insolvency

ACCA

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# insolvency newsletter

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# 1. Technical News

## SIP 16

A new Statement of Insolvency Practice, on pre-pack administrations, will be issued by the end of 2008.

The new SIP reminds IPs that, whether they are advising a company prior to appointment as administrator, or after appointment, they must have regard to the risks of pre-pack sales. They should keep a detailed record of the reasoning behind the decision to make a pre-pack, and should be prepared to justify and explain why they thought that this course of action was appropriate.

While the courts have held that, in some circumstances, the administrator has power to sell assets without the prior approval of the creditors or permission of the court, the SIP reminds IPs that this does not protect administrators from potential challenges under paragraph 74 of Schedule B1 to the Insolvency Act 1986, or from claims of misfeasance. In view of this, care should be taken to ensure that such action is taken genuinely in furtherance of the purpose of the administration.

The SIP reminds administrators of the nature and extent of their role and of their relationship with the company's directors in the pre-appointment period. In particular, they should make clear to directors that their role is to advise the company, and not the directors personally.

Given that unsecured creditors are not given the opportunity to consider the transaction before it takes place, the SIP says that it is important to provide those creditors with a detailed explanation of why the sale took place, so that they can be satisfied that the administrator has acted with due regard for their interests. Paragraph 9 of the SIP sets out a range of detailed information which the administrator should make available.

The new SIP will be included in ACCA's 2009 Insolvency Handbook and takes effect as from 1 January 2009.

## R3 SURVEY OF BUSINESS CONDITIONS

R3 conducted an on-line survey of its members in October 2008 to gauge their views on the implications for the insolvency profession of the current economic conditions.

- two thirds of respondents to the survey thought that the personal insolvency figures for 2008 would be between 120,000 and 160,000 (as compared with the 2007 figure of 121,000.

- More than half of members predicted that the personal insolvency figures for 2009 would exceed 150,000. On average, members predicted a rise of 22% on the 2007 figure.

- Over 90% of members thought that the number of business insolvencies in 2008 would exceed 14,000 (as compared to the 2007 total of 13,000), with an average forecast figure of 15,693.

- When asked what would be the likely figure for business insolvencies in 2009, 95% of members thought that the numbers would exceed last year's total, with an average forecast figure of 18,440 (a rise of 41% over 2007). Nearly 30% thought the likely figure for 2009 would be over 20,000.

- Over half of respondents said they were seeing an increase in the number of unsecured lenders attempting or achieving securitisation of debt against individuals' homes.

- Around 90% of members thought that repossessions by secured lenders would increase in both 2008 and 2009.

## EU PROPOSAL TO EXEMPT MICRO COMPANIES FROM ACCOUNTING AND REPORTING REQUIREMENTS

In the context of the EU's goal of achieving reductions in administrative burdens on SMEs, the European Commission is considering revising the rules currently set out in the Fourth Company Law Directive so as to allow individual member states to remove the obligation for a new category of 'micro company' to prepare or publish annual accounts. The new category would be defined by reference to three thresholds: turnover of up to 1 million euros, net assets of up to 500,000 euros and up to ten employees: it is thought that this definition would encompass around 90% of all the limited companies in the EU. A formal consultation setting out the Commission's proposals is likely to be published in February 2009.

## SIMPLIFIED VOLUNTARY ARRANGEMENTS

The Government has decided not to proceed with the planned measure to introduce simplified IVAs.

On SIVAs, the Insolvency Service has announced that the successful operation of the IVA Protocol has resulted in many of the improvements sought in the IVA marketplace, notably a situation where there are now far fewer modifications being proposed. With the Protocol being monitored by the IVA Standing Committee, it is now considered that further legislative change is no longer necessary.

On the separate issue of allowing persons to specialise either in IVAs or CVAs, the Government still plans to change the law so as to allow this. However, the Insolvency Service no longer believes it to be feasible to do this via the fast-track Legislative Reform Order procedure, so will be looking to take advantage of a suitable opportunity to do so via new primary legislation.

'Authorised practitioners' will be subject to an authorisation scheme similar to that which applies to IPs; this will include requirements for general and specific bonding. There will be no provisions for APs to be directly authorized by the Secretary of State.

