However, even though the members may appoint their choice of liquidator he has only very limited powers until such time as the creditors have met and confirmed him in office or not. He can take the company's property under his control and dispose of perishable goods and generally protect the company's assets but *no more*.

If the company nominates five persons for what is called the liquidation committee, both in a voluntary winding-up and also in a compulsory winding-up, the creditors can now nominate five more and veto the company's nominees, subject again to a right of appeal to the court.

### Purpose of liquidation committee

The purpose of such a committee is to provide a small representative body to help the liquidator. Moreover, if there is a major creditor, who regards the assets of the company as virtually his own, the committee may provide him with a useful safety valve. The liquidator becomes involved in many kinds of businesses but a major creditor, with his knowledge of the trade, can control the committee, and supervise the winding-up, and see that the run-down of the company is carried out to the best advantage. Since a liquidation committee can exercise certain powers, such as, for example, approving payment to any class of creditors, it will save the liquidator the necessity of calling a full meeting of creditors, whose approval would otherwise be necessary.

From now on we will combine consideration of the compulsory and voluntary winding-up process.

## The duties of a liquidator

### Appointment

The following points should be noted:

(a) If it is a compulsory winding-up, the Official Receiver, who automatically became provisional liquidator on the winding-up order (if not earlier on the presentation of the petition), will commonly continue as the liquidator.
(b) In the case of a voluntary winding-up, a person, other than a corporate body or a bankrupt, can be appointed, provided he is a qualified insolvency practitioner (see further Chapter 26 ➡). The liquidator is usually an experienced accountant.
(c) In a voluntary winding-up, the liquidator will have to notify his appointment to the Registrar of Companies and publish it in the *London Gazette*, both within 14 days.

➡ See p. 578

### General position of the liquidator

Section 143 states that the functions of the liquidator of a company *which is being wound up by the court* shall be to ensure that the assets of the company are got in, realised and distributed to the company's creditors, and, if there is a surplus, to the persons entitled to it.

Beyond this there is no clear definition of his role; it is a mixture of common law and statutory duties and obligations. He partakes partly of the nature of a trustee, partly of an agent of the company and partly of an officer of the company.

### (a) As a trustee

A liquidator is clearly not a trustee in the sense of the Trustee Act 1925, because the property of the company does not automatically vest in him as does trust property in trustees, although the court can make an order so vesting it. However, he takes over the powers of directors who equally, without being trustees, owe fiduciary duties to the company. His duty, like that of the directors, is owed to the company as a whole and not to individual contributories. Also, like a trustee, he cannot, by reason of the Insolvency Rules 1986 (which have been in part amended by The Insolvency (Amendment) Rules 2010 (SI 2010 No. 686)), buy the company's property without leave of the court, or make a profit out of sales to the company. Moreover, he is in a more vulnerable position than a lay trustee because he is always paid to assume his responsibility and in ***Re Home & Colonial Insurance Co*** [1929] All ER Rep 231 the court referred to the 'high standard of care and diligence' required from him. 'His only refuge was to apply to the court for guidance in every case of serious doubt or difficulty.'

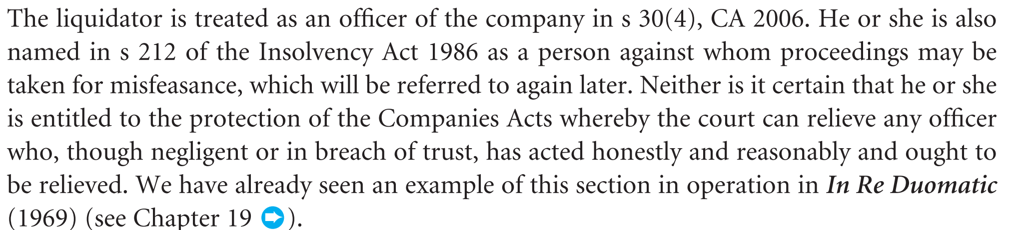
Furthermore, although it has not been definitely decided, it does not appear that the liquidator can claim the protection of s 61 of the Trustee Act 1925 if he has acted honestly and reasonably and ought to be excused. In ***Re Windsor Steam Coal Ltd*** [1929] 1 Ch 151 the Court of Appeal held on the facts that the liquidator had not acted reasonably in paying a claim without the directions of the court, but left open the question of whether s 61 was available as a defence.

### (b) As an agent

The liquidator can be described as an agent for the company in that he can make contracts on behalf of the company for winding-up purposes.

He has, of course, the paid agent's obligation to bring reasonable skill to his duties. However, he is not a true agent in that he controls the actions of his so-called principal, the company.

### (c) As an officer



The liquidator is treated as an officer of the company in s 30(4), CA 2006. He or she is also named in s 212 of the Insolvency Act 1986 as a person against whom proceedings may be taken for misfeasance, which will be referred to again later. Neither is it certain that he or she is entitled to the protection of the Companies Acts whereby the court can relieve any officer who, though negligent or in breach of trust, has acted honestly and reasonably and ought to be relieved. We have already seen an example of this section in operation in ***In Re Duomatic*** (1969) (see Chapter 19).

See p. 379

## Control by the court

Finally, the liquidator is subject to constant control by the court because any person aggrieved by an action or decision of a liquidator in a winding-up may apply to the court. However, it would seem that the court is not anxious to upset his acts. Thus, in ***Leon*** v ***York-O-Matic*** [1966] 3 All ER 277, where the liquidator was charged by a member of the company with selling assets at an undervalue, the judge said that in the absence of fraud there could not be interference in the day-to-day administration of the liquidator, nor a questioning of the exercise by the liquidator in good faith of his discretion, nor a holding him accountable for an error of judgment.

