



Companies Act Update 2006

Insolvency changes: reversal of Leyland Daf

On 6 April 2008, the Act introduced a new section 176ZA into the Insolvency Act 1986 (“IA 1986”), which is intended to reverse the effects of the House of Lords’ decision in Leyland Daf. That decision has had a significant impact on the liquidation procedure.

The effect of section 176ZA is that for liquidations commencing on or after 6 April 2008, general liquidation expenses can automatically be met out of assets subject to a floating charge, so far as the company’s general assets are insufficient to meet those expenses.

However, the application of section 176ZA is restricted in relation to litigation expenses, to expenses that have been approved by the floating charge holder (or any preferential creditors entitled to be paid in priority to the floating charge holder) or the Court.

Insolvency Practitioners and Banks should note that the new Rules inserted into the Insolvency Rules 1986 to give effect to this restriction differ in several respects to the draft Rules published by the Insolvency Service last year. Key changes are highlighted in this article.

Leyland Daf

In this case, the House of Lords, overturning long established case law, held that a liquidator could not deduct general liquidation expenses, including his own remuneration, from assets subject to a floating charge. They held that these expenses could only be met from the company’s general assets (assets not subject to either a fixed or floating charge). This contrasts with the position in an administration where an administrator is able to deduct administration expenses from assets subject to a floating charge.

The decision has had a significant impact on the liquidation procedure. Since most floating charges usually cover all available assets, there is unlikely to be any floating charge surplus available to meet general liquidation expenses. The decision has meant that insolvency practitioners have been inclined to favour administration, which offers them the relative certainty of recovering their expenses, rather than liquidation and impacted on the returns floating charge holders receive, depending on whether the company is wound up through liquidation or administration.

If you are thinking of taking advantage of the removal of the requirement to have a company secretary and would like us to review your Articles in order to determine whether or not you are able to do so or require any further information on any of the above changes, please contact us.

Section 176ZA IA 1986

The Government accepts that the House of Lords' decision in Leyland Daf runs counter to the general insolvency policy that the costs of a collective insolvency procedure, such as liquidation, should be paid out of available assets and effectively borne by all of the creditors. It has therefore acted to reverse the effects of the decision by (through section 1282 of the Act) introducing a new section 176ZA into the IA1986, which provides that the expenses of a liquidation, so far as the company's general assets are insufficient to meet them, have priority over any claims to assets subject to a floating charge.

Section 176ZA came into force on 6 April 2006 and applies to any liquidation in England & Wales commencing on or after that date.

Restriction on the application of section 176ZA: litigation expenses

Section 176ZA is expressly subject to any rules restricting its application in such circumstances as may be prescribed, to expenses approved by the floating charge holder (or by any preferential creditors entitled to be paid in priority to the floating charge holder) or by the Court.

Following consultation with interested parties, the Government decided that the only category of expenses that should be restricted in this way are litigation expenses, due to the scope for a liquidator to exhaust assets. It decided that all other categories of liquidation expenses should be capable of automatic deduction out of floating charge assets, where the company's general assets are insufficient to meet those expenses.

The relevant rules are contained in new Rules 4.218A to 4.218E, which were inserted into the Insolvency Rules 1986 on 6 April 2008.

The new Rules provide that litigation expenses may not be paid out of assets subject to a floating charge without the approval of the floating charge holder (or any preferential creditors entitled to be paid in priority to the floating charge holder) or the Court. The new Rules set out the scope of the exception and the procedure for obtaining approval for the purpose of deducting them as liquidation expenses from assets subject to a floating charge.

Insolvency Practitioners and Banks should note that the new Rules have changed in several respects from the draft Rules published by the Insolvency Service last year. Key changes are as follows:-

- The new Rules cover (in addition to legal actions and proceedings) arbitration or other dispute resolution proceedings and negotiations that are intended to lead or lead to a settlement or compromise of any legal action or proceeding or arbitration or other dispute resolution procedure
- A liquidator need only seek approval where litigation expenses exceed or are likely to exceed (and only in so far as they exceed or are likely to exceed) £5,000

- The new Rules apply not only where a liquidator himself institutes or proposes to institute or continue legal proceedings but also where he defends or proposes to defend any legal proceedings brought or likely to be brought against the company
- The provisions identifying from whom the liquidator must obtain approval have changed

Approval must be sought from the “specified creditor”, defined as the creditor who, at the time approval is sought, has a claim to property comprised in or subject to a floating charge and taking into account the value of that claim and any subsisting property then comprised in or secured by such a charge, appears to the liquidator to be the creditor most immediately likely of any creditors having such claims to receive some payment in respect of his claim but whose claim would not be paid in full.

A “creditor” is defined as meaning either a preferential creditor or floating charge holder. There may be more than one specified creditor.

- There is power for a liquidator to exclude information from Form 4.74 (the new prescribed form to be used when requesting approval) where the disclosure of that information could be seriously prejudicial to the winding up of the company
- There is power for the specified creditor to request further particulars from the liquidator. However, if the liquidator considers the request for further particulars to be unreasonable, he can ask the Court to approve his litigation expenses instead
- There is a new provision providing for deemed approval where the specified creditor fails to respond to a request for approval within 28 days
- The liquidator can apply to the Court without seeking approval from the specified creditor in cases of emergency
- If a Court application is necessary, the costs of the application (as well as the costs of any specified creditor appearing or being represented on it), are automatically treated as an expense of the liquidation unless the Court orders otherwise (the draft Rules provided that the Court had to make an order authorising the costs to be paid as an expense of the liquidation)

Contact us

Briefing notes on these changes will follow. In the meantime, for more information on any of the above changes, please contact:

Sue Lowry

DD 0845 310 7215

E sue.lowry@berryman.co.uk

Carl Mifflin

DD 0845 310 7265

E carl.mifflin@berryman.co.uk

Berryman Park House Friar Lane Nottingham NG1 6DN

DX 10004 Nottm 1 **T** 0115 945 3700 **F** 0115 948 0234

W www.berryman.co.uk

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