EXECUTIVE NOTE

THE INSOLVENCY ACT 1986 AMENDMENT (APPOINTMENT OF RECEIVERS) (SCOTLAND) REGULATIONS 2011

SSI 2011/140

The above statutory instrument was made in exercise of the powers conferred by section 2(2) of the European Communities Act 1972([1]) and all other powers enabling Scottish Ministers to do so. The instrument is subject to negative resolution procedure and comes into force on *17 March* 2011.

Policy Objective

These Regulations amend section 51 of the Insolvency Act 1986 ("the 1986 Act") to deal with an unintended consequence of the EU Council Regulation on insolvency proceedings (Regulation No. 1346/2000) ("the EU Regulation"). The Regulations ensure that a floating charge holder may appoint a receiver over the property situated in Scotland of a borrowing company which has its centre of main interests in another member state and which does not have an establishment in the UK.

Background

Floating charges are the means by which a lender may obtain security in relation to a loan in circumstances where a borrower company does not have fixed physical assets but does have other assets. The essence of the floating charge is that unless or until the company goes into liquidation or a receiver is appointed, the company can deal with the secured assets as normal by (say) selling them. If the company goes into liquidation or a receiver is appointed, then the floating charge "crystallises" at that date to become a fixed security over the assets owned by the company at that point and covered by the scope of the floating charge.

A 2004 survey of smaller quoted companies in the UK showed that nearly 60 per cent had granted a fixed charge and a similar percentage a floating charge; a significant minority had no borrowings. A floating charge thus clearly represents an important mechanism for providing security for investment: it may be of special importance in Scotland, as companies here are able to grant fixed charges over fewer types of asset than south of the border. Its full potential will actually be realised only if investors have confidence that a charge will be effective (i.e. that it will be possible to enforce the charge if such action becomes necessary).

Under section 51 of the 1986 Act, the holder of a floating charge may seek to appoint a receiver under Scottish law ***only*** in relation to the property of a company which the Court of Session has jurisdiction to wind up. Concern and uncertainty has been expressed about the impact on this provision of the coming into force of the EU Regulation. The concern is that the EU Regulation, which has the effect of limiting the jurisdiction of the Court of Session to open insolvency proceedings in relation to

([1]) 1972 c.68.

certain companies, has consequently also limited the power of a floating charge holder to appoint a receiver of the property in Scotland of those companies. Accordingly, it may not be possible to enforce a floating charge granted by those companies.

Before the EU Regulation, the presence of assets in Scotland owned by a company was sufficient to allow proceedings for winding up of that company to be commenced in the Court of Session This is still the case when dealing with companies with centres of main interest outside the EU, as demonstrated for example by *HSBC Bank plc* [2009] CSOH 147.

The EU Regulation, however, provides that courts of the member state in which a borrowing company has its "centre of main interests" have jurisdiction to open insolvency proceedings in relation to that company. The courts of another member state have jurisdiction to wind up such a company only where the company also has an establishment in that other member state. As a result, the Court of Session does not now have jurisdiction to wind up a company where that company has its centre of main interests in a member state other than the UK, unless it also has an establishment in the UK.

The provisions of the EU Regulation in relation to jurisdiction in insolvency proceedings affect section 51 of the 1986 Act because of the link in that section between the power of a creditor to appoint a receiver over the property of a company and the jurisdiction of the Court of Session to wind up that company. This now limits the ability of the creditors of companies with their centre of main interests in other member states to enforce floating charges over assets in Scotland. This amendment removes the limitation.

Consultation

A consultation was carried out between July 2010 and October 2010. The main issue covered in the consultation was the circumstances in which a receiver can be appointed. The consultation together with the list of consultees can be found at:

http://www.scotland.gov.uk/Publications/2010/07/insolvency-act.

Nine responses were received from:

Asset Based Finance Association (ABFA);
Dr Ross Anderson, University of Glasgow;
Faculty of Advocates;
Judges of the Court of Session;
The Law Society of Scotland;
Scottish Property Federation;
Shetland Islands Council;
The Society of Solicitors in the Supreme Courts of Scotland;
The British Bankers' Association.

Summary of responses

A summary of the responses can be found at

http://www.scotland.gov.uk/Topics/Justice/law/damages/Section51.

In short:

- All consultees agreed that even where a borrowing company (a) has its "centre of main interests" within the EU but outwith the UK, and (b) has no "establishment" within the UK, the holder of a floating charge should nevertheless have the power to appoint a receiver; and
- The majority of consultees were of the view that section 51 does not provide such a power.

