Common issues in corporate recovery and insolvency in England and Wales

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1. ISSUES ARISING WHEN A COMPANY IS IN FINANCIAL DIFFICULTIES

1.1 How does a creditor take security over assets in England and Wales?

Under English law, there are four types of consensual security: the pledge; the contractual lien; the mortgage; and the charge.

Pledge
The pledge involves the creditor taking actual or constructive delivery or possession of the debtor’s assets as security until the loan is repaid. A creditor has a number of implied rights in respect of pledged assets, the most important of which is the right to sell the assets to meet a defaulted obligation. As the pledge depends on possession, only assets that can be “possessed” can be pledged. The consequence of this is that only goods and “documentary intangibles” are susceptible to the pledge. A documentary intangible is a document which entitles its holder to ownership of the asset which the document represents; a good example of this is a negotiable security, such as a bearer bond.

Contractual Lien
A lien is the right to retain possession of another person’s property until that other person performs a specific obligation. It is therefore similar to a pledge. However, the fundamental difference between the two is that goods subject to a lien are initially deposited with the creditor not for the purposes of security but for some other purpose (such as custody or repair).

Mortgage
A mortgage involves the transfer of ownership of an asset by way of security for a debt, on the condition that ownership will be transferred back to the debtor on discharge of the debt. A mortgage does not require the delivery of possession (unlike a pledge or lien) and therefore any kind of asset, tangible or intangible, is capable of being mortgaged.

Charge
A charge, in contrast to a mortgage, does not involve the transfer of ownership of an asset. It is simply the appropriation of an asset or class of assets to the satisfaction of a debt. A charge creates an encumbrance or “weight” which hangs on the asset and travels with it into the hands of all third parties (except for certain good faith purchasers). A charge can be either fixed or floating. Under a fixed charge an asset which is ascertained and definite (or capable of being ascertained and defined) is appropriated to the satisfaction of a debt immediately or upon the borrower acquiring an interest in it.

A floating charge, on the other hand, constitutes a deferred “appropriation” in respect of a class of assets, including future assets, where the assets constituting the class would by their nature be changing from time to time and where, until an event occurs which causes the floating charge to crystallise, the borrower is free to dispose of and add to the assets comprised in the class in the ordinary course of business. A good example of such a class would be the inventory of a retailer. When the floating charge crystallises, it fastens on the assets then comprised in the class, effectively becoming a fixed charge. The borrower is then unable to deal in the assets comprised in the class.
1.2 In what circumstances might transactions entered into whilst the company is in financial difficulties be vulnerable to attack?

If a company enters into certain types of transaction within specified periods before its insolvency, it is possible that the liquidator or administrator (see section 2.3) may be able to challenge them.

**Transactions at an Undervalue**

A transaction is at an undervalue if a company makes a gift to a person or enters into a transaction on terms where the company receives no consideration or one which has a value which is significantly less than the value of the consideration provided by the company. One defence is that the transaction is entered into in good faith for the purpose of carrying on the company's business and that there are reasonable grounds for believing that it will benefit the company.

To be vulnerable, a transaction at an undervalue must have been entered into during the period of two years before the commencement of winding up or the commencement of administration and the company must have been insolvent on a cash flow or balance sheet test (see section 2.2) at the time it entered into the transaction or became insolvent by entering into it. There is a presumption of insolvency if the parties to the transaction are connected, for instance if it is an intra-group transaction or a transaction with a director.

**Transactions Defrauding Creditors**

The same undervalue definition applies in respect of transactions defrauding creditors, although there is no time limit between the transaction being effected and the onset of insolvency for the transaction to be attacked. However, the transaction must have been entered into for the purpose of putting the assets beyond the reach of a claimant or of otherwise prejudicing the interests of the claimant.

**Preferences**

A preference is given if the company does anything or allows anything to be done which has the effect of putting that person in a position which, if the company were to go into insolvent liquidation, would be better than the position he would have been in if the thing had not been done. The repayment of an unsecured debt by a customer to its bank could fall within this wide definition. The company must have been influenced in deciding to give the preference by a desire to produce the preferential effect, in order for the transaction to be vulnerable. There is a presumption of such influence if the parties are connected.

The period before the commencement of the winding up or the appointment of an administrator during which such transactions must have been entered into for them to be vulnerable is six months for a preference to a non-connected person and two years to a connected person. Further, for the transaction to be vulnerable, the company must have been insolvent on a cash flow or balance sheet test at the time of the transaction or as a result of entering into the transaction. If a transaction is established as being at an undervalue or a preference, the court has very wide powers to put the parties back into the position they were in before the transaction was entered into.

**Floating Charges**

A floating charge may be invalid if it is created within two years of the commencement of the winding up or the appointment of an administrator if the parties are connected or one year if they are not. There is a defence that the company was solvent when the charge was created (on a balance sheet and cash flow test) and did not become insolvent as a consequence of the transaction, but this solvency test will not apply if the parties are connected. The charge will, however, be valid to the extent of the value of so much of the consideration for the charge as consists of money paid or goods or services supplied to the company at the same time as or after and in consideration of the creation of the charge, together with interest, if any, payable under the relevant agreement.

1.3 What are the liabilities of directors (in particular civil, criminal or disqualification) for continuing to trade whilst a company is in financial difficulties in England and Wales?

Whilst a company is trading solvently, the Companies Act 2006 provides that the primary duty of the directors is to act in a way that they consider, in good faith, would
be most likely to promote the success of the company for the benefit of its members as a whole.

However, this duty is subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or act in the interests of creditors of the company. Whilst a company is clearly solvent there is no duty to consider creditors’ interests. However, when a company is insolvent, directors must consider creditors’ interests before those of shareholders.

Between these two points there is a grey area, and it is unclear precisely at what point, and to what extent, the directors’ duty to promote the success of the company for the benefit of its members is displaced by a duty to act in the interests of creditors.

Numerous duties are placed upon directors in these situations. A breach of these duties can lead to personal liability and possible disqualification from being able to act as a director or being involved in the management of the company for a specified period.

Common Law and Statutory Duties
Under common law, a director has a duty to act in the interests of creditors when a company is insolvent or of doubtful solvency, with a view to minimising the loss to the creditors of the company.

