Introduction to the Third Edition

Eight years have elapsed since the previous edition of this work. During that period a number of landmark events have occurred.

The global financial crisis[1] has impacted on the commercial environment and has produced some spectacular corporate insolvencies across the globe. Lehman Brothers led the roll-call of casualties in September 2008 when it entered US Chapter 11 bankruptcy and triggered a tidal wave of insolvencies in its local subsidiaries across the globe.[2] A dramatic increase in UK corporate insolvencies might have been expected in the wake of that global economic downturn. That has not happened. The statistics indicate a fall by a third between 2008 and 2015, with corporate insolvencies in England and Wales declining steadily from 21,811 to 14,600.

What explains this lack of business failures, particularly when the number of registered companies continues to rise? Firstly, many of the weaker businesses may have gone to the wall just prior to the 2008 crash. Secondly, many distressed businesses may have been saved through creative use of informal rescue schemes, cost-cutting measures and mergers. Many other firms have simply downsized rather than collapsed. It is also clear that secured creditors (particularly banks) have, on occasions, been reluctant to foreclose on struggling debtor clients because their assets were not worth realising during depressed economic times. The rise of the 'zombie' company, drip-fed with small amounts of funding but barely surviving as a viable business entity, has been noted.[3] That dynamic might change if the economy picks up significantly. There are also hints that some small companies are being 'abandoned' by their owners without undertaking formal insolvency procedures – but there is no hard data on this phenomenon.

[1] For an analysis of the potential regulatory issues generated by the global financial crisis, see A. Arora, 'The Global Financial Crisis: A New Global Regulatory Order?' [2010] JBL 670.

[2] In a supreme irony, the Lehman administration in the UK has produced a surplus, thereby triggering the clutch of so-called 'waterfall' cases which have had to determine how that surplus is to be shared out between creditors claiming post-administration interest, subordinated creditors and shareholders – see, for example, *Joint Administrators of LB Holdings Intermediate 2 Ltd* v. *Lomas* [2015] EWCA Civ 485.

[3] See R3 report, *The 'Zombie Businesses' Phenomenon: An Update* (January 2014) on zombie companies. Zombie companies are defined as companies just able to service interest on their debts. At the time of this report there were just over 100,000 such companies identified. Using other criteria, the figure of 227,000 companies was cited by Nick Hood, 'The Inexorable Rise of Britain's Army of the Walking Corporate Dead' [2013] 6 *Corporate Rescue and Insolvency* 180.

The overall number of corporate insolvencies may have declined steadily since 2008, but there have been significant variations in resort to different procedures. Thus, there were 4,822 administrations embarked upon in 2008, but this figure had fallen to 1,406 in 2015, which is a drop far more dramatic than that experienced with insolvencies. There were 587 Company Voluntary Arrangements (CVAs) in 2008, but this number also fell in 2015 (to 357). The decline has been most marked for receiverships, which reduced from 867 in 2008 to a position, at the time of writing, in which there are only single-figure incidences. That particular decline was predictable as the effect of the Enterprise Act 2002 reforms began to kick in.

Although the statistics would deny a massive upsurge in corporate insolvencies, the evidence of major casualties, particularly in the high street retail sector, cannot be denied. Woolworths (November 2008), Comet (November 2012) and BHS (April 2016) are all now high street absentees. The steel industry is experiencing extensive insolvencies as this book is being written. Ironically, very few banks have become formal insolvency statistics in the UK. Instead, some have 'merged' with other financial institutions, often with government encouragement, as part of a rescue strategy for the entire sector. Brand identity has been lost as part of this process. The State itself has pumped billions into other banks through the acquisition of shareholdings in order to avoid systemic collapse in the banking sector. The State has thus become a major equity stakeholder in a number of banks, though it is now in the process of selling off these shareholdings. There is increased attention to the role of the State as it often has to pick up the bill when a major firm collapses, with the central authorities covering certain arrears of wages and plugging gaps in pensions schemes that have been allowed to fall into deficit. The ensuing picture is one in which the State plays a significant role in underwriting many businesses.

