

EXPLANATORY MEMORANDUM TO
THE INSOLVENCY (SCOTLAND) AMENDMENT RULES 2007

2007 No. 2537 (S.5)

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.

2. Description

2.1 The Insolvency (Scotland) Amendment Rules 2007 amend the Insolvency (Scotland) Rules 1986 (SI 1986/1915) by inserting a new Rule 4.80 which makes provision for the circumstances in which a director of an insolvent company may avoid the prohibition under section 216 of the Insolvency Act 1986 by giving the notice prescribed in that Rule.

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

3.1 None.

4. Legislative background

4.1 The power to make the Insolvency (Scotland) Amendment Rules 2007 is contained in section 411 of the Insolvency Act 1986. A statutory instrument made under this section is subject to annulment in pursuance of a resolution of either House of Parliament.

4.2 This instrument amends the Insolvency (Scotland) Rules 1986 (S.I. 1986/1915). The Insolvency (Scotland) Rules set out the detailed procedure for the conduct of those insolvency proceedings in Scotland governed by the Insolvency Act 1986.

5. Extent

5.1 This instrument applies to Scotland.

6. European Convention on Human Rights

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

7. Policy background

7.1 Section 216 provides that where a company goes into insolvent liquidation, a person who has been a director of the company at any time within the 12 months

before it went into insolvent liquidation may not be a director of any other company that is known by a “prohibited name”, or in any way, whether directly or indirectly, be concerned or take part in the promotion, formation or management of such a company (or in the carrying on of a business carried on otherwise than by a company) unless he has the leave of the court to do so or he falls within an exception prescribed by Rules made under section 411 of the Insolvency Act 1986. A “prohibited name” in relation to such a person is a name by which the liquidating company was known at any time in that period of 12 months, or if it is a name which is so similar to that name so as to suggest an association with that company.

7.2 The provision is intended to address the issue known as “phoenixism”, and is designed to ensure that directors (or shadow directors) of companies in insolvent liquidation cannot benefit from continuing to use the “prohibited name”, without restriction.

7.3 Rule 4.80 provides an exception to the general prohibition, by which a director, or shadow director, of an insolvent company may act, without contravening section 216 of the Insolvency Act 1986. It involves the director, or shadow director, of the insolvent company giving notice to the creditors of that company and publishing the notice in the Edinburgh Gazette that he is acting, or intends to act, in any of the ways set out in section 216(3) in connection with, or for the purposes of, carrying on the whole, or substantially the whole, of the insolvent company’s business which has been acquired, or will be acquired, under arrangements made by the insolvency office holder.

7.4 A recent Court of Appeal judgment in the case of *First Independent Factors and Finance Ltd v Churchill* [2006] EWCA Civ 1623 highlighted a problem with the current drafting of the corresponding Rule for England & Wales (Rule 4.228 Insolvency Rules 1986 (S.I. 1986/1925)), in that it does not adequately distinguish between those cases where a business is acquired from an insolvency office holder other than a liquidator (such as an administrator, administrative receiver or supervisor of a voluntary arrangement), and only provides for the prospective appointment of the director in a successor company. Although the Court of Appeal decision is not binding in Scotland, it is likely that it would be persuasive were a similar case to be brought before the Scottish court (Rule 4.80 Insolvency (Scotland) Rules 1986 and Rule 4.228 Insolvency Rules 1986 being identical in content at the time of the Court of Appeal judgement). This issue is pertinent since if the insolvent company is in an insolvency procedure other than insolvent liquidation, then the section 216 prohibition would not apply to any successor company with which the director may be involved. In such a situation, the director of a successor company may wish to give the notice to creditors required by Rule 4.80, prospectively, in order to avoid any potential breach of the section 216 prohibition should the insolvent company subsequently move from an administration, receivership or voluntary arrangement into insolvent liquidation.

7.5 The revised drafting of the Rule therefore addresses the scenario outlined in paragraph 6.4 above, to ensure that the directors of a successor company who are not yet subject to the section 216 prohibition are able to give prospective notice to ensure that they are not in breach of the provision in the event that the insolvent company subsequently enters insolvent liquidation. Additionally, the Rule will allow a director, or shadow director, of an insolvent company to take advantage of the exception in

cases where the business of the insolvent company is or will be acquired from a liquidator by a successor company of which the individual is already a director, where at the date the notice is given the successor company is not known by a prohibited name. The revised draft also extends the exception to allow a person to carry on the business of the insolvent company other than through a limited company.

8. Impact

8.1 A Regulatory Impact Assessment has not been prepared for this instrument, as it has no impact on business, charities or voluntary bodies.

9. Contact

9.1 Tom Phillips at The Insolvency Service Tel 020 7637 6421 or e-mail: tom.phillips@insolvency.gsi.gov.uk can answer any queries regarding the instrument.