been a deep level of development, both legal and commercial, to which the procedure has adapted so that it has become flexible enough to provide solutions to both a company the size of Barings and to a small trading company with cashflow difficulties.
>
> It is indicative of the ingenuity of both practitioners and the process that recent developments have created even greater flexibility for the use of administrations, while also emphasising the active involvement of creditors as part the process, either informally or through the medium of a committee. I believe that creditor consultation, when feasible, is the most effective way of providing transparency and justifying the use of the procedure.

The article concludes:

> It is hoped that any changes to the CVA regime are successful in that the body of developed knowledge and skill within the profession can be brought to bear on those companies that will benefit from the moratorium. However, as the administration process has proved its flexibility across the last 14 years, it is also hoped that the wider review that is taking place does not entail wholesale change to a workable and

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[99] "The Insolvency Bill", *Recovery*, a publication by the Association of Business Rescue Professionals (R3), June 2000

[100] Trade and Industry Select Committee (HC), *Draft Insolvency Bill,* HC 112 1999-2000, 14 December 1999

> settled set of principles, except where such change does promote a more effective rescue system.[101]

A recent article in a professional publication, *Accountancy Age,* discussed the *Insolvency Bill* against the background of UK and US insolvency regimes. It said:

> Labour has made an enthusiastic show of support over the last three years to nurture a US approach to risk-taking in business and for insolvency legislation that gives struggling small companies time to get out of short-term crises.[102]

It continued:

> Government debate has centred on the debtor-friendly Chapter 11 of the US Bankruptcy Act[103], which allows management to file for reorganisation without consent from creditors, with some experts finding higher recovery rates for creditors under the law.
>
> A recent study by Rafeal Porta of the rights of senior secured creditors around the world found the UK still the most creditor-friendly regime. The United States emerges as one of the least pro-creditor countries, with an automatic stay on assets, unimpeded petition for reorganisation and provision for the company's board to remain in control.
>
> The UK government has got obsessed by Chapter 11, but if you look at incidences of successful business rescue it's very small in proportion to the successful rehabilitation of business in the UK under its corporate voluntary arrangement…The company rescue review has shown the government that the UK system is working and a turn-around culture is gathering momentum.[104]

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[101] "The Rescue of Administration", *Recovery,* a publication by the Association of Business Recovery Professionals (R3), June 2000

[102] 'Insolvency law shake-up bridges Atlantic divide', *Accountancy Age*, 8 June 2000

[103] Note: the article refers to the US Bankruptcy Act, but it is, in fact, the US Federal Bankruptcy Code

[104] 'Insolvency law shake-up bridges Atlantic divide', *Accountancy Age*, 8 June 2000

VI Other insolvency reform initiatives

In addition to matters contained in the *Insolvency Bill,* there have been over the past few years a number of other initiatives regarding insolvency law reform.

A. The Insolvency Regulation Working Party Review

In November 1996, a Working Party was set up by the Insolvency Service and the Recognised Professional Bodies responsible for the authorisation and regulation of insolvency practitioners.[105] The terms of reference given to this Working Party were:

> to review the current state of regulation in the insolvency profession and, in the light of that review, to consider whether there are ways in which, in the public interest and in the interest of all those affected by insolvency proceedings, such regulation could be made more efficient and effective.

In December 1997, a consultative document entitled *Insolvency Practitioner Regulation: Ten Years On* was published. The main issues outlined in this document included:

- Whether the existence of a variety of authorising bodies within the regulatory scheme posed problems.

- Whether the degree of responsibility delegated to professional bodies in the regulatory scheme was appropriate.

- Whether the procedures of the authorising bodies in dealing with complaints and disciplinary matters were satisfactory and whether such procedures could usefully be supplemented by the creation of an Insolvency Ombudsman.

- Whether the introduction of some regulatory mechanism would ensure that the wider public interests in insolvency processes could be articulated.

- Whether the dual source of authorisation of practitioners by professional bodies on the basis of professional examinations on the one hand and direct authorisation by the Secretary of State was desirable.

