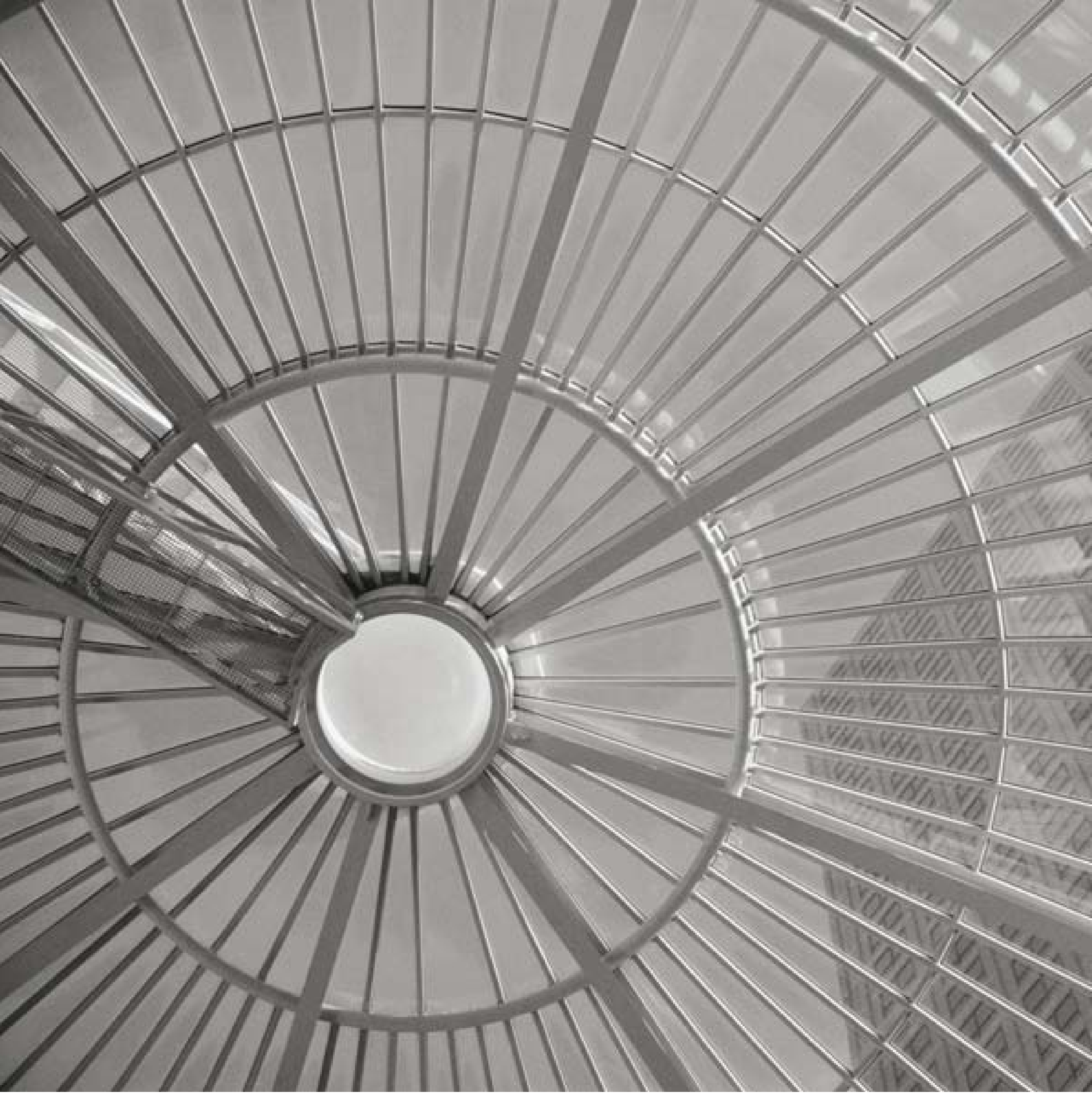

ACCA

insolvency newsletter

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COMPANIES ACT 2006

Members are reminded that many individual provisions of the Companies Act were brought into effect on 1 October 2007. The remaining provisions will come into effect in April 2008 – these concern most of the accounting and audit provisions, including the new provisions on audit liability limitation agreements – and then, finally, in October 2009. With regard to the latter tranche of provisions, the implementation date has recently been deferred from October 2008 to October 2009 due to computer issues at Companies House.

