A practical guide to UK insolvency proceedings

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Unlike the US, UK insolvency proceedings are mostly conducted out of court but are heavily regulated. Licensed 'insolvency practitioners' (IPs) are usually appointed to conduct the insolvency process in place of management. IPs are accountants from the UK accountancy firms. Creditors, especially secured creditors, tend to control the proceedings, either by initiating the process or at least dictating which process will be followed and which insolvency practitioners will act.

There are four principal types of insolvency proceedings applicable to corporations in the UK (England, Wales and Northern Ireland) – i.e., administration, receivership, liquidation and company voluntary arrangements and schemes. This article will briefly describe those four types, and also touch upon UK cross-border issues.

Administration

Administration under UK insolvency law is the collective rehabilitation proceeding in the UK and the most analogous to a Chapter 11 proceeding in the US. It is the most prevalent procedure used in UK corporate insolvencies, steadily taking over from receivership (discussed next) since 2003. The presentation to court of an administration application or the filing in court of a notice of intention to appoint an administrator triggers a moratorium on creditors' legal actions, which continues if the company goes into administration. There is an exception for the enforcement of security over financial collateral (such as cash, shares and tradable bonds) where the security is taken within the context of a security financial collateral arrangement.

The primary objective of an administration is to rescue the company as a going concern. The administrator must follow this objective unless he considers that to do so is not reasonably practicable or that the secondary objective (that of achieving a better result for the company's creditors as a whole than would be likely if the company was first wound up, without initially being in administration) would achieve a better result for the company's creditors as a whole, in which case he may follow the second objective.

The administrator may pursue a third objective, of realising property to make a distribution to one or more secured or preferential creditors, if it is not reasonably practicable to achieve either of the first two objectives and he or she does not unnecessarily harm the interests of the creditors of the company as a whole. There are some significant disadvantages in using a UK administration procedure, compared to a US Chapter 11 proceeding.

Many US companies are restructured in Chapter 11 proceedings, exit from bankruptcy and become successful companies. However, some may be liquidated in Chapter 11 as is the case with Lehman Brothers. UK administrations typically result in a sale of the business or liquidation rather than a restructuring. An administrator may be able to achieve the first two of the statutory purposes of an administration (the rescue of the company as a going concern or the achievement of a better realisation of the company's assets than would be obtained in liquidation) by a sale of the company's business and assets as a going concern in excess of liquidation values. An administrator may therefore prefer a sale to a restructuring, which may present a greater number of practical problems. Many of the business sales are carried out as a so-called 'pre-packaged' sale, on terms negotiated before the administrator is appointed, which are then completed immediately upon appointment of the administrator.

Receivership

Receivership is technically an out-of-court enforcement mechanism generally used by a secured creditor when a company is insolvent rather than an insolvency proceeding or a method of restructuring. There are two types of receiverships under UK law.

Administrative receivership

This method is not offered for most types of transaction. It is, however, available for certain types of capital markets, project finance and structured finance deals or where a floating charge was created before September 15, 2003. An administrative receiver is appointed by the holder of a floating charge given by a company that has charged all, or substantially all, of its assets to the chargeholder.

The function of an administrative receiver is to realise the charged assets and to repay the chargeholder. An administrative receiver can, and often will, take over the management of a company and sell the charged assets as a going concern for the benefit of the chargeholder. The remaining company will then be liquidated or dissolved.

Fixed charge receivership

The second type of receivership proceeding is also known as the Law of Property Act (or LPA) receivership as the powers and duties of this type of receiver are still governed by the Law of Property Act 1925. It is an enforcement mechanism used by holders of fixed charges, principally over real estate, to sell the charged assets and repay the chargeholder. The powers of an LPA receiver are more limited than an administrator or administrative receiver but given that their duties are less extensive and there is no court involvement, they can often be appointed more quickly and cheaply.

Liquidation

Liquidation is similar to a US Chapter 7 proceeding. A liquidator is appointed to take control of the company and to collect, realise and distribute its assets. Compulsory liquidation is liquidation by order of the court and is the only method by which a creditor can initiate liquidation. Creditors' voluntary liquidations (insolvent) and members' voluntary liquidations (solvent) are also possible but require shareholder approval. Once the liquidation has been completed, the company is dissolved.

Liquidators (and administrators) have the ability to challenge various payments or transfers of interests in property of the debtor within certain periods prior to the insolvency to ensure the equality of distribution to creditors of the debtor. The periods are typically between six months and two years, depending on the nature of the challenge. Court proceedings are generally required to reverse the transactions.

Company voluntary arrangements and schemes

Consensual out-of-court restructurings are common in the UK. Company voluntary arrangements (CVAs) or schemes of arrangement (Schemes) may also be used with the approval of the requisite majorities. Both of these require filings at court, and the latter also requires court hearings.

For a CVA to bind all unsecured creditors, it must be approved by more than 50% of shareholders and a majority in excess of 75% in value of the unsecured claims of creditors voting (in person or by proxy) at the CVA meeting. A CVA cannot affect the rights of preferential or secured creditors unless they agree.

