SMES, DIRECTORS & SHAREHOLDERS

Different types of company insolvency explained

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INTRODUCTION

There are five main types of formal corporate insolvency procedures as follows:

1 Receiverships

Administrative receivers are appointed by a secured creditor as holder of a floating charge over on company assets under the terms of that debenture or any other security document. A floating charge is a debt secured over property or assets which are fluid, for example invoices, stock, some plant and machinery and cash.

In specific circumstances (set out in the agreement, which is usually a debenture) – for example insolvency – the charge crystallises and upon notice the company can no longer deal with such assets without the creditor's approval (hence the appointment of an administrative receiver). The appointment of an administrative receiver is generally preceded by demand provisions under the terms of the debenture.

Since the Enterprise Act 2002 (which came into effect in September 2003), the use of administrative receivers is less common.

An administrative receiver will manage either specific property or the main business of the company but should not normally otherwise disrupt the company's on-going trading, as the secured creditor will rely on the net income (after costs of trading) from the business. However, where the administrative receiver sells a large asset of the company, s/he will be accountable to the secured creditor for any net proceeds arising from the disposal of such assets.

All creditors and debtors of the company must be notified of the appointment of the administrative receiver and s/he acts in their personal name as agent for the company and has no personal liability for any of their actions.

An administrative receiver can require that any individuals involved in the company's formation or management, particularly directors, to submit a statement of affairs on the company's assets, liabilities within 21 days of receiving the notice. The administrative receiver is also required to file a report at Companies House within 3 months of his appointment (unless an order from the court is sought otherwise) on the background to his appointment and the assets dealt with and distributions to the appointed debenture holder.

Despite the appointment of an administrative receiver or LPA receiver, a company can still be subject to other insolvency processes which can simultaneously occur and may lead to the discharge of the administrative receiver in certain circumstances.

2 Company voluntary arrangements ("CVA")

A company voluntary arrangement is a private arrangement between creditors and the company and is normally proposed at the request of directors of the company.

A CVA is usually entered into with a view to rescuing a company and only paying creditors a proportion of their debts. At least 75% of creditors by value must agree to enter into such an arrangement and, until such time as the CVA is agreed, creditors can proceed to enforce their claims against the company.

Under Section 1 (A) of the Insolvency Act 1986 eligible companies can seek, upon commencing the process to agree a CVA, an order from the court that a moratorium be granted restraining such creditors from taking any enforcement action pending the outcome of the CVA proposal. This provides the company some protection from enforcement against its assets by a dissenting minority of creditors.

Directors, under the guidance of an Insolvency Practitioner, will normally draft a proposal for how the CVA should work in practice. The proposal can be flexible and recent case law shows that different creditors can be treated in a different manner with a view to maximising the effectiveness of the proposal.

Once a proposal is prepared and provided to the nominated insolvency practitioner ("the nominee") then the nominee shall, within 28 days after he has given notice of the proposal, submit a report to court stating whether he or she considers it has a reasonable prospect of success and whether a meeting of creditors to agree the proposal should be convened (and the date and time on which it has been convened). Simultaneously, the Nominee will send out the proposal and his report to creditors together with confirmation of a date for the meeting of creditors for the purposes of approving the proposal.

Between the date of this notice and the meeting of creditors, it is quite common for creditors to propose modifications to the CVA proposals and such modifications may or may not be adopted either prior to at the meeting of creditors. Traditionally, the implementation of such modifications will satisfy the requesting creditor and secure their vote in favour of the CVA.

At the creditors meeting, the discussion as to the respective modifications will be finalised and the proposal in its modified form must be agreed by at least 75% of creditors to vote at the meeting, either in attendance, by proxy or in person and by value of their claim against the company. In addition to 75% (in value) of the company's total creditors voting at the meeting agreeing to the CVA more than half of creditors who are unconnected to the company must agree to the CVA. Upon this vote being passed, the CVA will commence and the nominee will now be referred to as the supervisor of the CVA.

A CVA will mostly commonly proceed on the basis of cash flow forecasts and anticipated income from the company's continuing trading (although it can be on asset sales over a much shorter period). It may treat creditors differently and once the CVA is approved, all creditors of the company are bound by the CVA regardless of whether they receive notice of the creditors meeting or not. This was a piece of legislation brought in by the Insolvency Act 2000 to prevent unknown or unnotified creditors disrupting the CVA process which otherwise was progressing successfully. However, there is a statutory procedure for such creditors to apply to court to either reconvene the creditors meeting or to modify or bring the CVA to an end.

