**Insolvency procedures**

This element insolvency procedures which may be used when a company is in financial difficulties.

**Administration – Schedule B1 of IA 1986**

Administration is an insolvency procedure introduced by the IA 1986. It was significantly amended by the EA 2002.

An important feature of administration is the creation of a moratorium which continues throughout the period of the administration. This provides the company in administration with a breathing space to achieve the purpose of the administration, as the moratorium prevents creditors without court or administrator consent from exercising their usual rights and remedies. Examples of creditor actions prevented during a moratorium include: the right to enforce their security; or in the case of a landlord, from attempting to terminate a lease by exercising a right of re-entry; or in the case of a creditor who has supplied goods on retention of title, from attempting to take possession of the goods to which it has title.

Administrators can be appointed either by court order or out of court (usually by directors or holders of “qualifying floating charges”- see later).

The **primary objective** of the administrator is the **rescue** of the company as a going concern.

If the rescue of the company is not reasonably practicable, then the administrator’s objective will be to achieve a better result for the company’s creditors as a whole than would be likely if the company were wound up without first being in administration.

Only when neither of the first two options are reasonably practicable and provided an administrator does not unnecessarily harm the interests of the creditors as a whole, then the final objective of the administrator will be to **realise property** in order to make a **distribution** to one or more **secured** or **preferential creditors** (Schedule B1 paragraph 3(1) IA 1986).

In reality, company rescue is rarely achieved. In most administrations, the relevant statutory objective is the second one.

**Qualifying Floating Charges**

In practice the most important and common form of security is a **debenture** which consists of fixed charges over most categories of a company’s assets together with a residual floating charge over any of the company’s assets not otherwise subject to a fixed charge. The debenture will usually include a provision giving the debenture holder (in a bilateral loan this is normally a lender whereas in a syndicated deal this would be the security trustee) the right to appoint an administrator following the occurrence of an event of default under the loan agreement. This right is the central remedy available to a debenture holder to enforce its security.

The debenture holder has the right to appoint an administrator only if the floating charge created by its debenture is a **Qualifying Floating Charge** (‘**QFC**’). This is defined in Schedule B1, paragraph 14 IA 1986 and includes a floating charge over the whole or substantially the whole of the company’s property (either alone or in conjunction with other security which the holder of the floating charge has) and the charging document either states that paragraph 14 applies to the floating charge or purports to give the holder of the floating charge the right to appoint either an administrator or an administrative receiver. The holder of such a charge is called a Qualifying Floating Charge Holder (‘**QFCH**’). Nearly always, the debentures created in practice are QFCs.

A floating charge has the following characteristics:

a) it is a charge over a class of assets of the debtor/chargor;

b) the particular assets within the class change from time to time in the ordinary course of the chargor’s business; and

c) the chargor remains free to deal with those assets in the ordinary course of its business until crystallisation of the charge (e.g. on winding up or other event specified in the debenture).

Assets most commonly subject to floating charges are book debts, stock and cash in current accounts. Lenders will usually seek to take fixed charges over all other categories of assets.

A floating charge is a charge which, when created, was a floating charge and therefore includes any floating charge which has crystallised (i.e. converted into a fixed charge either as a matter of law or pursuant to the terms of the debenture).

**Appointing an administrator**

The following parties can apply to the court for an administration order:

· the company itself (i.e. acting with the authority of a resolution passed by the members in general meeting);

· the directors of the company (by board resolution);

· a QFCH;

· a creditor (who is not a QFCH);

· the supervisor of a CVA; and

· a liquidator.

The following parties can use the out-of-court procedure to appoint an administrator:

· the directors of the company;

· a QFCH; and

· the company acting through its members.

**Appointing an administrator- out of court**

The most common method for appointing administrators is a directors’ out-of-court appointment. This is true even if there is a QFCH as QFCHs often do not like the publicity associated with appointing administrators. That said, a first ranking QFCH will usually be able to influence the timing of appointment and the identity of the administrator.

Appointments by the company (acting through the members) are very rare. Appointments by court order are fairly uncommon and usually occur when a creditor has begun winding up proceedings against the company and the directors wish to appoint administrators before the court has made a winding up order. In this situation, the out-of-court appointment procedure is not available to the directors and they must apply to court for an order to appoint administrators. If the court makes an administration order, the pending winding up proceedings are automatically dismissed.

Contrast the position where there is an outstanding winding-up petition and a QFCH uses the out-of-court procedure to appoint an administrator. In this case the petition is automatically suspended rather than dismissed.

