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LEADING LAWYERS ON ANALYZING THE EUROPEAN BANKRUPTCY PROCESS, DEVELOPING CREATIVE STRATEGIES FOR CLIENTS, AND UNDERSTANDING THE LATEST LAWS AND TRENDS

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ISBN 978-0-314-26774-0

For corrections, updates, comments, or any other inquiries please e-mail TLR.AspatoreEditorial@thomson.com.

First Printing, 2010
10 9 8 7 6 5 4 3 2 1

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Unique Aspects of Bankruptcy Law in the United Kingdom

Our discussion of bankruptcy law in the United Kingdom focuses predominately on the law in England and Wales. This is because, while the United Kingdom is a member of the European Union, the United Kingdom is itself made up of the constituent countries of England, Scotland, Wales, and Northern Ireland. Ireland is not part of the United Kingdom and is a separate member state of the European Union. In the United Kingdom, only England and Wales share a common form of legal system known as English law. Both the law of Scotland and Northern Ireland, though influenced by English law, are distinct. Thus, our discussion is based on the English law countries of England and Wales, where we are licensed, and references to the United Kingdom and U.K. law shall mean England and Wales, and English law, respectively.

The distinctions above help clarify how our country differs at its core from most of the rest of the European Union. England is the original common law jurisdiction, and English law remains the forerunner of common law legal systems. While there are twenty-seven member states in the European Union, only the United Kingdom and Ireland are common law states. The remaining European Union member states have civil law systems.

In short, the distinction means that in England and Wales, prior decisions of the courts are given greater weight than in civil law jurisdictions, the courts are generally empowered to make law, and the role of the adversarial process is more integral to the determination of disputes. The net result of this is that insolvency and bankruptcy law in the United Kingdom is significantly less codified than in other European Union member states.

Further, the nomenclature presumed in the title of this chapter is potentially misleading in England and Wales. "Bankruptcy" is a term that has been glamorized by U.S. practice, but is not accurately used in the context of insolvent companies in the United Kingdom. Bankruptcies in England and Wales are reserved for individuals and, in some instances, partnerships lacking limitation on liability.

With respect to corporations and other companies, these entities are subject to different insolvency procedures, namely liquidation and administration (administration order and administrative receivership), each described in greater detail below. The term "bankruptcy" is used often in public, non-legal discourse to refer to companies, but it tends to carry with it the connotation of liquidation. The term "bankrupt" is often used interchangeably with "debtor" to refer to the individual or company in bankruptcy or insolvency, as the case may be. Note, however, that the difference is both fundamental and procedural. Bankruptcy and business insolvency actions are administered by separate courts and are pursuant to different procedural rules.

Because an understanding of both bankruptcy and business insolvency makes one better at understanding either individually, we discuss both laws below, but with an emphasis on business law, as this is our practice. One should not lose sight, however, that this is one of the key hallmarks of the U.K. system: different systems for individuals versus companies, each of which has arisen and evolved in unique ways. This is discussed in further detail below.

Business insolvency law in the United Kingdom is not, therefore, generally referred to as *bankruptcy* law. As described in more detail below, businesses (for these purposes, corporations and other companies) have a variety of legal options in this regard, including, but not limited to, company voluntary arrangements/schemes of arrangement, receiverships, administration, and liquidation/winding up.

The core questions in all of these options, and concomitantly in comparing the United Kingdom's various options to those in the European Union or the United States, is the balance of competing interests and presumptions, such as:

1. Balancing creditor versus bankrupt protections
2. Determining whether bankrupts or third parties should take the primary role in determining process and outcome
3. Balancing efficiency versus cost
4. Weighing predictability against flexibility

Compared to the United States, the benchmark against which most bankruptcy systems are measured, the United Kingdom's business bankruptcy laws are less permissive and more creditor-protective. Further, though both systems are based in common law, the U.S. system is more statutorily confined. Codification is a prominent feature of the other states of the European Union. Whereas the United States focuses on providing a fresh start and a clean slate for bankrupts, European insolvency legislation prioritizes the satisfaction of creditors' claims. A bankrupt's property is not protected in the United Kingdom and the European Union in the same way it is in the United States. Creditors therefore have more possibility to enforce their claims, and bankrupts have to give up most of their property to serve creditors' claims.