## Powers of the liquidator

The following points should be noted:

(a) In a compulsory winding-up, s 167 provides that something like half of his powers can only be exercised with the approval of the court or of the liquidation committee, e.g. to bring or defend actions, to carry on the business of the company so far as may be necessary for its beneficial winding-up, and to pay any class of creditors in full. Otherwise he can do most acts on his own authority, e.g. sell the company's property or raise money on the security of the company's assets.
(b) In a creditors' voluntary winding-up, he can exercise all the powers on his own except three which need the sanction of the court, the liquidation committee or the creditors. These powers are: to pay creditors; to make a compromise with creditors; and to compromise calls and debts (s 165).
(c) While the liquidator in a voluntary winding-up has a freedom from supervision by the court which is not available in a compulsory winding-up, he can always get support and guidance by applying to the court on any matter arising out of the winding-up (s 112).

### Centrebinding

In the past, when no particular qualifications were required to undertake insolvency work, it was possible for the members in a creditors' voluntary to appoint a liquidator from among a group of unscrupulous persons prepared to participate in fraud. The person appointed would then proceed to dispose of the company assets and dissipate the proceeds often into other enterprises of the directors or their associates. This was done without the holding of a creditors' meeting to affirm the appointment of the liquidator, and by the time the creditors became aware of the liquidation it was too late to do anything about it. The difficulty was that the disposal of the assets by the members' liquidator was quite legal. The court so decided in ***Re Centrebind*** [1966] 3 All ER 889 and the procedure became known as 'centrebinding'.

The practice had been brought to an end for two reasons as follows:

(a) the requirement of qualified insolvency practitioners; *and*
(b) because of s 166, which provides that until a meeting of creditors has been called to approve the company's liquidator, that liquidator has power only to take control of the company's property and to sell perishable goods. Any other dispositions of the company's property are invalid.

## Collection of the assets

(a) The liquidator will take charge of all assets which can be physically brought under his control, including money in the bank.
(b) He will not be able to touch money subject to a trust. Thus, in ***Re Kayford*** [1975] 1 All ER 604 a mail order company in anticipation of liquidation had put customers' deposits for goods which the company might not be able to supply in a special 'Customer Trade Deposit Account' and it was held that these deposits were returnable to the customers and did not come under the control of the liquidator. However, if there are any other assets in the hands, for example, of a sheriff, who is intending to sell the goods as part of a judgment creditor's execution, the liquidator will be able to recover these assets if the process of sale has not been completed before the winding-up commenced.

(c) The liquidator will normally in a compulsory winding-up pay all money into the Insolvency Services Account at the Bank of England, but in a voluntary winding-up he need not do so unless he has in his hands assets unclaimed or undistributed for six months.
(d) He can bring actions to enforce debts due to the company.
(e) He will settle the list of contributories and he can ask the court to exercise its powers under s 237 to order an officer or any person who has previously held office as administrator or liquidator of the company or as an administrative receiver and any trustee for or any banker or agent or officer of the company to hand over any property or money or books, papers or records of the company under his control. Set-off is not allowed to a contributory until all the creditors have been paid in full. In the unlikely event of there being uncalled capital, he can call it up, and will settle the A list of present members and the B list of persons who have been members in the 12 months preceding winding-up. The B list members will only be liable for debts contracted while they were members to the extent that their successors failed to pay the balance due on their shares.

## Officers: co-operation with liquidator

It was held by the Court of Appeal Criminal Division in ***R* v *McCredie*** [2000] BCLC 438 that the company's directors and other officers are required by s 208(1) of the Insolvency Act 1986 to co-operate with the liquidator in terms of the ascertainment and delivery up of the company's property, not merely in a reactive manner but proactively. The requirement to deliver up does not depend on a prior request from the liquidator. It is a continuing and not a once-for-all-time duty. Failure to act in a proactive way can, as this case decides, be a criminal offence under s 208 punishable with imprisonment or a fine.

## Swelling the assets

It is the duty of the liquidator, subject to the problems outlined below, to swell the assets by recovering any sums due from the directors or officers of the company. His ability to recover may arise under a number of headings as follows:

### (a) Secret profits

It may be that the directors have made an unauthorised profit out of their position. As we saw in ***Regal (Hastings) Ltd* v *Gulliver***, 1942, the directors had helped the parent company out by putting up money for shares in a subsidiary company, but were made to repay to the parent company a profit on those shares when they were sold. Alternatively, the directors may have paid themselves unauthorised salaries which may be recovered. As we have seen, officers of the company can be summoned before the court for examination if they are suspected of having property of the company in their possession.

### (b) Wrongful and fraudulent trading

The company's officers, and others, may be held personally liable for certain debts of the company under the rules relating to wrongful and fraudulent trading. If the liquidator recovers money under the above heads, it goes into a fund for all the creditors (***Re William C Leitch Ltd (No 2)*** [1933] Ch 261). In the past if an individual creditor, such as the Revenue, was paid his debt by the directors as a result of his bringing an application for, say, fraudulent trading,

then he could keep the money (***Re Cyona Distributors*** [1967] 1 All ER 281). This will not arise now because only the liquidator may apply, under the relevant sections.

### (c) Power to conduct examinations

Section 212 allows the court on the application of the Official Receiver, the liquidator, a creditor or a contributory to examine the conduct of any promoter, past or present director, manager, liquidator, administrator, administrative receiver or officer of the company. If it appears that such a person has misapplied or retained or become liable or accountable for any money or property of the company, or been guilty of any misfeasance or breach of trust in relation to the company, the court can order him to repay or restore or to contribute to the assets of the company by way of compensation such a sum as the court thinks just.

## Corporate claims in liquidation

Although, in general terms, a liquidator will wish to swell the assets by recovering sums under the headings mentioned above, it should be noted that it is, generally speaking, unwise for a liquidator to enter into litigation for the company. First, because legal aid has been abolished in civil matters (except for family and clinical negligence cases). In addition, the Access to Justice Act 1999 specifically provides in s 6 and Sch 2, para 1(g) that the new Legal Services Commission shall not fund 'matters of company or partnership law', or under para 1(h) 'other matters arising from the carrying on of a business'. Second, because the Court of Appeal ruled in ***Mond*** v ***Hammond Suddards*** [2000] Ch 40 that the cost of an unsuccessful litigation will not be treated as an expense of the liquidation, even though the liquidator had not acted in any way improperly in defending a claim by the company's receiver in regard to title to certain of the company's property. As regards conditional fee arrangements (the no-win no-fee concept), these require security for costs by the litigant or the making of a single premium insurance arrangement which admittedly is recoverable from the defendant (if he has funds) where the action is successful but not otherwise. So costs remain a problem even where the lawyer receives no fee if the claim is lost. 'Lawyer' means the solicitor in the case. Separate arrangements are required with a barrister to take the case in court unless the solicitor is also an advocate. Thus cases that have a good chance of success will continue to be brought if funded by creditors but perhaps rarely otherwise. Litigation funding agreements are dealt with by s 28 of the Access to Justice Act 1999, which inserts a new s 58B into the Courts and Legal Services Act 1990.

