UK (England and Wales)

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FORMS OF SECURITY

1. What are the most common forms of security granted over immovable and movable property? Are there formalities that the security documents, the secured creditor or the debtor must comply with? What is the effect of non-compliance with these formalities?

Immovable property

The most common forms of security over immovable property are:

- **Mortgage.** A mortgage is a transfer of ownership in land or other property to secure the payment of a debt or to discharge some other obligation. The debtor has a right of redemption, under which the creditor must transfer title back to the debtor when the debt is repaid or the obligation discharged.
- **Fixed charge.** A fixed charge is typically taken over a specific, valuable asset (such as land, machinery, ships or aircraft). Title and possession remain with the borrower, but the borrower cannot usually dispose of the asset without the lender's permission or until the debt is repaid. This can cause difficulties where the relevant assets (for example, accounts receivable) are used in the ordinary course of the borrower's business and therefore floating charges are used in these cases (*see below, Movable property: Floating charge*).

  A lender holding a fixed charge has recourse to the asset if the borrower defaults under the loan. The lender usually has a power of sale over the asset, or the power to appoint a fixed charge receiver to deal with and realise the asset on its behalf (because of concerns over lender liability, the second option is normally used). The lender therefore has a claim over the proceeds of sale in priority to other creditors. Where the sale proceeds are less than the amount of the loan, the lender has an unsecured claim for the balance, but if there is a surplus after repayment of the loan, the balance must be returned to the borrower.

  A fixed legal mortgage or charge is the best security interest available as it gives the secured lender a proprietary interest in the asset ahead of the costs and expenses of office-holders appointed on an insolvency (other than those of the receiver appointed by the lenders), and the claims of floating charge holders, preferential creditors and unsecured creditors (*see Question 2*).

Movable property

The most common forms of security over movable property are:

- **Mortgage and fixed charge.** See above, *Immovable property*.
- **Floating charge.** A floating charge secures a group of assets, which fluctuate with time, such as cash in a trading bank account. Assets secured by a floating charge are identified generically rather than individually (for example, a borrower's undertaking and assets or inventory).

  Unlike a fixed charge, a floating charge allows the borrower to deal with the charged assets in the ordinary course of business without the charge holder's consent. If certain events occur (usually events of default set out in the charging instrument), the floating charge effectively becomes a fixed charge in relation to all assets over which it previously "floated", and which remain in the borrower's possession. At this point, the floating charge crystallises and the borrower is then unable to dispose of the assets without the lender's consent.

  In the order of payment on an insolvency, floating charge holders rank behind fixed charge holders and certain other creditors (*see Question 2*).
- **Pledge.** A pledge is a way to create security by delivering an asset to a creditor to hold until an obligation is performed (for example, a debt is repaid). The creditor takes possession of the asset while the debtor retains ownership. The creditor can sell the pledged asset if the obligation is not performed.
- **Lien.** A lien is the right to retain possession of another person's property until a debt is settled. Liens arise automatically under English law in certain types of commercial relationships, such as a client's relationship with his solicitors or bankers. They can also be created contractually. A lien does not confer a right on the holder to dispose of the relevant asset if the debt is not paid.

Formalities and non-compliance

Formalities for creating a security interest depend on the nature of the asset over which security is to be granted and the nature of the security interest to be granted.

To be effective against liquidators, administrators and buyers of relevant assets for value, most mortgages and fixed charges and all floating charges created by a company must be registered with Companies House within 21 days of their creation. Registration is not a requirement for attachment; an unregistered charge is effective against the company provided it is not in liquidation or administration.

Pledges and liens do not require registration.

Security over certain assets may also require registration at specialist registers (for example, land, certain intellectual property rights, ships and aircraft). If these security interests are not registered, these charges will be void against secured creditors, and against a liquidator or administrator and creditors generally in a liquidation.

CREDITOR AND SHAREHOLDER RANKING

2. Where do creditors and shareholders rank on a company's insolvency?

In corporate insolvencies, creditors and shareholders are paid in the following order of priority:

- **Fixed charge holders.** Fixed charge holders are paid up to the amount realised from the assets covered by the fixed charge (net of the costs of realising those assets). If the value of the charged assets is less than the amount of the debt, the charge holder can claim the balance as an unsecured creditor (or under any valid floating charge in its favour).
- **Liquidators.** Liquidators' fees and expenses have priority over preferred creditors and floating charge holders (subject to restrictions relating to certain expenses which have not been authorised or approved by floating charge holders, by preferential creditors or the court).
- **Preferred creditors.** Preferred creditors are mainly employees with labour-related claims (such as unpaid wages and contributions to occupational pension schemes).
- **Floating charge holders.** Floating charge holders are paid up to the amount realised from the assets covered by the floating charge. From 15 September 2003, part of the proceeds from realising assets covered by the floating charge must be set aside and made available to satisfy unsecured debts (prescribed part). The prescribed part is calculated as 50% of the first GB£10,000 (as at 1 February 2011, US$1 was about GB£0.6) of net floating charge realisations and 20% of the remainder, subject to a cap of GB£600,000. The prescribed part must not be distributed to floating charge holders unless the claims of unsecured creditors have been satisfied and there is a surplus.
- **Unsecured creditors.**
- **Interest.** Interest incurred on all unsecured debts post-liquidation.
- **Shareholders.** Any surplus goes to the shareholders according to the rights attached to their shares.