Under the Insolvency Act 1986, if in the course of a winding up anyone who has been involved with the promotion, formation or management of the company is found to have misapplied, retained or become accountable for any money or other property of the company, or been guilty of misfeasance or breach of a fiduciary or other duty in relation to the company, a court may on an application by the official receiver, liquidator or a creditor compel him to:

- repay, restore or account for the money or property of the company with interest; or
- contribute such sum to the company's assets by way of compensation in respect of the misfeasance or breach of fiduciary duty or other duty as the court thinks just.

Breaches of duty which could be relevant here would include a director’s involvement in the company

granting a preference or entering into a transaction at an undervalue (see section 1.2).

Fraudulent Trading
A court, on application by a liquidator in a winding up, can order that any person who was knowingly a party to carrying on the business of a company with intent to defraud creditors or any other person, or for any fraudulent purpose, be liable to make such contribution (if any) to the company’s assets as the court thinks proper. Liability may attach to persons who are not directors of the company but have been involved in the fraud, for example a company which assisted the insolvent company in perpetrating the fraud.

Fraudulent trading is also a criminal offence carrying with it the threat of a fine, imprisonment or both. Such an offence may apply whether or not the company has been, or is in the course of being, wound up. Fraudulent trading can arise when directors of a company allow it to incur credit when they know there is no good reason for thinking that funds will be available to repay the relevant debt when it becomes due or shortly thereafter.

Wrongful Trading
A court, on application by a liquidator in a winding up, can order that a director of a company which has gone into insolvent liquidation is liable to make such contribution (if any) to the company’s assets as the court thinks proper if:

- before the commencement of the winding up, the director knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation; and
- thereafter the director failed to take every step with a view to minimising the potential loss to the company’s creditors which he ought to have taken.

The standard required as to what a director ought to know, the conclusions he ought to reach and the steps he ought to take is the standard of what would be known, reached or taken by a reasonably diligent person with the general knowledge, skill and experience that may reasonably be expected of
a person carrying out the same functions as those of the director in relation to the company and with the general knowledge, skill and experience that the director has.

**Disqualification**

Apart from personal liability, where a director engages in fraudulent or wrongful trading or has been found guilty of other misconduct in connection with a company and is held to be unfit by the court, he may be disqualified by court order for a period of between two and fifteen years from acting as a director or from having any involvement in the promotion, formation or management of any company.

### 2. FORMAL PROCEDURES

#### 2.1 What are the main types of formal procedures available for companies in financial difficulties in England and Wales?

When a company is in financial difficulties there are five formal procedures which may apply:

- a) a company voluntary arrangement ("CVA") may be entered into between the company and its creditors;
- b) a scheme of arrangement may be effected;
- c) an administrator may be appointed;
- d) an administrative receiver or receiver may be appointed; or
- e) the company may go into liquidation (otherwise known as winding up). There are two types of liquidation: compulsory and voluntary. A compulsory liquidation is a court-based procedure and applies to insolvent companies. A voluntary liquidation can either be a members' voluntary liquidation ("MVL"), which applies to solvent companies, or a creditors' voluntary liquidation ("CVL"), which applies to insolvent companies.

In general terms voluntary arrangements and schemes of arrangement are restructuring tools which may be used in a reorganisation or rescheduling of debt. Receivership and liquidation, in contrast, are likely to signal an acknowledgement that the company itself has no future and all that can be sought is the maximisation of the proceeds of the sale of the company's assets or business. This may enable a purchaser to acquire at least part of its business as a going concern, thereby preserving the underlying business and employment. In contrast to receivership and liquidation, the first purpose of the administration regime is to act as a rescue mechanism in respect of those companies which are capable of rescue.

#### 2.2 What are the tests for insolvency in England and Wales?

English law does not use "insolvency" as a defined term. The relevant test is "inability to pay debts". Therefore, for the purposes of English law, a company is insolvent if it is unable to pay its debts. English law does not have a single definition of inability to pay debts. The two principal tests are known as the 'cash flow' and the 'balance sheet' tests. The cash flow test applies if a company is unable to pay its debts as they fall due. The balance sheet test is satisfied if the value of the company's assets is less than the amount of its liabilities, taking into account its prospective and contingent liabilities.

#### 2.3 On what grounds can the company be placed into each procedure?

**Company Voluntary Arrangement / Scheme of Arrangement**

There are no formal requirements that a company has to satisfy in order to be placed into either of these procedures. There is therefore no requirement that the company in question is unable to pay its debts before it can utilise either procedure.

**Administration**

A holder of a qualifying floating charge (which is defined as being a floating charge over the whole or substantially the whole of the company's property) is able to appoint an administrator either in or out of court (see below) at any time when an event has occurred which would allow him to enforce his charge (this will typically be some default under the
loan agreement). This right of appointment may well arise when the company is not insolvent. In all other circumstances in which an administrator is appointed, it will be necessary to show that the company is or is likely to become unable to pay its debts.

**Administrative Receivership / Receivership**
An administrative receiver is a manager of the whole or substantially the whole of the debtor’s assets which have been secured by a debenture creating fixed and floating charges. He will be appointed by the debenture-holder, on the default of the debtor, primarily to take control of and dispose of sufficient of the assets to cover payment of the amounts due under the debenture. His role is to be distinguished from that of a receiver of particular assets, appointed by a secured creditor under a fixed charge. Such a receiver has limited powers in respect of the property over which he is appointed and pays the proceeds of the property to the holder of the fixed charge.

The Enterprise Act 2002 introduced a prohibition on the appointment of an administrative receiver except in limited circumstances. Thus, where a charge is entered into on or after 15 September 2003 it will only be possible to appoint an administrative receiver where the company granting the charge falls into an exception to the prohibition. The exceptions include capital markets transactions (such as securitisations), companies which trade on the financial markets and companies involved in public-private partnership and utilities projects. Floating charges entered into before 15 September 2003 are not subject to the prohibition.

