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FINANCIAL MARKETS LAW COMMITTEE

ISSUE 120 – SECTION 868 OF THE COMPANY LAW REFORM BILL STATUTORY REVERSAL OF LEYLAND DAF

Clause 868 of the Company Law Reform Bill and the payment of liquidation expenses out of floating charge realisations

c/o Bank of England
Threadneedle Street
London EC2R 8AH
www.fmlc.org

FINANCIAL MARKETS LAW COMMITTEE

ISSUE 120 WORKING GROUP

Peter Bloxham – Freshfields Bruckhaus Deringer

John Davies – Simmons & Simmons

Jennifer Marshall – Allen & Overy

Richard Tett – Freshfields Bruckhaus Deringer

Joanna Perkins – FMLC Secretary

Stephen Parker – FMLC Legal Assistant

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Clause 868 of the Company Law Reform Bill and the payment of liquidation expenses out of floating charge realisations

Introduction

1. The role of the Financial Markets Law Committee ("FMLC") is to identify issues of legal uncertainty or misunderstanding, present and future, in the framework of the wholesale financial markets which might give rise to material risks, and to consider how such issues should be addressed.

2. In October 2005 various concerns relating to a Government proposal effectively to reverse by statute the House of Lords decision in *Buchler v Talbot* (*Re Leyland Daf*) [2004] UKHL 9; [2004] 2 AC 29 were raised with the FMLC. The purpose of this paper is to consider these concerns. The Committee has been assisted in its consideration of this issue by a Working Group, the members of which are listed above.

3. In short, the FMLC concludes that the Government proposal, if adopted in its current form, would give rise to significant uncertainty in relation to large-scale, structured finance transactions such as securitisations and project finance transactions.

4. Alternatives to the approach taken in the Government proposal are considered at the end of the paper.

Summary

5. Clause 868 of the Company Law Reform Bill[1] ("clause 868") is intended to reverse by statute the effects of the House of Lords decision in *Leyland Daf* by adding a new section 174A to the Insolvency Act 1986. If implemented in its current form, this section would have the effect that the expenses of a winding up would be paid out of the assets of the company (including floating charge assets) in priority to the claims of a floating charge-holder. This is expressed to be subject to any rules which may be made restricting the application of the section to expenses approved by the floating charge-holder or the court in certain prescribed circumstances.

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[1] As introduced to the House of Lords on 1 November 2005.

6. In *Leyland Daf*, the House of Lords held that the general costs and expenses of a winding up are not payable out of floating charge realisations in priority to the claims of the floating charge-holder. In this regard, the Court of Appeal decision in *Re Barleycorn Enterprises Ltd* [1970] Ch 465 was overruled. Clause 868 seeks to reverse the effect of the *Leyland Daf* decision and to return to the legal position established by the Court of Appeal judgment in *Barleycorn*.

7. The chief practical objection to this approach in large-scale structured finance transactions (such as securitisations and project finance transactions) is that liquidation expenses are inherently uncertain as to their amount at the time the security is taken and, indeed, continue to be uncertain up to and throughout the process of liquidation. This makes it difficult to predict how the parties structuring a securitisation or project finance transaction will take these liabilities into account. Moreover, the resulting uncertainty may cause secured lenders and/or rating agencies to require structural revisions to the proposed arrangements or further collateralisation, either of which would have potentially significant cost implications.

8. Although it could be argued that clause 868 will merely restore the law to its former position, as it was generally believed to be prior to the House of Lords decision in *Leyland Daf*, the FMLC considers that the statutory reversal of *Leyland Daf* needs to be viewed in a wider context, taking into account the recent evolution of both commercial practices and the common law.[2] Against this background, the FMLC believes that uncertainties in the law, whether imported by case law or statute, can be seen as more significant and potentially more detrimental than they may have been in the past.

