INSOL INTERNATIONAL

FOUNDATION CERTIFICATE IN INTERNATIONAL INSOLVENCY LAW

Module 3B Guidance Text

Insolvency System of the United Kingdom (England and Wales)

2023 / 2024

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1. INTRODUCTION TO THE INSOLVENCY SYSTEM OF THE UNITED KINGDOM (ENGLAND AND WALES)

Welcome to **Module 3B**, dealing with the **Insolvency System of the United Kingdom (England and Wales)**. This Module is one of the compulsory module choices for the Foundation Certificate.

The purpose of this guidance text is to provide a relatively detailed overview of the insolvency system of the United Kingdom (England and Wales). The guidance text for this module and the module dealing with the insolvency system of the United States (Module 3A), have been written in such a way so as to provide students with a comparative view of the two systems. The idea is to show, using the same or similar headings in each of the guidance texts, how each of the systems functions. In this way both the common features and the differences between the two systems can be highlighted. Although students are not required to do both these modules, it would be useful to do so as most insolvency regimes around the world show features of one or the other (or both) system(s).

This guidance text is all that is required to be consulted for the completion of the assessment for this module. You are not required to look beyond the guidance text for the answers to the assessment questions, although bonus marks will be awarded if you do refer to materials beyond this guidance text when submitting your assessment.

Please Note

If you have selected this module as one of your **compulsory modules**, the formal assessment for this module must be submitted by **11 pm (23:00) GMT on 1 March 2024**.

If you have selected this module as one of your **elective modules**, you have a choice as to when you must submit the assessment. You may either submit the assessment by **11 pm (23:00) GMT on 1 March 2024**, or by **11 pm (23:00) BST (GMT +1) on 31 July 2024**. However, if you elect to submit your assessment on 1 March 2024, you may not submit the assessment again on 31 July 2024 (for example, to obtain a higher mark).

Please consult the Foundation Certificate in International Insolvency Law website for both the assessment and the instructions for submitting the assessment via the course web pages. Please note that **no extensions** for the submission of assessments beyond 1 March 2024 (or 31 July 2024, depending on whether you have taken this module as a compulsory or elective module) will be considered.

For general guidance on what is expected of you on the course generally, and more specifically in respect of each module, please consult the course handbook which you will find on the web pages for the Foundation Certificate in International Insolvency Law.

2. AIMS AND OUTCOMES OF THIS MODULE

After having completed this module you should have a good understanding of the following aspects of the insolvency system of the United Kingdom (England and Wales) (UK):

- sources of law and insolvency terminology;
- the participants in insolvency proceedings;
- general overview of the various insolvency proceedings available;
- eligibility of debtors and jurisdiction of the courts under the various proceedings;
- relatively detailed understanding of the administration, company voluntary arrangement, moratorium, restructuring plan and scheme of arrangement rescue procedures and the purpose of each;
- a relatively detailed understanding of the liquidation procedure;
- a relatively detailed understanding of insolvency litigation under UK insolvency procedures;
- a relatively detailed understanding of the principles of cross-border insolvency law that apply in the UK; and
- a relatively detailed understanding of the principles applying to the recognition of judgments in the UK.

After having completed this module you should be able to:

- answer direct and multiple-choice type questions relating to the content of this module;
- be able to write an essay on any aspect of UK insolvency law; and
- be able to answer questions based on a set of facts relating to the UK insolvency system.

Throughout the guidance text you will find a number of self-assessment questions. These are designed to assist you in ensuring that you understand the work being covered as you progress through text. In order to assist you further, the suggested answers to the self-assessment questions are provided to you in Appendix A.

3. RECOMMENDED READING (NOT COMPULSORY)

The following textbooks deal with all aspects of insolvency law in England and Wales and are intended for an audience which includes undergraduate and postgraduate students as well as early career practitioners:

- A Keay and P Walton *Insolvency Law: Corporate and Personal* 5th edition (LexisNexisUK, 2020); and

- I F Fletcher, *The Law of Insolvency* (5th edition, Sweet and Maxwell, 2017).

These textbooks are similarly aimed but are limited to corporate insolvency law:

- R Goode and K van Zwieten, *Principles of Corporate Insolvency Law* (5th edition, Sweet and Maxwell, 2018); and

- E Bailey and H Groves, *Corporate Insolvency: Law and Practice* (5th edition, LexisNexisUK, 2017).

These annotated guides are very detailed and are used primarily by specialists in insolvency law but are also capable of being of great assistance to non-specialists:

- L Doyle, A Keay and J Curl, *Insolvency Legislation: Annotations and Commentary 2023* (11th edition, LexisNexisUK 2021); and

- D Milman and P Bailey *Sealy & Milman: Annotated Guide to the Insolvency Legislation* (26th edition, Sweet and Maxwell, 2023).

The following textbooks centre on particular types of insolvency (or related) procedures and may be of assistance where a deeper knowledge of those particular procedures is needed:

- T Robinson and P Walton, *Kerr and Hunter on Receivers and Administrators* (21st edition, Sweet and Maxwell 2020);

- G Lightman and G Moss, *The Law of Administrators and Receivers of Companies* (6th edition, Sweet & Maxwell, 2017);

- A Clutterbuck and P Loose *Loose & Griffiths on Liquidators* (9th edition, LexisNexisUK, 2019).

4. SOURCES OF LAW

4.1 Sources

The law is primarily found in the Insolvency Act 1986 (the Act) and the Insolvency Rules 2016 SI 2016/1024 (the Rules). The Act, which contains the primary law, has undergone a number of significant changes since it was enacted. Mainly for this reason, it is not the easiest statute to navigate as it contains a number of additional Parts and Schedules, the numbering of which can be perplexing at first sight. The original Insolvency Rules 1986 were revoked and replaced by the Rules. The Rules are more easily navigated and provide many of the practice-related detail needed to make the Act work. For example, the Rules contain details as to what must be included in notices to creditors, how decisions by companies and creditors are to be made and how the proceeds of the sale of insolvent debtors' assets are to be distributed to creditors.

4.2 Terminology

As with all areas of law, insolvency law has its own terminology. The following terms will be used throughout this module so it may be helpful to gain an understanding of what they are from the start.

The term **Insolvency Law** itself may seem a little unusual to those familiar with the USA's system where the equivalent regime is referred to as Bankruptcy Law. In England and Wales, the use of the term **Bankruptcy** is restricted to situations where individuals become insolvent and enter a formal process where their assets are realised for the benefit of their creditors. The term "Insolvency Law" is used more widely to include all the law which applies to debtors who are, or are likely to become, unable to pay their debts. It applies to both individual and corporate debtors. This module concentrates on corporate insolvency law so we will not consider bankruptcy or other individual insolvency provisions in any detail.

In corporate insolvency law, a debtor company is said to be insolvent (or more strictly "unable to pay its debts" under section 123 of the Act) if it is either **Balance Sheet** insolvent or **Cash Flow** insolvent. A company is balance sheet insolvent if the value of its assets is less than its liabilities (taking into account any future or contingent liabilities as well as its current liabilities). A company is cash flow insolvent where it is unable to pay its debts as they fall due. It is important to keep both of these types of insolvency in mind as a company may be cash flow insolvent due to short term liquidity issues but have a very strong balance sheet. Equally, a company may have many large future liabilities which it has no realistic chance of paying but be cash flow solvent at present as it can pay its current liabilities as they fall due.

A person or company who owes another person a debt is a **Debtor**. The person to whom the debt is owed is that person's **Creditor**. Creditors, when they decide to lend money to debtors may take security for the loan. A **Secured Creditor** is therefore a creditor of a debtor but one who has the benefit of some form of mortgage or charge on the assets of the debtor. The security may be a **Fixed Charge** which fixes on or attaches to a particular asset or class of assets. Any asset subject to a fixed charge cannot generally be dealt with by the debtor without the consent of the secured creditor (the holder of the fixed charge). Alternatively, the security may be a **Floating Charge** which is said to float or hover above a class of assets until such time that it becomes fixed in nature when it is said to **Crystallise**. Until a floating charge crystallises, the assets subject to it may be dealt with by the company debtor in the normal course of business without the consent for each dealing from the holder of the floating charge. It is common for a lender to take a combination of fixed and floating charges as security for any loan. Such a security document is what is usually referred to as a **Debenture** which term includes any document executed by a company which creates or acknowledges a debt (and so technically includes unsecured loans even though in practice it is used invariably only to include secured loans). The debenture holder (or secured lender) will be keen to take fixed charges on any permanent or semi-permanent assets and will usually take a floating charge over the rest of the company's assets which will include, for example, stock in trade and any debts owed to the company (usually referred to as **Book Debts**, that is debts owed to the company which it would record in its own accounting books). A floating charge is usually expressed to be over the **Undertaking** of the company which is interpreted as including all the company's property both present and future, including the right to carry on the business of the company. When a company becomes insolvent, a fixed charge is paid out ahead of a floating charge so is seen as a better security. Having said that, a floating charge usually gives the secured creditor the power to appoint an administrator who will take control of the charged assets and will attempt, amongst other things, to realise them to pay off the secured creditor. The power to appoint an administrator is available to the holder of a **Qualifying Floating Charge** which is a charge over the whole or substantially the whole of a company's property, both present and future.

There are other types of creditor who are often encountered in insolvency practice. For example, creditors who have funded a company's acquisition of equipment or vehicles may have done so in the form of a **Hire Purchase** or **Retention of Title** agreement (or similar) where the creditor retains legal ownership of the asset until it is fully paid for. Similarly, it is common for companies who have book debts payable in the future to assign (sell) those book debts to a **Receivables Financier**, sometimes referred to as a debt factor or invoice discounter, for an amount less than their value. This is usually done to ensure the company has available cash flow to keep its business going. Both hire purchase creditors and receivables financiers will usually own the assets in question when a company becomes insolvent and will therefore usually take possession of, and realise, those assets outside any formal insolvency procedure.

In terms of priority of payment, it will usually be the case that holders of fixed charges will be paid first usually outside of any formal insolvency (from the proceeds of sale of the assets subject to the fixed charges), then the expenses of the procedure (including the remuneration of the office-holder), then **Preferential Creditors** (in practice this class of creditor is limited to reasonably modest claims from employees who are owed money by their insolvent employers and some taxation debts owed to the Government where the company has acted in effect as a tax collector for the Government) will be paid, then floating charges (subject to any prescribed part deduction under section 176A of the Act which is discussed below at paragraph 5.9.5.4), then **Unsecured Creditors**, that is, those without the benefit of any security or title to assets, who will commonly be ordinary trade suppliers and taxation liabilities which are not preferential. If the company is found ultimately to be solvent, in that there is a surplus after payment of all its liabilities, that surplus will be returned to the members according to their rights under the company's constitution (its articles of association).

Not surprisingly, the insolvency regime gives primacy to secured creditors but unsecured creditors have a number of significant rights in the legislation. By way of example, they will often get to vote on: whether to approve an administrator's proposals; whether to approve a proposal for a company voluntary arrangement; who is appointed as liquidator; and how an office-holder is to be remunerated. In the past, creditors have made these decisions by passing resolutions at creditors' meetings. Such meetings are now rare in practice as creditors' decisions are now made either by the deemed consent procedure or by a procedure which does not require a physical meeting. Physical meetings are still possible but have to be specifically requested by a requisite majority of creditors.

All decisions of creditors in corporate (and personal) insolvency are now made by **Decision Procedures** which may or may not include an actual meeting being held. The default position is that no creditors' meeting will be held.

Section 246ZE(1) of the Act provides that a decision of the creditors may be considered using any qualifying decision procedure that the office-holder thinks fit, except that it may not be made by a creditors' meeting unless such a meeting is requisitioned by the requisite majority of creditors. A creditors' meeting may only be held if it is requested by a minimum number of creditors. That minimum number is 10% in value of the creditors, 10% in number of the creditors or 10 creditors.