The ruling in the ***Mond*** case was affirmed in ***Lewis*** v ***Inland Revenue Commissioners*** (2000) *The Times*, 15 November. The Court of Appeal ruled in that case that a liquidator had no automatic right to recoup litigation costs. A company's liquidator attempting to use the company's realised funds for the purpose of taking proceedings against directors for wrongful trading or the recovery of a preference could not automatically regard the cost as an expense of the liquidation and payable before all other claims under s 115, IA 1986. The liquidator's right to recoup was subject to making an application to the court, under s 112 (voluntary liquidation) or s 156 (compulsory liquidation), for the court to exercise its power under those sections as relevant to dictate a different order of priority of payment in terms of allowing recoupment of litigation costs at the court's discretion.

### Comment

The law is obviously anxious to look at each case on its merits. Even where the case is good, litigation is, after all, unpredictable and can be a very quick way to lose the company's funds.

## Creditors – proof of debts

The following points should be noted:

1 The liquidator will normally have written to every known creditor on first appointment, sending him a copy of the statement of affairs, and he will advertise in the *London Gazette* and a local newspaper (Insolvency Rules 1986) for details of debts to be submitted within a definite period, and he will normally require debts to be verified by affidavit. Then he will examine and decide on every debt, and a rejected creditor can appeal to the court.

2 The admission of debts will depend on whether the company is solvent or not. If the company is solvent, all debts can be proved which could have been enforced against the company if it had not gone into liquidation. However, statute-barred debts are only payable if all the members agree, and future debts are payable subject to a rebate of 5 per cent per annum because they are paid early.

3 If the company is insolvent, the following rules apply and certain debts are nonprovable as follows:

   (a) Claims for unliquidated damages in tort. Damages for breach of contract or trust are provable on an estimate. Thus, if a claim can be framed in either contract or tort, as might be the case where injury was caused to a person by the negligence of a company driver, it may be possible to include the claim as one of contract rather than of tort. This is a useful rule for a liquidator because in a compulsory liquidation he does not have to await the outcome of tort proceedings before winding up the company, though, as we have seen, an order can be made by the court restoring it to the Register so that a formal claim may be made against it to trigger its insurance company's duty to indemnify the company against the claim. However, in ***Re Islington Metal and Plating Works*** [1983] 3 All ER 218, Harman J decided that if a company which started liquidation as insolvent later became solvent, where, as in this case, an action by the liquidator on behalf of the company against its directors for misfeasance might succeed, debts of all descriptions could be proved. In such a situation, once the claims of the undoubted creditors were satisfied and the costs provided for, the tort claimants would be entitled to make claims before distribution of any surplus. Members' and creditors' voluntaries must be kept open while tort claims are quantified.

   (b) Debts incurred after notice of a transaction at undervalue or preference (see below), or if the company could not pay its debts as they fell due and had suspended payment of debts.

   (c) Contingent debts when the value cannot be fairly estimated. In ***Re Patent Floor Cloth Co*** (1872) 26 LT 467, two persons Dean and Gilbert were employed by the company as travellers for a period of three years on commission. In the first year they made £400 each and then the company was wound up. The court held that an estimate could be made of their entitlement to commission for the purposes of the winding-up but this would have been impossible if there had not been a first year commission on which to base it.

   (d) Debts barred by the Limitation Act 1980 at the commencement of winding-up are not enforceable, though time stops running on the commencement of the liquidation and if the debt is not statute-barred then it will not become so because of delay in payment arising out of the liquidation.

   (e) Illegal debts and unenforceable debts are not provable. For example, a debt on a contract for the sale of land which is not in writing as is required by the Law of Property

(Miscellaneous Provisions) Act 1989 is not provable. Nor would an illegal debt be provable as where a builder has built premises for a company knowing that there was no planning permission.

If a debt cannot be proved, the creditor gets no dividend and has no rights as a creditor, e.g. to attend and vote at meetings.

There are also certain *deferred debts*. These are provable but no dividend is payable nor is there a right to vote until all provable debts have been paid with interest (see below). The deferred debts are as follows:

(a) loans under a written agreement that the lender is to receive a rate of interest varying with the profits of the company; and
(b) where the vendor of a business sold to the company is receiving a share of the profits as payment.

## The Third Parties (Rights Against Insurers) Act 1930 as amended by The Third Parties (Rights Against Insurers) Act 2010

A method of circumventing a liquidation by a creditor is to be found in the above Act, which has been the subject of a Law Commission consultation paper. If a worker is injured by his employer's negligence and the employer is a company that goes into liquidation, the 1930 Act allows the injured worker to make a claim against the company's insurer, thus avoiding a proof in the company's liquidation which might only produce a small payment covering only part of the claim.

However, the claim against the insurer is by no means straightforward since the insurer is only liable to indemnify the company. Therefore, the worker must sue the company to establish its liability before the insurance company is obliged to pay. This may mean an action at law to restore the company to the register if it has been struck off on liquidation and another action against the company to establish its liability. It may then be necessary to bring a legal action against the insurance company if it disputes liability.

The Law Commission and the Scottish Law Commission published a joint report (Law Com No 272/Scot Law Com No 184) on 31 July 2001. The report recommended the repeal of the Third Parties (Rights Against Insurers) Act 1930 and its replacement with a new Act that would make it easier for a third party to obtain a remedy as well as provide that the third party should not have to take legal proceedings to restore a company to the register.