Those elements brought into effect in October 2007 include the new rules codifying the duties of company directors. Sections 170-177 of the Companies Act 2006 supersede the common law rules and principles. In summary, they amount to the following:

S170 – directors owe their duties to the company (and not, as a rule, to any third parties).

S171 – directors must act in accordance with their company's constitution and only exercise their powers for the purposes for which they are conferred.

S172 – directors must act in the way they consider, in good faith, to be most likely to promote the success of their company for the benefit of their members as a whole, and in doing so, must have regard to a range of specified factors, viz

- The likely long term consequences of their decisions
- The interests of their company's employees
- The need to foster the company's business relationships with suppliers, customers and others
- The impact of the company's operations on the community and the environment
- The desirability of the company maintaining a reputation for high standards of business conduct
- The need to act fairly as between members of the company.

(NB this provision does not affect the common law rule that, where a company is in an insolvent state the directors owe their duties to the company's creditors)

S173 – directors must exercise independent judgement

S174 – directors must exercise reasonable care, skill and diligence; this statutory test is framed along similar lines to the objective and subjective tests found in s214 of the Insolvency Act 1986.

S175 – directors must avoid situations where they have, or could have, a material conflict of interest.

S176 – directors must not accept benefits from third parties which are conferred by reason of them being or acting as directors and which give rise to a conflict of interest.

NB both s175 and s176 are actionable even after a director has ceased to hold office in a company.

S177 – directors must declare an interest in any proposed transaction or arrangement with the company.

While these duties are enforceable by the company, viz its directors or liquidator, there is a also a new statutory derivative action available to a company's individual members whereby they can bring proceedings against directors, in the name of their company, in respect of alleged breaches of their duties to their company.

An ACCA publication on the implications of the new Act for company directors is available from the ACCA website at http://www.accaglobal.com/publicinterest/activities/library/company_law

Still to come into effect is s1282 of the new Act which makes changes to the statutory rules regarding the payment of expenses in winding up (in consequence of *Leyland Daf*). S1282 inserts a new s176A into the Insolvency Act 1986. This new section provides that, where the assets of the company are not sufficient to pay the expenses of the liquidation, those expenses may be paid, in priority, out of any assets which are covered by a floating charge. Regulations are to be made under the new section which will oblige the liquidator to consult with floating charge holders and preferential creditors and will specify any restrictions which will apply to the liquidator's powers. These are likely to come into effect in the Spring of 2008.

MONEY LAUNDERING

The Money Laundering Regulations 2007 come into effect in the UK on 15 December 2007. These regulations supersede the Money Laundering Regulations 2003, which are withdrawn. The new regulations implement the requirements of the EU's Third Money Laundering Directive: accordingly, similar changes are happening throughout the EU.

The 2007 Regulations retain the following core elements:

- Accountants in public practice, as well as tax advisers and insolvency practitioners (and many other classes of businesspeople), are subject to statutory requirements under the Regulations by virtue of being deemed to be part of 'the regulated sector'.
- Client due diligence checks must be carried out in respect of new clients.
- Internal procedures must be put in place to minimise the risk of the firm being used for money laundering purposes.
- A money laundering reporting officer (or 'nominated officer') must be appointed by firms to act as the conduit for intra-firm reporting of suspicions and to assume responsibility for making final decisions on behalf of the firm as to whether particular matters stand to be reported to the Serious Organised Crime Agency (SOCA).

There is no change either in the basic provisions of the *Proceeds of Crime Act 2002*, namely that persons in the regulated sector must not themselves infringe the statutory money laundering offences and must report knowledge or suspicions of money laundering or terrorist financing: in the case of persons other than nominated officers, such reports must be made to the firm's nominated officer, while the nominated officer must make the decision on behalf of the firm as to whether or not to make an external report to SOCA. Neither is there any change in the 'all crimes' approach of POCA – the financial proceeds of any crime under UK law may give rise to a duty to report.