[105] The eight authorising bodies who commissioned the report were the Association of Chartered Certified Accountants (ACCA), the Insolvency Practitioners Association (IPA), the Institute of Chartered Accountants in England and Wales (ICAEW), the Institute of Chartered Accountants in Ireland (ICAI), the Institute of Chartered Accountants of Scotland (ICAS), the Law Society (LS), the Law Society of Scotland (LSS) and the Secretary of State.

- Whether the regulatory scheme should be extended in scope so as to cover areas related to insolvency such as *Law of Property Act* receiverships which are outside the scope of the *Insolvency Act 1986.*

- Whether authorisation should be conferred on firms of practitioners and not merely on individual practitioners within firms, as is the case at present.[106]

In February 1999, the Working Party published its report *Insolvency Regulation Working Party – A Review of Insolvency Practitioner Regulation.* The Report reaches the following conclusions:

> Although regulation and professional standards have developed substantially further than was contemplated when regulation was introduced, insolvency practitioners are keenly aware that external opinion is in many ways unsympathetic to them. It has therefore been a central concern of the Report to find a mechanism for public interest concerns to be reflected in a practical and appropriate way in the devising of regulatory standards.
>
> The Report identifies professional and ethical standard setting as that element in regulation which could most practically be influenced by such external inputs. It argues that a new regulatory mechanism focused upon these functions would preserve the efficiency, transparency and independence which are the clear virtues of the present system while assisting insolvency practice to adapt to changing demands.
>
> The institutional mechanism suggested by the Report is a new Insolvency Practices Council on which a majority of lay members would provide independence and a minority of representatives from the insolvency area would provide informed expertise. The role of this stakeholder body will be to put proposals to the bodies within insolvency which presently devise professional and ethical standards for insolvency practitioners. The new council would recommend issues to those bodies for consideration and also consider whether standards, once adopted, were observed and enforced. The professional bodies involved in insolvency regulation would be required to co-operate with the new council.[107]

The Report also considers the possible introduction of an Insolvency Ombudsman, but concludes that it would be unlikely to bring practical benefit because it would not be coherent with the particular nature of insolvency processes. It also notes that the professional bodies have made provision in their disciplinary procedures for independent lay review.

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[106] Department of Trade & Industry consultation document, *Insolvency practitioner regulation: Ten years on*, 1997

[107] Insolvency Regulation Working Party, *A Review of Insolvency Practitioner Regulation*, February 1999, pages 6-7

The Report makes various recommendations as regards the detailed form and scope of regulatory requirements. It also recommends that the Insolvency Service should be released so far as possible from the duty it has to monitor practitioners directly authorised by the Secretary of State, so that it can concentrate wholly on its high level function as a regulator of regulators.

Separately from this, it was announced on 16 May 2000, that as part of the normal process for reviewing non-departmental public bodies and executive agencies, the DTI is to carry out a review of the Insolvency Service over the next six months.

B. The Ferris Committee Report on Remuneration of insolvency practitioners

The remuneration of insolvency practitioners was the remit of a separate working party convened by the Vice Chancellor under the Chairmanship of Mr Justice Ferris. The Working Party's terms of reference were to consider and make recommendations concerning the basis on which the courts should fix remuneration in those rare cases where the courts are involved.

On 31 July 1998, this Working Party delivered its report to the Lord Chancellor's Office. Sir Richard Scott, the Vice Chancellor, said:

> I welcome the report, published today, of the working party chaired by Mr Justice Ferris into remuneration of 'office-holders'. I invited Mr Justice Ferris two years ago to look into this matter because of public concern over the very large sums paid in remuneration and legal fees in insolvency cases, and also my awareness of the limited experience of judges at all levels in assessing or approving these outgoings. The published report provides a helpful discussion of many of the issues which arise and offers proposals, which if implemented, will lead to the application of more logical criteria, a greater understanding of what is involved in the fixing of the remuneration of an office-holder and more effective procedures when this has to be undertaken by the court.
>
> I also welcome and approve the working party's proposal that it should remain in existence to take forward the task of preparing guidelines for office-holders and for those who have to scrutinise their remuneration claims. As the working party has recorded, this is the first time in recent years that detailed consideration has been given to the fixing or determination of office-holders' remuneration. This report is all the more valuable as normally review bodies in the field of insolvency are concerned with substantive law only. The next stage must be for wide discussion to take place on the working party's comments and proposals. It is also my hope and belief that they will command widespread support. I also hope that an early opportunity will be found to make the rule changes (and also the small changes in primary legislation) which the working party have proposed.[108]

