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KEY FACTS

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HODDER EDUCATION

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16.1 The legal framework

1. The law governing insolvency and liquidation was changed and updated by the Insolvency Act 1985, following recommendations of the Cork Report, and is now contained in the Insolvency Act 1986 (IA 1986). Further changes have been introduced by the Insolvency Act 2000 and the Enterprise Act 2002.
2. The changes were intended to introduce procedures to facilitate the survival of a company in financial difficulty.
3. It is necessary to distinguish between insolvency procedures and liquidation procedures. Not all insolvency procedures result in the liquidation of the company and in some circumstances (notably the members' voluntary winding up and winding up on the just and equitable ground) a company that is not insolvent will be put into liquidation.
4. The law relating to insolvency and liquidation is complex and extensive and this chapter covers some general principles only.

16.1.1 Objectives of corporate insolvency law

The following objectives have been suggested:

1. To facilitate the recovery of companies in financial difficulty.
2. To suspend the pursuit of rights and remedies of individual creditors.
3. To prevent transfers and transactions which unfairly prejudice the general creditors.
4. To divest directors of their powers of management in certain circumstances.
5. To ensure an orderly distribution of the assets and a fair system for the ranking of claims.
6. To impose responsibility for culpable management by directors and officers.

16.1.2 Insolvency practitioners

All liquidation and insolvency procedures require the appointment of an insolvency practitioner to a particular office as shown in the chart below.

Procedure	Office
Administrative receivership	Administrative receiver
Administration order	Administrator
Voluntary arrangement	Supervisor
Liquidation (voluntary or compulsory)	Liquidator

16.1.3 Qualification

1. Only an individual can act as an insolvency practitioner, and he or she must not be:
   - an undischarged bankrupt;
   - subject to a director's disqualification order;
   - a patient within the meaning of the mental health legislation.
2. He or she must be qualified to act generally: recognised professional bodies can authorise persons to act as insolvency practitioners.
3. A person who acts without being qualified to do so commits a criminal offence.

16.2 Company voluntary arrangements

These are governed by ss 1–7 IA 1986 as amended by the Insolvency Act 2000. In its original form, a company voluntary arrangement (CVA) did not provide for a moratorium on payment of the company's debts, which meant that it was possible that a creditor would petition for a winding up before the CVA could be agreed. The amended legislation provides for two kinds of CVA: without a moratorium and with a moratorium, which allows the company time to come to a binding agreement with its creditors.

16.2.1 Company voluntary arrangements without a moratorium

1. A proposal is made for a composition in satisfaction of the company's debts or a scheme of arrangement.

2. The proposal may be made by:
   - the directors of the company, where the company is not in administration or in liquidation;
   - the administrator if the company is in administration;
   - the liquidator where the company is being wound up.
3. The role of the nominee:
   - a person who will supervise the implementation of the proposal, called the nominee, must be nominated;
   - a liquidator or administrator may act as nominee or may nominate another insolvency practitioner;
   - the nominee must submit a report to the court indicating whether he or she thinks the proposal should be put to meetings of creditors and members;
   - if the nominee thinks the proposal should be put to meetings he or she must call separate meetings of all creditors whose addresses are known and members.
4. The meetings may approve or modify the proposal, but cannot approve an arrangement which deprives a secured creditor of his right to enforce the security without the consent of the creditor. Nor can they approve a proposal which alters the priority of preferential debts.
5. Under s 4A IA 1986 (introduced by the Insolvency Act 2000) if the meetings come to different decisions the decision of the creditors must prevail. However, the members may apply to the court within 28 days and the court may order the decision of the members meeting to have effect or make any order that it thinks fit.
6. Once the proposal is approved, it binds all creditors who had notice and were entitled to vote at that meeting. However, there is a 28-day period within which application may be made to the court to have the proposal set aside.
7. Once approved, the arrangement is implemented by the nominee, who becomes the supervisor of the arrangement. When complete all creditors must be notified and must receive an account of receipts and payments.

16.2.2 Company voluntary arrangements with a moratorium

1. Company voluntary arrangements with a moratorium are governed by the Insolvency Act 1986 Schedule A1, introduced by the Enterprise Act

2002. The procedure may be used only by small companies as defined by s 382(3) of the Companies Act 2006 (CA 2006) and there are other restrictions on eligibility set out in Schedule A1.