## DEBT RELIEF ORDERS (DROs)

DROs were introduced by the Tribunals, Courts and Enforcement Act 2007. They aim to provide a debt relief procedure for those who have small debts but no income or assets, and are thus unable to access bankruptcy proceedings. The Insolvency Service is now preparing to introduce these new procedures and hopes that they will be effective as from April 2009. DROs will be administered by means of on-line application but will in all cases have to be completed with the assistance of approved 'intermediaries'. These persons will have to meet requirements as to education and training but will not be allowed to charge for the provision of advice to debtors nor for the work they perform in completing and submitting forms on their behalf. For this reason it is likely that most if not all DRO intermediaries will come from the voluntary sector.

## THE IVA PROTOCOL

As members may be aware, a number of changes have been made, as of July 2008, to the Simple Consumer IVA Protocol agreed by the IVA Standing Committee under the auspices of the Insolvency Service. The revised document can be found on the Insolvency Service website at:

http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/policychange/foum2007/plenarymeeting.htm

## CONSUMER CREDIT ACT 2006

As of 1 October 2008, as the result of the extension of the scope of regulation by the OFT, any person carrying out debt administration and credit information (repair) services needs to hold a valid consumer credit licence. To reflect this development, as of 1 October ACCA's group consumer credit licence now extends to the following categories: A (consumer credit), C (credit brokerage), D (debt adjusting and debt counselling), G (debt administration) and H1 (provision of credit information services, including credit repair).

## MONEY LAUNDERING

A new guidance booklet on the obligations of those in the 'regulated sector' for money laundering/counter-terrorist financing purposes will be posted shortly on the ACCA website at www.accaglobal.com/publicinterest/subjects/moneylaundering

The booklet summarises the various requirements of the Proceeds of Crime Act 2002, the Terrorism Act 2000 and the Money Laundering Regulations 2007 as well as the formal guidance contained in the CCAB statement on these issues which was published earlier in the year.

# 2. Regulatory News

### ADMINISTRATIONS – BLANKET RESOLUTIONS IN PROPOSALS – EXTENSION OF ADMINISTRATION

Practitioners should be mindful when drafting 'paragraph 49' proposals that the proposals need to be specific and appropriate to the full circumstances and requirements of the particular administration. There will be cases where, at the date of the initial meeting, the administrator has formed the view that it is reasonably foreseeable that the administration may need to be run for more than 12 months and it is appropriate to obtain a resolution for the extension of the administration beyond the initial 12 month period within the administrator's paragraph 49 proposals. Such a resolution will clearly reduce costs as compared with seeking the consent of creditors at a later stage in the administration or an application to the court. It is not, however, appropriate for such a resolution to be obtained as a matter of course, within a standard proposal template, no matter whether consideration is given, or not, to the question of likely duration of the administration.

### BONDS ON INTER-LOCKING INDIVIDUAL VOLUNTARY ARRANGEMENTS

Where an IP is appointed as the nominee or supervisor in inter-locking IVAs he should bond for the full amount of all assets in each IVA estate. This should not present a problem as the bond providers are likely not to charge the full premium for each estate, but would typically apportion the charge for each "half" of the inter-locking IVA.

### MODIFICATIONS REQUIRING ANNUAL DIVIDENDS

A situation has come to ACCA's notice whereby a creditor has put forward modifications to IVA proposals requiring the practitioner to pay annual dividends, without discretion. Where such a modification has been accepted both by the meeting of creditors and the debtor, and there are insufficient funds available, then the IVA will be in default and, accordingly, action should be taken following the default provisions within the agreed terms of the proposal. It might be that the IVA would have to be failed and the supervisor petition for bankruptcy, or it might be possible to seek a variation.

The practitioner should, therefore, consider whether or not any proposed modification is workable before it is accepted. There is a duty upon the practitioner to consider whether the proposal is fair and feasible, and he must also consider whether the proposal (with any modifications) is structured and drafted in such a way that the terms of the IVA can be clearly understood and that the arrangement is likely to proceed to a successful conclusion. It is up to the practitioner, if he feels that a modification could jeopardize this, to discuss the issue with the creditor proposing the modification and seek a solution.

### RE-PRESENTATION OF PROPOSALS

Paragraph 6.6 of SIP 3 requires that "If the debtor/company has, within the previous twelve months, put forward a proposal that has been rejected, the nominee's comments should include a statement to that effect, and an explanation of why it is considered appropriate for the creditors to consider and vote on the current proposal."

Where a subsequent proposal is made, the nominee's comments should highlight and explain the differences within the revised proposals, where the debtor's circumstances have changed, to demonstrate why the proposals might now be acceptable to creditors.