The decision of the creditors will be made using either the deemed consent procedure or a qualifying decision procedure. The **Deemed Consent** procedure permits a decision to be made by notifying creditors of the intended decision (for example the approval of an administrator's proposal) and if that decision is not effectively objected to, it is deemed to have been made. The deemed consent procedure applies to any decision unless 10% by value of the creditors object before the date stated for the deemed consent procedure to take effect. In the absence of the 10% objection, the deemed consent is effective.

Deemed consent can generally be used for all decisions (except for fixing the basis of the office-holder's remuneration). Where deemed consent cannot be used, or where it is effectively objected to or where the office-holder decides not to use it, a decision is instead made by one of five qualifying decision procedures listed in the Rules,[1] namely: (a) correspondence, (b) electronic voting, (c) virtual meeting, (d) physical meeting, or (e) any other decision making procedure which enables all creditors who are entitled to participate in the making of the decision to participate equally. For most decisions, a majority in value of unsecured creditors in favour of any decision is sufficient for it to be passed.

5. INTRODUCTION TO INSOLVENCY PROCEDURES IN ENGLAND AND WALES

5.1 Overview of the participants

One characteristic of the English and Welsh insolvency regime is that many companies who enter a formal insolvency regime do so without any involvement of the court. As we will see, it is very common for a company to be placed into administration without the need to apply to court or to be placed into liquidation without any court order. A great deal of day-to-day practical insolvency therefore takes place without any court involvement. Having said that, it is important to remember that applications can be made (and frequently are made) where there is a problem with a procedure which has commenced out-of-court. It is equally important to be aware that companies can be placed into administration or liquidation by a court order. Both procedures

[1] Insolvency Rules 2016, r 15.3.

therefore may commence with an appointment of an administrator (or liquidator as the case may be) either out-of-court or by the court.

Where a company is ordered to be wound up by the court (**Compulsory Winding Up**), the court will usually appoint the **Official Receiver** to be the initial liquidator of the company. The Official Receiver is an employee of the Government. Where an individual has been made bankrupt, the Official Receiver will similarly usually be appointed as the first trustee in bankruptcy of the bankruptcy estate. As liquidator, the Official Receiver will usually investigate the reasons for the company's liquidation. They will often remain as liquidator of the company and therefore get in the assets and distribute the proceeds to the creditors. If the Official Receiver comes across evidence of unfit behaviour by the directors of the company the Official Receiver may take action, on the instructions of the **Secretary of State for Business, Energy and Industrial Strategy**, to disqualify the directors from being involved in the management of a company for up to 15 years under the Company Directors Disqualification Act 1986.

Apart from the Official Receiver, all other **Office-holders**, that is, in a corporate context, **Liquidators**, **Administrators**, **Administrative Receivers**, **Nominees** or **Supervisors** in a Company Voluntary Arrangement and **Monitors** in a Moratorium must be licensed **Insolvency Practitioners**. In an individual insolvency context, **Trustees in Bankruptcy** and nominees and supervisors of individual voluntary arrangements must also be licensed insolvency practitioners. Insolvency practitioners will be members of a **Recognised Professional Body** (RPB). The RPBs that regulate insolvency practitioners are the Institute of Chartered Accountants in England and Wales and the Insolvency Practitioners Association. Most insolvency practitioners are accountants (but a small number are lawyers). They must pass Joint Insolvency Board examinations and demonstrate they are fit and proper persons with suitable insolvency experience before their respective RPB will license them to act as insolvency practitioners. In addition, they are subject to a specific Code of Conduct and rules around security bonding to ensure that other stakeholders are protected if their behaviour causes loss, due, for example, to their fraudulent conduct.

RPBs are recognised and licensed themselves by the **Secretary of State for Business, Energy and Industrial Strategy** who oversees the insolvency regime. The **Insolvency Service** is an executive agency within the Department for Business, Energy and Industrial Strategy and leads on insolvency related matters. It employs the Official Receivers, exercises investigatory powers in the public interest and operates the directors' disqualification system. Complaints about insolvency practitioners are a matter for the relevant RPB but if disciplinary matters are not dealt with effectively, the Secretary of State has the power to de-recognise the RPB in question.

5.2 Brief overview of available procedures

Historically, prior to the Act being passed in 1986, a company which was financially distressed had limited options if it wanted to be rescued. Apart from any informal arrangements it might make with its creditors, the only formal procedures available to such a company were receivership or liquidation.

Liquidation, where a company's assets are realised and the company is dissolved (that is, it ceases to exist) is still the most common procedure entered by insolvent companies.

Receivership may come in various forms but for present purposes may take one of two principal forms. It has always been possible for a creditor holding a fixed charge over the assets of a debtor (who defaults under the loan agreement) to appoint a receiver over the fixed charge assets. A receiver's role is literally to receive the income from the charged assets but they will usually also be provided with an express power, in the charge document, to sell the charged assets and pay off the charge holder. Enforcement of such fixed charges in this way is still commonly encountered. As fixed charge receivers have some powers implied by the Law of Property Act 1925, they are sometimes referred to as LPA receivers. Such receivers do not need to be licensed insolvency practitioners.

Historically more significant than fixed charge receivers is what is defined in section 29 of the Act as an administrative receiver. The appointment of such a receiver was for over a century the preferred method of enforcement by a floating charge holder. If the floating charge was over the whole or substantially the whole of a company's undertaking (which it invariably will be), on default under the loan agreement by the company, the floating charge holder was able to appoint an administrative receiver under the terms of the charge document. As the charge will have included the company's undertaking, the right to carry on the business would be subject to the charge as well as the company's physical and other assets. This meant that the administrative receiver was able to carry on the business and in practice frequently did so, at least for a short period of time. The ability to carry on the business was often crucial to selling the business to a purchaser as a going concern which almost always led to a higher sale price than a piecemeal sale of individual assets (which is often all that is possible in a liquidation as a liquidator has only very limited powers to carry on the business of a company).

When the insolvency regime was reformed in 1986, one of the leading principles of the reform was to encourage the rescue of companies wherever this was possible. It was recognised by the Cork Committee (whose report led to the 1986 legislation) that administrative receivership often led to a relatively positive result. The appointment of the receiver, who took over the management of the company from its directors, often led to the company being better run and either the company itself was turned around by the receiver or the business was returned to financial health and was bought from the receiver by a purchaser. Either way, jobs were often saved and supply chains often remained in place which benefitted all stakeholders in the company. The Cork Committee recommended that where an administrative receiver could not be appointed (usually because there was no single floating charge holder with security over the company's undertaking) it should be possible for a company still to have an external specialist appointed to attempt to turn around the business's fortunes. It was this recommendation which led to the possibility of an application to court for an administration order which appointed an administrator who had powers similar to an administrative receiver but whose primary aim was to attempt to rescue the company or its business.

Between 1986 and 2002, it remained very common for a floating charge holder to continue to appoint an administrative receiver whenever the company became insolvent. Administrative receivers owed their primary duty to the floating charge holder and so viewed their main role to pay off the appointing debenture holder rather than rescue the company or try to reach a result which would benefit all the company's creditors, including its unsecured creditors. During this period, there were relatively few administrator appointments. The court procedure which led to an administrator order was viewed as complex and expensive and so was not popular.

The Enterprise Act 2002 made significant changes. It altered the Act by introducing a new section 72A which stated (subject to some very rare exceptions) that the remedy of appointing an administrative receiver would no longer be available to holders of floating charges executed on or after 15 September 2003. Instead, such debenture holders would be able to appoint out-of-court, an administrator. A new Schedule B1 was added to the Act which deals with appointments of administrators which may now be made out-of-court by the holder of a qualifying floating charge, the company itself (through a members' resolution) or the company's directors (by board resolution). It remains possible to apply to the court for an administration order but nowadays the vast majority of administrator appointments are made out-of-court. Due to the passage of time, there are now very few floating charges which were executed prior to 15 September 2003 which are still in force and so the possibility of appointing an administrative receiver has become extremely rare to the point where administrative receivership appointments appear to have effectively been abolished. Administration has therefore effectively replaced administrative receivership.

Perhaps the main unique characteristic of administration is its moratorium (or stay) on creditor actions. What this means is that whilst an administrator is in post, no creditor can take enforcement action against the company without the consent of the administrator or leave of the court. This breathing space is designed to provide the administrator with an opportunity to plan for the rescue of the company or, where that is not possible, to consider how to realise the company's assets in a way which would lead to a better result than an immediate liquidation. The administrator must prepare a proposal and ask the creditors to vote on it. If more than 50% in value of the unsecured creditors approve the plan, the administrator will continue to act to give effect to the plan. If the creditors refuse to approve the plan, the administration will usually come to an end. It is often the case that an administrator is not able to rescue the company as a separate legal person, but can rescue the business by finding a buyer for it. An administration is designed to be a temporary procedure (usually lasting for no more than 12 months) which permits a rescue or beneficial realisation of the company's assets. The administrator has powers to run the business and will often seek to do so in order to achieve a going concern sale. If the company itself cannot be rescued, once its business has been sold, it will usually be placed into liquidation or may go straight to dissolution.

An option which, if successful, leads to company rescue, introduced in 1986 and still reasonably popular is the company voluntary arrangement (CVA). This procedure allows a company (which may be in administration or liquidation but is usually not in either) to put forward a proposal to its creditors for payment of outstanding liabilities. The CVA will usually ask creditors for more time to pay (referred to in the Act as a scheme of arrangement) or ask creditors to accept in full payment a lesser sum than is owed (the Act calls this a composition of debts). If at least 75% in value of the company's unsecured creditors agree to the proposal it binds all the unsecured creditors even those who voted against the proposal or who were unaware of it. Secured creditors are not bound unless they agree to the CVA proposal. They usually will agree to the proposal as long as their secured status is recognised and protected under the terms of the CVA.

The Corporate Insolvency and Governance Act 2020 (the 2020 Act) has attempted to return at least part of the focus of the Act to support company rescue as opposed to business rescue which is the most common result of administration. In a bid to encourage debtor-in-possession company rescues, the 2020 Act introduced a short term (initially 20 days) stay or moratorium on creditor actions. This new Moratorium is designed to allow a company's management team some time to put together a plan to rescue the company. That plan may involve a proposal for a CVA (or a Part 26 Scheme or a Part 26A Restructuring Plan as explained in the next paragraph).

As an alternative to a CVA, and another possible debtor-in-possession option, is for a company to enter into a Scheme of Arrangement under Part 26 of the Companies Act 2006. Although designed and intended for the re-organisation of solvent companies, such Schemes, which have been around since the nineteenth century, are often used for the restructuring of insolvent companies. This procedure involves a great deal of court involvement as well as creditor consent and so is usually only seen in cases where a company has significant assets. It begins with the court being asked to convene meetings of creditors (as a scheme is a Companies Act procedure, it has retained physical meetings of creditors which are now rare in procedures under the Act). Creditors are split into different classes and each class of creditor must consent to the Scheme. Once approved by the company's respective classes of creditor, the scheme must then be sanctioned by the court. There is strong anecdotal evidence that many overseas companies come to England and Wales to take advantage of the flexibility possible under a Companies Act scheme.

A Restructuring Plan was introduced by the 2020 Act with a new Part 26A of the Companies Act 2006 which has much in common with Part 26 Schemes but has also borrowed from the US's Chapter 11. It is available for companies in financial distress and its main distinctive characteristic is its ability to "cram down" a class of creditors which has voted against the Plan (and so allow the Plan to be sanctioned by the court despite that class's dissent). Such a cram down is not possible with a Part 26 Scheme.