**Appointing an administrator – out of court (QFCH)**

The out-of-court procedure differs depending on who appoints the administrator. ​

If a QFCH appoints the administrator, it files a notice of appointment at court and the appointment commences on the date of the filing (subject to serving notice on any prior QFCH and to the rules on out of hours appointment). ​This is only possible where the QFC is valid and has become enforceable. The QFC will become enforceable if (i) the debenture and/or the loan agreement provides that the lender’s security is enforceable following the occurrence of an event of default, (ii) the lender accelerates the loan so that all advances under the loan are immediately due and payable and are repayable on demand, (iii) the lender makes written demand on the borrower for immediate repayment and (iv) the borrower fails to satisfy the demand

If the directors or the company appoint the administrator, then they must file notice of intention to appoint an administrator at the court and serve it on any QFCH, identifying the proposed administrator and giving the QFCH five business days’ notice of its intention to file a notice of appointment with the court. The QFCH then may appoint its own choice of administrator within the five business day period (assuming its security is enforceable and it has the right to appoint administrators at this point of time) or it will liaise with the directors in relation to the appointment process.​ The directors may only appoint an administrator if the company is/likely to become unable to pay its debts.

**Appointing an administrator – out of court (directors)**

The directors will file a notice of appointment with the court within a further five business day window. The administrators are appointed immediately on the filing of the notice of appointment.

The QFCH is usually able to override the directors’ or company’s choice of administrator. In practice the appointment of an administrator usually takes place at a time decided upon by the QFCH and the QFCH will liaise with the directors when it is ready and request the directors to appoint the administrators which it has chosen.

In such a case, the appointment can take place very quickly and it is usually possible for the directors to file the notice of intention to appoint administrators, to obtain the consent of the QFCH to the appointment and then to file the notice of appointment within a few hours.​

**Appointing an administrator – court appointments**

In certain circumstances, a court appointment will take place, including appointment by a creditor who is not a QFCH (though these are rare as such creditors will find presentation of a winding-up petition more straight forward).

The most common situation when an administrator is appointed by the court is when a creditor has presented a winding up petition against the company and the directors then seek to appoint administrators. They can only do so by making a court application.

**Administration moratorium**

The appointment of an administrator creates an immediate moratorium on certain creditor action whereby (except with consent of the court or the administrator in each case):

· no order or resolution to wind up the company can be made or passed;

· no administrative receiver of the company can be appointed;

· no steps can be taken to enforce any security over the company’s property or to repossess goods subject to security, hire purchase and retention of title;

· no legal proceedings, execution or other process can be commenced or continued against the company or its property; and

· a landlord cannot forfeit a lease of the company’s premises by means of peaceable re-entry.

There is also an interim moratorium if an application is made to court for the appointment of an administrator or a notice of intention to appoint the administrator is filed. Neither of these steps prevents a QFCH from appointing its own choice of administrator out-of-court (assuming its security is then enforceable and gives it the right to appoint an administrator).

**Powers and duties of the administrator**

Pending the appointment of an administrator, the directors remain in control of the company. The administrator usually takes on the management of the business in place of the directors once appointed.

**Duties -** the administrator will manage the company and its business with the aim of achieving the purpose of the administration. The directors are unable to exercise any management power without the consent of the administrator.The administrator acts as agent of the company and incurs no personal liability on contracts he causes the company to enter into provided he acts within his or her powers. The administrator is an officer of the court (even if appointed using the out-of-court procedure) and has a duty to the court and a duty to act in the interests of all the creditors.

**Powers -** administrators have wide powers set out in paragraph 1 of Schedule B1 to the IA 1986. These powers include: the carrying on of the business of the company; taking possession of and selling the property of the company; raising money on security; and executing documents and deeds in the company’s name.

As a general rule administrators do not have the power to pay a dividend to unsecured creditors without obtaining court permission. They can (and often do) pay a dividend to secured creditors out of the proceeds of the creditor’s security and can now (as result of the changes brought about by the Small Business Enterprise and Employment Act 2015) pay the prescribed part dividend to unsecured creditors out of the “prescribed part” (or ring-fenced) fund (see below).

If there is a dividend to be paid to unsecured creditors, this will be paid in the statutory order of priority and either the administrator will have to seek permission from the court to make the payment or the administration will convert into a liquidation and the liquidators will then make a distribution to creditors. In a more complex case, the administrator will propose a restructuring plan, a CVA or a scheme of arrangement on terms that the administrator has the power to make dividend payments.

Recoveries for unsecured creditors are usually low.