One consequence of the global financial crisis has been the desire of distressed European businesses to seek to resolve their financial difficulties by accessing business rescue procedures available in the UK. This is possible, in part,[4] because of the impact of the EC Regulation on Insolvency Proceedings (1346/2000). This phenomenon, coupled with a growth of cross-border insolvency litigation in general, has prompted the inclusion, below, of a discrete chapter on this subject (see chapter 18). Some last-minute reconsideration of this discussion has been required in view of the decision of the UK electorate on 23 June 2016 to leave the European Union.[5] This dedicated cross-border chapter is the only major change of chapter structure in this edition, though all chapters have been revised to reflect recent developments. We have, however, tried to remain faithful to the approach adopted in earlier editions of this work, save where the changing circumstances have compelled a rethink.

Another consequence of the global crash was to put the performance of the Financial Services Authority as a financial watchdog under the microscope. This post mortem has led, via the Financial Services Act 2012, to the break-up of the FSA and

[4] The scheme of arrangement procedure under the Companies Act 2006, dealt with in ch. 11 of this work, has also proved popular for foreign firms wishing to take advantage of flexible UK restructuring law.
[5] The recast European Insolvency Regulation (2015/848) is expected to come into force in June 2017.

the creation of two new organisations; the Financial Conduct Authority (FCA) (which has as its primary role regulation of investment activity) and the Prudential Regulatory Authority (PRA), which keeps under review the stability of banks and similar financial institutions.[6] The Insolvency Service has retained its key policy-making and regulatory roles, but it has had to confront the challenges presented by major financial cuts coupled with regular changes of leadership. The Insolvency Practices Council ceased operations at the end of 2011 as a response to the changing nature of regulatory structures in the insolvency world. The Department of Business, Enterprise and Regulatory Reform (BERR) morphed into the Department of Business, Innovation and Skills (DBIS) in June 2009. In July 2016, it was rebranded as part of the Theresa May Cabinet reforms to become the Department for Business, Energy and Industrial Strategy (DBEIS).

The business rescue imperative continues to influence both policy and practice. Great use has been made of the scheme of arrangement procedure prescribed by Part 26 of the Companies Act 2006. This procedure is not restricted to insolvent companies and may be a way of warding off formal insolvency. It is a particular favourite with overseas companies, and the English courts have allowed such firms to push at an open door by readily finding a link with the English jurisdiction. Reforms to the law on continuity of supplies of essential items to distressed companies, effected under delegated powers conferred by the Enterprise and Regulatory Reform Act 2013, also owe much to the desire to promote rescue.[7] The turnaround lobby can still exert influence. This influence is also reflected at local and EU level. So, in May 2016, the Insolvency Service (IS) launched a consultation exercise entitled *A Review of the Corporate Insolvency Framework*. The IS initiative looked at ways further to advance the rescue culture in England and Wales, and the responses to the consultation have been positive.[8] As this volume goes to press, the European Commission has published a Proposal for a new Directive designed to promote early restructuring of distressed businesses.[9] This Directive espouses many of the causes and values that are argued for in this text.

Insolvency practice has undergone significant change in the years since 2008. The administration 'pre-pack' has become firmly established as a tool in the armoury of insolvency practitioners. In spite of self-regulatory controls imposed by SIP 16 (which was revised in 2015), the pre-pack remains a process that gives rise to contention and was the subject of the Graham Review (which reported in July 2014). This Review supported continued use of self-regulation, albeit in upgraded form. There is a reserve legislative power contained in section 129 of the Small Business, Enterprise and Employment Act 2015, which is ready to be deployed if self-regulation does not succeed.