As mentioned above, liquidation is still the most common procedure which a company may enter. Liquidation (or winding-up, the terms may be used inter-changeably) is the process by which a company is killed off. It is a terminal procedure. The company's assets are realised by the liquidator and creditors are paid off in the statutory order (to the extent that the available assets allow). It is often the case that there is little or nothing available to unsecured creditors in a liquidation. A liquidation may be commenced by a court order - a winding up order - which is usually made on the petition of a creditor who proves that the company is either balance sheet or cash flow insolvent. This is referred to as a compulsory liquidation or winding up. The official receiver will usually be appointed as first liquidator by the court, although the creditors may have the opportunity to replace the official receiver with a private sector insolvency practitioner as liquidator. As an alternative to a compulsory liquidation, a company's members may resolve by special resolution (a 75% majority) to wind up the company. This is called a voluntary liquidation or voluntary winding up. If the company is insolvent, it will be a creditors' voluntary liquidation and the creditors will usually choose the insolvency practitioner who is to be the liquidator. If the company is solvent, the members will appoint the liquidator (who still needs to be a licensed insolvency practitioner) and it will be called a members' voluntary liquidation.

5.3 Opening of insolvency proceedings

5.3.1 Eligibility of the debtor

Although it will usually be the case that a debtor company must be unable to pay its debts to enter insolvency proceedings, this is not always technically the case. The conditions for eligibility for each procedure will be considered below under the appropriate heading.

5.3.2 Jurisdiction

Under the Act, any proceedings relating to the insolvency of a company must be brought in the court which has jurisdiction to wind up the company in question. Generally, the larger cases are reserved for the High Court with less valuable cases being heard in the County Court. Under section 117 of the Act:

(1) The High Court has jurisdiction to wind up any company registered in England and Wales;

(2) Where the amount of the company's share capital (paid up or credited as paid up) does not exceed GBP 120,000, the County Court, subject to some exceptions, also has jurisdiction to wind up the company.

The High Court has three divisions and it is the Chancery Division which has insolvency jurisdiction. Based in London, it includes a number of specialist lists including the Insolvency and Companies List. Outside London there are ten Chancery District Registries. A Chancery High Court Judge located in London supervises the District Registries. Cases are heard by a High Court Judge, a specialist Chancery Circuit Judge or a District Judge (who would normally sit in the County Court), depending upon the complexity, value and length of the proceedings. Since 2017 the Business and Property Courts have formed an umbrella for the specialist jurisdictions of the Chancery Division including the Insolvency and Companies list throughout England and Wales in the District Registries. There are approximately 15 High Court Judges attached to the Chancery Division. There are also six judges who are referred to as Masters (one of whom is the Chief Master), and five Insolvency and Companies Court Judges (previously known as Registrars in Bankruptcy) (and a Chief Insolvency and Companies Court Judge) as well as numerous part-time Insolvency and Companies Court Judges. District Registries do not have specialists corresponding to Insolvency and Companies Court Judges. Company and insolvency matters will be assigned between the Chancery supervising High Court Judges on circuit, Circuit Judges with authorisation to sit as Deputy High Court Judges and District Judges as part of their general Chancery work.

Not all County Court hearing centres have an insolvency jurisdiction. Those without an insolvency jurisdiction have their cases heard in an adjacent centre which does have such jurisdiction. District Judges hear cases in the County Court. County Court hearing centres are regional and will have jurisdiction (subject to the financial limit mentioned above) over company disputes where the company's registered office is within its region.

Self-Assessment Exercise 1

Question 1

Must all "receivers" be licensed insolvency practitioners?

Question 2

True or False? It has not been possible to appoint Administrative Receivers since 15 September 2003.

Question 3

Name one of the recognised professional bodies.

Question 4

True or False? Creditors' meetings remain an integral and compulsory part of all Insolvency Act 1986 procedures.

Question 5

True or False? The deemed consent procedure may be used to fix the remuneration of an office-holder.

Question 6

What percentage of unsecured creditors must approve proposals by an administrator?

Question 7

What percentage of unsecured creditors must approve a company voluntary arrangement?

Question 8

Why can an office-holder not usually realise assets subject to the interests of a receivables financier or hirer under a hire purchase contract or the supplier under a retention of title contract?

For commentary and feedback on self-assessment exercise 1, please see APPENDIX A

5.4 Reorganisation: Administration

5.4.1 Introduction

As explained above, administration was completely revamped by the Enterprise Act 2002. Prior to those changes, a court order was always required in order to put a company into administration. At that time a debenture holder with a floating charge over the whole or substantially the whole of a company's undertaking would invariably enforce its security against a defaulting company by appointing an administrative receiver. Since then, the power to appoint an administrative receiver has been greatly diminished and in practical terms has now been effectively abolished. A floating charge holder will nowadays usually look to enforce its security by the appointment out-of-court of an administrator. This power was introduced by the Enterprise Act 2002. The moratorium on actions which is a defining characteristic of administration may be used by the administrator either to rescue the company (possibly in conjunction with a CVA, scheme of arrangement or restructuring plan) or to realise the company's assets in a manner which is more beneficial for the creditors as a whole (not just the debenture holder) that would have been the case had the company entered liquidation without first being in administration.

5.4.2 Overview of the process

Administration is a temporary procedure designed to give the company the benefit of an experienced external manager, the administrator, and also some time free from creditor harassment during which the administrator may be able to rescue the company or business or at least improve matters for creditors relative to their likely position in an immediate winding up. In reality, a great many administrations do not involve any period of trading under the administrator, rather a sale of the business is conducted often on day one of the administration (a practice referred to as a pre-packaged administration, where the deal for the sale is agreed before the administrator is appointed and on appointment the administrator executes the agreement).

In outline, an administration involves the following stages:

(1) An administration commences when an administrator is appointed. The appointment may be made out-of-court by the holder of a qualifying floating charge or by the company or by the directors. In addition, the appointment may be made by the court making an administration order.

(2) As soon as the administrator is appointed, a wide-ranging moratorium comes into effect which generally prevents creditors taking any form of enforcement action against the company whether by court action, repossession of goods or enforcement of security.

(3) The appointment of the licensed insolvency practitioner as administrator is publicised and the fact of the administration must appear on all company correspondence and websites. The administrator takes over the management of the company from the directors.

(4) The administrator will require the directors (or others) to provide a statement of affairs of the company.

(5) The administrator must prepare a proposal designed to achieve one or more of the statutory purposes of administration.

(6) The creditors will be asked to vote on the proposal. If approved, the administrator will put it into effect. If not agreed to, the administrator may attempt to put forward further proposals or may take steps to terminate the administration.

(7) If the proposal successfully leads to the rescue of the company, the administrator will vacate office allowing the directors back in (this is very rare in practice).

(8) If the business is successfully sold on to a buyer (which is commonly the case) the administrator may distribute the proceeds to creditors according to the statutory order then take steps to end the administration (usually be conversion to a liquidation or to go straight to dissolution).

5.4.3 Opening of administration proceedings

5.4.3.1 Introduction

An administration may be commenced in one of three ways:

(1) By the court making an administration order;

(2) Out-of-court appointment by the holder of a qualifying floating charge; or

(3) Out-of-court appointment by the company or its directors.

An administrator cannot be appointed if the company is already in administration or liquidation.

Administration Order (under paragraph 13 of Schedule B1 of the Act)

The following may apply to the court for an administration order:

(a) The company;

(b) The directors of the company;

(c) One or more creditors whether they are owed debts which are current, future or contingent;

(d) Court officials where the company has failed to pay a fine;

(e) A combination of the above;

(f) Any liquidator of the company; or

(g) The supervisor of a CVA.

The court has a discretion whether or not to make the order but may only do so if satisfied that:

(a) The company is or likely to become unable to pay its debts on either the cash flow or balance sheet basis (there is no need for the court to be satisfied of this if the application is made by a qualifying floating charge holder with the power to appoint out-of-court); and

(b) The administration order is reasonably likely to achieve one of the statutory purposes of administration (for which see below at paragraph 5.4.3.2).

The appointment takes effect either when the order is made or at a time specified in the order.

Out-of-court by the holder of a qualifying floating charge (under paragraph 14 of Schedule B1 of the Act)

The holder of the qualifying floating charge must file at court a notice of the appointment which includes a statutory declaration confirming that the floating charge has become enforceable. The notice of appointment must identify the administrator who must consent to act and confirm their belief that one or more of the statutory objectives is reasonably likely to be achieved. The appointment is effective once all the requisite documentation has been filed at court. An appointment cannot be made by the holder of a qualifying floating charge unless it has given two business days' notice to the holder of any prior floating charge.

No out-of-court appointment may be made by the holder of a qualifying floating charge where:

(1) a provisional liquidator is in office; or

(2) an administrative receiver has been appointed.

Out-of-court appointment by the company or its directors (under paragraph 22 of Schedule B1 of the Act)

The company may resolve in general meeting by an ordinary resolution (over 50%) of its members to appoint an administrator or the board may pass a board resolution (by simple majority) to similar effect. Prior to the appointment taking effect, the company or directors must serve a Notice of Intention to Appoint on any holder of a qualifying floating charge at least five business days prior to the appointment. This provides the floating charge holder with the opportunity either to agree or to appoint its own administrator. In practice, holders of qualifying floating charges are often content for the directors to appoint the administrators subject to their agreement as to who is to be the administrator. A copy of the Notice of Intention to Appoint must be filed at court along with, amongst other things, a statement that the company is or is likely to become unable to pay its debts and is not in liquidation. The filing of the Notice of Intention to Appoint, in itself, under paragraph 44 of Schedule B1, produces a short-term interim moratorium which lasts 10 days. Any attempt to file successive Notices of Intention to Appoint, without a settled intention to an administrator, but with an intention to take advantage of successive interim moratoria, will be an abuse of process.[2]

Whether or not there is a holder of a qualifying floating charge, the person making the appointment must subsequently file a Notice of Appointment with the court which is accompanied by a statement from the administrator that they agree to act as such and that in their opinion the administration is reasonably likely to achieve one or more of the statutory objectives. The appointment takes effect when all the requisite documents are filed at court.[3]

No out-of-court appointment may be made by the company or its directors in certain circumstances:

(1) where the company has been in administration in the previous 12 months where the appointment was made by the company or its directors;

(2) a petition for the winding up of the company has been presented to the court;

(3) an application for an administration order has been made to the court; or

(4) an administrative receiver is in office.

Where any of these restrictions prevent an out-of-court appointment the person wishing to make the appointment may have to apply to the court for an administration order.

5.4.3.2 Purpose of administration

An administrator must act with one or more of three statutory objectives in mind. The objectives are listed in paragraph 3 of Schedule B1 of the Act and are listed in order of primacy. The first objective is to consider rescuing the company. If the administrator thinks that objective is not reasonably practicable (or thinks that a better result for the company's creditors as whole would be achieved by pursuing the second objective) they may move to the second objective, that of achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being placed into administration). If the administrator thinks that the second objective is not reasonably practicable they may pursue the third objective, that of realising property in order to make a distribution to one or more secured or preferential creditors (as long as they do not unnecessarily harm the interests of the creditors of the company as a whole).

In practice, the second objective is the one most commonly pursued by administrators. It focusses on achieving a better return to unsecured creditors as well as repaying secured creditors.

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2 *JCAM Commercial Real Estate Property XV Ltd v Davis Haulage Ltd* [2017] EWCA Civ 267.

3 For a discussion of cases where the formalities for the appointment out-of-court have not been satisfied, and the consequences of such failures, see *Re ARG (Mansfield) Ltd* [2020] EWHC 1133 (Ch).

The first objective involves rescuing the company as a going concern with the retention of all or a material part of the business of the company together with a restoration to solvency with all the creditors being paid in full.[4] Unlike an administrative receiver who owes a primary duty to the appointing secured creditor, an administrator must have regard to the interests of all of the company's creditors and can only limit their ambition to seeking to realise assets to repay a secured creditor (the third objective) if they think that it is not reasonably practicable to achieve anything else (and must not even in that case unnecessarily harm the interests of the creditors as a whole).

Much is left subjectively to what the administrator "thinks" is the best way forward. Only if an administrator's decision to pursue one objective as opposed to another is in bad faith or perverse, will it be open to attack by creditors.