9. In addition to the practical concern referred to above, the FMLC has a number of concerns about clause 868 from the perspective of legal certainty:

    a. Firstly, a concern that the clause will reflect and exacerbate any uncertainty there may be at common law as to the distinction between fixed and floating charges;

    b. Secondly, uncertainty about how clause 868 might interact with the Financial Collateral Arrangements Directive 2002/47/EC; and

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[2] That is, in particular, the effect of the House of Lords decision in *National Westminster Bank plc v Spectrum Plus Limited* [2005] UKHL 41, especially when considered in combination with the earlier case of *Re Toshoku Finance UK plc, Khan v IRC* [2002] UKHL 6; [2002] 1 WLR 671.

c. Thirdly, various drafting points which are discussed below.

Legal Background

Decision in Leyland Daf

10. Administrative receivers were appointed in respect of Leyland Daf Limited in 1993, causing the floating charge which had been granted by the company to crystallise. The receivers realised the assets comprised in the floating charge, paid the receivership preferential debts under section 40 of the Insolvency Act 1986 and made an interim distribution to the charge-holder. At the time of the judgment, the receivers held over £70 million of floating charge realisations which had not yet been distributed. Three years after the receivers' appointment, Leyland Daf was placed into a creditors' voluntary liquidation. It was estimated (at the time of the judgment) that the liquidation expenses (including the liquidators' remuneration and corporation tax) would be over £10m (before VAT and interest) and there were unlikely to be sufficient free assets to meet these expenses. The liquidators sought, and obtained from the Court of Appeal, a declaration that the liquidation expenses were payable out of the floating charge assets in priority to the claims of the floating charge-holder (although no claim was made to the money which had already been distributed). The receivers appealed the decision to the House of Lords. The House of Lords unanimously overruled the decision of the Court of Appeal.

Position prior to Leyland Daf

11. Prior to *Leyland Daf*, *Barleycorn* was the leading authority regarding the ranking between liquidation expenses and a floating charge-holder's claim. In *Barleycorn*, Lord Denning held that the costs and expenses of the winding up had to be paid before the charge-holder received any distribution. Accordingly, he ruled that the order of payment was: (i) the costs of the winding up; (ii) the preferential payments; (iii) the bank as holder of the floating charge; (iv) the unsecured creditors.

12. The *Leyland Daf* decision ultimately showed Lord Denning's order of payment to be incorrect. However, prior to *Leyland Daf*, the financial community and leading textbooks had proceeded on the basis of *Barleycorn*, namely that winding up costs ranked ahead of floating charge-holders.

Liquidation expenses and Re Toshoku

13. Rule 4.218 of the Insolvency Rules 1986 ("rule 4.218") provides a list of liquidation expenses. Prior to the House of Lords decision in *Re Toshoku Finance UK plc, Khan*

v IRC [2002] UKHL 6; [2002] 1 WLR 671, it had been argued that items within this list should be further limited by an additional "fairness" test referred to as the "liquidation expenses" principle. Lord Hoffmann summarised this argument as follows:

> [Rule 4.218] created only an outer envelope within which expenses were contained… they also had to pass a judge-made test which Nicholls LJ in *In re Atlantic Computer Systems Plc [1992] Ch 505, 520* called the "liquidation expenses" principle. That principle was one of fairness. If a liability was incurred as a result of a step taken for the benefit of the insolvent estate, it was fair that the burden should be borne by the persons for whose benefit the estate was being administered.[3]

14. *Re Toshoku* was an important decision because the House of Lords rejected the argument that rule 4.218 was subject to a liquidation expenses principle based on considerations of fairness. Lord Hoffmann said that there was no implied qualification of the heads of expense listed in rule 4.218 and whether an expense came within that rule was a question of construction and no more.

15. Following *Re Toshoku*, it is clear that any tax liabilities coming within rule 4.218 will be payable as liquidation expenses. Rule 4.218(1)(p) covers "corporation tax on chargeable gains accruing on the realisation of any asset of the company (without regard to whether the realisation is effected by the liquidator, a secured creditor, or a receiver or manager appointed to deal with a security)". Further tax liabilities may be liquidation expenses under rule 4.218(1)(m) (necessary disbursements) and this was indeed the case in *Re Toshoku*.