[6] For analysis of this reform, see E. Ferran, 'The Break-up of the FSA' [2011] 31 OJLS 455.
[7] See The Insolvency (Protection of Essential Supplies) Order 2015 (SI 2015/989), made under s. 93 of the Enterprise and Regulatory Reform Act 2013. As a result of this Order, s. 233 is expanded and a new s. 233A is inserted into the 1986 Act.
[8] See P. Bailey, 'Insolvency Service Publishes Response to Review of Corporate Insolvency Framework' [2016] 388 *Sweet and Maxwell's Company Law Newsletter* 1.
[9] See Proposal 2016/0359, COD of 22 November 2016.

The issue of the level of fees charged by insolvency practitioners remains a topic for vibrant discussion. The courts have been more than willing to use their power to revisit fees by applying a principle of value for money, and a new system of binding fee estimates was introduced in 2015 by the Insolvency (Amendment) Rules 2015 (SI 2015/443). One thing has not changed: the number of licensed insolvency practitioners operating in the UK remains roughly at the level it was when the first edition of this work was published. This, along with other factors, has attracted the interest of policy-makers. In 2010, the Office of Fair Trading conducted a market survey[10] on the supply of insolvency services. The conclusion reached was that professional fees were only properly regulated in cases where there was a secured creditor presence in the insolvency of a business. This market study has in part informed changes brought about by the Deregulation Act 2015 and the Small Business, Enterprise and Employment Act 2015.

To return to the prevalence of different insolvency procedures, current figures show that liquidation (whether it be via Company Voluntary Liquidation (CVL) or compulsory liquidation) is still the most widely used procedure. Reports of its imminent death have been exaggerated. The big disappointment concerns the declining use of administration. Why has this happened? One possibility may be the increased scrutiny of the controversial pre-pack procedure, which is discussed in chapter 10. If increased surveillance has weeded out abusive use of administration, then so much the better. Use of administration may also have been reduced by uncertainties regarding the validity of many administrations (notably, stemming from concerns about excessive informality in the appointment of administrators).[11] Such uncertainties, however, have largely been dealt with by the courts.[12] Additionally, it may be the case that the depressed state of the economy has made rescue using the tool of administration a more difficult goal to achieve.

Regarding the substantive law, noteworthy changes were brought about by the Deregulation Act 2015, particularly with regard to the possibility of partial authorisation of insolvency practitioners. This might help the turnaround industry. The Small Business, Enterprise and Employment Act 2015 will have a more widespread effect, reaching into wide areas of the regulation of insolvency practice, insolvency litigation and director disqualification. As for regulation of the profession, insolvency practitioners will have to adjust to a system resembling the regime applicable to lawyers under the Legal Services Act 2007. This new system reflects a number of changes suggested in the second edition of this work.

The company charge registration system has been tinkered with by the Companies Act 2006 (Amendment of Part 25) Regulations 2013 (SI 2013/600). These Regulations

[10] See *The Market for Corporate Insolvency Practitioners*, OFT1245 (June 2010). For comment, see A. Hudson, 'OFT Study: Focus on the Bigger Picture, Not on the Quick Headline' (2010) *Recovery* (Autumn) 27.

[11] This is the so-called '*Minmar* saga' – see the ruling of Sir Andrew Morritt in *Minmar 929 Ltd* v. *Khalatschi* [2011] BCC 485. For an overview, see E. Palser, 'Appointment of Administrators Out of Court: Clarity at Last?' (2012) 25 *Insolvency Intelligence* 113.

[12] See ch. 9 for discussion.

replace Part 25 with a new set of rules, but they fall far short of a major restructuring of this area of security law. The Law Commission continues to work in this field, with a view to providing a new registration model for personal property security interests, but its efforts are not bearing fruit. The denomination of preferential claims was modified in 2015 to take account of a new category of such claim introduced in response to European requirements.[13] This does not, however, represent a major change in substance or policy. The Third Parties (Rights against Insurers) Act 2010 was finally brought into effect in August 2016, after years of prevarication. This should make it easier for victims to sue the insurers of insolvent companies directly, without first having to restore a dissolved company to the register.

