



Insolvency and Companies

There are many terms used to describe an insolvent company including “in liquidation”, “in receivership”, “in administration”, or just “gone (or going) bust”. An insolvent company is not ‘bankrupt’ (except in America). These descriptions do not all mean the same thing as if a company is in administration or under a voluntary arrangement, it does not follow that the business has ceased trading and creditors will not be paid. However, if a company is in compulsory liquidation, there is unlikely to be an ongoing trading relationship for very much longer.

Corporate insolvency can be broadly divided into two categories: ‘Rescue’ procedures may be proposed where there is a viable business experiencing a short-term problem and some breathing space is needed. On the other hand, ‘run-down’ procedures come into play where there is nothing that can realistically be done other than attempt to maximise returns to creditors by selling whatever assets remain. Good early advice is essential otherwise it could be a case of “too little too late”.

Caution for management

Being a senior manager, partner in a firm or company director can be likened to being the driver of a car. If you cause damage or injury with your car, the Police will investigate the matter in case your conduct and actions in causing the accident were such that warrant punishment. For example, you failed to stop at a red traffic light or were speeding and not looking where you were going. A similar situation occurs in the event of a company or partnership entering into an insolvency procedure. The Insolvency Practitioner has a legal duty to investigate the directors’ and other senior office holders’ management and report this to the Department of Trade and Industry. If the court finds the conduct to have been lacking or contributed to or aggravated the deficit to creditors, punishment may be handed down. See below “Management and Insolvency” for some points to consider and this is another reason why good early advice is vital.

Company insolvency myths

I can start up again without any trouble. Not true. The ‘phoenix syndrome’ of companies going bust and a short-while later the directors are back up and trading under a similar name (almost as if the other company has not become insolvent) are severely punishable. It is possible to set up another business but certain steps have to be taken first.

I was not a director when the company was wound up so I am not to blame. Not true. This will depend upon your role and conduct in the business and the Insolvency Practitioner

can look back up to three years prior to the date of insolvency. However, the larger the gap between your resignation and the date of insolvency may be a mitigating factor.

I am the main shareholder so the company's assets belong to me. Not true. The assets belong to the company just like the debts (unless you have given a personal guarantee of them) and all the majority shareholding means is that you are control matters on which shareholders can vote in meetings. For example, declaring a dividend. Often, much of the directors own money will have been paid into the company to keep it going but this gives no priority in the event of insolvency and return of money paid by shareholders is at the bottom of the list or payments. You may be able to buy assets of the company from the insolvency practitioner.

When the company is in an insolvency procedure it ceases to function. Not true. Depending upon the procedure, the company may no longer be trading and the directors no longer holding office (except to assist the insolvency practitioner), but the company (through the insolvency practitioner) it is still capable of taking action against debtors, bringing actions against the directors and selling assets. If the company is in a 'rescue' procedure it may be trading with very little change at all.

'Rescue' procedures

The Enterprise Act 2002 has introduced a number of changes to make it easier for companies to be saved and to try to turn the emphasis away from making sure certain classes of creditors are satisfied. As a result, existing procedures have been revised with this view in mind. For example, banks have been unable to appoint an administrative receiver under floating charge agreements entered into after 15 September 2003 reducing some of the unfairness this procedure could cause. It is also the case that in insolvency commencing after 15 September 2003, debts owed to Customs & Excise and the Inland Revenue have lost their preferential status and will sit with those of other ordinary unsecured creditors. That way a business that is itself owed money may recover more and avoid its own insolvency problems.

Administration

(Not to be confused with a County Court Administration Order for individuals). In a nutshell, an insolvency practitioner is approached and proposals are prepared to achieve one or more aims set down in the Insolvency Act 1986. An application is made to the court for an order to block action being taken against the company by creditors and to allow time for the proposals to be prepared. If successful, (i.e. the company is or is likely to become unable to pay its debts and the administration order is reasonably likely to achieve the purpose of the administration) the proposal is put to creditors for approval. If given, the company will be placed into administration under the supervision of the Insolvency Practitioner (known as the administrator). The company can continue to trade (depending upon what the purpose of the order is) but under the control of the administrator. The company's directors remain in office, but they must not exercise their powers in a way that would interfere with the exercise by the administrator of his powers. The administrator has wide powers to assist with achieving the purpose of the order and the administration will come to an end upon the achievement of the purpose, or if this is not the case, on the dissolution or winding up of the company.