Where there have been no significant changes to the original proposals, but that the attitudes of creditors and their voting patterns have changed, such that an IVA previously rejected might now be accepted, then the nominee's comments should highlight and explain this change in creditor attitude.

### LIQUIDATOR'S ATTENDANCE AT SECTION 98 MEETINGS

A query has arisen as to whether a liquidator is required to attend the section 98 meeting of creditors. SIP 8 requires 'a liquidator appointed by the shareholders before the creditors' meeting takes place is required to attend the meeting of creditors personally. He must report to the meeting on any exercise of his powers under Insolvency Act sections 112, 165 or 166. Such attendance is required even if the shareholders' appointment was made only shortly before the creditors' meeting. He must also attend any adjourned meeting. He is liable to a fine if he fails to comply without reasonable excuse. He should in such a case document at the time the reason for non-attendance and ensure that a suitably experienced colleague attends in his place.' In ACCA's view, reasonable excuse might include being involved in a road traffic accident on the way to the meeting, but not where the practitioner was busy dealing with another job.

### VAT ON BOND DISBURSEMENTS

A general query has arisen in relation to whether or not a disbursements invoice in relation to the specific penalty bond should be subject to VAT. Advice has been received from HM Revenue and Customs that the specific penalty bond is subject to VAT and it should be charged on a disbursements invoice.

### DISTRIBUTIONS IN SPECIE

A question has been raised whether or not a distribution in specie should appear within the receipts and payments account. All transactions should be reflected gross; therefore, the receipt should be shown with a corresponding payment in receipts and payments accounts.

# 3. Legislation

## THE COMPANIES (TRADING DISCLOSURES) (INSOLVENCY) REGULATIONS 2008 (SI 2008/1897)

New regulations have been issued to cover the specific issue of trading disclosures made by companies that are in formal insolvency procedures. The new rules apply to situations where companies are in administrative receivership, receivership, CVA-related moratorium, administration or winding up. The regulations extend to all the specified procedures requirements (which already apply in liquidations) to disclose on companies' web sites the fact that the company concerned is in the relevant insolvency-related situation. The changes also have the effect of changing section 188 of the Insolvency Act 1986 so as to require disclosure of the company's situation on order for 'services' (as well as goods). The new regulations came into effect on 1 October 2008.

## THE COMPANIES ACT 2006

Among the provisions of the new Act which came into effect on 1 October 2008 are the following:

**Reduction of capital by private companies**

A private company need no longer go to court to confirm a proposed reduction of capital. It may now, if it wishes, adopt an alternative, non-court procedure, which will involve:

- the making of a statement of solvency by (all) the company's directors. In this, the directors say that i) they have formed the opinion that there is no ground on which the company could be found at that date to be unable to pay its debts as of that date and ii) the company will be able to pay its debts as they fall due within twelve months of the date of the declaration or, if the company goes into liquidation within that time, the company will be able to pay its debts in full within a further twelve months

- the passing of a special resolution by the company's shareholders.

Both the resolution and the statement of solvency must be filed with the Registrar.

It is a criminal offence for directors to make the statement of solvency without having reasonable grounds for making it.

**Directors' duties to avoid conflicts of interest and not to accept benefits from third parties**

With the entry into force of sections 175 and 176 the statutory statement of directors' duties is now fully implemented.

Under section 175, every director must, as a rule, avoid situations where they have, or can have, an interest which conflicts, or possibly may conflict, with the interests of the company. This rule can, however, be overridden in certain circumstances.

In the case of a private company, a breach of section 175 can be authorised by the other, non-conflicted directors provided the company's articles do not forbid them from doing this. In the case of a public company, the non-conflicted directors can authorise the conflict if the articles do actually empower them to take this action.

Given that, before 1 October 2008, it was only the shareholders who were entitled to give such authorisation to a conflicted director, there are transitional arrangements for existing companies. Thus, in the case of a private company, there is an additional requirement for the shareholders to pass an ordinary resolution to enable the directors to exercise this power.

Section 176 – directors must not accept benefits from third parties which are likely to give rise to a conflict of interest – also came into effect on 1 October.

Both section 175 and 176 apply to directors even after they have stepped down from office; accordingly, companies can sue their directors for compensation and return of profits even after resignation or dismissal.