UNPAID DEBTS AND RECOVERY

3. Do trade creditors use any mechanisms to secure unpaid debts?

The main mechanism used by trade creditors to secure unpaid debts is a retention of title clause in sale contracts. This provides that title in goods does not pass from the trade creditor to the buyer until it has received full payment for the goods. These clauses sometimes provide for title to be retained by the trade creditor until all outstanding amounts due to the trade creditor have been paid (and not simply the price for the particular goods sold).

Difficult issues can arise where goods which are subject to a retention of title clause are mixed or incorporated with other goods as part of a manufacturing process or the clause provides that, if the buyer sells the goods, it must account to the trade creditor for the sale proceeds.

4. Can creditors invoke any procedures (other than the formal rescue or insolvency procedures described in *Question 6*) to recover their debt? Is there a mandatory set-off of mutual debts on insolvency?

Court judgment

An unpaid creditor can bring proceedings against a debtor seeking a judgment for the debt. If the debt is undisputed, judgment can be sought on a summary basis.

Once judgment has been obtained, the creditor can enforce it by seeking either:

- A charging order over the debtor's property.
- An order requiring a third party to pay a receivable due to the debtor to the judgment creditor instead.

Receivership

Receivership is an out-of-court enforcement mechanism for secured creditors. If the debtor defaults under the relevant security documents, the secured creditor can appoint a receiver over secured assets to satisfy its debt.

Any duty the receiver owes to the company, its directors, other creditors and shareholders is secondary to the receiver's duty to realise the charged assets on behalf of the appointing chargee.

There are two main types of receivership under English law:

- **Administrative receivership.** Under the Insolvency Act 1986 (*see Question 6, Administrative receivership*).
- **Fixed charge receivership.** Where the creditor has fixed charges over specific assets, the creditor can appoint one or more fixed charge receivers over those specific assets. The receiver's main function is to sell the charged assets and to account to the creditor for the sale proceeds (net of costs). A fixed charge receiver need not be an authorised insolvency practitioner.

Insolvency set-off

The rules of insolvency set-off are mandatory and cannot be varied by contract. Where a creditor proves in a liquidation or administration (*see Question 6, Liquidation* and *Administration*), an account must be taken of the mutual dealings between the creditor and the company in liquidation or administration. The sums due from one party will be set off against the sums due from the other, except that sums due from the insolvent party will not be taken into account if the other party had notice at the time they were incurred of:

- A resolution or petition to wind up.
- An application for an administration order or notice of an intention to appoint an administrator.

All amounts, including future, contingent and unliquidated sums, are brought into account.

STATE SUPPORT

5. Is state support for distressed businesses available?

Special Rescue and Insolvency Procedures for Banks

The Banking Act 2009 (2009 Act) came into force in February 2009. The most significant aspect of the 2009 Act is the special resolution regime (SRR) which gives the government authorities various powers to deal with banks and other deposit-taking institutions which are failing. The rescue mechanisms are referred to as "stabilisation powers" and the SRR provides for three stabilisation options in relation to UK banks:

- Transfer of the banking business to a third party, to facilitate a private sector solution.
- Transfer of all or part of the bank's business to a publicly controlled ''bridge bank".
- Transfer of the bank into temporary public sector ownership.

The 2009 Act also introduces new insolvency and administration regimes for banks and building societies. The main features of the new bank insolvency procedure are based primarily on the existing liquidation provisions of the Insolvency Act 1986. The new bank administration procedure is to be used when part of the business of the bank has been sold to a third party or transferred to a "bridge bank" under the SRR and a bank administrator is appointed by the court to administer the affairs of the insolvent residual bank.

Enterprise Finance Guarantee

In January 2009, the UK Government launched the Enterprise Finance Guarantee (EFG). The EFG is a GB£1.8 billion loan guarantee scheme aimed at facilitating additional bank lending to small and medium enterprises (SMEs) with viable business cases but insufficient security. By providing lenders with a government-backed guarantee, the aim is to facilitate lending that would otherwise not be available and to ensure that SMEs can obtain the working capital and investment they require. The EFG is available until 31 March 2011, having recently been extended.