Formerly seen as a lengthy and expensive process suited only to large manufacturing companies or football clubs, changes have made it easier to appoint an administrator and imposing strict time limits for completion of the administration. For example, it is possible to appoint an administrator without having to apply to the court first. The purposes of the administration have also been simplified. The administrator must propose either rescuing the company as a going concern, achieving a better return for **all** creditors than likely if the company were to be wound up, or realising property to make a distribution to one or more secured or preferential creditors. It is now also possible for the holder of a 'qualifying floating charge' or a creditor to seek the appointment of an administrator in addition to the company and its directors.

This procedure offers speed and protection for the company but should not be considered lightly without expert advice from an insolvency practitioner and specialist solicitor.

Company Voluntary Arrangement

Known as a "CVA", this involves putting together a proposal with an insolvency practitioner to pay agreed monthly contributions or periodic lump sums into an account controlled by the insolvency practitioner (known as the supervisor). An arrangement can be proposed by the directors, an administrator or even a liquidator, and at the end of the arrangement (normally five years or less), the supervisor will distribute the fund to creditors in accordance with the terms of the arrangement. If the company can satisfy two or more of the following criteria, (turnover of less than £5.6 million, a balance sheet total of under £2.8 million or less than 50 employees), it may be able to apply to the court for a moratorium. If granted, the order will block action being taken against the company by creditors (normally for 28 days) to allow time for the proposals to be prepared and considered at a meeting of creditors.

The aim of the CVA proposal will be to show why creditors will be better off under the CVA as opposed to the company's liquidation. If accepted by over 75 percent in value of the company's creditors, every creditor entitled to notice of the meeting and to vote at it will be bound by its terms, so it is important to keep good records of the company's creditors. By accepting the CVA they will surrender rights to pursue the company further for the debt. Creditors may propose modifications and it is possible that a creditor who is not bound by the arrangement could still petition for the company's winding up. Provisions exist to challenge any arrangement within 28 days of it being entered into.

A CVA can be especially useful where the company has ongoing contracts under which payment will only occur on certain dates in the future, but will be forfeit or reduced if the contract is not finished due to liquidation. However, this does not suit everyone as the set up fee can be difficult to find and the proposed contribution too low so that insufficient creditors are likely to vote for the proposal and choose to take their chances in a liquidation. Additionally, if the arrangement fails (for example failure to make contributions or failure to make proper disclosure to creditors) the supervisor may be compelled to petition for the company to be wound up in any event.

The company may be able to come to a similar arrangement with its creditors without the requirements of the CVA, but if it does, it may not benefit from some of the protection given to it under the Insolvency Act 1986.

'Run down' procedures

Sometimes there is nothing that can be done to save a company and it is inevitable that the business must cease. This can be triggered in a number of ways; the most common form of run down procedure is liquidation or (where a floating charge was entered into before 15 September 2003), administrative receivership.

Liquidation

This can come about in one of two ways:

A winding up order is made following a petition to the court – This could be by a creditor (most common), the Department of Trade and Industry 'in the public interest', a disgruntled shareholder, the Supervisor of a failed CVA or even the company itself. Where the court has ordered winding up, the ensuing process is known as 'compulsory' liquidation. **If faced with a winding up petition from a third party, you must take steps and seek advice immediately as the consequences are very serious and time deadlines are very short.**

The company resolves to wind itself up voluntarily - This can occur in two situations. If the directors cannot reasonably carry on the business due to debt they may be advised to convene meetings to appoint a liquidator and cease trading, (a creditors' voluntary liquidation or "CVL"). On the other hand, if the company can pay all its debts in full (so is not insolvent) but the decision has been taken to cease trading the company then members' voluntary liquidation or "MVL" may be proposed.