2. The procedure is similar to that for a CVA without a moratorium except that:
   - the directors must apply for the moratorium;
   - they must give evidence that the company is likely to have sufficient funds to enable it to carry on business during the moratorium;
   - they must submit to the nominee any information he requires to enable him to form an opinion;
   - if the nominee forms a favourable opinion, the directors must file certain prescribed information with the court.
3. The effect of the moratorium is similar to an administration order, with the major difference that the directors retain their management role.

16.3 Administration

1. Unlike liquidation, which results in the company ceasing to do business, administration is designed to rescue the company, either as a whole or in part.
2. The law relating to administration orders has been overhauled by the Enterprise Act 2002 and is now contained in Schedule B1 of the Insolvency Act 1986 as amended. Previously only the court could appoint an administrator. An administrator may now be appointed by:
   - the court – application may be made by the company or its directors or by a creditor;
   - out of court appointment by the company or its directors;
   - out of court appointment by the holder of a qualifying floating charge.
3. The legislation provides for an hierarchical list of purposes. The administrator must perform his or her role with the objective of:
   - rescuing the company as a going concern, or
   - achieving a better result for the company's creditors as a whole than would be achieved if the company were wound up before going into administration, or
   - realising the property in order to make a distribution to one or more secured or preferential creditors.
4. The appointment of an administrator displaces the board of directors.

16.4 Receivers and administrative receivers

16.4.1 Appointment

1. A receiver is an individual appointed to take control of property which is security for a debt.
2. Receivers may be appointed by the court or in accordance with the terms of a debenture. Normally there is a clause in the charge which entitles the chargee to appoint a receiver.
3. An administrative receiver may be appointed by a creditor whose debt is secured by a floating charge on the whole, or substantially the whole, of the company's undertaking. He or she takes control of the whole, or substantially the whole, of the company's property. This right was abolished with respect to any floating charge created after 15 September 2003 by the Enterprise Act 2002. Holders of floating charges created before that date may still appoint an administrative receiver.

16.4.2 Effect of appointment of administrative receiver

1. The administrative receiver has sole authority to deal with charged property.
2. The directors continue in office but have no authority to deal with the charged property, so their role is extremely limited.
3. An administrative receiver is an agent of the company until the company goes into liquidation (IA 1986 s 44(1)(a)).
4. The administrative receiver must, within three months of appointment, prepare a report to be sent to the company's creditors and must call a meeting of unsecured creditors.
5. Apart from any contract for which specific performance may be ordered, the administrative receiver may cause the company to repudiate any existing contract.

16.5 Winding up

Winding up (liquidation) is the process whereby the company's assets are collected and realised, its debts paid and the net surplus distributed in accordance with the company's articles of association. Winding up is followed by dissolution of the company.

16.5.1 Voluntary winding up

The members adopt a resolution to wind up the company (special or extraordinary). This may result in a members' voluntary winding up or a creditors' voluntary winding up.

Members' voluntary winding up

1. The members of a company adopt a resolution to put the company into liquidation, following a statutory declaration by the directors that the company is able to pay its debts.
2. The members appoint a liquidator, usually at the meeting where the resolution to wind up the company is adopted.
3. On appointment of the liquidator, all powers of the directors cease.

Creditors' voluntary winding up

1. The members adopt a resolution to put the company into liquidation without a statutory declaration of solvency by the directors.
2. Members can nominate a liquidator, but the liquidator must hold a creditors' meeting at which they may nominate a liquidator, who will become the liquidator of the company unless the court directs otherwise.
3. The creditors may appoint a liquidation committee of up to five persons to act with the liquidator. Members may appoint five members to this committee.

16.5.2 Compulsory winding up

1. The court orders that the company be wound up on application to the court by a person entitled to petition. Section 124 provides that petitions may be made by:
   - any creditor who establishes a *prima facie* case;
   - contributories (shareholders who may contribute to the company's assets on liquidation);
   - the company itself;
   - the directors of the company;
   - a supervisor of a voluntary arrangement;
   - the clerk of the magistrates court if the company has failed to pay a fine;

- any or all of the parties listed above together or separately;
- the secretary of state;
- an official receiver – if the company is already in voluntary liquidation;
- an administrator of the company;
- an administrative receiver of the company.

2. The vast majority of petitions are by creditors.
3. The grounds on which a petition may be made are contained in s 122 Insolvency Act 1986. The most important are:
   - the company is unable to pay its debts (s 122(1)(f));
   - it is just and equitable to wind the company up (s 122(1)(g)).