**Liquidation**

**Compulsory Liquidation**
A compulsory winding up order is made by the court. The grounds on which a court can make a winding up order include the company being unable to pay its debts and where the court believes it is just and equitable that the company be wound up. For the purposes of liquidation, the company is unable to pay its debts if it fails either of the cash flow or the balance sheet tests. In addition, a company is deemed to be unable to pay its debts if: (a) a creditor who is owed over £750 has served the company with a written demand for payment and the company has for three weeks either not paid the sum, not secured the sum, or not compounded the sum to the reasonable satisfaction of the creditor; or (b) if an order of the court requiring the company to pay a certain sum to a creditor is not satisfied.

**Voluntary Liquidation**
There are two types of voluntary winding up: a “members’ winding up” and a “creditors’ winding up”. A members’ voluntary winding up is a solvent liquidation which is under the control of the company’s shareholders (also known as its members), and is only possible where the directors are able to make a declaration that all the liabilities of the company will be met within a period not exceeding twelve months. If the directors cannot make this declaration, then it will be a creditors’ winding up and control of the liquidation will pass to the creditors.

2.4 Please describe briefly how the company is placed into each procedure.

**Company Voluntary Arrangement**
The directors (or, if the company is in administration or liquidation, the administrator or liquidator) may propose to the shareholders and unsecured creditors a composition in satisfaction of the company’s debts or a scheme of arrangement of its affairs. A person authorised to act as the “nominee”, currently a licensed insolvency practitioner (a professional with insolvency experience, normally an accountant), reports to the court as to whether, in his opinion, the proposal should be put to shareholders and creditors. If he believes the proposal should be put, meetings of shareholders and creditors are called to approve the proposal. Approval requires a simple majority at the shareholders’ meeting and a majority of three-quarters or more (by value) at the creditors’ meeting (subject to the exclusion of secured creditors and certain other limitations concerning, for example, creditors who are connected with the company). A proposal, once approved, may be challenged on the grounds that there was some material irregularity in connection with the holding of the meetings, or that it unfairly prejudices the interests of any creditor.

**Scheme of Arrangement**
A company (or an administrator or liquidator) or any creditor or shareholder of a company may
petition the court to summon a meeting of creditors or shareholders to agree to a compromise or arrangement between the company and its creditors or shareholders. If a simple majority in number of those voting and a three-quarters majority in value is obtained at any meeting, and if the court sanctions the compromise or arrangement, then it will be binding on the company and the creditors or the shareholders. To secure approval of a scheme, each separate class of creditors must vote in favour.

**Administration**
An administrator may be appointed either by application to the court or by filing papers with the court documenting an out of court appointment. An out of court appointment may be made by a qualifying floating charge holder ("QFC holder"), the company or its directors. An application to court to appoint an administrator may be made by the company, its directors or any creditor. The grounds upon which a company can be placed in administration are described in section 2.3 above. In all cases, an insolvency practitioner’s opinion that the purpose of the administration is capable of being achieved must be provided. All administrations share the same purpose which is set out as a cascade of objectives. The first objective is the rescue of the company as a going concern. Only if this is not reasonably practicable or there would be a better result for the creditors as a whole does the second objective apply. The second objective is to achieve a better result for the creditors as a whole than would be likely if the company were wound up without first being in administration. Only if the second objective is not reasonably practicable does the third objective of realising the company’s property for the benefit of one or more secured or preferential creditors apply.

Where an administrative receiver is in office, the appointment of an administrator must be made by an application to the court. The court will only make an appointment where the appointor of the administrative receiver consents or where the court thinks that the security under which the administrative receiver was appointed is liable to be released or discharged as a preference or a transaction at an undervalue or that the floating charge is voidable for want of new consideration at the time of its creation.

Where a secured creditor retains the right to appoint an administrative receiver he may use this right to block the appointment of an administrator by appointing an administrative receiver prior to the appointment of an administrator. A person appointing an administrator must give notice to any person who may be entitled to appoint an administrative receiver or administrator as the holder of a qualifying floating charge. During the notice period, a secured creditor who retains the right to appoint an administrative receiver may do so or may instead substitute his choice of insolvency practitioner as administrator. A QFC holder who does not have the power to appoint an administrative receiver may substitute his choice of insolvency practitioner as administrator even though he cannot block the appointment of an administrator.

**Administrative Receiver**
There is no formal appointment procedure for an administrative receiver. When the grounds upon which an administrative receiver may be appointed arise, the secured creditor may elect to make an appointment. The administrative receiver must accept the appointment either orally or in writing.

**Liquidation**

**Compulsory Liquidation**
A company enters compulsory liquidation through an order made by the court. Proceedings are started by a petition that may be presented by a creditor, the company, the directors or any contributory. Receivers and administrators are also able to present petitions. If the court is satisfied that the grounds are satisfied, then it will make a winding up order. The Official Receiver (a civil servant in the Insolvency Service) then automatically assumes the role of the liquidator until another liquidator is appointed.

**Voluntary Liquidation**
A voluntary liquidation (whether creditors’ or members’) is initiated by the company’s members passing a resolution (requiring a three-quarters majority vote) which must either state that they are in favour of a voluntary liquidation (in the case of a members’ voluntary liquidation), or that the company cannot, by reason of its liabilities, continue its business and that it is advisable to wind it up (in the case of a creditors’ voluntary liquidation). The voluntary
liquidation commences on the date the resolution is passed. In a members’ voluntary liquidation, the shareholders appoint the liquidator, while in a creditors’ voluntary liquidation, the creditors appoint him. If, during the course of a members’ voluntary winding up, the liquidator forms the opinion that the company will be unable to pay its debts in full, together with any interest, the liquidation will be converted from a members’ voluntary winding up to a creditors’ voluntary winding up.

2.5 What notifications, meetings and publications are required after the company has been placed into each procedure?

Company Voluntary Arrangement
The chairman must prepare a report of the creditors’ meeting for the court, which must be filed within four business days of the meeting being held. Notice of the result of the meeting must be given to the creditors immediately after the report is filed in court. Notice must also be sent to the registrar of companies (a governmental body controlling the incorporation and administration of companies operating in England and Wales which maintains a register of companies available for public inspection), but only if the decision was to approve the voluntary arrangement. Thereafter the supervisor must circulate annual reports setting out the progress made and prospects for the successful implementation of the CVA. The reports must be sent to all creditors bound by the CVA, the company itself, the registrar of companies, and the auditors (unless the company is in liquidation) and the members.