Creditors or members holding common interests are divided into classes to vote on a Scheme of arrangement. If a majority in number of creditors or members holding 75% or more in value in a class vote (in person or by proxy) are in favour of the scheme, it will bind all the creditors (or members) of that class.

A CVA or Scheme does not trigger a moratorium on creditors' actions (except, in the case of a CVA in respect of a small company and certain other exceptions). A CVA or Scheme is sometimes combined with administration to take advantage of the moratorium provided on administration. CVAs have been used very effectively in distressed retail insolvencies to limit exposure to landlords of over-rented and superfluous premises.

UK cross-border issues

Given the global nature of businesses today, there are usually cross-border issues to consider in any UK insolvency proceedings, regardless of the type of corporate proceeding instituted under UK law. Most UK businesses will have a non-UK customer, supplier or investor.

EC Regulation on Insolvency Proceedings 2000

The EC Regulation on Insolvency Proceedings 2000 (Insolvency Regulation) has been adopted in all EU member states, except Denmark. The Insolvency Regulation establishes principles for recognition and cooperation in cross-border insolvencies across Europe and provides a framework within which the different insolvency regimes in each member state can operate and interact. The Insolvency Regulation, however, does not apply the same substantive insolvency proceedings or the same rules on the creation or enforcement of security across the member states. It does not apply to certain insurance companies, credit institutions or investment undertakings that hold funds or securities for third parties.

Under the Insolvency Regulation, the main insolvency proceedings of a debtor must be opened where it has its centre of main interests (COMI). The COMI is where the debtor conducts the administration of its interests on a regular basis and should be ascertainable by third parties. The Insolvency Regulation creates a rebuttable presumption that the COMI of a debtor is where it has its registered office. It is a legitimate, although controversial, exercise for a debtor to relocate its registered office specifically for the purpose of choosing the member state which it wants to have jurisdiction over its 'main proceedings'.

Main proceedings have universal scope and encompass all of a debtor's assets and affect all creditors, wherever located. UK administrations, CVAs

and liquidations (other than receivership and members' voluntary liquidations) may be main proceedings. The opening of main proceedings will not, however, prevent the enforcement of security in other jurisdictions.

Once main proceedings have been opened, secondary proceedings may be opened in other member states where the debtor has an 'establishment' (that is, carries out non-transitory economic activity with human means and goods). Although secondary proceedings in a jurisdiction are limited to liquidation or winding-up proceedings for the realisation of the debtor's assets in that specific jurisdiction, secondary proceedings may still complicate a restructuring. UK liquidations (other than members' voluntary liquidations) and winding-ups through administration may be opened as secondary proceedings.

If a US company has its COMI in the UK, an English court has jurisdiction to grant an administration order.

Cross-Border Insolvency Regulations 2006

The United Nations Commission on International Trade Law (UNCITRAL) Model Law has been adopted in the UK under the Cross-Border Insolvency Regulations 2006 (2006 Regulations) and in the US as Chapter 15 of the Bankruptcy Code. In the UK, if there is a conflict between the 2006 Regulations and the EU Insolvency Regulation, the EU Insolvency Regulation will prevail.

In the UK, if foreign proceedings are recognised as main proceedings, an automatic stay will apply to certain types of creditor action against the debtor's assets and the transfer or disposal of the debtor's assets in the UK. Discretionary relief may also be granted to protect the debtor's assets in the UK or creditors' interests.

The stay does not prevent a creditor from enforcing security over the debtor's property or exercising set-off, as long as such rights could be exercised in a UK liquidation. The stay will also not prevent the commencement of UK insolvency proceedings, although any such proceedings will be limited to assets in the UK.

If foreign proceedings are recognised as non-main proceedings, no automatic stay applies but discretionary relief may still be granted to protect debtor's assets in the UK or creditors' interests.

The 2006 Regulations also stipulates that a representative of a non-UK court can bring UK insolvency challenges, within the time periods for challenge, for acts or transactions in the UK (but by reference to the opening of the relevant foreign proceedings) other than certain exceptions such as transactions entered into before April 4, 2006 (when the 2006 Regulations came into effect) and security financial collateral arrangements. This time limit does not apply to insolvency challenges brought by any UK liquidator or administrator who may be appointed if the relevant company goes into liquidation or administration.

Conclusion

As the world economic conditions continue their slow and laborious recovery process, insolvency proceedings in the UK (with their attendant cross-border implications and complexities) will remain a vibrant and busy area of the legal landscape.

Notes:

1 See, e.g., Salerno, Kroop & Hansen, *The Executive Guide To Corporate Bankruptcy Second Edition* (Beard Books 2010); Salerno, "Reorganisation Of The Financially Distressed Business Enterprise In The US – Just How Far Afield Is It From The Rest Of The World?", *Global Insolvency & Restructuring Review 2008/09* p13.

2 Scotland has a separate legal system with very similar insolvency procedures and schemes.

3 For example, this occurred in Re BRAC Rent-A-Car International Inc. in 2003.

4 Title 11, United States Code, §§ 101 et seq.

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