5.4.3.3 Inability to pay debts

As explained above at paragraph 4.2 and further considered in the context of liquidation below at paragraphs 5.9.2.3 and 5.9.2.4, a company may be shown to be unable to pay its debts by demonstrating either cash flow or balance sheet insolvency. Although there is usually a requirement to show that the company is, or is likely to become, unable to pay its debts when applying for an administration order, this does not apply to an application by a qualifying floating charge holder[5] although the court must be satisfied that the floating charge holder would be able to appoint an administrator out-of-court (in that the floating charge must have become enforceable which usually happens due to default by the company), so there is some evidence of insolvency which is needed.

5.4.4 Effect of opening administration proceedings

5.4.4.1 Effect on other insolvency processes

Due to the nature of administration being a collective procedure whereby the administrator will usually take control of all the company's assets and act in the interests of all the company's creditors, it is usually incompatible for an administration to co-exist with other insolvency procedures.[6]

If the court makes an administration order, any outstanding winding-up petition is dismissed.

If a company goes into administration as a result of an appointment by a qualifying floating charge holder, any outstanding winding-up petition is suspended.

When an administration order takes effect, any administrative receiver must vacate office, and any receiver of part of the company's property must vacate office if required to by the administrator. An administrator must be careful not to decide to remove a fixed charge receiver unless there is a good reason to do so. If the value of the charged assets in the receivership is

4 See generally *Davey v Money* [2018] EWHC 766 (Ch).
5 Insolvency Act 1986, Sch B1, para 35.
6 See generally Insolvency Act 1986, Sch B1 paras 40 and 41.

likely to leave a shortfall owing to the appointing charge holder and the property is not needed for the administration, the removal is unlikely to be justified. Although an administrator must carry out the administration taking into account and balancing the rights of all creditors, both secured and unsecured, an administration should not be conducted for the benefit of the unsecured creditors at the expense of a secured creditor.[7] The receiver's rights to remuneration and any entitlement to an indemnity are protected even if removed by the administrator.

5.4.4.2 Estate

The administrator must on appointment take custody or control over all the property to which they think the company is entitled.[8] This will usually include assets subject to a security such as assets subject to fixed and floating charges but will not include book debts which have been effectively assigned to a receivables financier as such book debts will not belong to the company. Assets subject to a fixed charge may only be sold by the administrator with the consent of the chargeholder or the permission of the court (under paragraph 71 of Schedule B1). Goods subject to hire purchase or retention of title contracts generally will not belong to the company but the administrator may similarly ask for the owner's consent to sell or alternatively consider applying under paragraph 72 of Schedule B1 to the court for permission to realise those assets, for example as part of a sale of the business as a going concern.

If the administrator seizes or disposes of property which is not property of the company, the administrator will not be personally liable to any person in respect of any loss or damage resulting from the seizure or disposal as long as the administrator has not been negligent and had reasonable grounds for believing they were entitled to deal with the assets in question.[9]

5.4.4.3 Moratorium (stay)

While a company is in administration a moratorium prevents the following actions against the company:[10]

(a) no resolution may be passed for the winding up of the company;

(b) no winding-up order may be made against the company (other than on public interest grounds);

(c) no step may be taken to enforce security over the company's property except with the consent of the administrator or the permission of the court;

(d) no step may be taken to repossess goods in the company's possession under a hire-purchase agreement (which term includes retention of title contracts) except with the consent of the administrator or the permission of the court;

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7 See, eg, *Promontia (Chestnut) Ltd v Craig* [2017] EWHC 2405 (Ch).
8 Insolvency Act 1986, Sch B1, para 67.
9 *Idem*, s 234.
10 *Idem*, Sch B1, paras 42-43.

(e) a landlord may not exercise a right of forfeiture by peaceable re-entry in relation to premises let to the company except with the consent of the administrator or the permission of the court;

(f) no legal process (including any legal proceedings or execution of any judgment) may be instituted or continued against the company or property of the company except with the consent of the administrator or the permission of the court; and

(g) no administrative receiver may be appointed.

According to Nicholls LJ in the leading case *Re Atlantic Computer Systems Plc*[11] the purpose of the moratorium is to "give the administrator time to formulate proposals and lay them before the creditors, and then implement any proposals approved by the creditors". The moratorium is procedural in nature in that, although the power to enforce rights is suspended, those rights are not extinguished.

Whenever a creditor wishes to enforce any of its rights against a company in administration, it may do so only with the consent of the administrator or permission of the court. If an administrator has no use for an asset they may, for example, permit a creditor to repossess it. If the administrator is unwilling to allow a creditor to enforce its rights during the administration, the creditor must ask for permission of the court. When considering such an application the court will attempt to carry out a balancing exercise in deciding whether or not to permit such action. Nicholls LJ in the *Atlantic* case set out a number of principles relating to applications by creditors for permission to enforce their rights. The principles or guidelines have been followed in numerous cases subsequently. The principles are as follows:

(a) it is in every case for the person who seeks permission to make out a case to be given leave;

(b) the moratorium is intended to assist the company, under the management of the administrator, to achieve the purpose of the administration. If granting permission to a lessor of land or the hirer of goods (a lessor) to exercise their proprietary rights and repossess land or goods is unlikely to impede the achievement of that purpose, permission should normally be given;

(c) in other cases when a lessor seeks possession the court has to carry out a balancing exercise, balancing the legitimate interests of the lessor and the legitimate interests of the other creditors of the company;

(d) in carrying out the balancing exercise great importance is normally to be given to the proprietary interests of the lessor. The underlying principle is that an administration for the benefit of unsecured creditors should not be conducted at the expense of those who have proprietary rights which they are seeking to exercise;

[11] [1992] Ch 505.

(e) it will normally be a sufficient ground for the grant of permission if significant loss would be caused to the lessor by a refusal. If substantially greater loss would be caused to others by the grant of permission, or loss which is out of all proportion to the benefit which permission would confer on the lessor, that may outweigh the loss to the lessor caused by a refusal;

(f) in assessing these respective losses the court will have regard to matters such as: the financial position of the company, its ability to pay any rental arrears and continuing rentals, the administrator's proposals, the period for which the administration has already been in force and is expected to remain in force, the effect on the administration if permission were given, the effect on the applicant if leave were refused, the end result sought to be achieved by the administration, the prospects of that result being achieved, the history of the administration so far and the conduct of the parties;

(g) in considering these matters it will often be necessary to assess how probable the suggested consequences are;

(h) this list is not exhaustive. For example, the conduct of the parties may also be a material consideration in a particular case;

(i) the above considerations may be relevant not only to the decision whether permission should be given but also to a decision to impose terms if permission is granted;

(j) the above considerations will also apply to a decision on whether to impose terms as a condition for refusing permission.

5.4.4.4 Executory contracts

The appointment of an administrator does not automatically terminate a company's executory contracts. Terms in contracts of supply which provide for automatic termination have historically been generally effective but have now become subject to increasing statutory exceptions which largely make such automatic termination (or *ipso facto*) clauses void as explained below.

An administrator will frequently need to obtain or retain certain essential supplies. Section 233 of the Act applies to a supply of gas, electricity, water and communications services. The definition of communications services includes the supply of goods and services such as point of sale terminals, computer hardware and software, information, advice, and technical assistance, data storage and processing and website hosting. Suppliers are not permitted to require payment of outstanding debts in order to secure a new or continued supply to the company in administration. However, section 233 of the Act permits a supplier to stipulate that the administrator must personally guarantee payment of charges in respect of the new supply.

In addition, under section 233A a supplier of such services is generally unable to rely upon an "insolvency-related term" in a contract of supply which would otherwise entitle the supplier to terminate the supply, alter the terms of the supply or compel higher payments for continued supply.

The 2020 Act has now expanded these protections for an insolvent company by adding section 233B to the Act. Section 233B prohibits clauses which allow the supplier of any goods or services to terminate or "do any other thing" in relation to that contract if the company enters a formal insolvency procedure.

A provision of a contract for the supply of goods or services to the company is of no effect when the company enters an insolvency procedure, if, under that provision the contract would terminate or the supplier would be entitled to terminate the contract or to "do any other thing" upon the company entering an insolvency procedure. Section 233B therefore prevents suppliers from terminating a supply upon the company's insolvency but also prevent suppliers from making it a condition of continued supply that pre-insolvency arrears are paid and from making other changes to the contract such as increasing prices. Under section 233B, a supplier cannot insist on a personal guarantee from the administrator (as it can under section 233).

Under section 233B, a contract may still be terminated by a supplier where the company or insolvency office-holder consents or, on application to the court, the court is satisfied that the continuation of the contract would cause the supplier hardship, and grants permission for termination.

Section 233B complements the existing ss 233 and 233A of the Act which, in similar terms, prohibit termination by utility, communications and IT suppliers. Section 233B opens up the restriction on termination to all other suppliers (with a limited number of exceptions, for example, insurers; banks; electronic money institutions; recognised investment exchanges and clearing houses; securitisation companies; and overseas companies with corresponding functions).

Sections 233, 233A and 233B apply in administration and where a company enters a CVA. Section 233B, in addition, also applies where a company has entered into a Moratorium or a Restructuring Plan or has entered liquidation. The inclusion of liquidation is at first sight a little surprising as it is not usual for a company in liquidation to continue to trade a business. Although unusual, it is not impossible for a company in liquidation to continue its business at least for a brief period to ensure a beneficial winding up of the company's assets.

5.4.4.5 Effect on employees

The appointment of an administrator does not automatically terminate any contracts of employment. Employees retain their contractual and statutory rights against the company.

Of course, any contractual rights against the company may prove to be of limited or no value in the event that the company is unable to pay any of its unsecured creditors (which includes its employees). There are three main ways in which an employee of a company in administration is protected.

Although an administrator may decide to dismiss employees (as is frequently the case), if an employee is kept on for 14 days after the administrator's appointment, the employee's contract is deemed to be adopted by the administrator. Under paragraph 99 of Schedule B1, any "wages or salary" due to the employee by the company after the contract of employment is adopted has what is usually called "super priority" in that the wages or salary owed must be paid out ahead even of the administrator's own fees and expenses. The liability is charged on any property held by the administrator. For these purposes, "wages or salary" includes holiday pay, sickness pay and contributions to occupational pension schemes.

In addition, an employee who is owed money relating to services rendered prior to the appointment of the administrator is a preferential creditor and so will be paid some of the money ahead of any floating charge holder and any unsecured creditors. These rights are limited to the four months prior to the appointment and importantly are also limited to a maximum payment of GBP 800 in total.

The third main protection is under general employment legislation such as the Employment Rights Act 1996 whereby an employee has a right not to be unfairly dismissed, a right to be paid compensation if made redundant and a right to be paid arrears of wages. These rights are subject to a number of limitations but where the company is unable to pay these amounts the Government operated Redundancy Payments Service ensures the employees are paid what is owed.

If, as is commonly the case, the company's business is transferred by the administrator to a buyer, the effect of the Transfer of Undertakings (Protection of Employment) Regulations 2006 is broadly to transfer the employees' contracts of employment on existing terms to the buyer. Any employment law rights the employee had against the former employer are therefore preserved and enforceable against the new employer.

5.4.5 Information

Paragraph 47 of Schedule B1 of the Act requires that, as soon as is reasonably practicable after appointment, the administrator shall require one or more relevant persons to provide the administrator with a statement of the affairs of the company.

The statement must, amongst other things:

(a) be verified by a statement of truth;

(b) give particulars of the company's property, debts and liabilities;

(c) give the names and addresses of the company's creditors;

(d) specify the security held by each creditor; and

(e) give the date on which each security was granted.

A "relevant person" for these purposes means:

(a) a person who is or has been an officer of the company;

(b) a person who took part in the formation of the company during the period of one year ending with the date on which the company enters administration;

(c) a person employed by the company during that period; and

(d) a person who is or had been during that period an officer or employee of a company which is or has been during that year an officer of the company.