One set of consultees pointed out that it is an anomaly that the power should not exist in the type of company described above and commented that providing the power would secure consistency for companies and remove the serious practical disadvantages of reduced powers of enforcement.

It was also pointed out that because the 'centre of main interests' and/or an 'establishment' of a company can change, this can lead to uncertainty more generally about the enforceability of a floating charge.

Consultees were of the view that an amendment to section 51 of the 1986 Act was required.

Regulations

These Regulations make the necessary amendments to section 51 of the 1986 Act. Regulation 2(a) amends subsection (1) to include provision that the holder of a floating charge over the property of a company which a court of another member state of the European Union has jurisdiction to wind up may appoint a receiver of the property subject to the charge. Regulation 2(b) provides for a new subsection (2ZA) to ensure that the receiver may only be appointed in respect of property of such a company which is situated in Scotland. Regulation 2(c) amends section 51(6) to provide some new definitions for the purposes of the amended provisions.

The Regulations are made under section 2(2) of the European Communities Act 1972. They make provision dealing with a matter that arises out of directly applicable provisions of the EU Regulation. As explained above, the EU Regulation deals with insolvency proceedings, but itmakes an unintended change to the law on receivership as set out in section 51 of the 1986 Act. These Regulations reinstate the position on receivership to that which existed prior to the coming into force of the EU Regulation. They do not, therefore, substantially affect the provisions of section 51 of the 1986 Act and the negative procedure is considered to be appropriate in these circumstances.

Financial effects

A Business and Regulatory Impact Assessment was prepared following the consultation when it became clear that a change was required to the legislation. It is attached The main driver for change is that the current uncertainty about the enforcement of floating charges in the companies within the EU which do not have their centre of main interest or an establishment in the UK can inhibit investment.

Equality Issues

There appear to be no substantive equality issues. The change has limited application affecting a very small number of companies. There may be some marginal benefit for employees in affected companies in providing for the enforcement of floating charges by a receiver because, as a number of consultees pointed out, the alternative would be to raise insolvency proceedings. This can be cumbersome, costly and have undesirable consequences, resulting, for instance, in a diminution of the company's assets.

Scottish Government
Learning and Justice Directorate
2011

Amendments to section 51 of the Insolvency Act 1986 – appointment of receivers

Final Business and Regulatory Impact Assessment (BRIA)

Title of Proposal

Amendment to section 51 of the Insolvency Act 1986.
This BRIA relates to a proposed amendment to section 51 of the Insolvency Act 1986 (the 1986 Act) in relation to the appointment of receivers to enforce floating charges.

Purpose and intended effect

♦ **Objectives**

It is proposed to amend section 51 of 1986 Act, in relation to the appointment of receivers to enforce floating charges, to clarify the scope of the provision.

♦ **Background**

Floating charges are the means by which a lender may obtain security in relation to a loan in circumstances where a borrower company does not have fixed physical assets but does have other assets. The essence of the floating charge is that unless or until the company goes into liquidation or a receiver is appointed, the company can deal with the secured assets as normal by (say) selling them. If the company goes into liquidation or a receiver is appointed, then the floating charge "crystallises" at that date to become a fixed security over the assets owned by the company and covered by the scope of the floating charge.

A 2004 survey of smaller quoted companies in the UK showed that nearly 60 per cent had granted a fixed charge and a similar percentage a floating charge; a significant minority had no borrowings. A floating charge thus clearly represents an important mechanism for providing security for investment: it may be of special importance in Scotland, as companies here are able to grant fixed charges over fewer types of asset than south of the border. Its full potential will actually be realised only if investors have confidence that a charge will be effective (i.e. that it will be possible to utilise the charge if such action becomes necessary).

On this, concern has been voiced both during and since the passage of what became the Bankruptcy and Diligence etc (Scotland) Act 2007. The concern/uncertainty is focussed on the impact of the coming into force of the EU Council Regulation on insolvency proceedings (Regulation No. 1346/2000) on section 51 of the 1986 Act, the result of which is that it may not be possible to enforce a floating charge in Scotland in particular circumstances. This uncertainty may impact on lenders' willingness to invest.