Compared to the rest of the European Union, however, legislation in the United Kingdom is often considered the most bankrupt-friendly. Of all the European countries, the United Kingdom's bankruptcy legislation most resembles that of the United States, but it is still regarded as being stricter and more creditor-friendly than the United States. In addition to giving up most of their property, European bankrupts typically have to undergo a period of good conduct with a settlement plan to make a contribution to debt service. For example, Irish legislation foresees a waiting period of twelve years before the discharge of consumer debt (c.f., the twelve-month period in the United Kingdom, recently shortened from thirty-six months). This, too, is a hallmark of the U.K. insolvency regime: its overall flexibility (and not uncoincidental ability to do major tasks without court oversight or intervention, as discussed below).

This United Kingdom and European Union divide in part centers on the perception of whether a bankrupt, by being insolvent, has done something "wrong." In Chapter 11 in the United States, which stresses the "fresh start" of bankrupts (and their officers and directors), bankrupts receive a treatment akin to that of innocent victims of economic circumstances. As discussed in more detail below, recent reforms in the United Kingdom have sought to bridge this divide, with moderate degrees of success.

The differing U.S. perception leads to the U.S. approach of debtor-in-possession, a concept that, until recently, was completely foreign to the European Union member states (including the United Kingdom). Traditionally, European Union countries look more askance at bankrupts and their officers and directors in such circumstances. As noted below in more detail, this is changing, albeit in many instances slowly.

Still, as noted above, the United Kingdom is considered to be more permissive than the rest of the European Union. Indebted persons (and businesses) throughout Europe often turn to the United Kingdom to take advantage of its relative leniency. The practice, termed "forum shopping," involves potential bankrupts from other European countries setting up an address in the United Kingdom and filing for bankruptcy, allowing them to be debt-free quicker than in their own country (note the twelve years in Ireland mentioned above, or seven years in Germany). The courts and the Insolvency Service have been, however, working to detect and deter those who would use forum shopping in this manner.

European Union rules mean any bankruptcy ruling in the United Kingdom must be recognized by the other countries in the European Union, thus allowing a foreigner to be declared bankrupt in the United Kingdom, and thus benefiting from the one-year rule upon their return to their own country.

For companies, the issue is complicated by the factor of the center of main interests, whereby such forum shopping should be limited to the one true forum where the business has its nexus. However, determinations of the center of main interests are not without complication. For example, where a multinational corporation has independent business subsidiaries operating in multiple European Union member states, or where competing factors of the center of main interests lead to different results (e.g., a company founded under one member state's laws, headquartered in another, operating in a third, and with significant assets and liabilities in a fourth). The center of main interests also applies to individuals, making it more difficult to employ the tactic discussed above in recent practice.

The History of Bankruptcy in the United Kingdom

Historical Perspective

<u>Statute of Bankrupts 1542</u>

In England, bankruptcy law dates in codified form from the Statute of Bankrupts 1542 (34 & 35 Henry VIII, c. 4), but is certainly much older conceptually, and existed in England as a body of non-codified law prior to that time. It is important to note that, at this early stage, the emphasis of bankruptcy laws was not rehabilitation or discharge, but instead the orderly parsing of debts among creditors. Further, as with this and many subsequent laws, the goal was less to rehabilitate innocent but hapless bankrupts, and more to punish perceived negative behavior. The Statute of Bankrupts 1542 included in it, for example, the power to imprison bankrupts for non-payment of debts, which power arose from the civil enforcement of debt against a non-trader. Longer-term imprisonment for debt in the United Kingdom did not stop until 1869, while short-term imprisonment continued into the twentieth century (in some cases).

The Bankruptcy Act 1571

Under the Bankruptcy Act 1571 (13 Eliz. I, c. 7), commissioners of bankrupts could be appointed to allow a bankrupt to legally discharge his or her debts to creditors by an equitable and independent distribution of the bankrupt's assets, and then begin trading again with his or her outstanding debts wiped out. Further, the Fraudulent Conveyances Act 1571 provided the lord chancellor with the power to redistribute frauds in the aid of equitable creditor recovery.

Statute of Anne Bankruptcy Act 1705

The stated purpose under the Statute of Anne Bankruptcy Act 1705 (4 Anne, c. 17) was, once again, to prevent frauds by bankrupts. In actuality, however, this act had the effect of shifting focus away from the fraudulent presumption of bankrupts by introducing for the first time the concept of a discharge for the bankrupt who cooperated with its creditors ("all and every Person and Persons so becoming bankrupt…shall be…discharged from all Debts by him, her or them due and owing at the Time that he, she or they did become Bankrupt…."). The discharge was effectuated by obtaining a "certificate of conformity" from the bankrupt's creditors (in the requisite number and amount).

