C L I F F O R D

C H A N C E

Client briefing
April 2005

New Insolvency Regulations - effect on Salvage and EUIR

In August 2003, we distributed a note which in part discussed the case of Re The Salvage Association [2003] EWCH (Ch) 1028 ("**Salvage**"). The Salvage case held that an administration order could be made in respect of a UK entity which was not registered under any of the UK Companies Acts (in that case, against an entity incorporated by Royal Charter).

The Insolvency Act 1986 (Amendment) Regulations 2005 (which will come into force on 13th April 2005) (the "**Amendment Regulations**") amend the Insolvency Act 1986 (the "**1986 Act**") to clarify that it is only companies as defined by section 735(1) of the Companies Act 1985 and certain companies formed or incorporated outside the United Kingdom that can enter administration or a company voluntary arrangement.

Background

Section 8(1) of the 1986 Act gives the court power to make an administration order against a "company" if, inter alia, it is unable to pay its debts. The term "company" was not originally defined in the 1986 Act. Prior to the EU Insolvency Regulation (1346/2000) (the "**EUIR**"), the effect of section 251 of the Companies Act 1985 was that in order to qualify as a "company" under section 8(1), the company had to be registered under one of the UK Companies Acts.

After the coming into effect of the EUIR, article 3 provides that, a court may open insolvency proceedings against a company where that company's "centre of main interests" ("**COMI**") is situated within the territory of the member state in which that court is based. However, article 4 of the EUIR clearly leaves the question of "who" may be the subject of an administration order as a question for national jurisdiction.

When the EUIR came into effect, to ensure that the English courts had national jurisdiction in relation to companies whose COMI was situated in the UK, amendments were made to the 1986 Act to make it clear that "*a reference to a company included a reference to a company in relation to which an administration order may be made by virtue of article 3 of the [EUIR]*".

The Salvage decision

Sitting in the High Court, Mr Justice Blackburne allowed an administration order to be made against the Salvage Association. The Salvage Association was incorporated in the UK under Royal Charter and was not registered under any of the UK Companies Acts. Mr Justice Blackburne held that the amendments made to the 1986 Act had the effect of widening the range of UK entities against whom an administration order could be made. Article 3 of the EUIR allows insolvency proceedings to be opened in respect of "a company or legal person" and he held that the Salvage Association fell within this wider definition of "company". Mr Justice Blackburne referred to the amendments made to the 1986 Act as:

"*…making clear that a reference to a "company" in Part II [of the 1986 Act] goes beyond a company registered under the Companies Acts.*"

Key Issues

New Insolvency Regulations to clarify decision in Re Salvage Case

Industrial and Provident Societies not subject to administration

Administration available to EEA incorporated entities outside of the EUIR - unanticipated consequences

If you would like to know more about the subjects covered in this publication or our services, please contact:

Adrian Cohen +44 (0)20 7006 1627

Chris Oakley +44 (0)20 7006 2027

Dermot Turing +44 (0)20 7006 1630

Kate Gibbons +44 (0)20 7006 2544

Edwin Borrini +44 (0)20 7006 1791

Gabrielle Ruiz +44 (0)20 7006 1615

To email one of the above, please use firstname.lastname@cliffordchance.com

Comment

We argued at the time that the Salvage decision was incorrect as, though the amendments made to the 1986 Act were intended to ensure that a company which had its COMI situated in the UK could be subject to administration; they were not, we submitted, intended to widen it to cover entities based in the UK which were not registered as companies under the UK Companies Acts. This position has now been confirmed by Parliament.

The Salvage case had opened up the possibility that other types of entity which were not established as companies under the UK Companies Acts such as certain types of Housing Associations, which are established as Industrial and Provident Societies, might be allowed to enter administration. This doubt has now been removed and that is to be welcomed.

An unanticipated consequence

Although the Amendment Regulations clarify the position in respect of UK entities not registered under the UK Companies Acts, they may have an unexpected effect on which types of foreign companies can be subject to administration in the UK. This doubt is as a result of extending the definition of company to include at paragraph 111 (1A) of Schedule B1:

"(b) a company incorporated in an EEA state other than the United Kingdom, or

(c) a company not incorporated in an EEA state but having its COMI in a member state other than Denmark."

The reference to EEA states essentially includes all EU member states and in addition Iceland, Norway and Liechtenstein. (Denmark is included as an EEA state, not as an EU member state, as it opted out of the EUIR.) It is not immediately apparent why these three additional jurisdictions have been included, though informal discussions with the Insolvency Service, who are responsible for drafting the Amendment Regulations, indicate their inclusion was a deliberate attempt to capture the spirit of the EEA Agreement.

It appears that the legislation deals with EEA states which are also EU member states and suggests that companies incorporated in those states can be subject to administration even without a COMI in the UK. Such a result would be inconsistent with article 3 of the EUIR which clearly provides that the EUIR gives exclusive jurisdiction to the courts of the member state in which the debtor's COMI is situated, which would preclude administration under English law unless the company had its COMI in the UK (though this is set to change, see below). On the basis that the Amendment Regulations conflict with the EUIR, English courts will be required to disapply the provisions of the Amendment Regulations which are inconsistent. Therefore the EUIR analysis will continue to apply save to companies incorporated in an EEA state other than the UK which (i) also have their COMI in the UK or (ii) do not have a COMI in any EU member state but have sufficient nexus with the UK to trigger the application of the Amendment Regulations. We would therefore advise that transactions requiring insolvency analysis of companies incorporated in Iceland, Norway, Liechtenstein and Denmark should be the subject of specialist advice.

It is worth noting that amendments are shortly to be made to Annexes A and B of the EUIR to clarify that out of court administrations are covered by the EUIR and are "winding-up proceedings", so applying out of court administrations to UK assets of a company having only an establishment in the UK.

If a non-UK company can be subject to administration in the UK, there is considerable doubt that it will be possible to appoint an Administrative Receiver to block administration. (Administrative Receivership is now applicable only where a statutory exception applies - typically in complex transactions structured as a '"capital market arrangement".) Administrative Receivership of a non-UK company is not permitted because the definition of "company" for the purposes of Part III (Receivership) of the 1986 Act remains as in section 735 of the Companies Act 1985 (i.e. only a company formed under the UK Companies Acts unless the contrary intention appears) and has not been subject to the Amendment Regulations. These changes accentuate the problem of having unresolved the definition of "company" for the purposes of Part III of the 1986 Act and accordingly, the question whether the "capital market exception" applies to a foreign company.

So the Amendment Regulations and the changes to the definition of company, whose primary aim, we had understood, was to clarify the application of the Regulation to administration appears to have muddied the waters even more for non-UK companies.