Business Payment Support Service

In late 2008, the UK HM Revenue & Customs (HMRC) introduced a Business Payment Support Service (BPSS) to meet the needs of businesses affected by the economic downturn. The BPSS is available to all distressed businesses who have a viable business plan. Although the HMRC review each case on an individual basis, there is scope to suggest temporary, tailored options such as arranging for tax payments to be made over a longer period.

RESCUE AND INSOLVENCY PROCEDURES

6. In relation to each available rescue and insolvency procedure:

- **What is its objective and, where relevant, what are the prospects for recovery?**
- **How is it initiated, when, by whom and which companies can it be applied to?**
- **Can the company obtain any protection from its creditors during the procedure?**
- **What substantive tests apply?**
- **How long does it take?**
- **What consents and approvals are required?**
- **Who supervises the procedure and controls the company's affairs (for example, an independent accountant or the court)?**
- **How does it affect the company, shareholders, employees, trading partners and creditors?**
- **How is the procedure formally concluded and what happens to the company on conclusion?**

Administration

Objective. The administration procedure is a way of facilitating a rescue of a company or the better realisation of its assets. It allows an insolvent company to continue to trade with protection from its creditors through a statutory moratorium (*see below, Effect*).

The main aim of administration is to rescue the company as a going concern. However, if the administrator thinks this is not reasonably practicable or that a better result can be achieved for creditors as a whole, the second objective is to achieve a better result for the company's creditors than is likely if the company is wound up (without first being in administration).

The third objective, which only applies if the administrator thinks it is not reasonably practicable to achieve the first two objectives and if it will not "unnecessarily harm" the interests of the creditors as a whole, is to realise property to distribute the proceeds to the secured or preferential creditors. The 2002 Act does not explain what constitutes "unnecessarily harming" and it still remains to be seen what practical impact this will have on an administrator's decision to sell assets.

Initiation. An administrator can be appointed by court order. An application is usually made by:

- The company.
- The company's directors.
- One or more creditors of the company.

There is also an out-of-court procedure for placing a company in administration, which is available to both:

- A company through its directors or shareholders.
- Qualifying floating charge holders.

Administration is potentially available to both UK and foreign-registered companies. The rules concerning cross-border insolvencies are complex but the availability of the administration procedure generally depends on a company's centre of main interest (COMI) being located in the UK. A company's COMI depends on where it conducts the administration of its interests on a regular basis and should be ascertainable by third parties (*see also Question 12*).

Protection from creditors. See below, *Effect*.

Substantive tests. In most cases, an administration cannot begin unless it can be demonstrated that both:

- The company is, or is likely to become, unable to pay its debts.
- Administration is likely to achieve one of the purposes (*see above, Objective*).

If a qualifying floating charge holder appoints an administrator, there is no requirement for the company to be insolvent, although the floating charge underlying the appointment must be enforceable.

Length of procedure. The administrator's appointment terminates one year after the date the appointment took effect. However, the appointment can be extended by the court for a specified period or for a period not exceeding six months, with the creditors' consent.

Consents and approvals. Where the court appoints the administrator, the applicant must notify any qualifying floating charge holder. If a qualifying floating charge holder has already appointed an administrator or administrative receiver, the court does not usually grant an administration order.

Where the appointment is made out of court, the company or its directors must give all persons holding a qualifying floating charge five business days' written notice of their intention to appoint an administrator, who must also be identified in the notice. This is to enable a qualifying floating charge holder to appoint its own administrator if it does not approve of the company's or directors' proposed choice.

Supervision and control. One or more licensed insolvency practitioners can be appointed as administrators. The administrators:

- Are officers of the court (whether or not appointed by the court) and act as the company's agent.
- Have very extensive management powers (*see Question 10*).
- Have investigatory and enforcement powers, including powers to apply to the court to unwind pre-insolvency transactions (*see Question 9*).

The directors' management powers generally cease although the administrator may leave some or all of the powers with the directors.

Effect. An automatic statutory moratorium, which comes into effect when an application for administration or a notice of intention to appoint an administrator is filed, helps the administrator achieve the objectives of the administration. The moratorium is a stay on creditors from taking any legal action or enforcing their security against the company or its property.

There is no direct impact on employees if an administrator is appointed and the procedure does not interfere with company contracts.

Conclusion. The way in which an administration is concluded depends on its objective. Administration usually results in one or more of the following:

- The administrator selling the company's assets and distributing their proceeds to creditors and shareholders.
- A composition of creditors' claims through a company voluntary arrangement (*see below, Company voluntary arrangement*).
- A scheme of arrangement (*see below, Scheme of arrangement*).
- Liquidation and dissolution of the company (*see below, Liquidation*).