Insolvent Debtors (England) Act 1813

Under the Insolvent Debtors (England) Act 1813 (53 Geo. III, c. 102), the ability to imprison debtors for *de minimis* amounts was curtailed (raising the minimum amount to forty shillings). Still, creditors continued to rule the process and could often determine the length of a bankrupt's prison sentence. Famously, John Dickens, the father of novelist Charles Dickens, was imprisoned in 1824—accompanied by his wife and three youngest children (not including Charles), as was common practice at the time—at the infamous Marshalsea Prison for non-payment of a £40 debt. Though John was released three months later after using a legacy to satisfy the debt, Charles's visits to Marshalsea are thought to have influenced some of his writings.

The Bankrupts (England) Act 1825

The Bankrupts (England) Act 1825 (6 Geo. IV, c. 16) was not, as some have reported, the beginning of voluntary bankruptcies in the United Kingdom (that instead happened in 1869), though it is true that it introduced for the first time an ability of bankrupts to cooperate with friendly creditors for the bankrupt to be declared insolvent. The act also introduced for the first time the concept of composition (a formal system whereby creditors could agree among themselves how to divvy up the bankrupt's assets without resorting to the courts).

Joint Stock Companies Act 1844

It is important to note that, during most of this period, the concept of insolvency for businesses was hopelessly intertwined with the bankruptcy of the principals of the business. It was not until the enactment of the Joint Stock Companies Act 1844 (7 & 8 Vict. 1844) that incorporation became available on a wider basis in the United Kingdom. While the concept of limited liability would not be implemented until 1855, when incorporation become more widely available and with respect to the underlying legal principle that corporations have a separate, legal existence from their principals, more fulsome insolvency rules for incorporations were unsurprisingly more in demand. Parliament anticipated this, and with the 1844 Companies Act, enacted the Joint Stock Companies Winding-Up Act 1844.

Limited Liability Act 1855

As noted above, the Limited Liability Act 1855 (18 & 19 Vict., c. 133) referred to in the vernacular as the "Rogues Charter" by *The Law Times*, brought U.K. practices with respect to corporations more into line with the other states of Europe. Nonetheless, it is the codified origin of limiting the liability of corporation principals to their principal stake.

Companies Act 1862

In the Companies Act 1862 (25 & 26 Vict., c. 89), the general governance of companies and the winding up of companies were combined into a single statute. From this point forward and continuing for more than one hundred years, as a general rule of thumb, companies' insolvency rules were contained in the currently applicable Companies Act, and personal bankruptcy rules were contained in the currently applicable Bankruptcy Act.

Note, however, given the fact that bankruptcy law pre-dated the wide use of corporations in the United Kingdom, the laws pertaining to insolvency by corporations evolved independently and have an independent existence (noting also, however, that their remains sometimes overlap when it comes to partnerships).

The Three Bankruptcy Acts of 1869

A trio of acts in 1869 implemented the most major shift in focus in U.K. individual insolvency law to that date. The Bankruptcy Act (England) 1869 (32 & 33 Vict., c. 71) consolidated existing but fractured bankruptcy laws into a single statute, and introduced for the first time an entirely voluntary petition by the bankruptcy for liquidation by arrangement. The Debtors' Act (England) 1869 (32 & 33 Vict., c. 62) abolished in a general sense debtors' prisons, though permitted imprisonment on terms set forth in the concomitant Bankruptcy Act. The Bankruptcy Repeal and Insolvent Court Act (England) 1869 (32 & 33 Vict., c. 83), together with the concomitant Bankruptcy Act, eliminated the existing Insolvent Debtors' Court in favor of a system of Bankruptcy Courts both in and outside of London.

Insolvency Acts of 1985 and 1986

The preceding system of codification through numerous partially applicable laws continued until late in the twentieth century. In response to the report of the Insolvency Law Committee known as the "Cork Report," Parliament attempted to combine the fractured sources of law in this arena into a single statute known as the Insolvency Act 1985, and then in the Insolvency Act

1986. Nonetheless, it remains the case, as is noted above, that remedies for individuals versus companies are administered by different courts and under different procedures.

A Modern Perspective

The preceding history gives one a better understanding of the difference between business insolvency law and bankruptcy in the United Kingdom, and an appreciation for the fact that business "bankruptcy" in the United Kingdom has been, and to some degree is still today, governed by multiple sources of statutory and judicial precedent.

