**Order of priority**

This element examines the order of priority for payment of creditors of a company when it is wound-up.

**Order of priority in an insolvent liquidation or administration:**

1) Insolvency office holder's fees, costs and expenses incurred in preserving and realising assets subject to a fixed charge

2) Fixed charge creditors in respect of assets subject to a fixed charge

3) Other costs and expenses of liquidation/administration

4) Preferential debts (there are two tiers of preferential debts)

5) Prescribed part funds

6) Floating charge creditors

7) Unsecured creditors

8) Interest on unsecured (including preferential) debts

9) The shareholders

**Fixed charge creditors (in respect of assets subject to a fixed charge)**

· The proceeds of selling assets which are subject to a fixed charge (or mortgage) must first be used to pay the insolvency office-holder's costs, expenses and associated fees and expenses of realising those assets, then to pay off the debt secured by such charge (or mortgage). The term ‘expenses’ includes the professional fees of lawyers and other service providers engaged by the office holder.

· If the proceeds are not sufficient to discharge the debt in full, then the creditor must seek payment of the balance at an appropriate later point in the order of priority. This will depend on whether or not the same debt was also secured by a floating charge.

· The proceeds of selling the fixed charged assets will form the fixed charge fund. Only elements 1 and 2 in the statutory order of priority may be paid out of the fixed charge fund.

**Other costs and expenses of liquidation**

· This includes all other fees, costs and expenses of the administration/liquidation, including the costs of selling assets secured by a floating charge, debts arising out of contracts entered into by the liquidator or administrator or arising from litigation which the liquidator or administrator has brought.

**Preferential debts**

· For insolvencies occurring on or after 1 December 2020, there will be two tiers of preferential debts. The first tier (called ordinary preferential debts) must be paid in full before the second tier (called secondary preferential debts) can be paid. Ordinary preferential debts consist of mainly (i) employees for remuneration due in the four months before the ‘relevant date’ (generally the date of the commencement of the liquidation or administration) but subject to a maximum of £800 per employee, plus accrued holiday pay and (ii) certain contributions owing to an occupational pension scheme.

· The secondary preferential debts consist of debts due within certain prescribed periods to HM Revenue and Customs in respect of PAYE, employee national insurance contributions and VAT. These represent taxes which companies collect on behalf of HMRC from third parties (employees and customers).

**Prescribed part fund**

· The EA 2002 introduced the ‘prescribed part’ fund into the IA 1986 to increase the chance that unsecured creditors would get paid something in a liquidation or administration. The prescribed part fund is sometimes referred to as the “ring fenced” fund.

· The prescribed part fund is calculated by reference to a certain percentage (the ‘prescribed part’) of the company’s ‘net property.’ This is set aside (ring-fenced) for distribution to the company’s unsecured creditors; s.176A IA 1986. ‘Net property’ means the proceeds of selling property other than that which is subject to a fixed charge, after deduction of the liquidator’s fees, costs and expenses and any preferential debts (s. 176A (6) IA 1986).

· The amount of the company’s net property that will form the prescribed part fund is 50% of the first £10,000 and 20% thereafter up to a maximum fund of £600,000 for floating charges created before 6 April 2020 and £800,000 for floating charges created on or after that date. The ring-fencing provisions do not apply where the net property of the company is less than £10,000 as the cost of distributing the fund would be disproportionate to the benefit; see the Insolvency Act 1986 (Prescribed Part) Order 2003.

· The prescribed part fund is a pot of money set aside for distribution rateably among the unsecured creditors when they are paid. It should be noted that for this purpose, a floating charge holder who suffers a shortfall on floating charge realisations does not share in the prescribed part fund, although the shortfall does constitute an unsecured claim against the company.

**Floating charge creditors**

· After payment of the general expenses of the insolvency process, paying preferential debts and dealing with the prescribed part, the office holder then pays any remaining realisations from assets subject to floating charges to the floating charge holders themselves (according to the priority of their security if there is more than one floating charge holder).

· The proceeds of selling the company’s assets not subject to a fixed charge constitutes the floating charge fund. Elements 3 to 6 (other costs and expenses of liquidation, preferential debts, prescribed part fund and floating charge creditors) of the statutory order of priority will be paid out of the floating charge fund.

**Unsecured creditors**

For example:

· ordinary trade creditors who have not been paid;

· secured creditors to the extent that the security is invalid or assets subject to the security have not realised sufficient funds to pay off the secured debt; and

· employees’ outstanding remuneration to the extent that it does not rank preferentially.

All the unsecured creditors rank and abate equally. This is known as the ‘pari passu’ rule. For example, if a company has only two creditors (A and B) and creditor A has a claim against the company of 100 and creditor B has a claim against the company of 50 (making total claims of 150) but the assets available for distribution to the creditors are 75, creditor A will receive 50 and creditor B will receive 25. Note that secured creditors who have not been paid in full of the realisation of assets subject to their security can only claim for their shortfall as unsecured creditors against realisations from unsecured assets because they are not eligible to any payment from the prescribed part fund.

**Interest on unsecured (including preferential debts)**

Interest accruing on unsecured debts from the commencement of the winding up.

**Shareholders**

· The shareholders who participate in the equity of the company will rank last. However, their rights, as between themselves depend on the rights attributable to their particular class or classes of shares.

· These rights are set out in the company’s Articles of Association. For example, preferential shareholders may have preferential rights to a return of their capital on a winding up in priority to ordinary shareholders.

**Summary**

Assets are distributed by a liquidator/administrator in the statutory order of priority, being:

1) Insolvency office-holder’s fees, costs and expenses incurred in preserving and realising assets subject to a fixed charge;

2) Fixed charge creditors (in respect of assets subject to a fixed charge);

3) Other costs and expenses of the insolvency process;

4) Preferential debts;

5) Prescribed part fund;

6) Floating charge creditors;

7) Unsecured creditors;

8) Interest on unsecured (including preferential) debts; and

9) Shareholders.