Scheme of Arrangement
Once the court order is made approving the scheme, it is drawn up and an original, together with an official copy, is obtained by the company. The official copy is then delivered to the registrar of companies for registration and it is that filing process which makes the scheme effective and binding.

Administration
As soon as reasonably practicable after his appointment, the administrator must notify the company and all of its creditors of his appointment. The appointment must also be advertised in the London Gazette (which is the official newspaper of record in England and Wales) and in such other ways as the administrator sees fit. The administrator must also send a notice of his appointment to the registrar of companies. Following the appointment of the administrator, the directors are required to provide him with a statement of the company’s affairs, enabling him to assess the current position of the company and formulate his proposals for the company. The administrator must send a statement of his proposals to all creditors and members of the company within eight weeks of his appointment, and also file a copy of the proposals with the registrar of companies. An invitation to an initial creditors’ meeting, to be held as soon as reasonably practicable, will be included with the copy of the administrator’s proposals sent to each creditor. At the initial creditors’ meeting, the administrator presents his proposals to the creditors. The creditors can accept the proposals, with or without modifications, by way of a majority vote (by value) of claims. If they reject the proposals, the administrator must report to court and seek directions. Further creditors’ meetings are required if the administrator revises his proposals or if one tenth of the creditors (in value) demand it. Otherwise, the administrator will implement the approved proposals. The administrator must send six monthly progress reports to the creditors and the registrar of companies, the initial six month period commencing on the date the company entered administration.

Administrative Receivership
On appointment, the administrative receiver must send notice of his appointment to the company immediately and to all known creditors within 28 days. The notice must be advertised in the London Gazette and in such other ways as the administrative receiver sees fit. Every invoice, order for goods or business letter issued by the company must contain a statement that a receiver has been appointed. Following the appointment of the administrative receiver, the directors (together with any others involved in the company if required by the administrative receiver) must prepare a statement of affairs of the company for the administrative receiver. Within three months of his appointment the administrative receiver is required to send a report to the registrar of companies and to creditors, together with a summary of the directors’ statement and his comments on it. The administrative
receiver must then call a meeting of the unsecured creditors to consider his report.

**Liquidation**

**Compulsory Liquidation**

In a compulsory liquidation, the Official Receiver is required to advertise the liquidation in the London Gazette and in such other ways as he sees fit. The company must notify the registrar of companies. From this point on, it is a requirement that all company papers state that the company is in liquidation. Within twelve weeks of the winding up order being made, the Official Receiver must decide whether to call meetings of the creditors and contributories to appoint a licensed insolvency practitioner to act as liquidator. If he decides not to call meetings, he must give notice of his decision before the end of the twelve week period to the court and the company’s creditors and contributories. If he decides that meetings should be called, they must be held not more than four months from the date of the winding up order, and 14 days’ notice must be given to all creditors and contributories. In addition, he must call a meeting if requested at any time by one tenth in value of the company’s creditors.

**Members’ Voluntary Liquidation**

The directors’ statutory declaration of solvency and the special resolution to wind up the company must be filed with the registrar of companies within 15 days of the resolution being passed. In addition, within 14 days of passing a resolution for voluntary liquidation, the liquidator must publish a notice of his appointment in the London Gazette and advertise the liquidation in such other ways as he sees fit. He must also file notice of his appointment with the registrar of companies.

The liquidator must send annual progress reports to members and the registrar of companies, starting on the date that he was appointed. A final report must be laid before the final meeting of creditors.

A final meeting of the members is held prior to dissolution (at which point the company’s formal existence is terminated). This meeting is called by advertisement in the London Gazette on one month’s notice. The liquidator will lay before the meeting an account of how the liquidation was conducted. Within one week of this final meeting, the liquidator is required to send a copy of this account to the registrar of companies, and must file a final return with the registrar of companies with respect to the holding of the final meeting and its date.

**Creditors’ Voluntary Liquidation**

The requirements for giving notice of and advertising the liquidator’s appointment are the same as those for a members’ voluntary liquidation. A meeting of the creditors must be held within 14 days of the general meeting passing the resolution to wind up the company. At least seven days’ notice of the creditors’ meeting must be given to the creditors by post, and a notice advertising the creditors’ meeting must be placed in the London Gazette and at least two local newspapers. Before the meeting is held, creditors are entitled to inspect a list of names and addresses of the company’s creditors. The directors must produce a full statement of the company’s affairs, which has to be presented at the creditors’ meeting. The statement should include details of the company’s assets, debts and liabilities, the names and addresses of the company’s creditors and details of the security held by them. Details of the appointment, the shareholders’ resolution putting the company into liquidation and the statement of affairs must be filed with the registrar of companies. The shareholders’ resolution must also be published in the London Gazette. As for compulsory liquidation, the liquidator must send annual progress reports to members, creditors, and the registrar of companies, the initial annual period commencing on the day he was appointed. The final meeting of creditors in a creditors’ voluntary liquidation follows the same requirements and procedures as that for a members’ voluntary liquidation.

### 3. Creditors

#### 3.1 Are unsecured creditors free to enforce their rights in each procedure?

**Company Voluntary Arrangement**

If a CVA is approved, it binds all creditors who would have been entitled to vote, whether or not they had notice of the creditors’ meeting. The arrangement
can be challenged, however, if it unfairly prejudices the interests of a creditor or shareholder of the company or there has been a material irregularity at or in relation to the meetings. Since January 2003, there has been provision for an optional moratorium on legal processes for small companies, including the enforcement of security, of between one and three months for an eligible company contemplating a voluntary arrangement. Eligibility for the moratorium is principally determined by reference to the definition of a small company under the Companies Act 2006. A company will fall within the definition of a small company if it satisfies two or more of the following requirements in the year ending with the date it files for the CVA moratorium or in the last financial year of the company ending before that date:

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Limit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Turnover</td>
<td>Not more than £6.5 million</td>
</tr>
<tr>
<td>Balance Sheet Total</td>
<td>Not more than £3.26 million</td>
</tr>
<tr>
<td>Number of Employees</td>
<td>Not more than 50</td>
</tr>
</tbody>
</table>

A special purpose vehicle in a securitisation or other financial structure may fall within the definition of small company. However, the statute contains exclusions from eligibility for companies involved in certain financial transactions.