The new Regulations incorporate, however, a number of changes which members should note. These include the following

Client due diligence (regs 5–7)

The circumstances in which CDD checks must be carried out are extended. The Regulations now insist that CDD procedures are carried out when the regulated person

- establishes a business relationship
- the regulated person carries out an occasional transaction
- suspects money laundering or terrorist financing
- doubts the integrity of information previously obtained for CDD purposes.

CDD procedures must also be applied to existing clients on a 'risk sensitive basis'.

The new Regulations also go into further detail as to expected procedures. Reg 5 says that CDD checks amount to

- identifying the customer and verifying his identity on the basis of documents, data or information obtained from 'a reliable and independent source'
- obtaining information on the purpose and intended nature of the business relationship
- (where the client is an entity) identifying the 'beneficial owner', and taking 'adequate measures, on a 'risk-sensitive basis' to verify his identity; 'adequate measures' also include, in the case of legal entities (e.g. companies and trusts) steps to understand the entity's ownership and control structure.

A ‘beneficial owner’ is defined, in reg 6, as being, in the case of an unquoted company, a person who ultimately owns or controls more than 25% of the shares or voting rights in the entity, or who otherwise exercises control over the entity’s management. Separate definitions are included in reg 6 of the beneficial owners of trusts and partnerships.

On-going monitoring (reg 8)

Regulated persons are obliged to conduct ‘on-going monitoring‘ of a business relationship with a client. By virtue of this requirement, they are expected to scrutinise transactions entered into under the relationship to ensure that they are consistent with the their knowledge of the customer and his risk-profile. Under this requirement, they are also expected to keep documents which are kept for CDD procedures up-to-date.

Simplified due diligence (reg 13)

There is an exemption from the requirement to carry out the standard CDD checks where the regulated person believes the client is, inter alia, a listed company or a credit or financial institution which is itself subject to EU money laundering rules.

Enhanced due diligence (reg 14)

Regulated persons must carry out ‘enhanced’ CDD, and ‘enhanced’ on-going monitoring, in certain specified circumstances and in any other situation which presents a higher risk of money laundering or terrorist financing. Among the specified circumstances set out in the Regulations are where the customer has not been personally present for identification purposes and where the client is a ‘politically exposed person’ (or an immediate family member or known close associate of such a person). A ‘politically exposed person’ is an individual who, in the preceding year, has exercised ‘a prominent public function’ in a state or institution outside the UK.

Reliance on other persons (reg 17)

Regulated persons may rely on specified persons – which include external accountants, auditors, insolvency practitioners and tax advisers – to have carried out the standard CDD checks (provided that the other person consents to being relied upon for this purpose).

Record-keeping and internal procedures (reg 20)

Regulated persons are still required to establish and maintain in-house systems and procedures. But there is a new onus on them to establish ‘appropriate and risk-sensitive ‘ policies and procedures on such matters.

Supervision (reg 22)

All regulated persons (including all persons who act as external accountants and auditors) are to be supervised by an appropriate agency for their compliance with their compliance obligations under the Directive. In the case of ACCA members, this will ordinarily be carried out by ACCA itself, which is a supervisory authority under the new regulations, and no additional action need be taken by members. (Those external accountants who are not members of an approved supervisory authority will have to be apply to be supervised by HMRC).

The Money Laundering Regulations are covered in the current ACCA monitoring programme. The new regulations will mean an extension in the scope of the monitoring visit only slightly, to include all clients. Practitioners will therefore be monitored to confirm compliance with the Money Laundering Regulations for clients where no formal appointment is taken.

Members should note that, as a supervisory authority under the Regulations, ACCA has its own legal responsibility to inform SOCA whenever it acquires knowledge or forms a suspicion of money laundering or terrorist financing.

Professional guidance

To supplement the new statutory regulations, CCAB has revised the professional guidance for accountants, which ACCA had issued as Technical Fact Sheet 94. This new CCAB guidance will be issued by ACCA as a new Fact Sheet and will be posted on the ACCA web site during December.

The revised guidance is significantly lengthier than was the previous version. This is an inevitable consequence of i) the additional detail set out in the new Regulations, which the revised guidance seeks to explain; ii) changes in the law since 2003; and iii) the drafting approach adopted, which aimed to provide more comprehensive and helpful guidance than the more general advice that was contained in Fact Sheet 94.