In practice, the administrator will often sell all/part of the business on or shortly after they have been appointed (usually by means of a pre-agreed or pre-packaged sale) (a 'pre-pack'). Under a pre-pack the putative administrators negotiate the terms of the sale with the proposed buyer in advance of their appointment. The parties will sign the sale agreement and the signed counterparts will be held in escrow pending the administrators’ appointment. The advantage of the pre-pack to secured creditors is that it provides certainty of result as they will know before the administrator’s appointment what return they will receive from the pre-pack sale.

**Powers and duties of the administrator- swelling the assets of the insolvent estate**

The administrator (like a liquidator) has powers under the IA 1986 to apply to court and ask the court to make an order to set aside (avoid, or “claw back”) certain voidable transactions which occurred in defined periods before the start of the administration.

They are known as “antecedent transactions”, and you will be familiar with these from Business Law on the SQE 1 Preparation course. The two most well-known examples are transactions at an undervalue and preferences.

These orders are sought with the aim of increasing the pool of the company’s assets available to creditors.

Under the changes brought about by the Small Business, Enterprise and Employment Act 2015, administrators, like liquidators, now also have the power to bring claims against directors for wrongful or fraudulent trading.

**Ending administration**

The administrators’ appointment terminates automatically after 12 months. This period can be extended once by up to one year if the creditors agree. The court can also sanction any other extensions (which may be for more than one year).

Administrators can, in certain circumstances, bring the administration to an end without court involvement by filing the appropriate notice with the court. An example of when this procedure can be used is when an out-of-court appointed administrator believes that the purpose of the administration has been sufficiently achieved.

As mentioned above, administration may also be followed by another restructuring procedure (such as a CVA, restructuring plan or scheme) or by a liquidation.

**Fixed Charge Receivers**

A fixed charge receiver (“**FCR**”) is, as the name suggests, appointed by the holder of a fixed charge in the circumstances set out in the loan or security documentation (e.g. on the occurrence of the usual types of events of default found in loan agreements). The FCR will have certain limited powers set out in the Law of Property Act 1925 (‘**LPA 1925**’) and any additional powers (which are generally fairly extensive and include a power of sale) set out in the security documentation.

A fixed charge receiver becomes the receiver only of the property charged and is only entitled to deal with that property. The FCR is not normally entitled to deal with any other property of the company or to manage the company’s business. Fixed charge receivers are sometimes referred to as “**LPA receivers**”. Technically speaking, they are different. Fixed charge receivers are appointed pursuant to powers contained in a fixed charge or mortgage whereas an LPA receiver is appointed under the terms of the Law of Property Act 1925. Most receivers encountered in practice are fixed charge receivers because, as referred to above, this type of receiver has a more extensive set of powers.

· A fixed charge receiver cannot be appointed while a pre-insolvency moratorium subsists or if the company is in administration.

· Fixed charge receiverships are more likely to be used in relation to companies with significant assets subject to fixed charge(s) e.g., real estate.

· They are a ‘self-help' remedy, not a collective insolvency procedure.

**Administrative receivers**

Until the implementation of the EA 2002, debentures generally provided lenders with a quick and (compared with administration) cheaper method of enforcement through the appointment of an administrative receiver (‘**AR**’). Technically, the appointment of an AR is not an insolvency procedure but a 'self-help' procedure to enable a secured creditor to enforce its security by the realisation of the assets secured by the debenture.

The EA 2002 effectively abolished administrative receiverships under charges created on or after the *Relevant Date*, except in respect of floating charges created as part of some special transactions. The detail of these transactions is beyond the scope of this workstream.

As ARs owe their duty primarily to their appointor, chargeholders which took their security before the Relevant Date may be considered in a better position than holders of QFCs created after the Relevant Date, who can only appoint an administrator.

However, lenders have become comfortable with the administration procedure and an appointment of an AR under a floating charge created before the Relevant Date is extremely rare.

An AR cannot be appointed if a pre-insolvency moratorium subsists or if the company is in administration.

**Appointment of administrative receivers**

The holder of a floating charge created before the Relevant Date can appoint an AR without much formality, provided that the floating charge together with any other security the holder has is over the whole/substantially the whole of the company's property and expressly provides that the holder may appoint an administrative receiver (s.29(2) IA 1986).

The appointment can be made very quickly (usually within a few hours on a business day) either (i) following the occurrence of an event of default under the terms of the relevant loan agreement and the charge holder accelerates the loan and makes demand for immediate repayment and the debtor does not satisfy the demand, or (ii) where the loan is repayable on demand (such as an overdraft), following the charge holder making demand for immediate repayment and again, the debtor does not satisfy the demand.