After more than a decade of hesitation, the main body of secondary legislation, namely the Insolvency Rules, has been reconsolidated. The Insolvency (England and Wales) Rules 2016 (SI 2016/1024) will hopefully provide the minutiae of insolvency practice for years to come. The 2016 Rules will be dealt with at appropriate locations within the following chapters, but they do represent a significant redrafting of the much amended 1986 Rules, and they do facilitate changes in the administration of insolvent estates. This is achieved by moving away from the mandatory usage of creditor meetings in all cases where decisions by creditors have to be reached. Alternative decision-making procedures are specified in an effort to reduce administration costs. These reconsolidated rules are destined to take effect in April 2017. That said, we should not be surprised if the annual revisions of selected rules continue to occur in the years ahead.

The development of insolvency law has always depended upon constructive judicial decision-making, with a keen eye to the practicalities of corporate insolvency law. The courts have maintained that helpful tradition in recent years,[14] as exemplified by such cases as: *Belmont*,[15] *Eurosail*,[16] *Nortel* (*Bloom* v. *Pensions Regulator*)[17] and *Game Station*.[18]

There have been general developments affecting insolvency litigation. Procedural matters are now informed by the *Practice Direction: Insolvency Proceedings*.[19] The curbs on funding civil litigation and recovery of costs, which were imposed by sections 44 and 46 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012, were initially disapplied from insolvency recovery litigation by statutory instrument.[20] That concession was due to expire in April 2015, but it was extended indefinitely at the last minute as a result of a campaign conducted on behalf of the

[13] See Banks and Building Societies (Depositor Preference and Priorities) Order 2014 (SI 2014/3486). This has proved necessary to cater for EC Directive 2014/59.
[14] See the summary of key decisions provided by H. Anderson, 'Six of the Best: The Record of the Supreme Court in the Insolvency Cases Decided in its First Four Years' [2014] JBL 194.
[15] *Belmont Park Investments Pty Ltd* v. *BNY Corporate Trustee Services Ltd* [2011] UKSC 38.
[16] *BNY Corporate Services Ltd* v. *Eurosail UK 2007–3BL plc* [2013] UKSC 28.
[17] *Re Nortel Companies: Bloom* v. *Pensions Regulator* [2013] UKSC 52.
[18] Sub nomine *Jervis* v. *Pillar Denton Ltd* [2014] EWCA Civ 180.
[19] [2014] BCC 502.
[20] Legal Aid, Sentencing and Punishment of Offenders (Commencement No. 5 and Saving Provision) Order 2013 (SI 2013/77, C. 4).

insolvency profession. That campaign was based upon independent research,[21] which stressed the rewards to the public exchequer that flowed from such litigation. In spite of this effort to preserve the concession, the government announced that it was to be ended in April 2016 and it has now been removed.[22]

Throughout this work, as in previous editions, emphasis has been placed upon the 'measures' of accountability, expertise, efficiency and fairness. Since 2008 there have been significant developments that impact on the potential of insolvency processes to deliver on these fronts. The chapters below thus discuss the significance of such events as: the passing of the Deregulation Act 2015 and the Small Business, Enterprise and Employment Act 2015; the introduction of the 'value for money' criterion (first introduced in 2004 and subsequently reinforced by changes in secondary legislation in 2010 and 2015) as a way of holding insolvency practitioners more accountable for their fees; and the movement by the UK Government to cut red tape and eliminate unnecessary elements in insolvency procedures.

David Milman has joined, as co-author, in the production of this third edition of Vanessa Finch's original work.

Vanessa Finch and David Milman
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[21] See Peter Walton's study commissioned by R3: *The Likely Effect of the Jackson Reforms on Insolvency Litigation: An Empirical Investigation* (April 2014). For a summary, see Walton, 'Insolvency Litigation: A Case of "If it Ain't Broke, Don't Fix It"'(2015) 28 *Insolvency Intelligence* 9.

[22] See Legal Aid, Sentencing and Punishment of Offenders Act 2012 (Commencement No. 12) Order 2016 (SI 2016/345, C. 19).