**Scheme of Arrangement**

If a scheme of arrangement is sanctioned by the court, it may alter the rights of shareholders and creditors of the company, even where certain shareholders and creditors have not themselves voted in favour. The voting procedure requires each ‘class’ of creditors to be given a separate vote. If any one class of creditors fails to vote in favour of the scheme, then the scheme will fail. However, as there is no moratorium available with this procedure, there is nothing to prevent creditors taking enforcement action against the company up until the point at which the scheme is sanctioned.

**Administration**

Once an application to court to appoint an administrator has been lodged or notice of intention to make an appointment out of court has been given an interim moratorium automatically arises, the purpose of which is to protect the company and its assets from creditor action in the short period until an administrator is appointed. During that period, no steps may be taken to enforce security or repossess goods held under leasing, hire purchase, conditional sale or retention of title agreements, no landlord may exercise a right of forfeiture in relation to premises let to the company and no legal process may be commenced or continued without the consent of the administrator or the leave of the court. However, a QFC holder may appoint an out of court administrator or an administrative receiver and a petition to wind up the company may still be presented. If an administrator is appointed, the moratorium will continue unless the administrator or the court agrees otherwise.

**Administrative Receivership**

The appointment of an administrative receiver does not create an automatic moratorium. The creditors may therefore begin or continue legal actions against the company, including petitioning for its liquidation, whilst the company is in administrative receivership. An important consequence of this is that landlords may be able to exercise their right to forfeit the lease of the company’s premises.

**Liquidation**

The main function of a liquidator is to collect in and distribute the assets of the company amongst the company’s creditors in accordance with a strict hierarchy of priorities (see section 5.2). Unsecured creditors occupy the lowest position in the hierarchy, ranking only above the shareholders of the company. They have no freedom to enforce their rights under a liquidation although they are entitled to repossess assets (such as goods subject to a retention of title clause) which are not actually owned by the company.

3.2 Can secured creditors enforce their security in each procedure?

See section 3.1 for details on rights of enforcement in relation to schemes of arrangement, administration and administrative receivership.
**Company Voluntary Arrangement**

An important limitation on the CVA mechanism is that a CVA may not affect the rights of secured creditors of the company to enforce their security, except with their consent.

**Liquidation**

In a liquidation, secured creditors have several options in respect of their security. The first option is to enforce their security. If the value of the security exceeds the value of the debt which they are owed, they will make a full recovery and the balance will form part of the assets of the company to be distributed by the liquidator. If the value of the security is less than the value of the debt, then the secured creditor will recover the value of the security and will rank as an unsecured creditor for the balance of the sum owed to him. The second option is for the secured creditor to value his security and allow the liquidator to realise it for him. The final option is for the secured creditor to surrender his security for the general benefit of the creditors and to rank as an unsecured creditor in respect of the debt owed to him.

**3.3 Can creditors set off sums owed by them to the company against amounts owed by the company to them in each procedure?**

Insolvency law makes no special provisions for the application of set-off in administrative receiverships, company voluntary arrangements and schemes of arrangement.

**Liquidation**

Under the Insolvency Rules 1986, mandatory set-off applies in circumstances in which, before a company goes into liquidation, there have been mutual credits, mutual debts or other mutual dealings between the company and any creditor of the company proving or claiming to prove for a debt in the liquidation. In such circumstances, the sums due from one party are set off against the sums due from the other party. Only the balance, if any, is provable in the liquidation or, as the case may be, payable to the liquidator. However, sums due from the company to another party shall not be included in the account if that party had notice at the time that they became due that: (i) a meeting of creditors had been summoned; (ii) a petition for the winding up of the company was pending; (iii) an application for an administration order was pending; or (iv) any person had given notice of intention to appoint an administrator. In this context, a sum is “due” if it is payable at present or in the future, the obligation by which it is payable is certain or contingent or its amount is fixed or liquidated (or is capable of being ascertained by fixed rules or as a matter of opinion).

**Administration**

Set-off will only apply in an administration if the administrator has given notice that he intends to make a distribution to creditors. Prior to the giving of such notice by the administrator, normal rights of set-off can still be exercised. Once notice of intention to distribute has been given by the administrator, an account must be taken of what is due from each party to the other in respect of their mutual dealings, and the sums due from one party must be set off against the sums due from the other on a similar basis to that of a liquidation. This does not affect debts that have already been validly set off before the notice was given.

4. **CONTINUING THE BUSINESS**

4.1 Who controls the company in each procedure? In particular, please describe briefly the effect of the procedures on directors and shareholders.

**Company Voluntary Arrangement**

If a proposal for a CVA is approved, it is normally implemented under the supervision of the nominee, who then becomes known as the “supervisor”. The nature of his role will depend on the terms of the CVA. Following approval of the arrangement, the directors of the company will retain their positions but are obliged to do everything possible to put the relevant assets of the company into the hands of the supervisor. The rights of shareholders under the approved arrangement will not be affected by the CVA unless it involves some alteration of their rights, for example in a debt-for-equity swap.

**Scheme of Arrangement**

A defining feature of a scheme of arrangement is the fact that the incumbent management remains
in control of the company and no reliance is placed upon an independent insolvency practitioner. Consequently, the directors of the company retain their positions. A scheme of arrangement does not necessarily affect the rights of shareholders. It will only do so to the extent that their rights are modified by the scheme itself.

**Administration**

Upon appointment, the administrator manages the affairs, business and property of the company as its agent. The directors continue to hold office but cannot exercise any management powers without the administrator’s consent. The power of the shareholders to control the company ceases. The administrator is endowed with wide-ranging powers. These have the effect of allowing him to take control of the company’s assets, prepare proposals for the approval of the creditors, and to then carry out those proposals.

**Administrative Receivership**

An administrative receiver is appointed to manage the whole (or substantially the whole) of the company’s property. Accordingly, the company is under his control and his appointment leads to the suspension of the directors’ powers of management. His primary duty is owed to the secured lender who appointed him to seek repayment of the secured debt. The powers and rights of the company’s shareholders are generally also suspended.