STATISTICS

There were 3,106 company liquidations in England and Wales in the third quarter of 2007, up 1.8% on the previous quarter but down 4.4% on the third quarter of 2006. There were 26,072 individual insolvencies in the third quarter, made up of 15,833 bankruptcies – down 2.1% on the previous quarter but up 2.2% on the third quarter of 2006 – and 10.239 IVAs, down 4.3% on the previous quarter and down 14.3% on the third quarter of 2006. In Scotland, liquidations were down 24.2% on the second quarter of 2006 and down 19.9% on the third quarter of 2006. Individual insolvencies were slightly up on the second quarter but down 2.1% on the corresponding quarter of last year.

IVAS

The British Bankers Association (BBA) announced on 4 December that it had finalised the terms of a new voluntary code of practice for IVA administration, to cover matters such as advertising, advice, information and documentation, which it plans to introduce as from February 2008.

MARKET INTELLIGENCE

A report by Moody’s Investors Service, the credit rating agency, published in December, forecast that at least 4% of all debt-laden companies worldwide would default on their repayment obligations by the end of 2008. In Europe, Moody’s predicted that by the end of 2008 3% of companies would fail to meet interest repayments, meaning that they would either default or ask creditors for special terms. The firm said that its global default rate, which is at a 26-year low, would surge more than fourfold over the next 12 months as conditions in the credit markets deteriorate and the US economy threatens to go into recession.

2. Regulatory Update

REGULATORY PROCEDURES

Newly licensed practitioners will receive an introductory monitoring visit within a year of obtaining their licence. The purpose of the visit is to introduce the practitioner to ACCA's regulatory regime by way of a sample case review, to how a standard monitoring visit is conducted.

Insolvency practitioners licensed by ACCA are monitored on a three year cycle. The outcome of the last visit determines the timing of the next visit. An unsatisfactory visit will result in a shorter cycle and an exceptionally good outcome will result in a longer cycle (a maximum of four years).

Where a practitioner has a second unsatisfactory monitoring visit (not necessarily successive) he is likely to be referred to the Admissions and Licensing Committee, or in due course a Regulatory Assessor (see below) to consider whether regulatory action is appropriate.

ACCA has introduced "Regulatory Assessors" into the 2007 rulebook. Regulatory Assessors will be appointed by the Appointments Committee and will have delegated power from the Admissions and Licensing Committee. Regulatory Assessors will have power to make any order which the Admissions and Licensing Committee could make, other than for the removal of a licence. ACCA is currently looking to recruit Regulatory Assessors.

WORKSHOP IN 2008

Regulatory procedures will be covered in more detail in a workshop for Insolvency Practitioners which will be held in autumn 2008 (the date to be confirmed). The workshops will be advertised in spring 2008 and will count as verifiable CPD.

PENSION PROTECTION FUND

Practitioners are reminded of their obligation under the Pensions Act 2004 to give notice of "insolvency events" to the Pension Protection Fund and the arrangements set out in issue 12 of the Insolvency Newsletter, which is available on the ACCA website.

REGULATORY ISSUES IN 2008

2008 will be a busy year for the Practice Monitoring Department with a large number of visits planned in order to bring us up to date on our monitoring cycle. Visits to the remaining volume IVA providers (VIVAPs) who have not been visited under the new guidelines will be visited, and second visits under the guideline will be carried out; after that the monitoring cycle for VIVAPs is likely to be increased. For general practitioners the focus in monitoring will be similar to that in 2007, with compliance with the requirements of HM Revenue and Customs receiving a greater focus. The Practice Monitoring Department has been using updated checklists for sometime now and the new checklists will be on the ACCA website by the new year.

INSOLVENCY (AMENDMENT) RULES 2007 (SI 2007/1974)

This SI substitutes a new version for the existing Rule 4.228 of the Insolvency Rules 1986 (circumstances in which a director may act in relation to a company with a ‘prohibited name’ without obtaining leave of the court, and thereby criminal penalties and civil liability). This follows the case of First Independent Factors v Churchill [2006] EWCA Civ 1623, where the Court of Appeal held that one of the conditions formerly listed in Rule 4.228, viz the director must give notice to the insolvent company’s creditors, should not apply where an individual was already a director of the successor company that wished to acquire the business of the insolvent company and adopt the prohibited name.

