

**EXPLANATORY MEMORANDUM TO
THE INSOLVENCY (AMENDMENT) RULES 2008**

2008 No. 737

1. This explanatory memorandum has been prepared by the Department for Business, Enterprise and Regulatory Reform and is laid before Parliament by Command of Her Majesty. This memorandum contains information for the Joint Committee on Statutory Instruments.

2. **Description**

2.1 The Insolvency (Amendment) Rules 2008 amend the Insolvency Rules 1986 (“the principal Rules”). They make provision clarifying and amplifying the provisions of Rule 4.218 of the principal Rules which sets out the general rule as to the description of, and the order of priority in which, liquidation expenses are to be paid out of assets and property of a company in liquidation.

2.2 The amendment Rules also make provision subsequent to the insertion of section 176ZA into the Insolvency Act 1986 (payment of expenses of winding up - England and Wales), section 1282 of the Companies Act 2006. Section 176ZA provides for expenses of a winding up in England and Wales, so far as the assets of the company available for the payment of general creditors are insufficient to meet them, to have priority over any claims to property comprised in or subject to a floating charge created by the company and to be paid out of such property. This is made expressly subject to any rules restricting the application of the section in such circumstances as may be prescribed, to expenses authorised or approved by the holders of debentures secured by, or holders of, the floating charge or by any preferential creditors entitled to be paid in priority to them or by the court.

2.3 The Insolvency (Amendment) Rules 2008 restrict the application of section 176ZA in relation to litigation expenses (as defined in the Rules), which, subject to certain conditions, may not be paid out of property comprised in or subject to a floating charge without the approval or authorisation of the holder of a debentures secured by, or holder, of the floating charge or any preferential creditor or the court, as the case may be.

3. **Matters of special interest to the Joint Committee on Statutory Instruments**

None.

4. **Legislative Background**

4.1 Section 1282(1) of the Companies Act 2006 inserted section 176ZA into the Insolvency Act 1986. The new section was inserted following the judgment of the House of Lords in *Buchler and another (as joint liquidators of Leyland Daf Ltd) v Talbot and another (as joint administrative receivers of Leyland Daf Ltd) and Stichting Ofasec and others* [2004] UKHL 9 where the court held, on an

interpretation of section 175 of the Insolvency Act 1986, that it could not be relied upon to support the deduction of general expenses of a liquidation from property comprised in or subject to a floating charge created by the company. In the same judgment the court confirmed that liquidation expenses could be paid out of, and had priority as against preferential debts in relation to such assets as were available for the payment of general creditors. The new section ensures that liquidation expenses have priority and are to be paid out of assets available for the payment of general creditors, and, so far as the general assets are insufficient to meet them, to be paid out of property subject to a floating charge created by the company in priority to the claims of preferential creditors and holders of debentures secured by, or holders of, the floating charge.

4.2 The Insolvency (Amendment) Rules 2008 provide expressly for the expenses of a liquidation to be payable also out of the proceeds of any legal proceedings which the liquidator has power to bring in his own name or bring or defend in the name of the company and also for the recovery of expenses and costs relating not only to the conduct but also to the preparation of any such legal proceedings. The existing provision is extended so as to apply also to proceeds arising out of any awards made under arbitration or dispute resolution procedures or of any compromise or settlement of any legal action or dispute reached prior to a judgment or award being made. Correspondingly also included as costs or expenses of a liquidation are those properly incurred in the preparation or conduct of arbitration or dispute resolution procedures and negotiations leading to a settlement or compromise of any legal action or dispute.

4.3 The amendment Rules also insert new Rules 4.218A to 4.218E into the principal Rules. These new provisions are derived from the power to make exceptions to the amendment made by section 1282(1) of the Companies Act 2006 (c.46) to the Insolvency Act 1986 (c.45) as explained above. They provide a definition of those litigation expenses, which may not be paid out of property subject to a floating charge without the approval or authorisation of preferential creditors or the holder of the floating charge who have claims on it.

4.4 The Rules set out the conditions with which the liquidator must comply in seeking and obtaining authorisation or approval and the conditions with which creditors must comply in granting or refusing the liquidator's request.

5. Territorial Extent and Application

This instrument applies to England and Wales.

6. European Convention on Human Rights

As the instrument is subject to negative resolution procedure and does not amend primary legislation, no statement is required.

7. Policy background

7.1 The decision of the House of Lords in *re Leyland Daf Limited* overturned long established case law which had provided that the expenses of a liquidation

should be paid out first from available assets before payments to creditors in their statutory order of priority (including assets secured by or subject to a floating charge).

7.2 The decision significantly impacts on the liquidation procedure as the nature of most floating charges are such that they usually cover all available assets. Where there is no floating charge surplus there will be no funds available to meet the general expenses of liquidation. This runs counter to 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. The decision also impacts on the returns floating charge holders receive depending on whether the company is wound up through a liquidation or administration procedure. Additionally insolvency practitioners may be inclined to favour the administration procedure, which offers them relative certainty of recovering their expenses, rather than liquidation.

7.3 In view of the implications of the judgment section 1282 of the Companies Act 2006 inserted section 176ZA into the Insolvency Act 1986 and is intended to provide a mechanism whereby a liquidator will be able to recover the expenses of the liquidation in most cases. This does not represent a change in policy but reflects what has occurred in practice for more than 30 years.

7.4 However section 176ZA better recognises the interest that holders of floating charges (and in some cases preferential creditors) have in asset realisations in cases where they effectively become the party funding the liquidation. The new section is therefore made expressly subject to rules restricting the application in such circumstances that may be prescribed.

7.5 In response to a consultation various stakeholders, including members of the insolvency profession, legal advisors and banks, provided a clear consensus in the view that the only category of expenses that should be restricted are litigation expenses due to the scope for a liquidator to exhaust assets. In such circumstances approval/authorisation should be sought. Stakeholders were content that in all other circumstances liquidation expenses could automatically be taken out of property subject to a floating charge where the general assets of the company are insufficient to meet them. This provides a fair balance between the competing interests of holders of floating charges and the public interest in ensuring that assets are available to pay for the orderly winding up of insolvent companies.

8. Impact

An impact assessment identifying the costs and benefits to business of the insolvency provisions contained within the Companies Act 2006 and encompassing the areas covered by the Rules is available from www.berr.gov.uk/files/file29937.pdf (page 44 of the impact assessment).

9. Contact

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