3 Administrations

The appointment of an administrator is intended to achieve one of three things:

1. **It may rescue the company as a going concern, either by allowing it to trade for a short period under the benefit of a moratorium and/or by selling all or part of it to another company as a going concern business (with just a change in legal ownership). This is often referred to as a "pre-pack"; or**
2. **It may achieve a better result for the company's creditors as a whole than would be likely in the event of a winding-up; or**
3. **Where it is a quicker or more cost-effective way of realising company property to make a distribution to secured and/or preferential creditors.**

Upon the appointment of an administrator, all creditors of a company are restrained from taking any legal action against the company or continuing with any enforcement of their rights in respect of company assets (as described above this is called a "moratorium"). Additionally, administrators are not automatically required to pay any company expenses incurred prior to their appointment and these expenses will rank as creditors, potentially unsecured creditors, in the proceedings.

A pre-pack effectively removes all of the assets from the company and leaves a pot of funds out of which the administrator pays the administration expenses and costs, including his/her fees, amounts due to secured creditors and amounts due to preferential creditors (mainly employee arrears and unpaid holiday entitlement).

If there are any surplus funds available after this, then the administration may be converted to a Liquidation for the purpose of paying unsecured creditors.

An administrator will be appointed for 12 months and would have to seek an extension of his/her appointment period if he is unable to fulfil his duties within that time scale. An application to court must be made for these purposes or in some circumstances permission sought from creditors.

4 Compulsory winding-up or compulsory liquidation

A compulsory winding-up order is made upon the presentation of a petition for the winding-up of a company (a winding-up petition – "WUP").

A WUP is often presented by creditors of the company where they are unable to gain repayment of an undisputed debt. A defence for a winding-up petition may be that debt is disputed and therefore does not satisfy the statutory criteria. Please see our Frequently asked questions defending a winding-up petition which goes into this area in more detail.

Once the WUP is issued by the court, the petitioning creditor must then issue and serve it at the company's registered office and there is a requirement that it be advertised at least seven days prior to the court hearing.

It is quite common that upon advertisement the company's bank will freeze all company accounts with immediate effect and the only option available to a company who has a winding-up petition presented

against it is to seek at the first hearing (or beforehand on application) a restraint of the advertisement of the winding-up petition. The alternative is the freezing of the company's assets, and particularly its cash funds, which will often disable a company to such an extent that liquidation becomes unavoidable and thus it is vital to ensure that the advertisement of the winding-up petition is avoided if there is an intention to pay the creditor.

Once it is wound-up the official receiver annexed to that court will be provided with the petition details and will correspond with directors of the company to obtain further information as regards the company's affairs and to take control of its corporate identity and accounting records (which must be delivered up). If the company has assets, then an independent liquidator may be appointed to collect in all of the assets and make a distribution to unsecured creditors.

In the event that there are any transactions which may be in breach of either of the companies acts, the Insolvency Act 1986 or any other legislation, then the liquidators have considerable statutory powers to seek recovery of such assets or damages for any losses arising to the company as a result of the director's misfeasance. Please see our page on claims by liquidators or administrators which deals with these claims.

The appointed liquidator will also be required to report the Secretary of State on the director's conduct leading up to the winding-up of the company. This can potentially lead to director disqualification proceedings being brought against individual directors for a failure to comply with their fiduciary duties as director and we refer to our page director disqualification which deals with this.

5 Creditors voluntary liquidation ("CVL")

A CVL is an insolvent liquidation in a similar manner to a compulsory liquidation as described above. However, a CVL is usually instigated by either the company itself or directors of the company for the purpose of winding the company up.

Usually a director will be required to sign a statutory declaration on a statement of the company's affairs, including details of its assets and liabilities, and this will be presented to shareholders who at a general meeting would have to pass a resolution to take the company into liquidation. Although the liquidation starts at this point, a further meeting of creditors is required very shortly thereafter (usually the same day, although it can be up to seven days later) to confirm the identity of the Insolvency Practitioner who is appointed as liquidator of the company.

Once the liquidator is appointed, he takes control of the company's affairs and most often this is the point at which the company effectively ceases to trade. The liquidator begins to go about investigating past transactions, recovering the assets of the company and reporting on the directors' conduct in an identical fashion to his/ her role in a compulsory liquidation (see above).

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