**Liquidation**

On a winding up, the liquidator has wide-ranging powers which allow him to collect in and distribute the assets of the company. His appointment, whether on a compulsory or voluntary liquidation, leads to the termination of the powers of the directors. The rights of the shareholders, for all intents and purposes, also lapse.

4.2 How does the company finance these procedures?

A full review of the ways in which the procedures are financed is outside the scope of a general introduction. In general, to the extent officeholders require further funding they will typically look to the company’s existing lenders to provide it.

4.3 What is the effect of each procedure on employees?

**Company Voluntary Arrangement / Scheme of Arrangement**

When a CVA is approved, or a scheme of arrangement is sanctioned, there is no direct impact upon the employees of the company. It may well be that the consequence of the implementation of an arrangement may have an effect upon the company’s employees; however, this effect would be a consequence of the terms of the arrangement itself.

**Administration**

Since the main function of an administrator is to rescue the company as a going concern, there is no automatic termination of employment contracts on appointment. Administrators do, though, have the power to dismiss employees if their employment contracts are inconsistent with the administrator running the business. If employees are dismissed, this may give rise to an employment claim against the company.

The onset of administration does not therefore necessarily affect employees, unless their contracts are terminated or where the business of the company is sold. In the latter case, the operation of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (“TUPE”) may apply to protect the position of the employees. It should be noted that the interpretation of TUPE is not straightforward, and some difficult issues in relation to its precise scope remain to be resolved.

Administrators are not personally responsible for liabilities arising under employment contracts. However, if employment contracts of existing employees have been “adopted” by the administrator, then certain liabilities (principally salary – including holiday pay, sick pay and pension contributions) which arise under such contracts during the administration are payable in priority to payment of the administrator’s fees and expenses and any floating charge security.

An administrator will have adopted a contract of employment if he continues to employ staff and pay
them in accordance with their previous contracts for 14 days after his appointment.

If the administrator sells the business of the company, then TUPE may apply. If TUPE does apply, then the most important effect of this is that the purchaser of the business must take on the employees of the business on the same terms as they were previously employed; however, certain changes can be made to the contracts of employment of the affected employees if those changes are made with the intention of safeguarding employment by ensuring the survival of the business. These variations must be agreed with an employee representative.

**Administrative Receivership**
The position of employees in an administrative receivership is generally the same as for an administration.

**Liquidation**
On a compulsory liquidation the service contracts of employees are automatically terminated, and employment claims may arise against the company as a result.

The commencement of a voluntary liquidation, in contrast, does not automatically terminate the service contracts of employees. It may therefore be open to the liquidator to carry on the business of the company until he can sell some or all of its undertaking. If this does occur, then TUPE may apply, although the effects of its application might differ from those on an administration.

4.4 What effect does the commencement of any procedure have on contracts with the company and can the company terminate contracts during each procedure?

**Company Voluntary Arrangement / Scheme of Arrangement**
The effects of a CVA or a scheme of arrangement depend entirely upon its terms. The default position is that neither procedure automatically interferes with the contracts of the company.

**Administration**
Entering into administration does not have any automatic effect on company contracts, which continue in effect. The administrator is given no power (unlike a liquidator) to disclaim "onerous" contracts.

The administration moratorium does not prevent counterparties cancelling contracts with the company. It is a typical term of many contracts that the contract in question may be terminated upon the company entering into an insolvency procedure, such as administration. The administrator therefore may need to negotiate with the key suppliers and customers of the company if he wishes to enable the company to continue trading. There is, however, a critical exception to the general principle: the moratorium prevents landlords from forfeiting company leases.

**Administrative Receivership**
The treatment of company contracts during an administrative receivership is broadly similar to their treatment under an administration. The position is thus that the appointment of an administrative receiver does not terminate or affect company contracts unless provided for in the contract itself.

**Liquidation**
The onset of liquidation does not automatically terminate company contracts (although liquidation may be a ground for termination under the terms of certain contracts). However, unlike in administration and administrative receivership, the liquidator is given the power to unilaterally terminate onerous contracts in order to facilitate the winding up of the affairs of the company. This power is known as the right to disclaim onerous property.

If the disclaimer is available, the effect of it is to terminate the contract as at the date of the disclaimer, so that the respective rights and obligations of the company and its counterparty are fixed as at that date. The disclaimer therefore allows the company to avoid incurring future liabilities. However, it has no effect on liabilities that have already accrued. If the counterparty suffers loss as a result of a disclaimer, it may claim for such loss in the winding up. This loss will be calculated under the normal principles used to assess loss for breach of contract.
5. CLAIMS

5.1 Broadly, how do creditors claim amounts owed to them in each procedure?

Company Voluntary Arrangement / Scheme of Arrangement

The operation of these procedures depends upon their actual terms. Accordingly, the mechanism by which creditors seek payment of sums owed to them will vary according to the terms of each arrangement.

Administration

The Enterprise Act 2002 introduced provisions giving an administrator power to make distributions. He may distribute to secured and preferential creditors subject to the normal rules of priority and may make a distribution to unsecured creditors with court sanction. Before receiving a distribution the creditor must submit a statement of claim to the administrator to "prove" for his debt. The process for proving is similar to that described for liquidation below. An administrator also has a general power to make payments to unsecured creditors where such payments are necessary or incidental to the performance of his functions. This means that an unsecured creditor whose supplies are essential to the administration may be able to press for payment of pre-administration debts as a condition of further supply.

Administrative Receivership

The principal duty of the administrative receiver is to secure the repayment of the debt owed by the company to the secured creditor who appointed him. This is combined with a limited duty of care to the company, together with a statutory duty to preferential creditors (see section 5.2). The receiver does not owe a separate duty to the general body of unsecured creditors. There is no method by which creditors, other than the secured creditor who made the appointment, can claim amounts owed to them in an administrative receivership. If the general body of creditors are to be paid, then it will not be through administrative receivership. Their claims will either be met by the company itself, if the company emerges from receivership with a viable business after the receiver has repaid the appointing secured creditor, or (and more likely) in a liquidation.