Impact of the Enterprise Act 2002

16. Section 72A of the Insolvency Act 1986, which was inserted by the Enterprise Act 2002, imposes a general prohibition on the appointment of an administrative receiver by the holder of a qualifying floating charge in respect of a company's property.

17. However, sections 72B to 72GA contain important exceptions to this prohibition for certain structured finance arrangements ("the structured finance exceptions").[4] In

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[3] [2002] 1 WLR 671, at 675-6.

[4] A further exception to the prohibition occurs where the floating charge was created before the Enterprise Act came into force in 2003 and is therefore "grandfathered". There are still a significant number of such "grandfathered" debentures in the market-place and it will take some years before these work through the system.

cases where the structured finance exceptions apply, an administrative receiver may be appointed in respect of assets which are subject to a floating charge (and at the same time, of course, assets which are subject to a fixed charge). This administrative receiver will carry out his functions concurrently with those exercised by any liquidator who may be appointed in respect of a winding up of the company.[5]

18. Thus, if an administrative receiver has been appointed in respect of the assets under the floating charge and the company is concurrently in liquidation, there will be two sets of costs and expenses. Under the proposed clause 868 both sets of costs and expenses would be borne by the floating charge-holder.

Evolving common law

19. Developments relating to the distinction between fixed and floating charges in the last few years include the House of Lords decision in *National Westminster Bank plc v Spectrum Plus Limited* [2005] UKHL 41. This case and the earlier decision of *re Brumark Investments; Agnew v Inland Revenue Commissioner* [2001] UKPC 28 have generated debate about the distinction between fixed and floating charges and how these legal principles apply in practice. Those issues – and the extent of any uncertainty that may arise – are not within the scope of this paper, save to note that the cases mean that it is now significantly more likely that substantial assets will be secured by floating charges rather than fixed charges. Accordingly, post *Spectrum Plus*, the ranking of liquidation expenses in relation to floating charge realisations has become more important than it was before.

Commercial Background

Securitisation Market

20. Securitisation in the UK is growing rapidly and the shape and nature of the market are constantly changing.

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[5] The administrative receiver will not have to carry out his functions in parallel to the exercise by an *administrator* of his functions because: (i) by virtue of paragraph 39(1) of Schedule B1 of the Insolvency Act 1986, the court must dismiss an administration application in respect of the company where there is already an administrative receiver (subject to certain exceptions); (ii) the company and its directors also cannot appoint an administrator "out of court" if an administrative receiver is in office (paragraph 25(c)); and (iii) when a company is in administration, an administrative receiver may not be appointed (paragraph 43(6A)).

21. In 2004 the UK was the largest European issuer with $130 billion of securitised bonds being issued in just one year (43% of European issuance). This is nearly twice the volume by value of *total European* issuance just 4 years earlier in 2000 ($71 billion).[6]

22. The recent growth of securitisation has been driven by banks' need to diversify to alternative sources of funding in an increasingly competitive market place. Taking assets off-balance sheet allows banks both to reap capital efficiencies and to raise funds for further lending.

Securitisation Structures

23. There are various different securitisation structures and the market is constantly evolving. A vital element to securitisations is that effective and valuable security is given (ultimately) in favour of the holders of the securities. Broadly, all securitisations involve floating charges, both for the control on enforcement provided by the potential appointment of an administrative receiver and for the priority provided over realisations. Wherever possible, investors seek to take fixed charge security, however, sometimes that cannot be achieved as the underlying business requires use of the assets in a manner which prevents the secured party from having the necessary level of control for the charge to be fixed.

24. This arises particularly (but not only) in whole business securitisations. In such a transaction, a special purpose vehicle ("SPV") issues capital market securities. There is no sale of the operating assets but the SPV on-lends the proceeds of the securities to the operating company. The operating company then gives security over its assets. As it is trading, various categories will be subject to a floating charge only. In an insolvency situation, the holders of the securities will look to realisation of the operating company's assets to recover their debts and a substantial part of those realisations will be floating realisations.