Company voluntary arrangement

Objective. A company voluntary arrangement (CVA) is a form of statutory composition between a company and its creditors. Its aim is to enable a company in financial difficulty to propose a compromise or arrangement with its creditors.

Initiation. A CVA can be commenced by a company's directors, or if the company is already in administration or liquidation, by the company's administrators or liquidators.

A copy of the proposed arrangement is filed in court, but the court has no active involvement in the procedure. While it does not need to be prefaced by an administration, it is often used in conjunction with administration because a CVA does not itself provide for a moratorium unless the company is a "small company" (this is based on the company's financial returns) (*see above, Administration*).

A CVA is available to the same companies as for administration (*see above, Administration: Initiation*).

Protection from creditors. There is generally no protection but a moratorium on legal processes, including the enforcement of security, is available for small companies contemplating a CVA. The moratorium lasts between one and three months. See also below, *Effect* and *Question 13*, which outlines proposed reforms to extend the moratorium to medium and large companies.

Substantive tests. The company does not need to demonstrate that it is, or is likely to become, insolvent.

Length of procedure. The duration of a CVA depends on its terms.

Consents and approvals. A CVA must be approved by creditors holding at least 75% in value of the claims held by all unsecured creditors voting at a meeting convened for this purpose. Shareholders must also approve the CVA by a majority vote, but if the creditors approve the CVA and the shareholders do not, the creditors' approval prevails (although dissenting shareholders can challenge the CVA by applying to the court on the grounds of unfair prejudice or procedural irregularity).

Supervision and control. If a proposal for a CVA is approved, it is normally implemented under the supervision of a licensed insolvency practitioner. The company's directors must do everything possible to put the relevant assets of the company into the hands of this supervisor. The directors do, however, otherwise remain in control.

Effect. The CVA binds the company and all creditors, irrespective of whether they attended the creditors' meeting or received notice of it (although any creditor who did not receive notice of the creditors' meeting is entitled to treatment under the CVA as if he received notice of it, and has 28 days to challenge the CVA from the date he becomes aware of it). However, the CVA does not bind secured creditors unless they consent to be bound by it.

There is no direct impact on employees and the procedure does not interfere with company contracts.

Conclusion. A CVA is concluded once its terms have been implemented. The company reverts to its former status and control returns to its directors and shareholders.

Scheme of arrangement

Objective. Like a CVA (*see above, Company voluntary arrangement*), a scheme of arrangement (scheme) enables a company to reach a compromise or arrangement with its creditors or with certain classes of its creditors.

Initiation. A scheme can be initiated by the company itself or by the company's administrator or liquidator. The process is relatively complex, time consuming and can be costly, as it involves both applications to court and meetings of the various classes of creditors and shareholders who may be affected by the scheme. Since the preparatory steps of a scheme are not protected from creditor actions, when they are used in restructuring scenarios, they are often used in tandem with administration, which does provide a moratorium (*see above, Administration*).

A scheme is generally available to companies registered in the UK, but may also be available in the case of a non-UK registered company which could be wound up in the UK, provided that it has its centre of main interest or an establishment in the UK or potentially some other sufficient connection.

Protection from creditors. There is no moratorium so creditors may take enforcement action against the company up until the point at which the scheme is sanctioned.

Substantive tests. It is not necessary for the company to show that it is, or is likely to become, insolvent.

Length of procedure. The duration of a scheme depends on its terms.

Consents and approvals. All classes of creditors affected by the scheme must approve the scheme. A class approves the scheme if at least 75% in value and more than half in number of the creditors in that class present and voting at the scheme meeting (in person or by proxy) vote in favour of it. Once all required classes have approved the scheme at the scheme meetings, the parties request the court to sanction or approve it.

Supervision and control. The directors of the company remain in control.

Effect. Once the scheme has been sanctioned by the court and a copy of the order filed at Companies House, it binds the company and all of its creditors, including any creditors who did any of the following:

- Voted to reject the scheme.
- Did not attend the scheme meeting.
- Did not receive notice of the scheme.

Secured creditors can also be bound if their class approves the scheme.

There is no direct impact on employees and the procedure does not interfere with company contracts.

Conclusion. The scheme is concluded in accordance with its terms and the company reverts to its former status.

Administrative receivership

Objective. Administrative receivership is an out-of-court enforcement mechanism for secured creditors. As a result of legislative changes introduced by the Enterprise Act 2002 (2002 Act), this process is now used very rarely, and generally only for securitisations and regulated industries.

The mechanism is used to realise assets to satisfy a secured creditor's debt. Any duty the administrative receiver owes to the company, its directors, other creditors and shareholders is secondary to his duty to realise the charged assets on behalf of the appointing secured creditor.