Under section 51 of the 1986 Act, the holder of a floating charge may seek to appoint a receiver under Scottish law ***only*** where the relevant company can be wound up by the Court of Session. Before the EU Regulation, the presence of assets in Scotland owned by a company was sufficient to allow proceedings for the winding up of that company to be commenced in the Court of Session. This is still the case when dealing with companies with centres of main interest outside the EU, as

demonstrated for example by *HSBC Bank plc* [2009] CSOH 147.

The EU Regulation, however, provides that the courts of the member state in which a borrowing company has its "centre of main interests" have jurisdiction to open insolvency proceedings against that company. The courts of another member state have jurisdiction to open insolvency proceedings in respect of such a company only where it also has an 'establishment' in that member state. As a result, the Court of Session does not now have jurisdiction to wind up a company where that company has its centre of main interests in a member state other than the UK, unless it also has an establishment in the UK.

Accordingly, the link in section 51 between the power of a creditor to appoint a receiver over the property of a company and the jurisdiction of the Court of Session to wind up that company now limits the ability of the creditors of companies with their centre of main interests in other member states to enforce floating charges in Scotland. An amendment is therefore proposed to address the limitation.

- **Rationale for Government intervention**

Given the importance of floating charges to businesses in Scotland, it is critical that the potential for their use is fully realised. This will only be achieved if investors have confidence that a charge will be effective (i.e. that it will be possible to enforce the charge if such action becomes necessary).

Given the Scottish Government's strategic objective of ensuring that Scotland is the most attractive place for doing business in Europe, any limitation on the potential for the use and benefit of floating charges should be remedied. An amendment to section 51 of the 1986 Act is required to prevent investment opportunities in Scotland being lost.

Consultation

- **Within Government**

Officials in Civil Law Division considered concerns raised by stakeholders, developed a consultation paper and analysed the responses liaising with those in Enterprise and the Accountant in Bankruptcy for their interests. Legal advice was provided by SGLD on stakeholders' concerns and, following the outcome of the consultation, how best to address the issues through legislation.

- **Public Consultation**

A consultation document was published July 2010 and closed in October 2010. The main issue covered in the consultation was the circumstances in which a receiver can be appointed.

Nine responses were received from:

Asset Based Finance Association (ABFA);
Dr Ross Anderson, University of Glasgow;
Faculty of Advocates;
Judges of the Court of Session;
The Law Society of Scotland;

Scottish Property Federation;
Shetland Islands Council;
The Society of Solicitors in the Supreme Courts of Scotland;
The British Bankers' Association.

Summary of responses

- All consultees agreed that even where a borrowing company (a) has its "centre of main interests" within the EU but outwith the UK, and (b) has no "establishment" within the UK, the holder of a floating charge should nevertheless have the power to appoint a receiver.
- The majority of consultees were of the view that section 51 does not provide such a power.

The Judges of the Court of Session pointed out that it is an anomaly that the power should not exist in the type of company described above and commented that providing the power would secure consistency for companies and remove the serious practical disadvantages of reduced powers of enforcement.

It was also pointed out that because the 'centre of main interests' and/or an 'establishment' of a company can change, this can lead to uncertainty more generally about the enforceability of a floating charge.

Consultees were of the view that an amendment is required to section 51 of the 1986 Act.

- **Business**

Leading specialist business organisations, legal advisors and relevant experts were included in the consultation.

The responses to the consultation represented the key interests in the field, including lenders, legal advisers to the commercial sector and the judiciary. The responses were compelling. It was clear that an amendment to section 51 of the 1986 Act would be required to address concerns about the ability to appoint receivers to enforce floating charges where companies have a centre of main interest in another EU Member State and no establishment in the UK to ensure that it was not a barrier to investment in Scotland. The view taken therefore was that it was unnecessary to seek to meet 6-12 individual businesses to discuss the issues and their impact further.

Options

Sectors and groups affected

Those companies who (a) have their "centre of main interests" within the EU but outwith the UK, and (b) have no "establishment" within the UK who wish to borrow funds **and** those who wish to lend to them. In addition, because a company may change its 'centre of main interest' or cease to have a UK 'establishment', a larger group of borrowing companies and lenders may potentially be affected.

Option 1 - amend section 51 of the 1986 Act to provide for the appointment of

receivers to enforce floating charges where a borrowing company does not have its 'centre of main interest' or an 'establishment' in the UK.

- **Benefits**

Lenders will have the confidence that a floating charge can be enforced in the situations under consideration. This may lead to a greater investment in this category of company doing business in Scotland. Stakeholders advise that whilst the impact is narrowly defined, the potential value could be substantial, depending on the economic climate.