25. The securities issued as a result of securitisations are rated by Credit Rating Agencies. The rating which is accorded to the securities depends on a variety of criteria including the Agency's assessment of any legal or operational risk potentially affecting the enforcement of any security arrangements. When modelling an enforcement, the Credit Rating Agencies deduct from the floating charge realisations any amounts that rank ahead of the floating charge-holder. Clearly an increase to the

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[6] Statistics supplied by International Financial Services, London, and available at www.ifsl.org.uk. No statistics are yet available for 2005.

deductions from the floating charge realisations will adversely impact on the rating analysis.

Clause 868 - Commercial Impact

General Concerns

26. The FMLC is concerned that clause 868 could have a significant impact on large-scale securitisation and project finance transactions. These types of transaction were excluded, by means of the structured finance exceptions, from the general prohibition on appointing an administrative receiver that was introduced by the Enterprise Act 2002.

27. Because the amount of the liquidation expenses in any given case is impossible to ascertain in advance (and potentially very large compared with the preferential payments that will be made), it is unclear how the parties structuring a securitisation or project finance transaction which involves a floating charge will take these liabilities into account. (In contrast, the preferential claims[7] and prescribed part[8] which also have priority over a floating charge can be sized in the cash-flow modelling.) The FMLC is concerned that secured lenders and the Credit Rating Agencies in large-scale structured finance transactions, when confronted by the possibility of uncertain liabilities, will require additional collateral or possibly more convoluted structures in order to maximise the arguments that the security takes effect as a fixed charge; this would clearly have an impact upon the costs of putting such transactions together.

28. Moreover, this uncertainty is likely to be exacerbated in an individual transaction by any residual legal uncertainty about the distinction between fixed and floating charges.

29. The impact on the structured finance market as a whole of the uncertainty affecting individual transactions is unclear. However, any prejudice to the market which might have been occasioned by the law as it was thought to be before *Leyland Daf*, is likely to be aggravated by its reversal several years later given the rapidity with which the securitisation market, in particular, has grown and developed. It will be further

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7 See section 196 of the Companies Act 1985 and sections 40 and 175 of, and paragraph 65(2) of Schedule B1 to, the Insolvency Act 1986.

8 See section 176A of the Insolvency Act 1986.

aggravated by the expansion of the category of floating charges in the wake of *Spectrum Plus*.

Specific Concerns

30. As stated above, where an exception to the general prohibition applies, it is still possible for an administrative receiver to be appointed concurrently with a liquidator. This could result in two sets of expenses, both of which (following the coming into force of clause 868) will have priority over the claims of the floating charge-holder but only one of which will have been incurred for the benefit of that charge-holder.

31. A particular concern arises in relation to post-liquidation corporation tax. If a company is in liquidation and administrative receivership concurrently, and the administrative receiver sells fixed charge assets at a profit (thus incurring a capital gains tax liability), the receiver would not be required to pay the capital gains tax out of the fixed charge realisations (as this remains a liability of the company rather than the receiver). However, under Rule 4.218(1)(p) of the Insolvency Rules 1986, the capital gains tax would be an expense of the liquidation and so, in accordance with clause 868, would be payable out of the floating charge realisations.

32. As a result of the amendments made to Rule 4.218(1)(a)(i),[9] a liquidator can now recover as an expense of the liquidation the costs of pursuing unsuccessful litigation; so long as these costs were properly incurred. If clause 868 is implemented in its current form, this would entail that, where a liquidator sought to challenge the validity or characterisation of the security and failed in the attempt, the secured creditor would have to bear the litigation costs out of the floating charge realisations. This is something which Lord Millett held in *MC Bacon Ltd* [1991] Ch 127 would be unjust.[10] Further it may lead to a request by the Credit Rating Agencies for greater litigation reserves and credit enhancement which could, in turn, have an impact on the cost of securitisations and other rated structured finance transactions.

33. Concerns also arise about how clause 868 might interact with the Financial Collateral Arrangements Directive 2002/47/EC (as implemented in the UK by the Financial Collateral Arrangements (No 2) Regulations 2003, "the Financial Collateral Regulations").

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9 Following the decision in *Re Floor Fourteen Ltd* [2002] BCC 198.

10 [1991] Ch 127, at 141-142.