The Law Commissions' recommendations were accepted by Government in 2002, and the Third Parties (Rights Against Insurers) Bill was introduced in Parliament in November 2009. The Bill proceeded through Parliament via a trial procedure for Law Commission bills, and received Royal Assent on 25 March 2010.

The key changes made by *Third Parties (Rights Against Insurers) Act 2010* are:

- A new court procedure is available to third parties. The third party has a right to seek declarations as to the insured's liability to them and as to the insurer's potential liability under the insurance contract in one set of proceedings. If the court or tribunal makes such declarations, it will be able to make an appropriate judgment which is likely to be a money judgment. This mechanism is optional; the third party may alternatively bring proceedings against the insured before commencing proceedings against the insurer (as at present).

- The third party will no longer be obliged to join the insured in proceedings against the insurer; but if this is not done where a declaration is made regarding the insured's liability to the third party, it will not bind the insured.

## Position of secured creditors

As regards secured creditors, a secured creditor must state in his proof that he is a secured creditor and either:

(i) surrender the security and prove for the whole debt as an unsecured creditor; *or*
(ii) value the security and prove for the balance which then remains as an unsecured creditor.

If the creditor values the security and proves for the balance, then the liquidator may (a) redeem the security by paying the creditor the amount of the valuation, or (b) require the security to be sold by auction to establish its value.

The creditor may at any time after lodging his proof by notice in writing require the liquidator to choose between (a) and (b) above. The liquidator then has six months from receipt of the notice to make a choice. If he does not make a choice, the creditor owns the security at his valuation and may prove for the balance as an unsecured creditor.

Under s 189 the surplus remaining in any winding-up after payment in full of proved debts is to be applied in the payment of interest to the extent specified on the amount of those debts before it is available for members. The rate of interest payable under the section in respect of any debt is whichever is the greater of:

(a) the rate specified in s 17 of the Judgments Act 1838 on the day on which the company went into liquidation (currently 8 per cent per annum (SI 1993/564)); and
(b) the rate applicable to that debt apart from the winding-up, e.g. the contract rate of interest, if any.

The court may on the application of the liquidator vary or set aside any extortionate credit transaction between the company and a creditor.

## Provisions which may invalidate a charge or debt

There are various provisions, some of which have been considered briefly already, which may invalidate a charge granted by the company or any other disposition it has made or any debt which it has incurred. These are as follows:

(a) A charge will be invalid against the liquidator or creditors if it is not registered under the Companies Act 2006 within 21 days with the Registrar. If it is invalid the holder falls to the level of an unsecured creditor.
(b) Section 241 enables the court on the application of the liquidator to make orders for restoring the position of the company and its creditors to what it would have been if the company had not entered into a transaction at an undervalue or given a preference to a creditor before the commencement of the winding-up. Preferences within six months from the commencement of winding-up can be set aside. The period is two years if with a connected person, e.g. a director. Transactions at undervalue made up to two years before can be set aside whether the recipient was connected with the company or not.

The Act applies to the creation of a charge and to any delivery of goods or the payment of money. A simple example from previous legislation of a preference is ***Re Kushler*** [1943] 2 All ER 22, where ordinary creditors were ignored but the company paid some £700 into the bank merely to clear the overdraft guaranteed by the directors. Repayment was ordered.

(c) As we have seen, a floating charge created by a company within the year before the commencement of its winding-up or within two years if given to a connected person, e.g. a director, may be void.

The purpose of this section appears to be similar to a preference to prevent a company, while it is unable to pay its debts, from preferring an unsecured creditor by giving him a floating charge on its assets.

(d) Consider the impact that ss 39–40 of CA 2006 (a company's capacity and powers of directors to bind a company) will have to eliminate the availability of a liquidator claiming a debt is invalid because it is *ultra vires*. The problem of an *ultra vires* obligation will fall to the wayside in the future to the extent that post-2006 Act companies will not have memorandums with object clauses in them anyhow. An *ultra vires* debt is invalid and the liquidator need not pay it, though the creditor may follow and trace his property into the company's assets. See the recent case of ***Progress Property Co Ltd*** v ***Moore*** [2009] EWCA Civ 629; [2010] 1 BCLC 1 (in which the particular transaction under attack was actually held to be *intra vires*) as an example of the general company law treatment of *ultra vires*.

See p. 79

The Companies Act 2006 will now operate to render most transactions valid. The position under the 2006 Act was considered in Chapter 3.

See p. 412

(e) If the liquidator can prove fraudulent trading or wrongful trading against, for example, a director or officer under the Insolvency Act 1986, which have already been considered, the court may order that person to become personally liable for the debt. (Note also management by disqualified persons, in Chapter 20.)

(f) Finally, the liquidator has a very powerful weapon in the right to disclaim given to him by ss 178 and 179. The sections allow him to disclaim property, e.g. stock or shares, unprofitable contracts, property unsaleable or not readily saleable or land burdened with onerous covenants. As regards the latter, an illustration is provided by ***Re Nottingham General Cemetery Co*** [1955] 2 All ER 504 where contracts between the company and the owners of the grave plots prevented its use for a purpose other than a cemetery. The liquidator can, of course, disclaim such land, and if he does it vests in the Crown subject to the right of any interested party, e.g. a local authority, to ask that the land be vested in him.

The liquidator must disclaim in writing within 12 months (this does not apply if he is the Official Receiver) and if he hesitates, anyone concerned can ask him to decide within 28 days what he will do. If he fails to tell the court within 28 days that he intends to disclaim he will lose his right. The court can assist persons affected by the disclaimer because, although they can no longer prove as creditors in the liquidation, they are entitled to damages. These damages may or may not equal the full amount of the debt. An illustration taken from the law of bankruptcy, which is the same on this point, is set out below.