**Powers of administrative receivers:**

· All the express powers are set out in the debenture (the security documentation incorporating the floating and fixed charges); and

· Unless expressly excluded, the AR also has extensive powers set out in Schedule 1 to the IA 1986 (these are the same powers that are granted to an administrator).

The AR’s most important power is to take possession of and sell the assets of the company and repay the debenture holder. An AR does not have the benefit of a moratorium. This means that during the receivership, a creditor has the right to seek to exercise its rights and remedies e.g. to petition to wind up.

**Role and duties of the administrative receiver**

The AR is required to be a licensed insolvency practitioner.

Although nominally the agent of the company, ARs owe a primary duty to **their appointor**, and generally owes only a limited duty to the company and other creditors. The company as principal is not able to give instructions to the AR.

The AR is both a receiver and a manager (as stated above fixed charge receivers are receivers only and are not normally entitled to manage a company’s business). The AR’s role is to take possession of the assets secured by the charge under which he or she is appointed. Usually the assets are sold (preferably on a going concern basis), with the AR and his or her staff in the meantime running the business with the assistance of existing workforce (and perhaps the existing management).

The order of priority for payments on the realisation of assets by the AR is essentially the same as on winding up.

**Liquidation (or ‘winding up’) – ss.73 – 229 of IA 1986**

Liquidation is the oldest of the corporate insolvency procedures. The liquidator’s function is to realise the company’s assets for cash, determine the identity of the company’s creditors and the amount owed to each of them and then pay a dividend to the creditors on a proportionate basis relative to the size of their determined claims (creditors of the same rank are said to rank ‘pari passu’).

The ranking of creditors’ claims (that is, the order in which they must be repaid) is set out in the IA 1986, the IR 2016 and by general law.

Liquidation is not a rescue mechanism and a liquidator has only very limited powers to carry on the business of a company**.** Liquidators will usually close a company’s business and dismiss employees very soon after their appointment and sell assets on a piece-meal basis rather than selling the assets and business as a going concern.

In a compulsory winding up (discussed later), there is a very limited statutory moratorium involving a bar on bringing or continuing legal proceedings against the company. For this reason, administration is usually preferable, at least initially, if sufficient funds are available to fund the administration. In particular, the ability of an administrator to maximise value for creditors by selling a business as a going concern is an important advantage of administrations over liquidations.

**Types of liquidation**

There are two **types of liquidation**:

· Compulsory

and

· Voluntary

Voluntary liquidations are further divided into:

Members' voluntary liquidations (which are solvent liquidations)

and

Creditors' voluntary liquidations (which are insolvent liquidations)

**Compulsory liquidation**

· Compulsory liquidation is a court-based process for placing a company into liquidation.

· To begin the process an applicant (called a ‘petitioner’) presents a winding up petition to the court under which the petitioner requests the court to make a winding up order against the company on one of a number of statutory grounds.

· The court issues the petition and fixes a date for the hearing of the petition. The petitioner then serves the petition on the company. There are restrictions on the directors' ability to take certain actions between the service of the winding up petition and the court hearing.

**The following can apply to the court for the issue of a winding up petition:**

1) a creditor;

2) the company (acting by the shareholders; this would happen where there are insufficient assets in the company to fund a voluntary liquidator);

3) the directors (by board resolution); again, this would happen where there are insufficient assets to fund a voluntary liquidator;

4) an administrator;

5) an administrative receiver;

6) the supervisor of a CVA; and

7) the Secretary of State for Business, Energy & Industrial Strategy (on public policy grounds).

Given the ability of a QFCH to appoint an administrator, where the QFC becomes enforceable, it is usually an unsecured creditor who will apply to the court for a winding up order.

A secured creditor which holds only fixed charges (and so is not a QFCH) will usually enforce against the assets subject to its fixed charges by appointing a fixed charge receiver and will not usually resort to issuing a winding up petition.

**Grounds of petition for liquidation**

The usual grounds are:

· the company’s inability to pay its debts (s.122(1)(f) of IA 1986); or

· the court being of the opinion that it is just and equitable that the company be wound up (s.122(1)(g) of IA 1986).

Technically, the just and equitable ground to wind up a company is not an insolvency situation.

**Demonstrating inability to pay debts**

There are a number of ways in which a company may be deemed to be unable to pay its debts for the purposes of a winding-up petition:

1) Failure by the company to comply with a creditor’s statutory demand. A statutory demand is a written demand in a prescribed form requiring the company to pay a specific debt. The statutory demand can only be used if the debt exceeds £750 and is not disputed on substantial grounds. The company has 21 days in which to pay the debt, failing which the creditor has the right to petition the court to wind up the company. This is the most common route basis for a winding-up petition.