Looking forward to today, the major statutes governing bankruptcy and insolvency in the United Kingdom are the:

- Companies Act 2006
- Insolvency Act 1986
- Insolvency Rules 1986
- Insolvency Act 1994
- Insolvency Act 2000
- Insolvency (Amendment) (No. 2) Rules 2002
- Council Regulation (EC) No. 1346/2000
- Insolvency (Amendment) (No. 2) Regulations 2002
- Tribunals, Courts, and Enforcement Act 2007
- Enterprise Act 2002
- Insolvency (Amendment) Rules 2003 (SI 1730/2003)

It is probably more helpful, rather than to parse the aforementioned statutes (and keeping in mind that numerous other statutes may affect outcomes), to consider the options at a meta level. Other than doing nothing (or evading debts), the relief available to both individual and corporate insolvents may be parsed into useful, general categories. They are:

1. Informal, unsupervised remedies

    a. Unstructured settlements (individuals or companies)
    b. Forbearance/refinance (individuals or companies)
    c. Workouts (companies)

2. Formal, minimally supervised remedies

   a. Individual voluntary arrangements (individuals)
   b. Company voluntary arrangements (companies)
   c. Administrative receivership (companies)
   d. Administration (companies)
   e. Liquidation by a creditors' voluntary winding up (companies)

3. Formal, court-governed remedies

   a. Bankruptcy (individuals)
   b. Schemes of arrangement (companies)
   c. Liquidation by a compulsory winding up (companies)
   d. Dissolution (companies)

Each is discussed briefly in turn below. However, it is important to note that, given the number of substantial changes to the relevant laws in recent times, commentators do not seem to be able to reach agreement even as to the foregoing classification. Are schemes of arrangement still a major tool, for example? Is a company voluntary arrangement an independent tool or an aspect of administration? These are questions best left to be debated another day. The breakout contained herein is as we perceive the state of the law.

Categories of Bankruptcy Relief in the United Kingdom

Informal, Unsupervised Remedies

It is difficult to track the prevalence of unsupervised, out-of-court remedies, as they are, by their nature, non-public. Some commentators have argued that such remedies make up the bulk of insolvent remedies in the United Kingdom, while others argue that such remedies are seldom used. As virtually every known bankruptcy system has, as its foil, a less formal alternative, the use of such informal remedies must certainly have its place.

It seems, however, that such informal remedies—at least for companies—are less often used in the United Kingdom than in other jurisdictions. This is because, unlike countries such as the United States, which has both formal bankruptcies and informal workouts but nothing of substance in between, the United Kingdom has what is essentially three tiers of remedies with a middle tier that balances formality and oversight. In the United States, where the choice is more binary, those seeking to avoid the harsher realities of the Bankruptcy Code are forced to craft their own out-of-court remedies. In the United Kingdom, the middle ground is well trodden, thus intuitively requiring less from the more informal alternatives in this category.

In addition to frequency of use, the success of such strategies can be measured in large part by this same availability of the alternative remedies. When, as has been the case in the United Kingdom, the alternative schemes are almost entirely creditor-friendly, the net result is dysphasic. Parties seeking the less formal alternatives may be motivated to do so out of a desire to avoid the aforementioned bias. At the same time, however, such informal remedies tend to reflect the same bias existing in the alternative remedies, as parties negotiate in part with an eye on their perceived chances of success should an alternate remedy be required.

Success in this regard is measured first by the lens applied to the situation (i.e., are we representing the creditor or the debtor?), and then by the ability to shape outcomes that are viewed favorably through that lens (i.e., what, in light of the foregoing, is our goal?). Further, because, by their nature, voluntary negotiations are most easily accomplished with a limited number of parties, and the logical choice for such a subset of creditors is those creditors with the largest or most sophisticated obligations, the use of workouts as a remedy tends to favor such large, often institutional creditors. Thus, success viewed through the creditors' lens may be a relative matter.

A special note should be made with respect to workouts, which is the most formal of the informal remedies. While the term "workout" in the United States connotes a free-form, completely un-predetermined process, in the United Kingdom workouts tend to be almost exclusively with banks, and they tend to follow a set pattern, which is known as the "London approach" and was primarily used prior to 1997. Under such workouts, the company seeking to propose the informal solution to its difficulties first approaches its banks and requests both a voluntary moratorium on enforcement and a continued availability of credit during the process (akin to the forbearance and waiver process in the United States). During the