Initiation. Any holder of a floating charge over all or substantially all of a company's assets created before 15 September 2003 can appoint one or more administrative receivers after an event of default. Subject to certain limited exceptions, the changes introduced by the 2002 Act now prevent the appointment of an administrative receiver in relation to floating charges created after 15 September 2003. Administrative receivership is available to a company incorporated within the UK.

Protection from creditors. The appointment of an administrative receiver does not create an automatic moratorium. Creditors may therefore commence or continue legal actions against the company.

Substantive tests. The appointment of a receiver is subject to the enforcement provisions contained in the security documents.

Length of procedure. There is no time limit, but an administrative receiver usually seeks to realise and distribute assets as quickly as possible.

Consents and approvals. No consent or approval is required.

Supervision and control. The administrative receiver controls the affairs of the company. The directors' powers of management are suspended.

Effect. Administrative receivers have the power to sell all or part of the company's business and assets to satisfy the secured creditors' claims.

There is no direct impact on employees and the procedure does not interfere with company contracts.

Conclusion. Once a sale has occurred and the administrative receiver has accounted to the secured creditor for the proceeds of sale (net of costs), control of the company is returned to the directors for either continued operations or final liquidation (*see below, Liquidation*).

Liquidation

Objective. There are two types of liquidation:

- **Voluntary liquidation.** This is not a court proceeding and can be started in relation to a solvent company (members' voluntary liquidation (MVL)) and an insolvent company (creditors' voluntary liquidation (CVL)).
- **Compulsory liquidation.** This is a court proceeding.

Liquidation is used to wind up a company, and realise and distribute its assets to creditors and shareholders.

Initiation. Voluntary liquidation is initiated by a shareholders' resolution to wind up the company. Compulsory liquidation is started by the presentation of a petition to the court by any of the following:

- The company.
- The company's shareholders.
- The company's directors.
- The company's creditors.

A company and its directors are not required to file for liquidation on insolvency, but may wish to do so to avoid incurring liability for wrongful or fraudulent trading (*see Question 8*).

While the rules relating to cross-border insolvencies are complex, CVL and compulsory liquidation are potentially available to both UK and foreign-registered companies, provided they can demonstrate they have their centre of main interest or an establishment in the UK or potentially some other sufficient connection. MVL is only available to companies incorporated in the UK.

Protection from creditors. See below, *Effect*.

Substantive tests. The most common ground on which creditors petition the court for a compulsory winding-up order is that the company is unable to pay its debts, which is deemed if any of the following occur:

- A creditor who is owed more than GB£750 by the company serves a statutory demand on the company and the company fails to pay.
- A judgment remains unsatisfied.
- It is proved to the court that the company is unable to pay its debts as they fall due.
- It is proved to the court that the company's liabilities (including contingent and prospective liabilities) are more than the company's assets.

A court can also wind up a company if it can be shown that it is just and equitable to do so.

An MVL must be supported by a statutory declaration sworn by the directors that the company will be able to pay its debts in full, together with interest, within 12 months of the start of the MVL.

Length of procedure. This depends on the substance of the liquidation and the company's situation.

Consents and approvals. Resolutions for MVL and CVL must be approved by 75% of shareholders voting at the relevant shareholders' meeting. A CVL also requires approval by a majority by value of the company's creditors at a meeting called for that purpose. A court order is required to place a company into compulsory liquidation.

Supervision and control. See below, *Effect*.

Effect. Compulsory liquidation (unlike an MVL or CVL) provides for an automatic stay or moratorium by prohibiting any action or proceedings from being started or continued against the company or its property, without leave of the court. Once the court makes a winding-up order, the company's directors are automatically dismissed and replaced by the liquidator, who is vested with extensive powers to act in the name of the company (*see Question 10, Liquidation*).

On a compulsory liquidation and CVL, employees' service contracts are automatically terminated, unlike an MVL.

Company contracts are not automatically terminated but a liquidator has the ability to terminate onerous contracts to facilitate a winding-up.

Conclusion. The company is dissolved once the liquidator has realised all the company's assets and, where applicable, made distributions to creditors and shareholders.

STAKEHOLDERS' ROLES

7. Which stakeholders have the most significant role in the outcome of a restructuring or insolvency procedure?

While English insolvency procedures are favourable to senior lenders, most restructurings involve negotiations between creditors and the company outside of any statutory procedure. Typically, the creditors (including bondholders and lenders) are required to vote on the acceptance of a restructuring proposal and a proposed CVA or scheme can be defeated if the statutory majorities of creditors do not vote in favour of it.