2) The creditor obtains a judgment against the company and fails in an attempt to execute the judgment debt.

3) Proof to the satisfaction of the court that the company is unable to pay its debts as they fall due (the “**cash-flow test**”). The cash flow test is usually satisfied by going through the statutory demand process in 1 above but that is not essential.

4) Proof to the satisfaction of the court that the value of the company’s assets is less than the amount of its liabilities, taking into account contingent and prospective liabilities (the “**balance sheet test**” although case law shows this is not a pure accounting exercise).

**Voluntary liquidation**

**Creditors’ voluntary liquidation (‘CVL’) –** this is a form of insolvent liquidation commenced by resolution of the shareholders but under the effective control of the creditors who can choose the liquidator.

The procedure is for the shareholders to pass a special resolution to place the company into a CVL. The shareholders may also nominate a person to be liquidator, but in any event within 14 days after the special resolution has been passed, the directors of the company must ask the company’s creditors either to approve the nominated liquidator or to put forward their own choice of liquidator. Where the creditors’ choice of liquidator differs from that of the company’s shareholders, the creditors’ nomination will take precedence. The directors must also draw up a statement of the company’s affairs (setting out the company’s assets and liabilities) and send it to the company’s creditors.

**Effect of the pre-insolvency moratorium**

A company cannot be placed into any type of liquidation while a pre-insolvency moratorium subsists (unless approved by the directors) or if the company is in administration.

**Liquidator’s powers and duties**

The liquidator acts asagent of the company and has extensive statutory powers. Generally, the directors lose their powers upon the liquidator’s appointment. The liquidator’s powers include:

· To collect in and realise the company’s assets and to distribute them in the statutory order of priority.

· To make any compromise or arrangement with creditors.

· To bring in or defend any action or legal proceeding in the name of and on behalf of the company.

· To maximise the assets available for distribution to the company’s creditors by:

**- challenging voidable antecedent transactions** or bring a claim against one or more of the directors for wrongful or fraudulent trading. Liquidators (and administrators) also have the power to assign the right to wrongful and fraudulent claims as well as preference and transactions at an undervalue causes of action. This allows them to realise some money for the benefit of the estate without assuming the risk of litigating the claims; and

**- disclaiming onerous property** (**s.178**) e.g. onerous, unsaleable or unprofitable contracts. This is available equally in both solvent and insolvent liquidations. The most important example of onerous property is a lease of land. When notice of disclaimer is given by the liquidator, all rights, interests and liabilities of the company in respect of the property cease. A person who suffers any loss resulting from a disclaimer is entitled to prove in the liquidation as an unsecured creditor, or in certain circumstances, to apply to the court for an order to have disclaimed assets vested in him.

**Proceedings against the company**

After presentation of a petition and before a winding up order is made, the company, or any creditor or contributory, can apply to the court to request it to make a provisional order to stay any action or proceedings then current against the company.

The effect of a winding up order will be automatically to stay any action or proceedings against the company, unless the court otherwise determines.

**Members’ voluntary liquidation (‘MVL’) -** the MVL procedure can only be used if the company is solvent because a necessary part of its procedure is that the directors must make a statutory declaration of solvency. Under the declaration, they must state the company will be able to pay its debts in full within a period specified in the declaration (not exceeding 12 months from the commencement of the winding up) with the risk of criminal liability if a director makes a declaration without reasonable grounds.

The statutory declaration must attach a simplified form of balance sheet listing and giving values for the company’s assets and liabilities and showing that the assets exceed the liabilities.

The shareholders pass:

· a special resolution to place the company into an MVL; and

· an ordinary resolution appointing a liquidator.

Notice of intention to put a resolution for voluntary liquidation to the shareholders must be given in advance to any QFCH. The MVL will be converted into a creditors’ voluntary liquidation if the company becomes unable to pay its debts within the period (for all intents and purposes one year) specified in the statutory declaration.

**Summary**

· Administration is the main English law insolvency procedure. It must be conducted with a view to achieving one of the three statutory objectives. The most important is the second: to achieve a better result for creditors than would be achieved in a liquidation

· Fixed-charge receivership and administrative receivership are self-help security enforcement procedures rather than collective insolvency procedures.

· Liquidation is a procedure used to wind up the company. It involves the liquidator realising the company’s assets and distributing them to creditors by way of a dividend in accordance with the statutory order of priority.