There are slight variations between the process of compulsory liquidation and voluntary liquidation but they are conducted in similar ways. A liquidator (again a Licensed Insolvency Practitioner) will take office and the business will generally cease from the date of appointment. The liquidator will be responsible for getting in and realising the company's assets, investigating the reasons for the company's insolvency and distributing the proceeds of the asset sales to creditors. The directors will also cease to hold office except for the purposes of assisting the liquidator although it is possible for the business to remain trading in certain circumstances. At the end of the liquidation, the company will be dissolved and its name removed from the Register of Companies at Companies House.

Administrative receivership

The banks have come in for much criticism for their conduct during the recession of the early 1990's by appointing administrative receivers too soon and too often, with the result that many businesses were not even given a chance to recover before insolvency beckoned. As mentioned above, this procedure is still with us (and will be for some time to come) but its scope will be much reduced. An administrative receiver is appointed when a floating charge or debenture 'crystallises' (i.e. repayment is demanded and not met or some other event occurs), so that repayment in full becomes due. The charge is normally secured over all the assets of the business (premises, stock, book debts, etc.) and the administrative receiver's role is to take possession of, get in and collect the company's property with a view to selling it for the benefit of the charge holder. In most cases once the bank debt and receivership costs

have been paid off, there is very little left for other creditors and the company enters into liquidation.

Management and company insolvency

Whilst the courts will acknowledge that a business can and will fail through no fault of management and despite the partners' or directors' best attention and efforts, where management fail to react to the signs until it is too late, or aggravate the failure, questions will be asked. Directors also owe duties to the company to carry out their duties with skill and care and in the best interests of the company. A partner or director who acts negligently and cause loss to the company or firm may find him/herself exposed to a claim for damages by the company or the remaining partners. Much will depend on each individual case but examples of such conduct might include:

Paying selected creditors in preference to others so they are put in a better position than they would have been in the event of liquidation. This could include paying someone with the effect that any liability you may have under a personal guarantee is reduced, repaying your director's loan account or paying certain suppliers first with a view to them treating you favourably in your next business venture. Extensive powers are available to the courts to reverse the effect of transactions.

Failing to pay taxes on time or at all. In effect, the business is trading at the expense of the Crown, conduct that is regarded as very serious indeed.

Selling assets at undervalue. Transfers of assets with a view to putting them beyond the reach of creditors are another example and again, extensive powers are available to the courts to reverse the effect of transactions.

Failing to properly manage the business. As a partner or director It is no defence to say you did not know the business was in trouble if you did not take reasonable steps to ascertain the position for yourself or simply left it to others. (If you were prevented from doing so or misled, this may be an element of mitigation).

Obstructing or failing to assist the Insolvency Practitioner. For example, concealing altering or destroying company records or property or failing to provide information when requested.

If the court finds that management's conduct has been such as to class them 'unfit' to be a company director, a disqualification order of between 2 (minimum) and 15 years (the most serious cases) may be made under the Company Directors Disqualification Act 1986. (This has been extended to cover partners in a partnerships business). If disqualified the director or partner would then not be able hold a senior position in the running of a company without the permission of the court for the duration of the order. There are also certain criminal offences which can arise such as defrauding creditors or making false representations to them.

Management may also be liable to contribute to the company's debts if they continue trading the business past the point when they knew or ought to have known that the business had no reasonable prospect of avoiding insolvency.

The individual director or partner will have much to consider from his or her own point of view in the event of insolvency as his or her own livelihood and future career could be in jeopardy. Resignation will not automatically absolve a manager from blame, but there are steps that can be taken to protect your position. For example, insist that directors' or partners' meetings are regularly held, that you attend them and keep detailed notes of what was discussed and decided. If matters have been decided or dealt with in your absence, challenge those conclusions. Doing this may not change the end result but by doing so you are reducing the areas where you may be open to criticism.

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