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[108] Lord Chancellor's Department press notice PN 245/98, *Report of the Ferris Working Party*, 31 July 1998

The Report begins by reviewing the existing statutory provisions for determining office holders' remuneration and concludes that many of them are in some way unsatisfactory. The Working Party identified three key features that should be present in any system for determining the remuneration of office holders. These are:

- *Predictability* – both the office holder and creditors need to know, with a reasonable degree of certainty, the basis on which the office holder is to be remunerated.

- *Transparency* – interested parties need to see how a claim for or award of remuneration matches up to the regulations.

- *Proportionality* – the office holder needs to provide sufficient information to enable creditors or the court to have a clear view of what the office holder has done or intends to do and of the value of assets he has protected for creditors. At the same time, however, the burden of regulatory requirements needs to be matched to the value of the assets at stake.[109]

The Report recommended changes that should lead to a system for fixing remuneration that is both 'predictable and transparent'. The underlying principle is that the value achieved by Insolvency Practitioners should be rewarded, rather than just the time incurred. It recommends that the existing formula used to assess provisional liquidators' charges (the 'PL formula') should be universally adopted as the basis for quantifying value. Although time is one factor to be taken into account under the 'PL formula', there are others, which may be summarised as complexity, exceptional responsibility, effectiveness and assets. The Report also suggests that no-win, no-fee arrangements might be appropriate in certain cases (or tasks within cases).

The Ferris Working party reconvened on 25 January 1999, to expand upon its original proposals. On 20 June 2000, Dr Kim Howells set out in a written answer what action the DTI has taken over the Ferris report:

> Following receipt of the first report by Mr Justice Ferris, The Association of Business Recovery Professionals (formerly the Society of Practitioners of Insolvency) issued preliminary guidance to its members on the possible format of application for fee approval. Further guidance is awaiting publication of the final report of the Ferris Working Party and the issue of a revised Statement of Insolvency Practice on remuneration of office holders. My Department is represented on the Working Party and is continuing to monitor the position.[110]

[109] Lord Chancellor's Department, *Report by Mr Justice Ferris - Remuneration of office-holders*, 1998
[110] HC Deb 20 June 2000 cc 138-139W

C. Reform of bankruptcy law

In addition to the review of company rescue procedures, the Competitiveness White Paper, *Our Competitive Future – Building the knowledge driven economy*, announced the setting up of a working party (whose members are compiled from the Insolvency Service) to review personal insolvency law in England and Wales.[111]

The aim of this review is to make a distinction between those bankrupts whose financial conduct has been responsible and lawful and those who have behaved irresponsibly. Ways in which the stigma may be removed from bankruptcy were also to be considered. On 2 February 1999, in a speech at the Mansion House, Stephen Byers, Secretary of State for Trade and Industry, said:

> To foster a climate of responsible risk taking, we must also tackle head-on the stigma attached to business failure in this country.
>
> At present our bankruptcy laws make no distinction between the responsible risk taker who works hard but is unsuccessful and those individuals who deliberately set out to cheat their creditors or abuse limited liability.
>
> I believe that the law in this area can be improved and have established a working group to review our insolvency and bankruptcy laws. They will report to me at the end of April.
>
> I want careful consideration given to how we deal with responsible risk takers – those entrepreneurs who have ideas, put in a lot of their own money, work hard, but then fail.
>
> In other countries such people are not simply written off and regarded as failures: they are regarded as people who have learned from their own personal experiences.
>
> Whilst protecting the responsible risk taker we must come down hard on those who exploit the system – often inflicting pain and financial ruin on individuals and businesses in the process. Such people have nothing but contempt for their creditors. I will bring forward legislative proposals to enable us to handle the disqualification of unfit directors more efficiently and effectively.
>
> I want an insolvency regime which is complementary to enterprise and responsible risk taking. Both to help the enterprising recover from bankruptcy and to reduce the inhibition of those who fear the consequences of failure.[112]

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[111] *Our Competitive Future- Building the knowledge driven economy*, White Paper, December 1998, Cm 4176