Liquidation

A creditor wishing to claim in a liquidation must "prove" his debt. To do so, the creditor must submit a formal claim to the liquidator, which is known as a proof of debt. The liquidator is obliged to send forms of proof to every creditor of the company who is known to him. Creditors are entitled to submit proofs in respect of any type of claim, whether it is present or future, certain or contingent, liquidated or unascertained. The liquidator must then examine every proof he receives, and either admit it, reject it (giving his reasons in writing to the person concerned), or request further information. As regards debts that are contingent or of an uncertain value, the liquidator should estimate a value, which may subsequently be revised as further information comes to light. If a creditor is unhappy with a liquidator’s decision he may apply to court for a review of the decision. It is only claims which have been proved that may form part of any payment (which is technically known as a “dividend”) made by the liquidator.

5.2 What is the ranking of claims in each procedure?  
In particular, do any specific types of claim have preferential status?

Company Voluntary Arrangement / Scheme of Arrangement

Where a distribution is made pursuant to a CVA or a scheme of arrangement, the terms on which it will be made will be governed by the arrangement itself, which the creditors will have voted on and approved by the requisite majorities. Accordingly, there is no general rule which applies to the ranking of claims in these procedures. It is important to note that a CVA cannot affect the rights of preferential creditors or of secured creditors without their consent.

Administration

On an administration, the order of priorities is broadly as follows:

a) the administrator’s costs and expenses of realising fixed charge assets;

b) fixed charge holders (to the extent of their security);
c) the obligations incurred under "new" contracts and the pay of employees whose contracts have been adopted;

d) the general expenses and costs of administration;

e) preferential creditors (preferential debts now relate almost exclusively to employees' rights, including accrued pay and pension rights);

f) floating charge holders (subject to the "prescribed part provision", which is explained in more detail below);

g) unsecured creditors; and

h) shareholders.

The prescribed part provision was introduced by the Enterprise Act 2002, and was intended to ensure a fairer distribution of the assets of an insolvent company for the benefit of its unsecured creditors. Under the old regime, floating charge holders were paid in full before any sums were payable to the unsecured creditors. Now, the administrator is obliged to set aside a certain amount of money from the "net property" of the company to pay unsecured creditors. Net property is defined as all the property of the company remaining after the payment of fixed charge liabilities, preferential debts and the administrator's costs of realising assets. The prescribed part is then calculated as being 50% of the first £10,000 in value of net property, and 20% of net property thereafter, up to a maximum of £600,000. Floating charge holders whose charges were created before 15 September, 2003 are not subject to the prescribed part provisions.

Liquidation
The order of priorities on liquidation is broadly the same as for an administration.

5.3 Are tax liabilities incurred during each procedure?

Company Voluntary Arrangement
The entry of a company into a CVA does not, of itself, affect the corporation tax liabilities of the company (save to the extent that previously accrued tax liabilities are compromised by the arrangement itself). Tax arising on disposals of assets, or on income earned during the course of the arrangement, will be a liability of the company in the normal way.

On the release of a debt, whether a trade debt or a loan, a company debtor will normally be taxed on the amount released. It is an attractive feature of the CVA regime that the release of a debt pursuant to such an arrangement does not give rise to a receipt for tax purposes.

Scheme of Arrangement
The tax treatment of a company entering into a scheme of arrangement is broadly the same as on a CVA.

Administrative Receivership
The appointment of an administrative receiver does not, of itself, affect the liability of a company to tax, which continues to be computed on the same basis as before unless and until the company ceases to trade. In general terms, the administrative receiver is not liable to pay tax on profits made by the company after his appointment, whether arising via trading income or on the disposal of assets. In relation to chargeable gains arising on such a disposal of assets, tax legislation expressly treats the receiver as a nominee of the company.

Administration
A company entering into administration continues to be subject to tax on profits which arise during the procedure. Whilst the liability for tax arising during the administration remains with the company, it is the administrator who must account for any such tax as an expense of the administration. To ensure that the extent of this liability is clear, the legislation
now requires a company to commence a new accounting period for tax purposes upon the onset of administration.

**Liquidation**

Similar principles apply on a liquidation. A company entering into winding up remains subject to tax on profits arising during the procedure. The liquidator is responsible for payment of any such tax which is due as an expense of the liquidation and the commencement of liquidation causes the company’s current tax accounting period to end and a new one to begin.

### 6. ENDING THE FORMAL PROCEDURE

#### 6.1 Is there a process for “cramming down” creditors who do not approve proposals put forward in these procedures?

The two procedures best suited to achieving a “cram down” are company voluntary arrangements and schemes of arrangement.

This is because approval of the terms of these arrangements depends on majority voting, the outcome of which binds dissenting creditors as if they had indeed agreed to the terms. However, it should be appreciated that the scope of these procedures to achieve a true cram down may be limited by minority protections.

**Company Voluntary Arrangement**

Once the terms of a CVA have been completed successfully, a company reverts to its former status and control returns to its directors and shareholders. It is possible (and this occurs frequently in practice) that the arrangement may fail. If so, it is likely that the company will enter into another procedure, such as liquidation.

**Scheme of Arrangement**

Once a scheme is approved by the court, it is implemented under the supervision of the company’s directors. Once the implementation is completed, the company reverts to its former status.

#### 6.2 What happens at the end of each procedure?

**Administration**

There are several exit procedures for an administration. They include the termination of the administration (and the company returning to the control of its directors) if the administrator considers that its purpose has been achieved, or moving into winding up proceedings if he considers that that will be the most appropriate method to distribute the company’s assets. Provision is also made for the administrator to dissolve the company, thereby bringing its existence to an end, if he thinks that the company has no assets to distribute.

**Liquidation**

Following the final meeting of creditors, the company is automatically dissolved three months later.

### 7. ALTERNATIVE FORMS OF RESTRUCTURING

#### 7.1 Is it common to achieve a restructuring outside a formal procedure in England and Wales? In what circumstances might this be possible?

Restructuring in England and Wales can be achieved by adopting one or a combination of non-formal processes in order to avoid the need to realise a company’s assets. In recent years, lenders have become less hasty in pursuing formal insolvency routes such as appointing an administrator, administrative receiver or liquidator to realise a debtor’s business, recognising that they may increase their debt recovery if the debtor’s business is reorganised rather than liquidated.