34. The primary focus of this paper is secured finance transactions. The Financial Collateral Regulations may be relevant in the context of large-scale structured finance transactions (such as project finance or securitisations transactions) where share pledges are taken over shares in subsidiary companies or where security is taken over portfolios of investment securities.[11] The collateral-taker in a structured finance transaction that involves a floating charge over financial collateral may rely on the Financial Collateral Regulations to guarantee aspects of the transaction against certain known legal risks. However, the Financial Collateral Regulations are also relevant in a variety of other situations potentially affected by clause 868.

35. One objective of the Financial Collateral Arrangements Directive is to protect transactions involving assets which comprise "financial collateral" against certain known legal risks which impact on enforcement and thereby to promote certainty in financial collateral arrangements. In these circumstances, it could be argued that it would undermine the spirit and objective of the Financial Collateral Arrangements Directive to grant priority to the recovery of inherently uncertain liquidation expenses (some of which may be unconnected to the enforcement of the floating charge) over and above the right of the charge-holder to realise the proceeds of the charge which underlies the arrangement.[12] It may be, therefore, that it would be thought desirable to disapply the provisions of clause 868 not only in respect of structured finance transactions but in all circumstances where a security financial collateral arrangement is being enforced.[13]

Drafting concerns

36. The FMLC is not proposing to give detailed drafting comments on the wording of clause 868 and confines itself here to pinpointing a couple of high-level drafting issues which are of particular concern from the perspective of legal certainty.[14]

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[11] In the case of a share pledge, there should be little risk of the security being recharacterised as a floating charge. However, in cases where the grantor of the security has the right to substitute assets in and out of the portfolio of secured assets, the security may take effect as a floating charge even though the collateral-taker has sufficient "possession and control" of the secured assets to fall within the terms of a security financial collateral arrangement.

[12] Particularly in light of the fact that, where the floating charge satisfies the definition of a "security financial collateral arrangement", preferential claims and the prescribed part no longer have priority over the claims of a floating charge-holder.

[13] The FMLC notes that the Financial Collateral Regulations pre-date the decision in *Leyland Daf* by several months and is uncertain whether any consideration was given to this problem at the time of their implementation.

[14] The fact that the scope of the paper is limited in this way should not be taken to indicate that the drafting of clause 868 is endorsed in other respects.

37. The proposed new section 174A, inserted in the Insolvency Act 1986 by clause 868, refers to the expenses of the winding up being paid out of the "assets of the company". When used in the context of section 175 of the same Act, this expression has given rise to some debate and confusion in a number of cases (including *Leyland Daf* and *MC Bacon*) as it is not clear whether it includes assets which are the subject of a floating charge. Indeed, in *Leyland Daf* it was held that the company's assets did not extend to assets that were the subject to a crystallised floating charge. In light of the proposed section 174A(1)(b), it would be hard to argue that this expression did not include assets that were the subject of a floating charge but the FMLC considers that it would be helpful if this could be clarified.[15]

38. Section 174A(1)(b), as inserted in the Insolvency Act 1986 by clause 868, is inconsistent with section 175(2)(b) and leads to confusion as to whether the difference in wording between the two sections was deliberate or whether the two sections were intended to operate in the same way.[16]

39. Section 174A(2), as inserted in the Insolvency Act 1986 by clause 868, is intended to introduce secondary legislation making provision for the approval of the quantum of the liquidation expenses by the floating charge-holder or the court. However, it is not clear from section 174A(2) when the approval of the floating charge-holder would be required and when the liquidator would be required to seek the approval of the court. The FMLC would welcome further clarification on the proposed terms of the secondary legislation.

Retroactivity issues

40. The FMLC does not know whether and how it is intended that the proposed transitional provisions for the Company Law Reform Bill should apply in relation to clause 868. There are a number of possibilities, including the following:

    a. clause 868 could be brought into effect with application to floating charges created prior to the date of its entry into force, including cases where a liquidation has commenced prior to that date;

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[15] The FMLC notes the helpful amendment tabled by Lord Sharman and Lord Razzall adding the words "including assets subject to a floating charge".