[112] DTI press office, *Speech by the Rt. Hon. Stephen Byers, Secretary of State for Trade and Industry at the Mansion House*, 2 February 1999

Officials reported to Ministers on 30 April 1999.[113] The working party had differentiated between 'responsible risk takers' and 'culpable' bankrupts. On 2 July 1999, Stephen Byers outlined the details of the bankruptcy study in a speech to a joint US Embassy, DTI and Treasury conference on 'Fostering Enterprise – the American Experience':

> We must come down hard on the estimated 7-12% of bankrupts who are culpable, that is those who deliberately set out to mislead and deceive. But for those who fail for reasons beyond their control and despite their best efforts to save their business we need a new attitude.
>
> I now plan to consult on this proposal and on the possibility of differentiating between bankrupts who have been simply unfortunate and those who are guilty of unacceptable behaviour.
>
> The study suggests culpable bankrupts could face disqualification for between three and five years, with exceptionally bad cases being extended to 15 years. On the other hand responsible risk takers could be discharged earlier than at present. Six months instead of three years is suggested.
>
> As well as consulting on these ideas I hope to introduce some important, but uncontroversial amendments to insolvency law as soon as possible, including the possibility of a rescue period for companies in trouble. Building on these ideas, the DTI and Treasury are also carrying out a joint review of company rescue mechanisms.
>
> This is the start of a debate about how we change attitudes and encourage responsible risk taking. With new markets emerging in the knowledge driven revolution and the potential for businesses to go from start-up to global player in matter of months it is an issue we ignore at our peril.[114]

On 7 April 2000, a consultation document entitled *Bankruptcy – A Fresh Start* was published.[115] The document again makes a distinction between those who fail for reasons beyond their control and those who fail deliberately in order to deceive creditors. A survey of business failures carried out by the Insolvency Service during January and February 1999 revealed that out of 1,412 cases where it had been possible to identify the main cause of failure, less than 2% were attributed to fraud.[116]

The consultation document proposes changes in five areas of bankruptcy law:

(i) An earlier discharge from bankruptcy for the majority of 'honest' bankrupts

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[113] HC Deb 25 February 1999 cc 370-371W

[114] Department of Trade and Industry press notice P/99/575, *Byers outlines details of bankruptcy study*, 2 July 1999

[115] Department of Trade and Industry press notice P/2000/257, *Radical new approach to bankruptcy law planned*, 7 April 2000

[116] Ibid.

Currently, the majority of bankrupts are discharged after three years. Whilst bankrupt, an individual is automatically disqualified from being a director of a limited company and is also subject to other restrictions (for example, prohibited from holding public office). For those whose failure is honest, it is proposed that they be discharged from bankruptcy within six months of the date of the Bankruptcy Order. This would not affect the ability of a trustee to claim any assets that the bankrupt had at the time of the order. In circumstances where the bankrupt will not co-operate with the trustee in bankruptcy in the administration of the estate, the trustee would be able to apply to the court to prevent an automatic discharge after six months.

(ii) Post-bankruptcy individual voluntary arrangements administered by either trustees or the official receiver

The consultation document introduces the possibility of post-bankruptcy individual voluntary arrangements (IVAs) to be supervised by the official receiver (at present these must be set up and supervised by private sector practitioners). It is envisaged that these IVAs would be of benefit in circumstances where the bankrupt wishes to apply future income against the debts in the bankruptcy. The reason for using IVAs in this way is to reduce costs and increase returns to creditors. However, the existing provision for bankrupts to be ordered by the court to make payments to their trustee would remain.

(iii) The introduction of restriction orders for the minority of dishonest or irresponsible debtors

It is proposed that dishonest and irresponsible bankrupts should be regulated by a new, stricter regime. In brief, the official receiver would be able to apply to the court for a restriction order against the bankrupt for a period of up to fifteen years. During the life of the restriction order the individual would be:

- prohibited from acting as a company director or from taking part in the management of a limited company;
- prohibited from obtaining credit over a certain sum without disclosing his status; and
- prohibited from trading in a name other than that in which he was made bankrupt, unless he discloses that name.