**Financial assistance for the purchase of a company's own shares**

Statutory restrictions on the purchase by a private company of its own shares have been repealed.

## BANKING BILL

The Banking Bill, introduced to Parliament in October 2008, provides for a special insolvency regime for banks. Under this regime, an application for a 'Bank Insolvency Order' could only be made by the Bank of England, the FSA or the Government. The application would nominate a named insolvency practitioner to act as the 'Bank Liquidator'. Any application will have to meet specified criteria, viz the bank is or is likely to become unable to pay its debts, or it would be in the public interest to wind up the bank, or it would be 'fair' to wind up the bank. The Bank Liquidator would have two objectives – firstly, to work with the Financial Services Compensation scheme to ensure that eli ible depositors receive payment due to them and, secondly, to wind up the affairs of the bank to achieve the best result for the bank's creditors as a whole. It is likely that the Bill will be enacted early in the New Year.

# 4. Cases

## DIRECTORS CAN BE DISQUALIFIED FOR PAYING ILLEGAL DIVIDENDS

**Re AG (Manchester) Ltd; Official Receiver v Watson [2008] BCC 497**

Judgment delivered 24 January 2008

A director, especially a finance director, has a duty to ensure that dividends paid by their company are lawful under the Companies Act.

On an application by the Official Receiver under section 6 of the Company Directors Disqualification Act 1986, it was held that the finance director had a particular duty to inform the other directors and the shareholders of any concern he had about a dividend proposal. If the company's shareholders were determined to pay themselves a dividend at a level the company could not afford, the directors had no option but to resign – it was not open to them simply to rubber stamp the shareholders' wishes.

The conduct of the finance director was considered to fall well below the standards expected and he was disqualified from holding office for a period to be determined later.

## INTERNATIONAL CO-OPERATION IN INSOLVENCY CASES

**McGrath v Riddell, House of Lords [2008] UKHL21**

Judgment delivered 9 April 2008

The House of Lords allowed an appeal from the Australian courts concerning a request made under section 426 of the Insolvency Act 1986 to require provisional liquidators appointed under UK courts to transfer assets held by those companies to Australia,

The case involved four companies in the HIH insurance group, which became insolvent in 2001. Winding up petitions were brought against four of the companies which held assets in the UK and provisional liquidators were appointed. Under section 426, the UK courts are required to assist the courts having corresponding jurisdiction in any other relevant country or territory. The lower courts had argued that Australian law gave preferential rights to insurance creditors and re-insurance creditors which had no equivalent in English law, and consequently the request should not be complied with.

The House of Lords disagreed and allowed the appeal of the Australian courts. It held that English courts had a common law jurisdiction to issue directions to ancillary liquidators to remit English assets notwithstanding any difference between the English and the foreign system of law. In complying with the Australian request, the court would only be exercising its right direct the remittance of the assets, and would be leaving all questions of distribution to the Australian system. The fact that Australian law might treat insurance creditors better, and non-insurance creditors worse, than English law was no reason for saying that the Australian law offended against English principles of justice.

## ASSETS SUBJECT TO A PURPOSE TRUST

**Cooper v PRG Powerhouse Ltd (in liquidation), [2008] EWHC 498 (Ch)**

Judgment delivered 14 March 2008

If funds held by a company on its entry into insolvency meet the definition of a purpose trust, they can be claimed back in full by the person making the payment.

This case concerned a former managing director of a company that went into administration and later liquidation. Prior to those events, the managing director had resigned from the company. As part of his termination arrangements, he came to an agreement with the company to buy the company car he had been driving by paying a sum of around £35,000 to settle the amount outstanding on the contract with the supplier. It was agreed between the employee and the company that the former would pay the money to the company and it would pay it on to the supplier. When the company went into insolvency, the employee argued that the money paid was held on trust for him by his former company for the express purpose of settling the outstanding amount due on the car; if that purpose failed, the money should be returned to him. The liquidator argued that there was no evidence of trust and that the former employee ranked only as unsecured creditor. The employee sought an order from the court.

The court held that whether a purpose trust existed was a question of fact. To prove the fact of its existence, it was necessary for the payer to show that the arrangement for which the payment was made defined the purpose for which it was made in such a way that it was understood by the recipient that the funds were not at his free disposal. On the facts of the case, there was clear evidence that the payment to the company was subject to a purpose trust to pay the money to the supplier. The court therefore allowed the application and agreed to issue the order.

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