16.5.3 Appointment and role of the liquidator

1. The official liquidator attached to the court where the order is made will be appointed.
2. If there are substantial assets, an insolvency practitioner may be appointed to replace the official liquidator.
3. Once the liquidator is appointed the directors cease to have any right to manage the company.
4. The role of the liquidator is to realise the assets and distribute them to those entitled to payment.
5. In an insolvent liquidation, priority of payment is important:
   (a) Where a debt is secured by a fixed charge, the asset charged may be taken in settlement of the debt. Charges secured by a floating charge are subject to the ring-fencing provisions of the Enterprise Act 2002 (see chapter 9, section 9.1.2 above).
   (b) The principle of set-off will allow a creditor who is owed money by the company to deduct the difference before paying the company, thus in effect receiving full payment of his debt to the company.
6. Subject to these two principles, the order of payment is:
   - expenses of the winding up, including the liquidator's remuneration;
   - preferential debts: up to four months' salary of employees, up to a prescribed amount, holiday pay and contributions to state and occupational pension schemes;
   - unsecured creditors;
   - deferred debts, for example debts due to a shareholder in his capacity as such, like dividends declared but not paid;

- where the company is not insolvent, any surplus will be distributed among members in accordance with class rights.

16.6 Fraudulent and wrongful trading

16.6.1 Fraudulent trading

1. Where a person (often, but not always, a director of a company) was involved in running a company which is in the course of being wound up and which was operated with the intention of defrauding creditors, the liquidator can apply to the court for an order that the person must contribute towards the assets of the company (s 213 Insolvency Act 1986).
2. In addition to civil liability, the director may be disqualified under the Company Directors Disqualification Act 1986 or prosecuted under s 993 CA 2006.
3. To establish fraud, intention or recklessness must be proved (*R v Grantham* (1984)).

16.6.2 Wrongful trading

1. A liquidator may apply for an order that a director, former director or shadow director of the company is liable to contribute to the company's assets if it can be shown that:
   - the company has gone into insolvent liquidation;
   - at some time before the start of the winding up, the director knew or ought to have known that there was no prospect of the company not going into insolvent liquidation; and
   - the director was a director at the time of the relevant transaction (s 214 Insolvency Act 1986).
2. The director's conduct should be judged against the standard of a reasonably diligent person having both:
   - the knowledge, skill and experience that would reasonably be expected of someone carrying out the same function, and
   - the knowledge, skill and experience of the director himself.
3. The main reason for these provisions is to compensate creditors in situations where directors have acted improperly in the ways described above. If the company is in insolvent liquidation cases are more likely

to be brought under s 214, where it is not necessary to prove fraud or dishonesty.

16.7 Dissolution

1. Dissolution of a company takes place when its name is removed from the register kept at Companies House. On liquidation, three months after the liquidator has sent his final accounts to the Registrar, dissolution automatically follows unless an application is made to the court seeking deferral of the date of dissolution. There are slightly different procedures for voluntary and compulsory liquidations.
2. There are a number of other ways in which dissolution may take place, including:
   - In an administration, three months after notification by the administrator that there is nothing to distribute to creditors the company is deemed to be dissolved.
   - By order of the court as part of a compromise, arrangement or reconstruction.
   - s 1000 CA 2006 sets out a procedure by which the Registrar is empowered to strike a company off the register. This accounts for a large number of dissolutions, where after sending letters to the company and advertising the Registrar is satisfied that the company has ceased to do business.
   - Under s 1003 CA 2006, on application of the company itself three months after publication of a notice in the Gazette.

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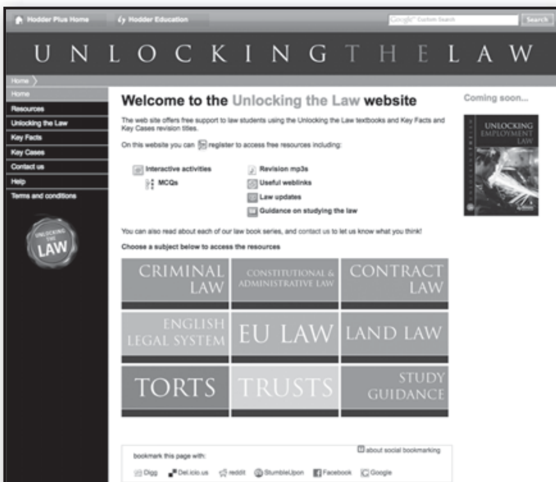

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