(iv) The exemption (under tightly defined circumstances) of a fixed amount of any equity in a bankrupt's home from the claims of the trustee in bankruptcy

It is proposed that to a limit of £20,000, there should be a pound for pound exemption in relation to any equity in the family home for a bankrupt who can prove he

introduced capital into a business, which was used appropriately. It is clear from the consultation document that this limit of £20,000 is open to discussion. It is also clear that this exemption would not be available to bankrupts made the subject of a restriction order.

(v) Possible financial counselling for bankrupts, where appropriate

The main objective would be to help those bankrupts where the lack of financial management skills has been identified as a material cause of their insolvency, and who wish to start another business. The consultation document identifies the Small Business Service, among others, as a potential provider of such advice.

The consultation period ended on 30 June 2000. According to the Insolvency Service, responses to the consultation are being analysed and will be reported back to the Secretary of State shortly.[117]

Commenting on the proposal that a bankrupt, who is neither dishonest nor reckless, can retain up to £20,000 of his assets, which can be used as a deposit on a family house or to enable them to start up in business again, the Association of Business Recovery Professionals (R3) said:

> The reasoning behind this proposal is, at face value, not only sensible but indeed commendable. Too often a business fails within the first few years –R3's survey shows that 40% of businesses failed within the first four years –usually due to under capitalisation. Anything that encourages entrepreneurs to ensure that their business is better capitalised in the early years should be applauded. Additionally, protecting the matrimonial home, or ensuring that the debtor's family are not left to the mercy of the state, might lessen what is typically a very stressful time for the whole family.
>
> However, whilst this might protect the few, it could result in damage to the many. R3's survey showed that in almost four out of five cases (78%) the debtor has less than £20,000 in assets. The total number of bankrupts a year, assuming current levels, who could gain the maximum benefit from the Government proposals is only 4000 people. This benefit to debtors will harm a far larger group of individuals, small businesses and larger organisations – the debtors' creditors.
>
> To quantify the damage – the average debtor has 15 creditors, of which 13 are unsecured creditors. The proposals increase the risk that this second group, or an annual total of more than 300,000 unsecured creditors, will have none of their debt repaid. The knock on effect of insolvency should not be treated lightly. In some years, one in three personal insolvencies, where the principal cause was business related, resulted in the insolvency of another individual. Often this is a business supplier/customer.

[117] Insolvency Service on line register on the progress of its consultation documents: http://www.insolvency.gov.uk/information/con_doc_register/closedindex.htm, 4 October 2000

> Will the Government succeed in removing the fear of failure of insolvency but replace it with the fear of extending credit to others? Credit scoring agencies already believe that the cost of credit will increase as a result of the proposals or that companies will request part-payment up front from new customers.[118]

In considering the proposal for an automatic discharge after six months for a blameless bankrupt, some insolvency practitioners have questioned whether six months would be enough time to establish culpability or otherwise.

On 20 June 2000, Dr Kim Howells provided a written answer to a question about the recommendations of the Insolvency Working Party:

> **Mr Mitchell**: To ask the Secretary of State for Trade and Industry how he defines the difference between responsible risk takers and culpable bankrupts for the purpose of implementing the recommendations of the Insolvency Working Party; and if he will estimate the proportion of each.
>
> **Dr Howells**: I am satisfied that there is a clear distinction to be drawn between individuals who are dishonest or whose conduct with regard to their creditors is irresponsible and those whose use of credit and treatment of their creditors is conscientious and above board. Examples of irresponsible conduct would be an individual continuing to trade and incur credit at a time when he or she knew themselves to be insolvent; or an individual consumer obtaining credit without any regard to his ability to repay the debts incurred. Information available from Official Receivers indicates that the very great majority of individuals subject to bankruptcy are neither dishonest nor irresponsible.[119]

D. Forensic Insolvency Recovery Service (FIRS)

On 20 July 2000, Kim Howells, Competition and Consumer Affairs Minister, announced that the Insolvency Service has launched a pilot scheme called Forensic Insolvency Recovery Service (FIRS).[120] FIRS is a multi-disciplinary team of insolvency practitioners, solicitors, counsel and enquiry agents whose remit is to take legal action against disqualified directors where there has been misappropriation, misfeasance or negligence. The legal action will seek to recover monies personally from those directors who have abused the system, for the benefit of the creditors. Whilst these powers exist in law already, it is thought that in many cases insolvency practitioners do not use the powers because of a lack of funds or enthusiasm amongst creditors to pursue additional legal action.