**_Re Hooley, ex parte United Ordnance and Engineering Co Ltd_ [1899] 2 QB 579**

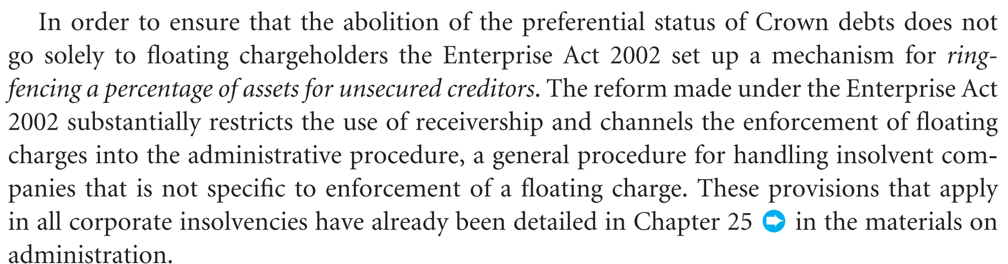
Hooley's trustee in bankruptcy disclaimed certain unpaid shares which Hooley held in the company, the shares being of low value. Hooley owed £25,000 under the contract to take the shares. The court assessed the damages payable to the company on the basis of the company's indebtedness. It appeared that the gross amount owed by the company was £16,169. The court deducted from this the cash in hand of £4,000 and directors' fees owing of £1,669, leaving a balance of £10,500.

*Held* – this was the measure of damages which the company could prove for in the bankruptcy.

## Distribution of assets

The liquidator is now able to distribute the assets. The order laid down for a compulsory winding-up under the Insolvency Rules is usually followed. The order is as follows:

1 First come the costs of the winding-up. In broad terms these cover the costs of getting in the assets, of the petition, of making the statement of affairs, the liquidator's remuneration and the expenses of the committee of inspection.
2 Then come the preferential debts (see Insolvency Act 1986, Sch 6). These debts rank equally between themselves so that if the property of the company is not sufficient to pay them all in full they will have to abate proportionately. The preferential debts are as follows:
   (a) wages or salaries of employees due within four months next before the relevant date up to a maximum of £800 for each employee;
   (b) all accrued holiday remuneration of employees;
   (c) it should be noted that assessed taxes are no longer preferential and also that if a bank has provided funds to pay wages and salaries that debt becomes preferential under the rule of subrogation;
   (d) contributions to an occupational pension fund.
3 Next come charges, secured by a floating charge, which take second place to preferential creditors. Fixed chargeholders are not subject to the claims of preferential creditors.
4 These are followed by the unsecured ordinary creditors. It should be noted that secured creditors are paid before the unsecured creditors if the liquidator is allowed to sell the assets charged. This is, however, rare because secured creditors, e.g. fixed chargeholders, normally appoint a receiver to sell the assets charged, returning any surplus after sale to the liquidator. If there is a shortfall and the proceeds of sale do not cover the debt, the secured creditors prove for the balance as unsecured creditors, as they do if they surrender the security to the liquidator.



In order to ensure that the abolition of the preferential status of Crown debts does not go solely to floating chargeholders the Enterprise Act 2002 set up a mechanism for *ring-fencing a percentage of assets for unsecured creditors*. The reform made under the Enterprise Act 2002 substantially restricts the use of receivership and channels the enforcement of floating charges into the administrative procedure, a general procedure for handling insolvent companies that is not specific to enforcement of a floating charge. These provisions that apply in all corporate insolvencies have already been detailed in Chapter 25 in the materials on administration.

See p. 562

5 Lastly come the deferred debts. These have already been referred to but one could add at this stage sums due to members in their capacity as members, such as dividends declared but not paid.

If there is money left at this stage, the company is solvent and debts such as unliquidated damages in tort will be admitted and paid when quantified by the court.

Finally, any surplus will be distributed among members according to their rights under the articles or the terms of issue of their shares.

## Insolvency: protection of employees

Under ss 166–168 of the Employment Rights Act 1996 an employee who loses his job when his employer (in this case a company) becomes insolvent can claim through the National Insurance Fund arrears of wages, holiday pay and certain other payments which are owed to him, rather than rely on the preferential payments procedure.

Any payments made must be authorised by the Secretary of State and the legal rights and remedies in respect of the debts covered are transferred to the Secretary of State, so that he can try to recover from the assets of the insolvent employer the costs of any payments made, up to the preferential rights the employees would have had. Major debts covered are as follows:

(a) Arrears of wages for a period not exceeding eight weeks up to a rate of £380 per week. The definition of wages includes the same items as are mentioned above.
(b) Pay in respect of holidays actually taken, and accrued holiday pay up to a rate of £380 per week, up to a limit of six weeks.
(c) Payments in lieu of notice at a rate not exceeding £380 a week, up to the statutory minimum entitlement of a particular employee under the Employment Rights Act 1996 (one week after one calendar month's service rising to one week per year of service up to a maximum of 12 weeks (new earnings will be taken into account)).
(d) Any payment outstanding in regard to an award by an employment tribunal of compensation for unfair dismissal.
(e) Reimbursement of any fee or premium paid by an apprentice or articled clerk.

There is no qualifying period before an employee becomes eligible and virtually all people in employment are entitled.

## Completion of winding-up

The final stages of the winding-up are as follows:

(a) *Compulsory winding-up*. Once the liquidator has paid off the creditors and distributed the surplus (if any) and summoned a final meeting of the company's creditors, under s 146 he may vacate office and obtain his release. The company is dissolved at the end of three months from the receipt by the Registrar of the liquidator's notice that the final meeting of creditors has been held and that the liquidator has vacated office.
(b) *Voluntary winding-up*. In a voluntary winding-up the liquidator will call final meetings of the company and creditors for approval of his accounts. Within a week he will file with the Registrar his accounts and a return of the meetings, and under s 201, two months later the company is dissolved.

See p. 588

Whether it is a compulsory or voluntary liquidation, the court can restore the company to the register. The law relating to this has already been considered at Chapter 26.

We have now completed a consideration of the two main methods of winding-up. However, it is possible for a company which is in voluntary liquidation to be compulsorily wound up and this is referred to in the next section.