Furthermore, formal insolvency proceedings may preclude debtor-in-possession restructuring. US based holders of UK corporate bonds are increasingly expecting restructuring outcomes which are similar to those achieved by a debtor-in-possession procedure under Chapter 11 of the US Bankruptcy Code, typically involving debt for equity swaps and the dilution of existing shareholdings along with a further injection of funds. As a restructuring is a non-statutory remedy, however, it is subject to certain limitations: there will be no moratorium other than by agreement between the creditors and there is no statutory mechanism by which to compel a dissenting creditor to participate in the restructuring.
A number of different factors will affect the ability of a company to negotiate a restructuring, the most important of which will be (i) the viability of the underlying business of the company (including its ability to generate cash to service its debt), (ii) the terms of its finance documents (including their event of default provisions and thresholds for lenders’ consent) and, (iii) the identity of the lenders (and in particular whether they are the company's relationship banks or a number of distressed-debt investors).

If a deal for a restructuring (such as a debt-for-equity swap) can be reached, then it may be implemented contractually. However, if the relevant finance documents impose a high consent threshold (for instance, requiring 90 or 100 per cent of lenders to agree to such a transaction), then the company may propose a scheme of arrangement or CVA to compel minority creditors to participate.

7.2 Is it possible to reorganise a debtor rather than realise its assets and business?

A debt for equity swap is one of the most common methods of reorganising a struggling company. It involves the company’s lenders converting the debt owed to them into one or more classes of the debtor’s share capital. This conversion is often undertaken in conjunction with other recapitalisation strategies by the company, such as issuing further shares or attracting a strategic investor. There is no prescribed format for a debt for equity swap and details of the rights and restrictions attached to the lenders’ shares will depend on a large number of different factors. Nonetheless, it is common for the shares issued to the lenders to be a mixture of ordinary shares, and preference shares which will rank ahead in priority over the company’s ordinary shareholders. However, as outlined in section 7.1, whether a debt for equity swap is possible will depend on the terms of the finance documents and the level of consent required from lenders. In circumstances where the requisite proportion of lenders do not agree to a debt for equity swap, a CVA or scheme of arrangement may be necessary to implement the transaction. A pre-packaged administration sale of the business, under which not all the company’s liabilities are transferred to the new owner, may also be considered.

7.3 Is it possible to achieve an expedited restructuring of the debtor by means of a pre-packaged sale? How is such a sale effected?

In a pre-packaged sale (“pre-pack”), a company is put into administration and then immediately sold pursuant to a sale agreement which was arranged before the administrator was appointed.

Pre-packs are intended to salvage a company’s business where the company is insolvent but its business is viable. The company’s directors, assisted by an insolvency practitioner and, on occasion, an investment bank, first prepare a detailed assessment of the company, its financial condition and the marketplace. The aim of this exercise is to assist with the valuation of the business: insolvency practitioners who are involved in pre-packs are typically concerned to ensure that the valuation placed on the business that is sold is equivalent to the business’ market value. This is because, unlike the course of a typical administration, creditors are not given the opportunity to vote upon and approve a pre-packaged sale. Given this, the administrator is vulnerable to claims that he failed to achieve the best value possible for all the company’s creditors. The valuation exercise for a pre-pack may be done by means of a marketing exercise.

The prospective purchaser may be an unconnected third party, or may be a new company (“Newco”) which is specially incorporated and capitalised so that it may purchase the company’s assets. Newco may be owned either by the company’s existing lenders (if they are seeking to convert their holding of the company’s debt into ownership of the company's business) or may be owned by the existing owners or directors of the company. Where the company has granted security over its assets, the consent of the creditors with the benefit of such security may also be required in order to sell those assets.

Once a purchaser is found, the company is placed into administration through the appointment of an administrator (either by court application or through an out of court appointment). Immediately after the appointment, the administrator will execute the business sale agreement, and the sale will complete on
the same day. The proceeds of sale are then distributed to the company’s creditors in accordance with normal principles.

Pre-packs are not specifically provided for by English insolvency legislation, but the Insolvency Service issued a Statement of Practice in January 2009 ("SIP 16") which contains guidance on best practice for administrators involved in a pre-pack. SIP 16 aims to improve the level of disclosure provided by the administrator to the company’s creditors so that their interests may be better protected. A revised Insolvency Code of Ethics was also issued in January 2009 and includes additional professional guidance for administrators in the context of a pre-pack.

8. INTERNATIONAL

8.1 What would be the approach in England and Wales to recognising a procedure started in another jurisdiction?

There are four mains sources of cross-border insolvency law in England and Wales: the EC Regulation on Insolvency Proceedings (the "EC Regulation"), the UNCITRAL Model Law on Cross-Border Insolvency (the "Model Law"), the Insolvency Act 1986 and case law.

The EC Regulation

Insolvency Proceedings opened in an EU Member State under the EC Regulation must be recognised without any formality in all member states, including England and Wales, from the time the judgment opening the proceedings becomes effective in the member state in which the proceedings are opened.

The Model Law

The Cross-Border Insolvency Regulations 2006 (the "Regulations") enacted the Model Law into the law of England and Wales on 4 April 2006. The Regulations provide for the recognition of a foreign proceeding commenced in any foreign country, in most cases whether or not that foreign country has enacted a version of the Model Law.

Insolvency Act 1986 (the "Act")

Section 426 of the Act provides for co-operation between jurisdictions within the United Kingdom and also co-operation between the United Kingdom and other designated jurisdictions, which mainly include Commonwealth countries. Where Section 426 of the Act applies, it provides an alternative means of relief and assistance to the Model Law. It is likely that the countries or territories that have the benefit of Section 426 of the Act will continue to use it until there is sufficient certainty about the operation of the recognition proceedings under the Regulations and where it confers greater advantages than the Regulations.

Case law

In circumstances where the EC Regulation, the Model Law and Section 426 of the Act are not applicable, recognition of foreign proceedings by the English courts will depend on common law principles developed by the courts. The English courts have an inherent jurisdiction to co-operate with foreign insolvency representatives and recognise foreign proceedings.