LIABILITY

8. Can a director, parent company (domestic or foreign) or other party be held liable for an insolvent company's debts?

The main ways in which a company's directors (including de facto and shadow directors) can be held liable to contribute to the company's assets are as follows:

- **Misfeasance or breach of fiduciary duty.** A liquidator, any creditor or any contributory can bring proceedings against any officer of the company or anyone involved in promoting, forming or managing the company, in connection with any alleged misfeasance or breach of fiduciary or other duty.
- **Fraudulent trading.** Any person who is or was knowingly a party to the carrying on of business by a company with intent to defraud creditors may be liable to contribute to the company's assets. Criminal penalties may also be imposed for fraudulent trading even if the company is not insolvent.

- **Wrongful trading.** A successful wrongful trading action imposes personal liability on directors if they allow a company to continue trading after they knew, or ought reasonably to have known, that there was no reasonable prospect of avoiding insolvent liquidation. However, it is a defence to a wrongful trading action if the directors can show that, from the relevant time, they took every step to minimise the potential loss to the company's creditors.

  If an insolvent company is an employer with an occupational defined benefit pension scheme, the pensions regulator can, in certain circumstances, serve notices on persons who are connected or associated with the company (which includes other members of a corporate group, directors and shareholders with one-third or more voting control), which may make them liable for the company's pension obligations.

SETTING ASIDE TRANSACTIONS

9. Can an insolvent company's pre-insolvency transactions be set aside? If so:

- **Who can challenge these transactions, when and in what circumstances?**
- **Are third parties' rights affected?**

Challenging pre-insolvency transactions

On a company's liquidation or administration, the liquidator or administrator can apply to the court for an order to avoid or unwind certain transactions that took place before the insolvency. The court has wide discretion to grant these orders if it determines that a pre-insolvency transaction should be avoided or unwound. The overriding principle is to restore the company to the position it would have been in if the improper transaction had not occurred.

The transactions that can be set aside are as follows:

- **Transactions at an undervalue.** The court can set aside a transaction entered into by a company for no consideration, or for significantly less consideration than the value of the transaction, unless both:
  - the company enters into the transaction in good faith and for the purpose of carrying on its business;
  - at the time, there were reasonable grounds for believing that the transaction would benefit the company.

  The vulnerable period is two years before the start of liquidation or administration.

- **Preferences.** A preference is a transaction by a company that prefers a creditor, surety or guarantor by putting that party (in a hypothetical insolvent liquidation of the company), into a better position than that party would have been in if the transaction had not taken place. The court can set aside a preference if there is evidence that the company was influenced by a desire to prefer the creditor. The vulnerable period is six months before liquidation or administration starts, unless the preferred creditors are connected to the company (for example, the company's directors), in which case the period is two years.

- **Avoidance of floating charges.** Floating charges created by an insolvent company in the year before the insolvency are invalid, except to the extent of the value of the consideration given to the company by the lender when the charge was created. This period is extended to two years where the charge was created in favour of a "connected person" (*see above, Preferences*).

  Generally, a transaction is only a transaction at an undervalue (*see above, Transactions at an undervalue*) or a preference, and a floating charge is only avoided, if at the time the company enters into the transaction or creates the charge, it is unable to pay its debts or becomes unable to do so as a consequence of the transaction or preference.

- **Transactions defrauding creditors.** This is similar to a transaction at an undervalue (*see above, Transactions at an undervalue*), but the court only makes an order to unwind a transaction if it is satisfied the transaction was entered into to defraud creditors by putting assets beyond the reach of claimants against the company. No time limit applies for unwinding the transaction.

- **Dispositions after the start of winding up.** Any disposition of a company's property made after winding up has started is void, unless the court orders otherwise. This provision can cause difficulties, as a compulsory winding-up is deemed to start when the petition is presented, rather than on the date of the court order.

Third party rights

The rules concerning third party rights in pre-insolvency transactions are complex. Although third-party rights may be affected, there is generally protection for bona fide purchasers acquiring property or benefits for value without notice of the relevant circumstances. Persons who are not direct recipients, parties to the transaction, or connected with the company or the parties to the transaction, are usually accorded a broad defence.

CARRYING ON BUSINESS DURING INSOLVENCY

10. In what circumstances can a company continue to carry on business during insolvency or rescue proceedings? In particular:

- **Who has the authority to supervise or carry on the company's business?**
- **What restrictions apply?**

Administration

On appointment, an administrator assumes management of a company and, although the directors usually remain in place, they cannot exercise any powers in a manner that is inconsistent with the administration (directors can be dismissed by the administrators at any time).

The administrator can do anything necessary or expedient for the management of the company's affairs, business or property, such as:

- Sell the company's assets.
- Borrow money on behalf of the company.
- Bring or defend proceedings.

During the administration, the administrator must report to creditors and seek approval for his proposals. If a creditor believes that the administration is not being conducted properly, he can apply to court for the removal of the administrator.

CVA and scheme of arrangement

The directors remain in control of the company, continue to trade and undertake the company's business, unless otherwise provided by the terms of the CVA or scheme.