## Compulsory winding-up by a company in voluntary liquidation

The following points should be noted:

(a) A voluntary winding-up does not by reason of s 116 bar the right of a creditor or contributory to have the company wound up by the court, though it is necessary to show one of the grounds for a compulsory winding-up. If a creditor applies to the court, the court will take into account the wishes of all the creditors and the majority view would almost certainly prevail. In the case of contributories, the Act provides that the court must be satisfied that the rights of contributories will be prejudiced by a voluntary winding-up and that a compulsory order would be justified if, for example, the voluntary winding-up was being conducted in a fraudulent manner or there were suspicious circumstances and a searching investigation was required.

(b) Under s 124 the Official Receiver may present a petition but the court will not order winding-up unless it is satisfied that the voluntary winding-up cannot be continued with due regard to the interests of the creditors and contributories. Thus, in ***Re Ryder Installations*** [1966] 1 All ER 453 the liquidator in a voluntary winding-up had not after eight years called a meeting of creditors and he had five convictions for failing to make the appropriate returns. Here the court ordered a compulsory winding-up by the court.

(c) The Secretary of State can also present a petition for a compulsory winding-up after a voluntary winding-up has been started. Thus, in ***Lubin, Rosen & Associates*** [1975] 1 All ER 577 the Secretary of State for Trade and Industry petitioned because an investigation suggested there had been fraud and the company, formed to build flats in Spain, never had sufficient share capital for its activities. In the event, 198 creditors with claims totalling £540,000 opposed compulsory winding-up. Megarry J held that while such opposition by creditors was a formidable obstacle, the petition of the Secretary of State carried great weight and that when there were circumstances of suspicion it was highly desirable that the winding-up should be by the court with all the safeguards that that provided. Consequently, he ordered a compulsory winding-up.

## Essay questions

1 Insolvent Ltd is in compulsory liquidation and its assets are insufficient to meet its liabilities in full. Advise the liquidator as to what action he should take in respect of the following matters:

(a) Three months before the commencement of the winding-up Insolvent Ltd created a floating charge over all its assets to its bank, to secure its overdraft, and this charge was duly

registered. Immediately after this the bank allowed the overdraft to be increased by £50,000, which was used in paying wages to company employees.

(b) A private individual has put in a claim for an allegedly slanderous statement made by the managing director in the course of his duties.

(c) 18 months prior to the winding-up and at a time when the company was solvent a floating charge was created in favour of Grab Ltd which is controlled by a director of Insolvent Ltd.

(d) The following debts, *inter alia*, are due from the company:
   (i) 12 months' VAT;
   (ii) 12 months' corporation tax;
   (iii) £20,000 arrears of salary due to 10 employees.

(e) A 20-year lease on a factory which had to be shut down as being unprofitable.

(*University of Plymouth*)

**2** Deadloss plc has gone into insolvent winding-up. The petition was presented on 1 April 2005 and the winding-up order was made on 30 May 2005. The liquidator is uncertain as to the priorities and whether the following transactions are binding on him:

(a) Deadloss created a floating charge on its undertaking and assets on 1 January 2004 to secure a loan of £500,000 from Financings Ltd. The charge contained a clause restricting Deadloss from creating any further charges ranking in priority or *pari passu* with it. This charge was duly registered within the requisite period.

(b) On 1 June 2004 Deadloss created a fixed charge over its land and buildings in favour of Easymoney to secure a loan of £200,000. The charge was not dated and, owing to an oversight, not registered either. The oversight was discovered on 10 July 2004. The secretary of Deadloss promptly filled in the date as 10 July 2004 and had the charge registered, obtaining a certificate of registration from the Registrar of Charges.

(c) Deadloss had accumulated a debt of £100,000 with Suppliers Ltd. In order to ensure uninterrupted supplies of raw materials and to prevent an anticipated petition for winding up the company, Deadloss created a floating charge over its assets on 10 January 2005, in favour of Suppliers Ltd. The charge was duly registered within 21 days of execution.

(d) The following debts are, among many others, owed by Deadloss:
   (i) Twelve months' VAT amounting to £10,000;
   (ii) Eight months' PAYE amounting to £12,000;
   (iii) One hundred employees of the company are each owed £900 in wages for the three months prior to the winding-up order;
   (iv) Twelve months' corporation tax is due to Inland Revenue.

Write a report advising the liquidator on each of the above transactions.

(*University of Plymouth*)

**3** (a) What kinds of liquidation or windings-up are there and what distinguishes them from each other?

(b) In what order must a liquidator distribute the assets?

(c) Distinguish between fraudulent trading and wrongful trading and say what consequences may follow if a person is found guilty of either of them. (*Kingston University*)

4 On the liquidation of Technix plc the assets and liabilities of the company are stated as follows:

| *Assets* | £ | *Liabilities* | £ |
|---|---|---|---|
| Factory | 350,000 | Alpha plc | 300,000 |
| Finished products | 70,000 | Beta plc | 200,000 |
| Computer components | 20,000 | Delta Bank plc | 20,000 |
| Vehicle fleet | 30,000 | In. Rev. & employees | 30,000 |
| Machinery | 50,000 | Trade creditors | 25,000 |
| | | Managing Director | 10,000 |
| | 520,000 | | 585,000 |

The liquidator of Technix seeks your advice as to the priority of each of the company's creditors. You are given the following additional information:

(i) In 2003 a charge was created over all the company's assets and undertaking, both present and future, in favour of Alpha.

(ii) In 2004 finance was provided by Beta with the company's factory being used as security.

(iii) In 2005 a second charge was created over the company's entire undertaking in favour of Delta, in order to secure the company's overdraft facility of £20,000. The instrument creating the charge specified that Delta was to have priority over any earlier charge.

(iv) Six months prior to the winding-up, the Managing Director secured a specific charge over the company's vehicle fleet as security for loans made in the past which remain unpaid. Owing to an administrative error, his charge was not registered.

(v) Of the trade creditors, Psion Ltd claim that the contract, under which microchips were supplied to Technix at a cost of £10,000, for which Psion has not received payment, contained a reservation of title clause. (*University of Greenwich*)

5 You are required to discuss the following liquidation matters.

(a) An allegation by a creditor of a company during a winding-up that the directors of the company continued trading when business debts could not be met.