The revised Rule 4.228 says that a director of a company in liquidation may act as a director of another company where that other company uses a prohibited name and acquires the whole or substantially the whole of the insolvent company’s business. But notice must be published in the Gazette and given to all creditors known to the director or whose names and addresses could be ascertained by the director making reasonable enquiries.

This SI came into effect on 6 August 2007.

INSOLVENT COMPANIES (DISQUALIFICATION OF UNFIT DIRECTORS) PROCEEDINGS (AMENDMENT) RULES 2007

This SI amends the Insolvent Companies (Disqualification of Unfit Directors) Proceedings Rules 1987 (SI 1987/2023). Its main effect is to extend the scope of application of the Rules to applications other than those for disqualification orders which may be made under the CDDA. These include applications to enforce the duties of liquidators and other office holders to provide information to the Secretary of State and applications for leave of the court to act.

This SI also came into effect on 6 August 2007.

TRUSTEE'S RIGHT TO FAMILY HOME FOLLOWING DIVORCE

Haines v Hill [2007] EWCA 1284
Judgment delivered 5 December 2007

The Court of Appeal has overturned a ruling in the High Court that a trustee in bankruptcy could claim the proceeds of the sale of property that was awarded to a spouse as part of a divorce settlement.

In 2002, the couple in question had bought a farm as joint tenants in law, for a total of £302,000, of which most was borrowed on security of the farm. The wife commenced divorce proceedings against her husband in April 2003 and a district judge ordered the husband to transfer his interest in the farm to his wife as part of the divorce settlement. Decree absolute was granted in February 2005.

The husband petitioned for his own bankruptcy in March 2005. The husband's trustee in bankruptcy subsequently claimed that the transfer of the husband's interest was a transaction at an undervalue under s339 of the Insolvency Act 1986. The Court of Appeal disagreed with the High Court and ruled against the trustee.

In summing up, Lord Justice Rix said it would be 'unfortunate in the extreme' if a settlement approved in a divorce court could be undone up to five years later because of the former husband's bankruptcy. That, he said, could even encourage bankruptcy on the part of a disaffected husband. While a collusive arrangement by a divorcing couple could well be caught by s339, it would be inconsistent with the concept of 'clean break' for a valid settlement approved by a divorce court to be routinely overturned in this way.

Limitation period for actions against directors
Re Eurocruit Europe (in liquidation)
Judgement given 21 June 2007

Though a liquidator has the right to bring an action under s212 of the Insolvency Act 1986 in his own name, the claimant in any such action is, in substance, the company itself. The High Court ruled thus in acceding to an application to strike out proceedings against a director for misfeasance and breach of fiduciary duty which had been brought by a liquidator against a director who had already been disqualified (for 7 1/2 years) for unfitness in connection with his conduct as director of the company being wound up. The liquidator had commenced proceedings one day before the 6th anniversary of the commencement of the company's liquidation. The defendant argued that the proceedings should be struck out on the basis that any damage to the company would have occurred before the company ceased trading, which it had done a month before going into liquidation. The Court ruled further that the liquidator was unable to rely on s32(1)(b) of the Limitations Act 1980, to postpone the operation of the six year limitation period, because the director had not attempted to conceal from him his responsibility for the company's financial management at the material time.

CESSATION OF APPOINTMENT OF ADMINISTRATOR

Re T M Kingdom Ltd (in admin)
Judgement delivered 26 March 2007

The court has power to rule that an administrator's term of office can be terminated even though the conditions set out in Schedule B1, para 79 of the Insolvency Act 1986 have not been met.

The joint administrators of a company had applied to the court for directions since they wished to put the company into liquidation. They did not consider that their circumstances were addressed by the conditions set out in the Act relating to cessation of office.

The court ruled that the power in para 79(1) was not confined to the circumstances set out in the succeeding paragraphs (2) and (3). Paragraph 79(1) meant exactly what it said, viz 'the court may provide for the appointment of an administrator of the company to cease to have effect from a specified time'. It was therefore open to the administrator to apply to the court for cessation in circumstances other than those listed and it was for the court to determine whether, in any particular case, it should grant the application.

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