[16] The FMLC notes the helpful amendment to section 174A(1)(b) which has been tabled by Lord Sharman and Lord Razzall. This would have the effect that the liquidation expenses would only be payable out of floating charge realisations in so far as the assets of the company not subject to the floating charge were insufficient to meet such expenses.

b. clause 868 could be brought into effect with application to floating charges which have been created prior to the date of its entry into force, excluding cases where a liquidation has commenced prior to that date; or

c. there could be saving provisions (as there are for grandfathered floating charges under the Enterprise Act 2002) for any floating charge created prior to the date on which clause 868 comes into effect.

41. The FMLC considers that option (a) could give rise to difficulties if a liquidator (based on *Leyland Daf*) had already made payments to the floating charge-holder prior to the date on which clause 868 came into force. Such a liquidator may seek to claw-back such payments on the basis of clause 868 and this could give rise to uncertainty.

42. The FMLC also considers that option (b) could prejudice floating charge-holders who had structured their transactions, and priced their loans, on the basis of the rights and remedies available to them following *Leyland Daf* (i.e. on the understanding that the liquidation expenses would not be payable out of the floating charge realisations). This prejudice is likely to be particularly acute in the case of structured finance transactions, where the consequences may be unintentionally serious given the complexity of the context.

43. The preferred option is therefore option (c). However, the FMLC acknowledges that the effect of such general saving provisions would be to exempt grandfathered charges irrespective of whether they meet the structured finance exceptions, including structures set up before the decision in *Leyland Daf* under the authority of *Barleycorn*. The FMLC considers, therefore, that a pragmatic approach would be to enact savings provisions for any floating charge created prior to the entry into force of clause 868 which simultaneously satisfies the structured finance exceptions.

Proposals

44. As discussed above and to avoid an adverse impact on the securitisation market and large structured finance transactions, the FMLC considers that any reversal of *Leyland Daf* should not apply to such transactions. In the same way that the Enterprise Act acknowledged that these complex transactions should be treated differently, the FMLC proposes that there should be an appropriate carve-out from clause 868. The FMLC's suggested amendment is for two additional subsections to section 174A as follows:

"*(3) Subsection (1)(b) does not apply if an administrative receiver of the company is appointed where, further to any of the exceptions in sections 72B to 72GA, section 72A did not prevent [or would not have prevented]*[17] *such appointment.*

(4) Subsection (1)(b) does not apply in respect of financial collateral (as defined in the Financial Collateral Arrangements (No.2) Regulations 2003) secured by a floating charge which is a financial collateral arrangement (as defined in those Regulations)

45. By way of explanation, the FMLC notes that:

(a) The suggested amendment as drafted applies to all the exceptions in sections 72B to 72GA. The exceptions in section 72DA (urban regeneration), section 72G (registered social landlords) and section 72GA (protected railway companies etc) are of less relevance to the wholesale financial market. The FMLC expresses no view as to whether those should be carved out from clause 868. The current drafting is to provide consistency in the approach with the Enterprise Act. It could be changed to list the exceptions to which the suggested amendment should apply if that were considered appropriate.

(b) The suggested amendment only applies on actual appointment of an administrative receiver.[18] Theoretically, a charge-holder entitled to appoint an administrative receiver could decide not to appoint. In practice, this is very unlikely for a structured finance transaction which satisfies the criteria in sections 72B to 72GA. However, should there be no administrative receivership, then the liquidation expenses would be payable ahead of the floating charge-holder.

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[17] Regarding an appointment pursuant to a pre-Enterprise Act floating charge (*supra* n.4), section 72A only applies to floating charges created on or after 15 September 2003. Accordingly, the suggested amendment includes the words "or would not have prevented" to encompass pre-Enterprise Act floating charges which meet the criteria in section 72B to 72GA. These additional words are redundant if, in any event, the proposed transitional provisions of the Company Law Reform Bill are not intended to apply in relation to clause 868.

[18] The FMLC is aware of arguments to the effect that, because an administrative receiver bears obligations to report on directors' conduct which are similar to those imposed on liquidators, the arguments for reversing *Leyland Daf* are less forceful than they would otherwise be (*infra*, appendix). However, these arguments clearly do not apply where an administrative receiver is not appointed.