A person required to submit a statement of affairs must do so within 11 days beginning with the day on which they receive notice of the requirement. A person commits an offence if they fail to comply with a reasonable requirement to provide the administrator with a statement of the affairs of the company.

5.4.6 Administrator's powers and duties

Under paragraph 59 of Schedule B1 of the Act, the administrator has the power to do anything necessary or expedient for the management of the affairs, business and property of the company. Without prejudice to the generality of this statement, the administrator also has the wide-ranging powers specified in Schedule 1 of the Act which include the power to dispose of assets and to bring or defend legal proceedings. In exercising their functions under Schedule B1 of the Act, the administrator acts as the company's agent. A company in administration or an officer of a company in administration may not exercise a management power without the consent of the administrator. For these purposes a "management power" means a power which could be exercised so as to interfere with the exercise of the administrator's powers.

As mentioned above, an administrator must on appointment take custody or control of all the property to which they think the company is entitled.

An administrator is required to manage the company's affairs, business and property in accordance with:

(a) any proposals approved;

(b) any revision of those proposals made by the administrator which they do not consider substantial; and

(c) any revision of those proposals approved under paragraph 54 of Schedule B1 of the Act by the creditors.

This is subject to any directions which may be given by the court. However, the court may only give such directions if:

(a) no proposals have been approved by the creditors;

(b) the directions are consistent with any proposals or revision approved by the creditors;

(c) the court thinks the directions are required to reflect a change in circumstances since the approval of the proposals (or their revision); or

(d) the court think the directions are desirable because of a misunderstanding about proposals or a revision approved.

An administrator will frequently wish to sell a company's business as a going concern and as part of the sale will wish to include assets which may be subject to security or which are owned by others under hire purchase or retention of title contracts.

The ability of an administrator to sell assets subject to a security depends on the type of security interest conferred. Under paragraph 70 of Schedule B1 of the Act an administrator may dispose of or take any action relating to property which is subject to a floating charge as if it were not subject to the charge. In relation to any property subject to a security which is not a floating charge, such as a fixed charge, paragraph 71 of Schedule B1 of the Act provides that the administrator may apply to court for an order permitting them to dispose of that property where the court thinks such disposal would be likely to promote the purpose of administration. In addition, under paragraph 72 of Schedule B1 of the Act, assets subject to hire purchase or retention of title contracts may be sold by the administrator providing the administrator obtains a court order permitting such a disposal. Where assets are disposed of under paragraph 70, the floating charge transfers to the proceeds of sale. Where a court orders the sale of assets under paragraphs 71 or 72, it will require that the proceeds of sale are used first to pay off the secured creditor or owner of the assets. If the sale proceeds are not equal to the market value, the administrator must use other assets of the company to make up the shortfall.

5.4.7 *Processes for claims and verification*

The administrator of a company may make a distribution to a creditor of the company which must be made according to the statutory priority of creditors. A payment may not be made by way of distribution to a creditor of the company who is neither secured nor preferential unless the court gives permission.[12] Only creditors of the company are eligible to receive distributions under paragraph 65 of Schedule B1 of the Act and, for these purposes, a debt of the company is any debt or liability to which the company is subject at the date it goes into administration or to which it becomes subject by reason of any obligation incurred before that date.

Under rule 14.3 of the Rules, a creditor wishing to recover a debt must submit a "proof" of that debt to the administrator. In certain types of case, an administrator may have to spend significant time and energy in agreeing the proofs of relatively low value creditors and so the Act permits an administrator (and other office-holders) to pay dividends to small value creditors based upon the information contained within the company's statement of affairs or accounting records. In such circumstances, a creditor is deemed to have proved for the purposes of determination and payment of a dividend where the debt is no greater than GBP 1,000.

[12] Unless the payment is a distribution to unsecured creditors under the prescribed part deduction from the floating charge proceeds provision in s 176A of the Act – for which see below in para 5.9.5.4.

An administrator may allow or reject a proof of debt (or reject it in part). Any creditor has the right to apply to court to ask it to review any decision by the administrator to allow or reject a proof of debt.

Generally, where an administration has come to an end and there are funds to distribute to unsecured creditors (once the administrator has paid off secured and preferential creditors), the administration will usually be converted into a creditors' voluntary liquidation and the liquidator will make the required dividend payments to the unsecured creditors.

The administrator of a company may make a payment otherwise than in accordance with paragraph 65 of Schedule B1 of the Act if they think it likely to assist the achievement of the purpose of the administration. This power will only be exercised in unusual circumstances, for example, English administrators of foreign registered companies have been permitted to apply local rules of distribution instead of the English distribution and priority rules, where doing so was likely to advance the purposes of the administration.

5.4.8 *Formulation and submission of proposals*

The administrator is under a general duty to make a statement setting out proposals for achieving the purpose of administration. The statement must include amongst other things:

(a) details of the administrator's appointment;

(b) if a statement of affairs has been submitted, a copy or summary of it, (and an explanation of why there was no statement of affairs if one was not provided);

(c) a full list of the company's creditors;

(d) a statement of how it is proposed that the purpose of the administration will be achieved, and how it is proposed that the administration will end, including, where it is proposed that the administration will end by the company moving to a creditors' voluntary winding up details of the proposed liquidator (who will usually be the administrator);

(e) a statement of the method by which the administrator has decided to seek a decision from creditors as to whether they approve the proposals;

(f) the manner in which the affairs and business of the company have, since the administrator's appointment, been managed and financed, and will, if the administrator's proposals are approved, continue to be managed and financed.

Where applicable, the proposals must explain why the administrator thinks that the objectives of rescue or a better result than an immediate liquidation cannot be achieved. The proposal may include a proposal for a company voluntary arrangement (CVA) under the Act or a proposal for a restructuring plan or scheme of arrangement under the Companies Act 2006. The administrator's proposals may not include any action that would affect the rights of secured or preferential creditors without their consent.

The proposal must include a statement of the basis on which it is proposed that the administrator's remuneration should be fixed by a decision of the creditors (or creditors' committee if there is one).

The administrator must send a copy of the proposals to the Registrar of Companies, every creditor of the company of whose claim and address they are aware and every member of the company of whose address they are is aware. They must send out the statement of proposals as soon as reasonably practicable, and in any event within eight weeks of the date the company entered administration.

5.4.9 *Approval of the proposals*

The administrator must seek a decision from the creditors as to whether or not they approve the administrator's proposals. The initial decision date for that decision must be within 10 weeks of the date the company entered administration, subject to extension as for sending out proposals.

As already explained above all decisions of creditors are now made by "decision procedures" which may or may not include an actual meeting being held. The default position is that no creditors' meeting will be held.

The decision of the creditors will be made using either the deemed consent procedure or a qualifying decision procedure. The deemed consent procedure permits a decision to be made by notifying creditors of the intended decision (here the approval of the statement of proposals) and if that decision is not effectively objected to, it is deemed to have been made. The deemed consent procedure applies to any decision unless 10% by value of the creditors object before the date stated for the deemed consent procedure to take effect. In the absence of the 10% objection, the deemed consent is effective.

Deemed consent can generally be used for all decisions in administration (except for fixing the basis of the administrator's remuneration).

Where deemed consent is effectively objected to or where the administrator decides not to use it, a decision is instead made by one of five qualifying decision procedures listed in rule 15.3 of the Rules, namely: (a) correspondence, (b) electronic voting, (c) virtual meeting, (d) physical meeting, or (e) any other decision making procedure which enables all creditors who are entitled to participate in the making of the decision to participate equally. The decision date is to be set at the discretion of the administrator (termed the convener), but must be not less than 14 days after the date of delivery of the notice.

The administrator does not normally need to seek a decision of the creditors if the statement of proposals states that they think that:

(a) the company has sufficient property to pay all its creditors in full;

(b) the company has insufficient property to enable a distribution to be made to unsecured creditors other than by virtue of the prescribed part under section 176A of the Act;[13] or

(c) neither the rescue nor the better result purpose (under paragraph 3 of Schedule B1) can be achieved.

The administrator must still seek a decision from the creditors as to whether or not they approve the proposal if requested to do so by creditors whose debts amount to at least 10% of the total debts of the company.

The creditors may approve the proposals by a simple majority in value of the unsecured creditors who take part in the decision procedure, without modification, or with modification to which the administrator consents.

Where the administrator reports to the court that the creditors have failed to approve the proposal (or a proposed revision), the court may:

(a) provide that the administrator's appointment shall cease to have effect;

(b) adjourn the hearing;

(c) make an interim order;

(d) make a winding up order on a petition suspended as a result of appointment by a floating charge holder;

(e) make any other order the court thinks appropriate.

The administrator must report the result of the creditors' decision to the court, the Registrar of Companies, and every creditor of whom they are aware.

The creditors may establish a creditors' committee. Rule 17.30 of the Rules provides that, where it is resolved to establish a creditors' committee, it shall consist of at least three and not more than five creditors of the company elected by creditors' decision. The administrator must call a first meeting of the committee to take place within six weeks of its establishment. After the calling of the first meeting, the administrator must call a meeting if so requested by a member of the committee.

A creditors' committee may require the administrator: (a) to attend on the committee at any reasonable time of which they are given at least seven days' notice, and (b) to provide the committee with information about the exercise of their functions. The committee shall assist the administrator in discharging their functions and act in relation to them in such manner as may be agreed from time to time. Importantly, if there is a creditors' committee, it will decide upon the administrator's remuneration.

[13] A statement made under the Insolvency Act 1986, Sch B1, para 52(1)(b).

5.4.10 Modification of proposals

The administrator must seek a further decision of the creditors if they propose to make substantial revisions to proposals which have already been approved. The decision may approve the proposed revision without modification, or with modification to which the administrator consents.

The administrator must also seek a decision of the creditors (on any matter) if requested by creditors whose debts amount to at least 10% of the total debts of the company or if directed by the court.

5.4.11 Post-commencement financing

As part of the wide-ranging powers which administrators have under Schedule 1 of the Act, they may borrow money to use in pursuing the objective of the administration. In the same way that liabilities under adopted contracts of employment attract "super priority" under paragraph 99 of Schedule B1 of the Act, so does any liability or debt arising out of a contract entered into by the administrator. This means that any financing taken out by the administrator will be payable in priority to the administrator's own fees and expenses. The liability is charged on any property held by the administrator and has an equal priority to sums owed to employees whose contacts of employment have been adopted by the administrator.

5.4.12 Administrator's fees and expenses

An administrator' remuneration must be fixed either:

(a) as a percentage of the value of the property with which the administrator has to deal;

(b) by reference to the time properly spent by the administrator and their staff in attending to the administration (the time-cost basis); or

(c) as a set amount (or a combination of any of the three bases).

If there is a creditors' committee in place the task of determining the basis for the administrator's remuneration will fall to it. If there is no committee or it does not fix the basis of remuneration, the creditors may fix the basis of remuneration by a decision procedure.

Where the administrator has made a statement under paragraph 52(1)(b) of Schedule B1 of the Act to the effect that there are insufficient funds to enable a distribution to be made to unsecured creditors other than under the prescribed part provisions under section 176A of the Act, and there is no creditors' committee, or the committee fails to determine the basis of remuneration, the basis may be fixed by either the consent of each secured creditor of the company or, where the administrator intends to make a distribution to preferential creditors, the consent of each secured creditor and a decision procedure of the preferential creditors (effectively a majority in value of the preferential creditors). The deemed consent procedure cannot be used for determining the remuneration of an administrator. A decision-making procedure is necessary.

In fixing the remuneration the creditors' committee or the creditors (as the case may be) must have regard to:

(a) the complexity or otherwise of the case;

(b) any respects in which responsibilities of an exceptional kind or degree fall on the administrator;

(c) the effectiveness with which the administrator appears to be carrying out or to have carried out his duties; and

(d) the value of the assets with which they have had to deal.

