



Companies Act 2006 (Re Leyland DAF Ltd) - draft amendments to the Insolvency Rules 1986

Summary

As you will be aware, the Companies Act 2006 (the “Act”) includes a provision¹ designed to reverse the ruling in *Re Leyland DAF Ltd*² that general liquidation expenses are not payable out of the assets subject to floating charge security. This provision of the Act expressly provides for rules to be made restricting its application in certain prescribed circumstances. Both the provision and the rules are scheduled to come into force on 6 April 2008 and will have prospective effect.

A draft of these rules (The Insolvency (Amendment) Rules 2008) (the “Rules”) has been circulated by the Insolvency Service for comment by 12 October 2007. In addition to restricting the application of the new provision, the Rules also address the issue (which arises from the current drafting of Insolvency Rules 1986, Rule 4.218) that a liquidator may not recover his costs of pursuing an office holder claim (eg for wrongful trading) from the recoveries resulting if that claim is successful.

s1282 of the Act

s1282 of the Act provides that the expenses of a winding up (to the extent that the assets of the company available for payment of the general body of creditors are insufficient to meet such expenses) have priority over floating charge property and shall be paid out of such property (and hence in priority to the claims of both floating charge holders and preferential creditors).

The Rules - Re Leyland DAF Limited

In relation to “litigation expenses”, the priority afforded by the Act is restricted. “litigation expenses” are the expenses or costs of a liquidation which are properly chargeable or incurred relating to the preparation and conduct of any legal proceedings which a liquidator has the power to bring whether in his own name or in the name of the company.

Pursuant to the Rules “litigation expenses” do not have priority unless the liquidator seeks and obtains the requisite approval or authorisation from the preferential creditors and the floating charge holders or, in certain circumstances, from the Court. The Rules prescribe

the circumstances in which a liquidator must seek such approval or authorisation, being as soon as reasonably practicable after the date on which he forms the opinion that the assets available for the payment of the general body of creditors are or will be insufficient to pay all or part of the litigation expenses and, in order to pay all or part of such expenses, he will have to have recourse to the floating charge property. This obligation to seek approval or authorisation applies both in circumstances in which a liquidator intends to institute legal proceedings and once such proceedings have been commenced. A liquidator will therefore need to keep under review the level of both the available assets and the litigation expenses.

The Rules prescribe the information to be given to preferential creditors and floating charge holders when seeking approval or authorisation. This includes a statement specifying the amount of litigation expenses for which approval is sought (the "Specified Amount"). Recipients have 28 days within which to respond.

If there are two or more preferential creditors and two or more of them respond, approval or authorisation is taken to have been given where a majority in value of those responding within the 28 day period approve or authorise the Specified Amount. If only one such creditor responds then his approval or authorisation (if given) is sufficient as regards preferential creditors.

The circumstances in which the liquidator may seek approval or authorisation from the Court are limited to those in which: the preferential creditor/floating charge holder is (or is intended to be) a defendant in the legal proceedings; approval or authorisation has been either declined or given in an amount which is less than the Specified Amount; or the preferential creditors/floating charge holders have failed to respond to the liquidator's request. The Court has a wide power to grant such approval or authorisation subject to such terms and conditions as it thinks fit (including as to the amount or nature of the litigation expenses and as to any obligation to make further applications to the Court in this regard).

The Rules - recoveries resulting from an office holder claim

The Rules amend the text of Insolvency Rules 1986, Rule 4.218 such that the expenses of the liquidation (including litigation expenses) are payable out of, inter alia, the proceeds of any legal proceedings which the liquidator has the power to bring or defend, whether in his own name or in the name of the company. This should resolve the current issue that a liquidator may not recover his costs of pursuing an office holder claim from the recoveries resulting if that claim is successful.

Conclusion

The Rules are only in draft and it is possible that the consultation process will lead to amendments being made prior to their coming into force.

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1. s1282 Companies Act 2006
 2. Buchler v Talbot [2004] 1 All ER 1289 (HL)

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