- **Costs**

There should be no substantive costs. In essence the proposed change simply clarifies the legal position and removes a potential limitation.

Option 2 – do nothing

- **Benefits**

None – the uncertainty which consultees suggest may be hindering investment in the companies under discussion will remain.

- **Costs**

Consultees were not able to quantify the potential loss of investment in these companies.

Scottish Firms Impact Test

As above, the view was taken that it was unnecessary to meet with individual businesses given the compelling responses from key players in the field.

The proposal relates only to companies which have a centre of main interest in another EU Member State and no 'establishment' in the UK.

- **Competition Assessment**

An example set out in the consultation paper outlines the current potential disadvantage as follows - an Irish or Italian company wishes to invest in Scottish property – anything from a leisure complex, to a retail development, to a dockside housing conversion – and seeks to raise finance for that purpose. Potentially, would-be lenders might fear that – because the company has its centre of main interests in Ireland or Italy (i.e. in the EU but not in the UK) and has no actual "establishment" (as opposed to potential property assets) in the UK – it would not be possible to appoint a receiver of the property in Scotland in respect of any floating charge granted to it in return for investment. As a consequence of such fear, would-be lenders may refuse to make funds available to the Irish or Italian company (or to agree to make funds available only on a quite unfavourable basis), and that company may then look instead for investment opportunities outwith Scotland.

An amendment to section 51 of the 1986 Act should ensure lenders' confidence in enforcing the security for their investment in businesses operating in Scotland which have no 'centre of main interest' or 'establishment' in the UK.

The number of companies affected is likely to be quite small (although the value may be high) particularly as in many cases a borrower which would otherwise fall into the category under discussion will incorporate a single purpose vehicle in Scotland both to limit liability for the investment and preserve organisational structures within its business.

We applied the competition filter and the answers were as follows:

- This proposal will not directly limit the number or range of suppliers.
- This proposal will not indirectly limit the number or range of suppliers.
- This proposal will not limit the ability of suppliers to compete.
- This proposal will not reduce suppliers' incentives to compete vigorously.

Therefore, no full competition assessment was necessary.

- **Test run of business forms**

No new forms are being introduced by this proposal.

Legal Aid Impact Test

As discussed with Access to Justice colleagues, the proposed amendments relate to corporate lenders and borrower companies and will therefore have no impact on legal aid.

Enforcement, sanctions and monitoring

These amendments do not impose duties and therefore will not require enforcement or sanctions for non-compliance. Floating charges are enforced by receivers appointed by the court.

Implementation and delivery plan

These amendments are of a minor nature. They simply remove an anomaly securing consistency for companies and removing the serious practical disadvantages of reduced powers of enforcement for those which have a centre of main interest in another EU Member State and no 'establishment' in the UK.

There is therefore no implementation and delivery plan.

- **Post-implementation review**

We do not plan a post-implementation review. These amendments simply remove an anomaly securing consistency for companies.

Summary and recommendation

Option 1 to amend section 51 of the 1986 Act to clarify that the holder of a floating charge granted by a borrowing company which does not have its 'centre of main interest' or an 'establishment' in the UK may appoint a receiver in respect of the property of that company situated in Scotland will provide lenders with confidence in the enforceability of floating charges . This may lead to a greater investment in this category of company doing business in Scotland. Stakeholders advise that whilst the impact is narrowly defined, the potential value could be substantial, depending on the economic climate.

Option 2 to do nothing would mean that the uncertainty which consultees suggest may be hindering investment in the companies under discussion will remain. It has not been possible to quantify the potential loss of investment which results.

Recommendation

For the reasons stated above we recommend Option 1.

Total benefit per annum:	**Total cost per annum:**
Option 1 Not possible to quantify but confidence for lenders that their security can be enforced has the potential to increase investment in businesses operating in Scotland	No additional costs anticipated
Option 2 None	Not possible to quantify the potential loss of investment which results.

Declaration and publication

I have read the Business and Regulatory Impact Assessment and I am satisfied that (a) it represents a fair and reasonable view of the expected costs, benefits and impact of the policy, and (b) that the benefits justify the costs I am satisfied that business impact has been assessed with the support of businesses in Scotland.

Signed……..

Date……

FERGUS EWING MSP
MINISTER FOR COMMUNITY SAFETY