Liquidation

Once the court makes a winding-up order, the company's directors are automatically dismissed and replaced by the liquidator who is vested with extensive powers to act on the company's behalf. The liquidator can continue to operate the company's business if this achieves better realisation of the assets than an immediate liquidation, but it is rare for a liquidator to do so.

ADDITIONAL FINANCE

11. Can a company that is subject to insolvency proceedings obtain additional finance (for example, debtor-in-possession financing or equivalent)? Is special priority given to the repayment of this finance?

Administration and liquidation

An administrator or liquidator can raise money on the security of the unencumbered assets of the company. Such additional funding has priority over all claims as an expense of the administration or liquidation.

CVA and scheme of arrangement

The raising of finance and the use of assets as security tends to be a matter for agreement between the company and its creditors. Typically, the company will look to its existing lenders to provide additional funding.

MULTINATIONAL CASES

12. In relation to multinational cases:

- **Do local courts recognise insolvency and rescue procedures in other jurisdictions, and court judgments made during these procedures? Is recognition given under specific legislation or under case law (for example, principles of comity)?**
- **Do courts co-operate where there are concurrent proceedings in other jurisdictions?**
- **Is your jurisdiction party to any international treaties, model laws or EU legislation (if applicable)?**
- **Are there any special procedures that foreign creditors must comply with when submitting claims in local insolvency proceedings?**

Recognition

Section 426 of the Insolvency Act 1986 provides a statutory framework for the reciprocal co-operation with English courts in relation of a number of former UK colonies and dependencies. When considering whether to provide assistance, the court can apply substantive English insolvency law or the law of the foreign jurisdiction if it is consistent with English law.

Regulation (EC) 1346/2000 on insolvency proceedings (Insolvency Regulation) requires the English courts to automatically recognise insolvency proceedings started in other EU member states and contains detailed provisions on concurrent proceedings in different member states (*see below*).

Directive 2001/24/EC on the reorganisation and winding up of credit institutions provides for a single set of winding-up or reorganisation proceedings to be commenced in the EU member state in which a credit institution has been authorised to take up its business. Subject to certain exceptions, the home member state's insolvency rules apply throughout the EU and any decision relating to the commencement of reorganisation or winding-up procedures is automatically effective in another member state.

Concurrent proceedings

The UNCITRAL Model Law on Cross-Border Insolvency 1997 was implemented in England and Wales on 4 April 2006 by the Cross-Border Insolvency Regulations 2006. The Regulations provide uniform legislative provisions to deal with cross-border insolvency and promote:

- Co-operation between the courts and competent authorities involved in cases of cross-border insolvency.
- Fair and efficient administration of cross-border insolvency that protects the interests of all creditors and other interested persons, including debtors.
- The protection and maximisation of the value of the debtors' assets.
- The rescue of financially troubled businesses.

International treaties

The following international treaties apply:

- Insolvency Regulation.
- Cross-Border Insolvency Regulations 2006.

Procedures for foreign creditors

Generally, foreign creditors can claim debts due to them in UK insolvency proceedings in the same manner as local creditors. Foreign currency debts are converted into sterling. However, to ensure that local creditors are not prejudiced, if there are concurrent proceedings abroad, any recovery made in the foreign insolvency proceedings will be taken into account.

REFORM

13. Are there any proposals for reform?

In early December 2010, an important decision concerning administration expenses was handed down in the High Court in the cases of Nortel Networks and Lehman Brothers (*Bloom and ors v The Pensions Regulator and ors [2010] EWHC 3010 (Ch)*). It has been held that liabilities under financial support directions issued by the Pensions Regulator against companies after they have gone into administration should be treated as an expense of the administration rather than provable debts and, therefore, rank above floating charge holders and unsecured creditors in the insolvency process. The ruling has a significant impact both on the status of the Pensions Regulator's so-called "moral hazard" powers, which enable it to issue companies with financial support directions, and the priority of claims in administration. Following the decision the government is also likely to review the priority of claims in relation to pensions, leases and other expenses although in both cases, an appeal against the High Court decision has been lodged and is likely to be heard in the summer of 2011.

The UK government is also currently considering a number of more general proposals to reform insolvency law and some of these are set out below. However, the austerity measures unveiled by the coalition government means it is unclear whether these measures will be implemented.

The Insolvency Rules

Over the last two years, the Insolvency Service has implemented a series of modernisation changes to the Insolvency Rules (which supplement the Insolvency Act 1986). Some of the most important changes include:

- A more flexible regime for the advertising and/or publicity of insolvency events.
- Enabling an insolvency office holder to recover costs and expenses incurred before his appointment as an expense of the administration.
- Facilitating the delivery of documents electronically between insolvency office holders and creditors and allowing remote attendance at creditors' meetings.