(c) Subsection (4) is intended to deal with the point raised in paragraphs 33 to 35 above.

Conclusion

46. The FMLC concludes that clause 868, if adopted in its current form, would give rise to significant uncertainty, particularly in relation to large-scale, structured finance transactions such as securitisations and project finance transactions. There is, therefore, a strong argument for exempting these transactions along the lines of the Enterprise Act exemption for structured finance transactions.

47. Although aware of general policy justifications for the enactment of clause 868, the FMLC does not believe these apply with the same force to structured finance transactions. The FMLC is not aware of any overriding benefit to be obtained by applying clause 868 to companies involved in structured finance transactions which would justify the prejudice which is likely to be caused by the resulting increase in legal and operational uncertainty.

48. Although it could be argued that clause 868 will merely restore the law to its former position, as it was generally believed to be prior to the House of Lords decision in *Leyland Daf*, the FMLC considers that this proposed statutory reversal of *Leyland Daf* needs to be viewed in a wider context, taking into account the recent evolution of both commercial practices and the common law, including the rapid growth of the securitisation market in the last couple of years and the decision of the House of Lords in *National Westminster Bank plc v Spectrum Plus Limited*. Against this background, the FMLC believes that uncertainties in the law, whether imported by case law or statute, can be seen as more significant and potentially more detrimental than they may have been in the past.

APPENDIX

The FMLC has been given to understand that clause 868 is intended to give effect to the Government's policy (on which the FMLC does not intend to comment) that the funding of a collective insolvency procedure (such as liquidation) should be met by a levy on the assets of a company (including those assets subject to a floating charge). The justification for this policy is, at least in part, that secured lenders benefit from the proper funding of the liquidation procedure, including the statutory requirements placed on liquidators to scrutinise the conduct of directors and to take action against "rogue" directors[19]. These requirements arise primarily under the Company Directors Disqualification Act 1986 ("the CDDA").

Section 7(3) of the CDDA imposes an obligation on an officeholder to report forthwith to the Secretary of State if it appears to the officeholder that a director's conduct is such that it makes him unfit to be concerned in the management of a company. The Insolvent Companies (Reports on Conduct of Directors) Rules 1996 set out more details on this reporting obligation and the prescribed D forms which the officeholder is to use.

Section 7(4) of the CDDA gives the Secretary of State and the official receiver the power to require an officeholder (or a former officeholder) to furnish him with certain information as the Secretary of State or the official receiver may reasonably require. While not wishing to comment on the underlying policy objective of the Government in this regard, the FMLC would point out that administrative receivers have similar obligations under the CDDA to liquidators. They are obliged to file D forms in respect of the directors' conduct and can be required by the Secretary of State or official receiver to provide further information.

For completeness, the FMLC notes that some legal actions are available to a liquidator but not an administrative receiver (e.g. wrongful trading and transactions at an undervalue under sections 214 and 238 of the Insolvency Act 1986 respectively). Further, Statement of Insolvency Practice 2 ("SIP 2") provides guidance as to the best practice to be adopted by a liquidator when investigating the affairs of the insolvent company.

Both these legal actions and SIP 2 are primarily focused on ascertaining and recovering assets for creditors rather than the scrutiny of directors, although relevant information

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[19] See also *Pantemaenog Timber* [2003] UKHL 49.

discovered should be reported under the CDDA regime. Further, in terms of SIP 2 and wrongful trading being distinguishing features in favour of liquidation, the FMLC notes that as well as not applying in administrative receivership, they do not apply in administrations (which under the Enterprise Act can now lead directly to distributions and dissolution without a liquidation).

Hence there is a prescribed regime that applies in administrative receivership and liquidation alike whereby directors' conduct is reported to the appropriate authorities for review. Further, in structured finance transactions, often with multiple interested parties and advisers, it is hard to see that there would be a lack of scrutiny of the directors' conduct where the transaction had ended in insolvency.

FMLC COMMITTEE MEMBERS

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