Most insolvency practitioners use the time-cost basis for their remuneration. Administrators (and other office-holders), who wish to use the time-cost basis for their remuneration, must provide a "fees estimate", that is an estimate of the likely fees to be incurred (and an estimate of the cost of other likely expenses which will be incurred) during the administration, prior to the basis of their remuneration being agreed. The administrator's remuneration can only exceed the fees estimate if the increase is approved (usually by the same creditor group who will have initially agreed to the basis for remuneration). If the creditors' committee or creditors, as the case may be, fail to fix the basis for remuneration, the administrator may apply to the court for it to be fixed.

Any secured creditor or any unsecured creditor with either the concurrence of at least 10% in value of the unsecured creditors or with the permission of the court, may apply to the court for an order:

(a) reducing the amount of remuneration which the administrator is entitled to charge;

(b) reducing any fixed amount;

(c) changing the basis of the remuneration;

(d) that some or all of the remuneration or expenses in question is not treated as an expense of the administration;

(e) that the administrator pay to the company the amount of the excess remuneration; or

(f) any other order it thinks just.

The application must be made no later than eight weeks after receipt by the applicant of the progress report which first reports the charging of the remuneration in question.

Rule 3.51 of the Rules lists the order of priority in which expenses incurred by an administrator are to be paid. It first lists those contractual liabilities with "super priority" under paragraph 99 of Schedule B1 of the Act. These are followed by the following list which are payable in the order listed:

(a) expenses properly incurred by the administrator in performing the administrator's functions;

(b) the cost of any security provided by the administrator;

(c) where an administration order was made, the costs of the applicant;

(d) where the administrator was appointed otherwise than by order of the court – the costs and expenses in connection with the making of the appointment;

(e) any amount payable to a person in respect of the statement of affairs;

(f) any necessary disbursements by the administrator in the course of the administration;

(g) the remuneration of any person who has been employed by the administrator;

(h) the administrator's remuneration; and

(i) the amount of any corporation tax on chargeable gains accruing on the realisation of any asset of the company during the administration.

5.4.13 Publicity

During the administration of a company, all its business documents which will include its orders and invoices (whether hard copy or electronic) and any websites must state the name of the administrator and that they are managing the company's affairs.[14]

As soon as reasonably practicable, the administrator must send a notice of their appointment to, amongst others, the company and its creditors. Within seven days of appointment they must send a notice to the Registrar of Companies.[15] The Rules require notice of the appointment to be advertised in the Gazette and to be advertised in such other manner as the administrator thinks fit.[16]

The administrator is required to send a number of "progress reports" to the creditors, the court, and the Registrar of Companies. The reports are required to cover the period of six months from the date the company went into administration and every subsequent period of six months, or the period until the administrator ceases to act. Each report must be sent within one month of the end of the period covered by that report.

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14 Insolvency Act 1986, Sch B1, para 45.
15 *Idem*, para 46.
16 Insolvency Rules 2016, r 3.27.

On the conclusion of an administration the administrator is required to prepare a "final progress report" which is a progress report which includes a summary of:[17]

(a) the administrator's proposals;

(b) any major amendments to, or deviations from, the proposals;

(c) the steps taken during the administration; and

(d) the outcome.

5.4.14 Pre-packs

A "pre-packaged" sale (or "pre-pack" administration) process has been described in the following terms:[18]

> "Pre-packs are increasingly common and highly controversial. The term refers to a sale of all or part of the business and assets of a company … negotiated 'in principle' while it is not subject to any insolvency procedure, but on the footing that the sale will be concluded immediately after the company has entered into such a procedure, and on the authority of the insolvency practitioner appointed."

A pre-pack therefore commonly involves a financially distressed company entering into an agreement along with a prospective administrator to sell the business of a company immediately after the administrator is appointed. The sale is usually on day one of the administration and will not therefore allow for the administrator to prepare proposals or have those proposals considered and voted upon by the company's creditors prior to the sale. The deal is negotiated in secret and the first the creditors hear of it is after the company has entered administration and the business has already been sold.

The advantages of pre-packs are that they provide certainty for suppliers, customers and employees, they preserve goodwill and alleviate the need to fund continuing trading during an administration. However, there are also concerns about pre-packs. Where a pre-pack is agreed, the administrator will not have been able to expose the business to the market in the course of the sale process. A pre-pack also limits consultation with creditors and raises concerns about transparency, particularly if the business is being sold to persons previously involved in the ownership or management of the company.

In light of these concerns, the Insolvency Service, in consultation with the insolvency regulatory authorities, issued Statement of Insolvency Practice 16 (SIP 16) which sought to increase transparency in the pre-pack process by setting out various matters to be borne in mind by insolvency practitioners. In particular, SIP 16:

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17 *Idem*, r 18.2.
18 *Re Kayley Vending Ltd* [2009] BCC 578.

(a) emphasises that administrators should be mindful of the interests of unsecured creditors and clear about the nature and extent of their relationship with directors in the pre-appointment period;

(b) emphasises that, when considering the manner of disposal of the business or assets, administrators should bear in mind the requirements of paragraph 3 of Schedule B1 of the Act which provides, amongst other things, that the administrator must perform their functions in the interests of the company's creditors as a whole and, where the purpose of administration is to make a distribution to one or more secured or preferential creditors, the administrator is under a duty to avoid unnecessarily harming the interests of creditors as a whole;

(c) highlights the importance of giving unsecured creditors a detailed explanation and justification of why a pre-packaged sale was undertaken, so that they can be satisfied that the administrator has acted with due regard for their interests;

(d) provides a detailed list of information which should be disclosed to creditors in all cases where there is a pre-packaged sale. If there are exceptional circumstances which justify not providing such information, the administrator should provide the reasons why it has not been provided.

SIP 16 is designed to enable unsecured creditors to understand the pre-package sale process and to evaluate (and potentially challenge) its use by the administrator.

In response to pressure from creditor groups and the media, the Insolvency Service commissioned an independent report into pre-packs which reported in 2014. The Graham Review made a number of recommendations which were brought into force voluntarily by the insolvency practitioner profession. A re-drafted SIP 16 now contains an appendix detailing marketing essentials which need to be considered in order to ensure that a proper price is paid for the business informed by an independent valuation. Principles of marketing are now included.

In addition, the "Pre-Pack Pool" was set up. Purchasers of a business via a pre-pack were able voluntarily to ask an independent expert to assess whether or not the proposed sale was reasonable from the creditors' point of view. It was hoped that this voluntary process would become widespread and would encourage more confidence in the way pre-packs operate generally.

Despite these measures, pre-packs continued to be seen as a controversial practice and the Government has exercised a power to create regulations with mandatory provisions relating to pre-pack sales to connected persons by an administrator. The Administration (Restrictions on Disposal etc to Connected Persons) Regulations 2021 now restrict pre-pack sales which constitute a substantial disposal of the company's property to connected parties such as the existing management team. A substantial disposal is one where either all or a substantial part of the company's business or assets is being sold. The Regulations apply to any disposal within the first eight weeks of the administration. Prior to any such pre-pack sale, the Regulations require either (i) prior creditor consent via a decision procedure to the sale; or (ii) the connected party who is acquiring the business must obtain an independent opinion in relation to the sale, to justify the terms of the sale including the price. The independent opinion must come from an Evaluator who is suitably qualified to provide such an opinion. Members of the Pre-Pack Pool, for example, would be suitably qualified. The Evaluator need not be an insolvency practitioner.

The written opinion of the Evaluator must state whether the Evaluator is satisfied that the consideration for the sale and the grounds for the disposal are reasonable in the circumstances (so that the case for the sale is made) or that the Evaluator is not so satisfied (so that the case has not been made). The report will set out the Evaluator's reasons for the opinion and will summarise the evidence relied upon. The administrator must consider any report from an Evaluator but even where they concludes that the case for the disposal has not been made, the administrator can still proceed with the disposal but in such circumstances will be required to provide a statement setting out the reasons for doing so. The administrator will be required to send a copy of any Evaluator's report to creditors.

It remains to be seen whether the new regime will instil more confidence in the procedure but it has increased transparency and accountability of pre-packs in favour of connected parties.

5.4.15 Performance according to the proposals

It is possible that the successful completion of an administrator's proposals may lead to the rescue of the company as a going concern. If so, the administration will come to an end and the management of the company will be returned to the directors. This level of success is rare in practice. The most commonly encountered successful result of an administration is where the business is sold on to a buyer and, once the proceeds of sale are distributed amongst the creditors, the company itself is left as an empty shell which may need to be wound up or dissolved (for which see paragraph 5.4.16).

If an administrator appointed by an order of the court thinks that the purpose of the administration has been sufficiently achieved they shall make an application to the court for an order to the effect that the appointment is to come to an end from a specified time.[19] If the administrator has been appointed out-of-court, and they think the purpose of the administration has been sufficiently achieved, they file a notice with the court and with the Registrar of Companies which brings the administration to an end.[20]

5.4.16 Closure of administration proceedings

Under paragraph 76 of Schedule B1 of the Act, the appointment of an administrator will cease automatically one year after it takes effect, although it can be extended in the following ways:

(a) by order of the court, for a specified period;

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19 Insolvency Act 1986, Sch B1, para 79.
20 *Idem*, para. 80.

(b) with the consent of the creditors, for a specified period not exceeding one year.

Within five business days of automatic termination the administrator must file in court a notice of automatic termination together with a final progress report. A copy of the notice and report must be sent as soon as possible to the Registrar of Companies, to the directors and to all persons to whom notice of the appointment had been delivered.[21]

Under paragraph 83 of Schedule B1 of the Act, the administration may be converted into a creditors' voluntary liquidation where the administrator forms the view that:

(a) the amount due to each secured creditor has been paid or each secured creditor will receive payment in respect of its debt, and

(b) there will be a distribution to unsecured creditors (which is not a distribution by virtue of the prescribed part provisions of section 176A of the Act).

In those circumstances the administrator may send a notice to the Registrar of Companies. The notice must be accompanied by the administrator's final progress report, including details of the assets to be dealt with in the liquidation. As soon as reasonably practicable the administrator must file a copy of the notice and accompanying report in court and send a copy to, amongst others, all known creditors. When the Registrar registers the notice, the administrator's appointment comes to an end, the company goes into liquidation as if a resolution for voluntary winding up were passed on the day the notice is registered, and the winding up is deemed to have commenced on that date.

The liquidator will be:

(a) the person nominated in the administrator's proposals or revised proposals if approved by the creditors;

(b) an alternative person nominated by the creditors prior to the approval of the proposals;

(c) if no such person is nominated, the administrator.

Any creditors' committee which was in existence immediately before the end of the administration will continue in existence as if appointed as a liquidation committee.

If the administrator forms the view that there is no property for distribution to the creditors (after any distribution which might have been made to secured and preferential creditors) the administrator must take steps to dissolve the company. The administrator must send a notice to the Registrar of Companies, together with his final progress report. As soon as reasonably practicable the administrator must file a copy of the notice and accompanying report in court and send a copy to, amongst others, each creditor. The company will be dissolved three months after registration of the notice sent to the Registrar.

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[21] Insolvency Rules 2016, r 3.55.

5.5 Reorganisation: Company Voluntary Arrangement (CVA)

The Cork Committee had identified in 1982 a need for a simple procedure to be introduced, where the will of a significant majority of creditors in agreeing to a debt arrangement could be made binding on an unwilling minority. This gave rise to Part 1 of the Act and what is now Part 2 of the Rules which govern the operation of CVAs.

As we have seen above, the main statutory objective of administration is the rescue of the company. Although in practice such an objective is rarely achieved, the Act is designed so that an administrator, benefitting from the administration moratorium, may take the opportunity to put together a CVA proposal to which the creditors may agree. The CVA is designed to rescue the company. In these circumstances, the procedure is for the initial proposals from the administrator (under Schedule B1 of the Act) to be agreed by the creditors (by a simple majority in value of unsecured creditors taking part in the decision making procedure) and then a separate procedure needs to be followed for the creditors to agree to the terms of the CVA (a three-quarters majority of unsecured creditors need to approve a CVA).