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118 'Removing the stigma from bankruptcy or just making it worst?', *Recovery*, a publication by the Association of Business Recovery Professionals (R3), June 2000

119 HC Deb 20 June 2000 c138W

120 Department of Trade and Industry press notice P/2000/510, *Rogue directors face new offensive*, 20 July 2000

The intention is for FIRS to advise the Insolvency Service during the course of the pilot scheme. According to the DTI, cases targeted for action will be reviewed regularly and a decision taken after the completion of ten cases as to whether the procedure should be introduced across the country.

Dr Howells explained the role of FIRS as follows:

> This partnership between the Insolvency Service and the private sector will use existing legal mechanisms for recovery which have previously been underused because of lack of assets to fund legal proceedings. FIRS will operate on a no-win-no-fee basis with insurance or an indemnity to protect against possible adverse costs. The ultimate objectives are to deter those contemplating abuse of the privilege of limited liability, and to provide returns to creditors. We will be judging the success of the pilot on those criteria.[121]

E. European insolvency regulation

It has proven difficult to reach any Community agreement on bankruptcy harmonisation. The UK failed to sign the European Bankruptcy Convention (EBC) within the period prescribed by article 49 of the Convention. This expired on 23 May 1996. Consequently, the EBC, being a Convention, and lacking unanimous support, lapsed.

The German and Finnish delegation submitted a Council Regulation (EC) on insolvency proceedings on 26 May 1999 (the German presidency and the Finnish presidency succeeded each other in 1999). The key provisions of the Regulation have preserved in all material respects the text of the draft Convention.

On 29 May 2000, the EC Regulation on Insolvency Proceedings was enacted. It will come into force in the UK at the end of May 2002.[122] The main effect of the Regulation is to determine which country's laws will control insolvency proceedings when an insolvent company based in one EC country also has business interests in other EC countries.

The Regulation provides that the legal principles of the Member State where the debtor's main interests are situated will apply. However, the liquidator (or local creditors) can establish secondary bankruptcies in a country where the debtor has assets, but which is not the centre of the debtor's main interests.

A recent report in *Insolvency Law & Practice*, assessed the significance of the new Regulation as follows:

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[121] Ibid.

[122] Annex A, which is an integral part of this Regulation, sets out for each Member State the proceedings that fall within the definition of collective insolvency proceedings

> How successful is the conclusion to the EC's phase 1? One has to say that the new Regulation is a long way from a single, universal regime operating in all Member States of the EC, but this must not be allowed to obscure a real achievement. It goes some of the way to achieving the realistic goals of:
>
> (a) establishing which country's bankruptcy law principles will apply in given circumstances;
>
> (b) the mutual recognition of bankruptcy regimes and officers of the different Member States;
>
> (c) providing assistance to a liquidator appointed elsewhere seeking to exercise power in a different Member State; and
>
> (d) co-operation between different liquidators appointed in the same bankruptcy.
>
> It is also within a system in which a strong central court can play a role in resolving disputes over different interpretations of the provisions of the Regulation and so can create greater conformity in the way in which the Regulation is applied in the different Member States.
>
> The Regulation is expressed to apply to collective insolvency proceedings which entail the partial or total divestment of a debtor and the appointment of a liquidator but insolvency proceedings concerning insurance undertakings, credit institutions, investment undertakings and collective investment undertakings are excluded.[123]

The *Insolvency Law & Practice* report concludes:

> Diversity in the several legal systems is inevitable and is often positive and fruitful as courts seek solutions to new problems, solutions which can fit well within the existing legal culture. The present Regulation will provide much increased scope for practitioners and judges to become familiar with many different responses to the various problems which cross-border bankruptcy brings. At the same time, the Regulation undertakes some bold initiative in the direction of harmonisation of some commercial bankruptcy provisions and invites a generally innovative and bold ECJ to seize the opportunity to encourage further harmonisation.[124]

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[123] *Insolvency Law & Practice*, Vol.16, No.4, 2000
[124] Ibid.