As the final phase of the modernisation work, the Insolvency Service intends to produce a new set of Rules which will restructure and entirely replace the Insolvency Rules. This final phase is planned to take place during 2011.

Restructuring moratorium

During 2010, the Insolvency Service also launched a consultation paper, Proposals for a restructuring moratorium, which sets out proposals for a new three month court sanctioned moratorium for companies seeking to restructure their debt. The current proposals have evolved from proposals made in 2009 to extend the moratorium currently available to small companies in a CVA to medium and large companies. A far wider restructuring moratorium is now proposed, which should be available to a company which is either seeking a contractual compromise with its creditors or proposing a statutory compromise by way of CVA or Scheme of arrangement. The proposals raise a number of significant issues particularly relating to the relationship between the proposed moratorium procedure and existing insolvency procedures and it therefore remains to be seen whether the proposals will be implemented.

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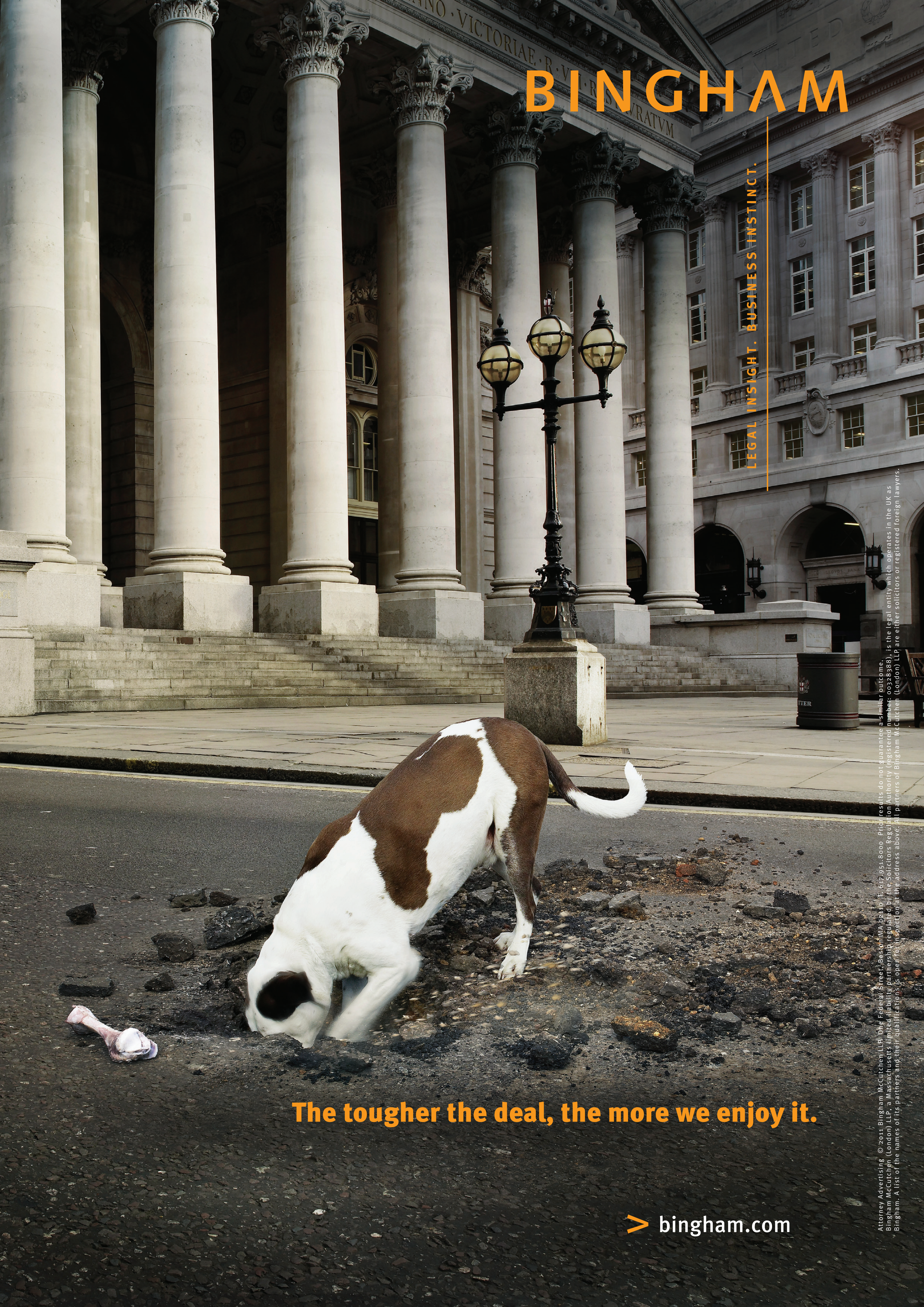
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