(b) A view reached by a company liquidator that certain directors of the company ought to be restricted in their intention to form a new company operating in the same business area as soon as liquidation is complete.

(c) The order of priority which a liquidator should afford to claims from company employees for backdated wages, unsecured trade creditors for unpaid goods supplied to the company, and debenture holders secured by way of floating charge for repayment of their loans. (*The Chartered Institute of Management Accountants*)

## Test your knowledge

*Four alternative answers are given. Select ONE only. Circle the answer which you consider to be correct. Check your answers by referring back to the information given in the chapter and against the answers at the back of the book.*

1 A company may go into a members' voluntary winding-up if the directors or a majority of them make a declaration to the effect that the company will be able to pay its debts in full within a period not exceeding:

A One year B Six months C Two years D Three years

2 The members of a solvent company may resolve to wind it up following the passing of:

A An ordinary resolution after special notice.
B An ordinary resolution.
C An extraordinary resolution.
D A special resolution.

3 Thames Ltd is in a creditors' voluntary winding-up. The members and the creditors have nominated different persons as liquidators. What happens?

A An application must be made to the court to decide who shall act.
B The creditors' nominee becomes liquidator but any director, member or creditor may apply to the court to appoint the members' nominee.
C The creditors' nominee becomes liquidator in any event.
D The members' nominee will become liquidator but any creditor may apply to the court to appoint the creditors' nominee.

4 Tees Ltd is insolvent and its directors have made a payment to one of its creditors which is designed to improve the position of that creditor in the event of a liquidation. The creditor is not connected with the company. The company is now in liquidation. The liquidator can recover the payment if it was made within:

A Two years of the winding-up.
B Twelve months of the winding-up.
C Six months of the winding-up.
D Eighteen months of the winding-up.

5 What kind of resolution is required to commence a voluntary winding-up when no declaration of solvency can be given?

A Special B Extraordinary C Ordinary D Ordinary with special notice

6 When does a voluntary winding-up, whether members' or creditors', commence?

A When the relevant resolution is passed.
B When notice of the passing of the resolution is received by the Registrar.
C When the resolution is approved by the court.
D When notice of the resolution is published in the *London Gazette*.

*Answers to test your knowledge questions on p. 617.*

Visit **www.mylawchamber.co.uk/keenancompany** to access study support resources including practice exam questions with guidance, weblinks, legal newsfeed, answers to questions in this chapter, legal updates and further reading.

# Answers to test your knowledge questions

## Chapter 1
1 (D)
2 (B)
3 (C)
4 (D)

## Chapter 2
1 (D)
2 (D)
3 (B)
4 (B)
5 (B)
6 (B)

## Chapter 3
1 (A)
2 (C)
3 (C)
4 (B)

## Chapter 4
1 (C)
2 (C)
3 (C)
4 (C)

## Chapter 6
1 (C)
2 (A)
3 (A)
4 (B)

## Chapter 7
1 (B)
2 (A)
3 (D)
4 (A)
5 (C)

## Chapter 8
1 (C)
2 (A)
3 (B)
4 (D)
5 (C)

## Chapter 9
The relevant questions and answers appear at pp. 208–210.

## Chapter 10
1 (C)
2 (C)
3 (A)
4 (A)
5 (A)
6 (C)

## Chapter 11
1 (D)
2 (B)
3 (C)
4 (B)
5 (C)
6 (B)

## Chapter 12
1 (B)
2 (D)
3 (A)
4 (C)
5 (B)
6 (C)

## Chapter 13
1 (C)
2 (C)
3 (A)
4 (B)
5 (D)
6 (A)

## Chapter 14
1 (D)
2 (B)
3 (A)
4 (C)
5 (C)

## Chapter 16
1 (D)
2 (A)
3 (C)
4 (D)
5 (A)

## Chapter 17
1 (C)
2 (B)
3 (A)
4 (A)
5 (A)
6 (C)

## Chapter 18
1 (B)
2 (D)
3 (C)
4 (C)
5 (A)

## Chapter 19
1 (C)
2 (D)
3 (A)
4 (B)
5 (D)
6 (C)

## Chapter 20
1 (A)
2 (D)
3 (B)
4 (B)
5 (A)
6 (A)

## Chapter 21
1 (B)
2 (D)
3 (A)
4 (C)
5 (C)
6 (A)

## Chapter 22
1 (D)
2 (A)
3 (D)
4 (B)
5 (C)

## Chapter 23
1 (C)
2 (A)
3 (D)
4 (C)
5 (B)
6 (D)

## Chapter 24
1 (B)
2 (C)
3 (A)
4 (D)
5 (D)
6 (B)

## Chapter 25
1 (D)
2 (D)
3 (A)
4 (C)
5 (D)
6 (D)

## Chapter 27
1 (A)
2 (D)
3 (B)
4 (C)
5 (B)
6 (A)

# Appendix 1 Companies (Model Articles) Regulations 2008, SI 2008/3229

## SCHEDULE 1
## Model Articles for Private Companies Limited by Shares

## Part 1: Interpretation and limitation of liability

### Defined terms

**1.** In the articles, unless the context requires otherwise –

'articles' means the company's articles of association;

'bankruptcy' includes individual insolvency proceedings in a jurisdiction other than England and Wales or Northern Ireland which have an effect similar to that of bankruptcy;

'chairman' has the meaning given in article 12;

'chairman of the meeting' has the meaning given in article 39;

'Companies Acts' means the Companies Acts (as defined in section 2 of the Companies Act 2006), in so far as they apply to the company;

'director' means a director of the company, and includes any person occupying the position of director, by whatever name called;

'distribution recipient' has the meaning given in article 31;

'document' includes, unless otherwise specified, any document sent or supplied in electronic form;

'electronic form' has the meaning given in section 1168 of the Companies Act 2006;

'fully paid' in relation to a share, means that the nominal value and any premium to be paid to the company in respect of that share have been paid to the company;

'hard copy form' has the meaning given in section 1168 of the Companies Act 2006;

'holder' in relation to shares means the person whose name is entered in the register of members as the holder of the shares;

'instrument' means a document in hard copy form;

'ordinary resolution' has the meaning given in section 282 of the Companies Act 2006;

'paid' means paid or credited as paid;

'participate', in relation to a directors' meeting, has the meaning given in article 10;

'proxy notice' has the meaning given in article 45;

'shareholder' means a person who is the holder of a share;

'shares' means shares in the company;

'special resolution' has the meaning given in section 283 of the Companies Act 2006;

'subsidiary' has the meaning given in section 1159 of the Companies Act 2006;

'transmittee' means a person entitled to a share by reason of the death or bankruptcy of a shareholder or otherwise by operation of law; and

'writing' means the representation or reproduction of words, symbols or other information in a visible form by any method or combination of methods, whether sent or supplied in electronic form or otherwise.