A CVA must take the form of a scheme of arrangement (whereby a company promises full payment to creditors but spread over a period of time) or a composition of debts (where only a percentage of the debts owed are promised to be paid) or a combination of the two. It is common for unsecured creditors to accept the promise of payment of, for example, 50% of the debt owed, under the terms of a CVA, as they are likely to receive less than that percentage (if anything) if the company is instead placed into liquidation. Although there is no formal requirement for a company to be insolvent to enter into a CVA, it is unlikely that creditors would accede to a CVA if the company were not insolvent (or likely to become insolvent in the near future).

It is most commonly the directors of a company who propose a CVA without the company first being put into administration. Where the directors propose a CVA they must approach an insolvency practitioner to act as "nominee". The nominee's role is to opine on the proposal (and will frequently assist with its drafting in the role of adviser as distinct from nominee). If the nominee's opinion is that the proposal has "a reasonable prospect of being approved and implemented" that opinion will be filed at court and the proposal will be put to the members and creditors of the company. If the unsecured creditors agree to it by a majority of at least 75% in value of those creditors voting (with at least 50% of creditors unconnected to the company voting in favour), the CVA becomes binding upon the company and all the unsecured creditors (even those who voted against the proposal or were unaware of the CVA proposal because, for example, they did not receive notice of the creditor decision procedure as they were future or contingent creditors at the time). Secured creditors are only bound if they agree to be bound (a CVA may not be approved which fails to recognise the priority of preferential creditors which usually requires preferential creditors to be paid in full before any other unsecured creditors receive any dividend under the CVA). Creditors may apply to the court if the CVA's terms are unfairly prejudicial (for example, if unsecured creditors are treated differentially under the terms of the CVA) or if there was some material irregularity in the procedure leading up to its approval (for example, if valid votes of creditors are not counted for some reason).

Once approved, the CVA is given effect to under the supervision usually of the nominee who becomes the "supervisor" upon the CVA being approved. Its terms are then carried out in much the same way as any other commercial contract. It is common for a CVA to permit the business of the company to continue on the basis that a proportion of the company's debts will be paid off by monthly instalments (often over a period ranging from three to five years). If all creditors are paid what the CVA has promised, the CVA will complete. If the company does not satisfy the terms of the CVA, for example, if it is unable to keep up with monthly payments, the CVA's terms will often have provisions for how to deal with its termination. A CVA which terminates will often lead to the company entering a subsequent insolvency procedure, most often a liquidation.

The CVA procedure in itself contains no moratorium on actions against the company whilst the CVA proposal is prepared and considered. Creditors may therefore frustrate a possible CVA by enforcing their rights prior to the decision-making procedures convened to approve the proposal. In cases where a moratorium would be helpful in allowing time to permit the CVA to be put to the creditors, two main possibilities exist.

As mentioned above, the company may be placed into administration. The moratorium on creditor enforcement action may permit the administrator, who will have taken over the directors' management role, some respite from creditor harassment whilst they attempt to achieve the primary purpose of administration, that is, to rescue the company.

It is possible for the directors of a company to remain in post and, without the need to enter administration, to acquire the benefit of a short-term Moratorium under Part A1 of the Act (discussed below).

From the directors' viewpoint, putting the company into administration so as to ensure a stay on creditor action, has the marked weakness that the administrator controls the company and the process, not the directors. It may also prove to be expensive due to the administrator's fees.

The Part A1 Moratorium permits the directors to remain in control of the company.

Although the Act states that a liquidator may suggest a CVA, in practice this is extremely rare.

5.6 Reorganisation: Moratorium

The 2020 Act introduced the new Moratorium by way of a new Part A1 to the Act. The Moratorium is a standalone procedure and is not linked to any other procedure. The Moratorium is a debtor-in-possession procedure whereby the directors remain in control of the company, subject to the supervision of a monitor. The intention behind entering the Moratorium is to rescue the company as a going concern.

Directors can apply for a Moratorium by filing relevant documents in court. The directors are required to state that they wish to apply for a Moratorium and that the company is, or is likely to become, unable to pay its debts (as defined under s 123 of the Act). No court hearing is required.

If there is an outstanding winding up petition (or the company is an overseas company) the directors will have to apply to court for a Moratorium and the court will only make an order where it is satisfied that the Moratorium would 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 a Moratorium).

Assuming no court hearing is required, the process of filing relevant documents at court leads automatically to a Moratorium for an initial period of 20 business days. This period can be extended by the directors for a further period of 20 business days by the filing of further relevant papers in court (or with creditor consent for a maximum period of up to one year in total). In either case there is no court hearing but in both cases the directors must make a statement that all debts which have fallen due during the Moratorium have been paid, and that, in their view, the company is, or is likely to become, unable to pay its pre-moratorium debts. The directors' statement must be accompanied by a statement from the monitor that, in the monitor's view, it is likely that the extension to the Moratorium will result in the rescue of the company as a going concern. An extension beyond one year is possible but that does require an application to the court.

The Moratorium is also extended where consideration of a CVA is pending and the Moratorium then lasts until the CVA proposal has been considered (whether it is approved or rejected).

The Moratorium is subject to the agreement to act, and continued supervision, of a monitor. The monitor must be a licensed insolvency practitioner who will be an officer of the court.

Companies will not be eligible to apply for a Moratorium if:

- they are already subject to an insolvency procedure;
- a winding up petition is outstanding (unless the court orders otherwise);
- if, at any time in the period of 12 months ending with the filing date, a Moratorium of the company was in force; and
- if, at any time in the period of 12 months ending with the filing date, the company was subject to an insolvency procedure (such as a CVA, administration or liquidation).

Certain specific types of company are also ineligible for a Moratorium (for example, any company which owes a capital market debt of at least GBP 10 million, insurance companies; banks; electronic money institutions; recognised investment exchanges and clearing houses; securitisation companies; parties to capital market arrangements; public-private partnership project companies; and overseas companies with corresponding functions).

The procedure effectively requires the company to be able to pay debts as they fall due during the Moratorium. The Moratorium provides a stay on actions in relation to debts incurred prior to the Moratorium only. There are restrictions on the company paying most of its pre-Moratorium debts, the so-called "payment holiday".

Prior to the commencement of the Moratorium, the monitor has to state that the company is an eligible company and that, in their view, it is likely that a Moratorium for the company would result in the rescue of the company as a going concern.

The Moratorium does not prevent enforcement of creditor actions in relation to debts incurred during the Moratorium but does impose restrictions on the enforcement or payment of the debts which are pre-Moratorium debts for which a company has a payment holiday during the Moratorium.

There is a stay on enforcement of pre-Moratorium debts (that is, debts falling due before the Moratorium and which fall due during the Moratorium by reason of a pre-Moratorium obligation) except in so far as they consist of amounts payable in respect of:

(a) the monitor's remuneration or expenses;

(b) goods or services supplied during the Moratorium;

(c) rent in respect of a period during the Moratorium;

(d) wages or salary arising under a contract of employment;

(e) redundancy payments; or

(f) debts or other liabilities arising under a contract or other instrument involving "financial services" which term is somewhat inexactly defined as including a contract consisting of lending, financial leasing or providing guarantees.

The role of the monitor is to monitor the company's affairs for the purpose of forming a view as to whether it remains likely that the Moratorium will result in the rescue of the company as a going concern. If such a rescue is no longer likely the monitor must bring the Moratorium to an end. Similarly, the monitor must terminate the Moratorium if they think that the company is unable to pay any of its Moratorium debts (or pre-Moratorium debts for which the Moratorium does not provide the company a payment holiday).[22] A significant issue for a company which is considering using a Moratorium is that it will usually require the support of its bank or other secured creditor. As the payment holiday does not prevent such financial creditors from demanding payment during a Moratorium, if such demand is made, it will usually result in the company being unable to pay that debt in which case the monitor must bring the Moratorium to an end.

The actions and remuneration of monitors (and the actions of directors) may be challenged by creditors in the court.

The stay on actions created by the Moratorium is very similar to the stay or moratorium imposed when a company enters administration. During the Moratorium, the company cannot generally

[22] For an example of a situation where a company became unable to pay its "financial services" debts (money owed under a guarantee to a bank) during a Moratorium, see *Re Corbin & King Holding Ltd* [2022] EWHC 340 (Ch).

enter liquidation or administration; no landlord can exercise a right of forfeiture, generally security rights cannot be enforced and again, generally no legal process may be instituted or continued against the company.

Floating charges will not crystallise during the Moratorium and the directors may continue to run the company in the ordinary course of business with any major decisions being subject to the consent of the monitor or the court.

A Moratorium comes to an end if the company enters into a scheme or arrangement or restructuring plan (under Parts 26 or 26A of the Companies Act 2006) or enters into a relevant insolvency procedure (for example, a CVA, administration or liquidation).

A peculiarity of the Moratorium is that if the company is not rescued as a going concern but instead enters administration or liquidation within 12 weeks of the end of the Moratorium, the priority of debts in that subsequent administration or liquidation may be different to the priority of debts which existed prior to the Moratorium. Section 174A provides that certain unpaid pre-Moratorium or Moratorium debts (the debts which are not part of the payment holiday), such as debts owed to employees or "financial services" debts, are paid in the subsequent liquidation, in priority to even the liquidator's fees and expenses. Section 174A therefore affords certain unsecured debts a form of "super priority" in a subsequent liquidation. For example, if a director has not been paid for months prior to a Moratorium, if the Moratorium leads to an unsuccessful rescue attempt and the company enters liquidation, the pre-Moratorium unsecured debt of the director will acquire "super priority" in the liquidation. Unsecured (or secured) pre-Moratorium bank debt, falling within the definition of "financial services", will also acquire such a "super priority" although there is an exception which prevents such liabilities acquiring such "super priority" where the debt is accelerated debt, that is, any pre-moratorium financial services debt which fell due by reason of the operation of, or exercise of rights under, an acceleration or early termination provision in the financial services contract.

5.7 Reorganisation: Scheme of Arrangement

Under Part 26 of the Companies Act 2006, a company can enter into a scheme of arrangement which is binding on all its creditors. Voting by creditors is carried out by different classes of creditors. Broadly speaking this means that classes of both secured creditors and unsecured creditors must vote separately to approve the scheme. Such a scheme may be used by both companies which are solvent and those which are insolvent. Indeed, it is designed primarily for the reorganisation of solvent companies even though it is frequently used by companies which are insolvent or are likely to become insolvent. Due to the time and relatively lengthy procedure that needs to be followed, a Companies Act scheme is realistically only an alternative to a CVA where the company in question is reasonably large with a reasonable asset base. It is usually not feasible for a small company to consider due to the time and costs involved. It will take a good deal longer to set up than a CVA.

There is no provision for a moratorium on creditor actions during the planning period for a scheme and so it may be necessary to combine a scheme with first putting the company into administration or obtaining a Moratorium if protection from creditor action is required whilst the scheme is put together and considered by the company and its creditors. In practice, a scheme is sometimes entered into by first putting the company into liquidation or provisional liquidation and asking the court to stay all proceedings against the company while the liquidator acts to obtain the approval of the company, its creditors and the court. If a petition for winding up has been presented to the court and a scheme is proposed, the court will usually order the winding-up proceedings to stand over and stay proceedings against the company pending the approval or otherwise of the scheme.