Unless the context otherwise requires, other words or expressions contained in these articles bear the same meaning as in the Companies Act 2006 as in force on the date when these articles become binding on the company.

### Liability of members

**2.** The liability of the members is limited to the amount, if any, unpaid on the shares held by them.

# Part 2: Directors

## Directors' powers and responsibilities

### Directors' general authority

**3.** Subject to the articles, the directors are responsible for the management of the company's business, for which purpose they may exercise all the powers of the company.

### Shareholders' reserve power

**4.** – (1) The shareholders may, by special resolution, direct the directors to take, or refrain from taking, specified action.

(2) No such special resolution invalidates anything which the directors have done before the passing of the resolution.

### Directors may delegate

**5.** – (1) Subject to the articles, the directors may delegate any of the powers which are conferred on them under the articles –

(a) to such person or committee;

(b) by such means (including by power of attorney);

(c) to such an extent;

(d) in relation to such matters or territories; and

(e) on such terms and conditions;

as they think fit.

(2) If the directors so specify, any such delegation may authorise further delegation of the directors' powers by any person to whom they are delegated.

(3) The directors may revoke any delegation in whole or part, or alter its terms and conditions.

### Committees

**6.** – (1) Committees to which the directors delegate any of their powers must follow procedures which are based as far as they are applicable on those provisions of the articles which govern the taking of decisions by directors.

(2) The directors may make rules of procedure for all or any committees, which prevail over rules derived from the articles if they are not consistent with them.

## Decision-making by directors

### Directors to take decisions collectively

**7.** – (1) The general rule about decision-making by directors is that any decision of the directors must be either a majority decision at a meeting or a decision taken in accordance with article 8.

(2) If –

(a) the company only has one director, and

(b) no provision of the articles requires it to have more than one director,

the general rule does not apply, and the director may take decisions without regard to any of the provisions of the articles relating to directors' decision-making.

### Unanimous decisions

**8.** – (1) A decision of the directors is taken in accordance with this article when all eligible directors indicate to each other by any means that they share a common view on a matter.

(2) Such a decision may take the form of a resolution in writing, copies of which have been signed by each eligible director or to which each eligible director has otherwise indicated agreement in writing.

(3) References in this article to eligible directors are to directors who would have been entitled to vote on the matter had it been proposed as a resolution at a directors' meeting.

(4) A decision may not be taken in accordance with this article if the eligible directors would not have formed a quorum at such a meeting.

### Calling a directors' meeting

**9.** – (1) Any director may call a directors' meeting by giving notice of the meeting to the directors or by authorising the company secretary (if any) to give such notice.

(2) Notice of any directors' meeting must indicate –

(a) its proposed date and time;

(b) where it is to take place; and

(c) if it is anticipated that directors participating in the meeting will not be in the same place, how it is proposed that they should communicate with each other during the meeting.

(3) Notice of a directors' meeting must be given to each director, but need not be in writing.

(4) Notice of a directors' meeting need not be given to directors who waive their entitlement to notice of that meeting, by giving notice to that effect to the company not more than 7 days after the date on which the meeting is held. Where such notice is given after the meeting has been held, that does not affect the validity of the meeting, or of any business conducted at it.

## Participation in directors' meetings

**10.** – (1) Subject to the articles, directors participate in a directors' meeting, or part of a directors' meeting, when –

(a) the meeting has been called and takes place in accordance with the articles, and

(b) they can each communicate to the others any information or opinions they have on any particular item of the business of the meeting.

(2) In determining whether directors are participating in a directors' meeting, it is irrelevant where any director is or how they communicate with each other.

(3) If all the directors participating in a meeting are not in the same place, they may decide that the meeting is to be treated as taking place wherever any of them is.

## Quorum for directors' meetings

**11.** – (1) At a directors' meeting, unless a quorum is participating, no proposal is to be voted on, except a proposal to call another meeting.

(2) The quorum for directors' meetings may be fixed from time to time by a decision of the directors, but it must never be less than two, and unless otherwise fixed it is two.

(3) If the total number of directors for the time being is less than the quorum required, the directors must not take any decision other than a decision –

(a) to appoint further directors, or

(b) to call a general meeting so as to enable the shareholders to appoint further directors.

## Chairing of directors' meetings

**12.** – (1) The directors may appoint a director to chair their meetings.

(2) The person so appointed for the time being is known as the chairman.

(3) The directors may terminate the chairman's appointment at any time.

(4) If the chairman is not participating in a directors' meeting within ten minutes of the time at which it was to start, the participating directors must appoint one of themselves to chair it.

## Casting vote

**13.** – (1) If the numbers of votes for and against a proposal are equal, the chairman or other director chairing the meeting has a casting vote.

(2) But this does not apply if, in accordance with the articles, the chairman or other director is not to be counted as participating in the decision-making process for quorum or voting purposes.

## Conflicts of interest

**14.** – (1) If a proposed decision of the directors is concerned with an actual or proposed transaction or arrangement with the company in which a director is interested, that director is not to be counted as participating in the decision-making process for quorum or voting purposes.

(2) But if paragraph (3) applies, a director who is interested in an actual or proposed transaction or arrangement with the company is to be counted as participating in the decision-making process for quorum and voting purposes.

(3) This paragraph applies when –