The procedure to enter into a Part 26 scheme is court led. It is commenced with an application to the court. The company, a creditor, a member, an administrator or a liquidator may apply to the court. A scheme can lead to an element of cramdown on minority creditors in particular classes but cannot cramdown a whole dissenting class. The scheme may affect the respective rights of the company and its creditors (or a class of creditors) and / or the company and its members (or a class of them). The court may order that meetings of creditors (or classes of creditors) and / or members (or classes of members) affected by the proposed scheme are summoned. Care is required when "determining the correct classes of creditor, for which purpose the relevant criteria are the existing rights of creditors and their rights as affected by the scheme".[23] Each meeting (or class meeting) must approve the scheme by a simple majority in number and a majority of 75% or more in value of the creditors or members present and voting. After the meetings have approved the scheme there is a second hearing. If the court sanctions the scheme at this hearing, it becomes binding on all the company's creditors or members (as the case may be). The court will look to ensure that the procedure has been carried out correctly and also that the scheme is fair to all creditors bound by it, including those who voted against it. The meaning of "fairness" in this context has a very similar meaning to "fairness" when considering claims that a CVA is "unfairly prejudicial". Members of classes of creditors or members must generally be treated in the same way under the terms of the scheme (subject to existing priorities).

In most corporate insolvency situations, a scheme does have some potential advantages over a CVA. A number of overseas companies have in recent years used the Part 26 scheme to restructure their companies in preference to using the restructuring mechanisms available under their respective domestic legal regimes. A scheme can be made binding upon members of a class of creditors (for example, secured creditors) even where not all the class consents to it. This is different to a CVA, which cannot be made binding upon any secured creditor without its consent. The management of a company subject to a scheme usually remains in place and so control of the company is not lost to an independent insolvency practitioner as it would be if the company entered administration. This avoids costs and any external party investigating past dealings of the company which may be above suspicion, but would still entail time consuming costs.

5.8 Reorganisation: Restructuring Plan

The 2020 Act introduced a new Part 26A to the Companies Act 2006 which largely replicates the mechanism already available as the Scheme of Arrangement under Part 26 of the 2006 Act.

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23 Per Richards J in *Re T & N Ltd* [2005] 2 BCLC 488 at 79.

Similar to Part 26 Schemes, a Part 26A Restructuring Plan requires an initial application to the court which is asked to order class meetings of creditors (and members). Again, similar to a Scheme of Arrangement, once the Restructuring Plan is approved at these meetings, the court is then asked to sanction the Plan and it is then given effect by court order.

The Part 26A Restructuring Plan is a debtor-in-possession procedure. It allows a company in financial difficulties to enter into an arrangement or reconstruction. Part 26A applies to all companies, including overseas companies which are liable to be wound up in England and Wales.

A compromise or arrangement under Part 26A is only available where:

(1) the relevant company has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern (this appears to be a widely defined gateway and would seem to include a great many trading companies); and

(2) (a) that a compromise or arrangement is proposed between the company and

(i) its creditors, or any class of them, or

(ii) its members, or any class of them, and

(b) the purpose of the compromise or arrangement is to eliminate, reduce or prevent, or mitigate the effect of, any of the said financial difficulties.

On the application of the company, any creditor or member of the company, a liquidator or administrator, the court may order that a meeting of the creditors or class of creditors, or the members, or a class of members, be summoned in such manner as the court directs.

The court may sanction the compromise or arrangement if a number representing 75% or more in value of the creditors or class of creditors, or members or class of members (as the case may be) agree to terms of the Restructuring Plan. This differs from a Part 26 Scheme which requires a majority in number as well as 75% or more in value of each class to approve the Scheme.

The other main characteristic which distinguishes the Part 26A Restructuring Plan from a Part 26 Scheme is the ability of the court to cram down a dissenting class which does not approve the Restructuring Plan. In circumstances where one or more classes dissent, if Conditions A and B below are met, the fact that the dissenting class has not agreed to the Restructuring Plan will not prevent the court from granting sanction.

Condition A is that the court is satisfied that, if sanctioned, none of the dissenting class would be any worse off than they would be in the event of the "relevant alternative" (which will usually be a liquidation or administration).

Condition B is that the compromise or arrangement has been agreed by 75% in value of at least one class of creditors or members, as the case may be, who would receive a payment, or have a genuine economic interest in the company, in the event of the "relevant alternative".

As long as Conditions A and B are satisfied, one class of creditor can impose, via a court order, the Restructuring Plan on all classes of creditor, even dissenting creditor classes.

The potential benefit of using the cross class cram down under a Part 26A Restructuring Plan as opposed to a Part 26 Scheme of Arrangement may be seen from the following example.

A company has unsustainable debts of GBP 310 million and assets totalling GBP 286 million (realisable in a liquidation – which is the next most likely outcome if the proposal is not sanctioned). The table shows how a proposal seeks to redistribute value from Class 1 creditors to Class 3 creditors and how the different classes of creditors intend to vote.

Creditor class	Details	For or against
Class 1	• Debt: GBP 250 million • In liquidation, would receive: GBP 250 million • Proposal: retain debt of GBP 240 million	For
Class 2	• Debt: GBP 50 million • In liquidation, would receive: GBP 35 million • Proposal: retain debt of GBP 35 million	Against
Class 3	• Debt: GBP 10 million • In liquidation, would receive: GBP 1 million • Proposal: retain debt of GBP 5 million	For

Class 1 creditors are top-ranking secured creditors. Class 2 are also secured creditors but with a lower priority. Class 3 are trade suppliers, some with the benefit of retention of title clauses. Any rescue of the company will need to ensure supplies are continued in the future.

Class 1 is keen to support the company's long-term survival and is willing to allow Class 3 creditors to share in the value of its interest in the company's assets. Class 3 can see how it will benefit under the proposal as opposed to their position in a liquidation. Classes 1 and 3 therefore will vote in favour of the proposal.

Class 2 is not supportive of the proposal. It is attempting to "hold out" for a bigger share of the assets. They will receive the same value whether the proposal goes ahead or whether the company goes into liquidation. Class 2 will therefore vote against the proposal.

If the proposal is to be sanctioned by the court as a Scheme of Arrangement under Part 26, all classes of creditor will need to vote in favour. The rejection of the proposal by Class 2 will prevent the Scheme being approved and the company is potentially left only with the option of liquidation.

If the proposal is put forward as a Part 26A Restructuring Plan, the court will be able to sanction the Plan as the class that voted against it would be no worse off than they would be in the next most likely outcome (liquidation). The court therefore has an absolute discretion to sanction the Plan but may still refuse to sanction if it is just and equitable to do so. Class 2 may therefore be crammed down under Part 26A in circumstances where this would not be possible with a Part 26 Scheme.

Self-Assessment Exercise 2

Question 1

What are the three statutory objectives for administration?

Question 2

In what ways may an administrator be appointed and by whom?

Question 3

List at least four elements of the administration moratorium on actions?

Question 4

How long does an administration last unless it is extended?

Question 5

Who decides on how the administrator is remunerated?

Question 6

Can the administrator make a distribution to unsecured creditors?

Question 7

Can an administrator ever sell assets which are held under a retention of title clause contract?

Question 8

How does a pre-pack administration differ from a traditional administration?

Question 9

In what circumstances can a company move directly from administration to dissolution?

Question 10

Who is entitled to "super priority" in administration and what does this mean?

Question 11

Who can propose a CVA?

Question 12

On what grounds can a creditor object to the court about an approved CVA?

Question 13

What form must a CVA take?

Question 14

True or False? There is no requirement for any court approval for a CVA.

Question 15

True or False? There is no requirement for any court approval for a scheme of arrangement under the Companies Act 2006.

Question 16

True or False? In order for a company to enter a Moratorium the proposed monitor must state that the company will be able to pay all debts which fall due during the Moratorium?

Question 17

How do Part 26A Restructuring Plans differ from Part 26 Schemes of Arrangement?

Question 18

Which reorganisation procedures may be described as debtor-in-possession and which require the appointment of an outsider to take over the company's management?

For commentary and feedback on self-assessment exercise 2, please see APPENDIX A

5.9 Liquidation

5.9.1 Introduction

Liquidation is a terminal procedure that leads to the company being dissolved and ceasing to exist. It may be used by solvent companies where the participators wish to bring the business to an orderly end and to receive payment of the surplus funds once all the assets are realised and all the creditors have been paid. More commonly, a company that enters liquidation will be insolvent and therefore unable to pay all its creditors. In such circumstances, the purpose of liquidation is to ensure that all the company assets are got in; any questionable circumstances leading up to its liquidation are investigated and appropriate action taken to swell the assets of the company and, if necessary to punish any wrongdoers; and the assets are realised and distributed to the creditors in the most efficient manner subject to the statutory order of distribution. A liquidator will not usually look to trade the company's business and has a power only to continue the business to the extent that it is needed for a beneficial winding up (for example, the liquidator may complete partly manufactured goods with a view to selling them).

5.9.2 Opening of liquidation proceedings

Liquidation may be commenced voluntarily by the company's members (termed voluntary liquidation and there is no involvement of the court unless its assistance is called upon) or it may be commenced by a petition to the court which may order the company to be wound up (termed compulsory liquidation or winding up by the court).

5.9.2.1 Voluntary liquidation

A voluntary liquidation is an out-of-court procedure which commences on the passing by the company of:

(a) a special resolution that the company be wound up voluntarily; or

(b) when the period (if any) fixed for the duration of the company by its constitution has expired, or some other event occurs on the happening of which the articles provide that the company shall be dissolved, an ordinary resolution that the company be wound up voluntarily (this is rare in practice).

There are two types of voluntary liquidation – members' voluntary liquidation where the company is solvent and creditors' voluntary liquidation where the company is insolvent. Both are commenced by a members' special resolution (75% of members voting) although in a members' voluntary liquidation, the members decide who is to be the liquidator. The creditors will be paid in full in a members' voluntary liquidation and therefore have little involvement in the liquidation. In a creditors' voluntary liquidation, although the members may choose a liquidator, the creditors may nominate an alternative and it is their choice who is appointed. As the members will not receive anything from an insolvent liquidation, it is the creditors who effectively have various powers as part of the process.

Under section 84 of the Act, a members' voluntary liquidation takes place when a declaration of solvency has been sworn by a majority of the directors before the passing of the winding-up resolution that the directors making it have conducted a full enquiry into the company's affairs and formed the opinion that it will be able to pay its debts, together with interest at the official rate, in full within a stated period not exceeding 12 months from the date of the commencement of the winding up (the date of the members' resolution). The members decide who is appointed as liquidator (as with all office-holders, the liquidator must be a licensed insolvency practitioner). Under section 89 of the Act, any director who makes a declaration of solvency without having reasonable grounds for believing that the company will be able to pay its debts in full within the period stated in the declaration of solvency, is liable to a fine or imprisonment or both. If the debts are not paid or provided for in full within the period stated in the declaration, it will be presumed that the director did not have reasonable grounds for their opinion unless they prove the contrary. In such circumstances, the members' voluntary liquidation comes to an end and is converted into a creditors' voluntary liquidation.

A creditors' voluntary liquidation is a voluntary liquidation which is not preceded by a declaration of solvency.

The creditors may, if they wish, appoint a liquidator and a liquidation committee. If they do not appoint a liquidator, any person appointed by the company itself will act instead. The purpose of a creditors' voluntary liquidation is to realise the company's assets and, after the payment of costs, to distribute the proceeds among the creditors according to their respective rights and interests.

In a creditors' voluntary winding up, at the same time that the members pass the resolution to wind up the company, they will usually also nominate a person to be liquidator. Under section 100 of the Act, the company's creditors may nominate their own choice of liquidator and the company's directors are under a duty to seek such a nomination from the creditors. The liquidator will be the person nominated by the creditors, or where no person is so nominated, the person (if any) nominated by the company. Under the Rules, the creditors' nomination must be sought either by way of the deemed consent procedure or a virtual meeting.

Under section 99 of the Act, the directors must make out a statement of the company's affairs and send it to the company's creditors within seven days of the day on which the company passes a resolution for voluntary winding up.

Under rule 6.19 of the Rules, when the decision is sought from the company's creditors as to nominations for the position of liquidator, the convener of the decision must at the same time invite the creditors to decide whether a liquidation committee should be established. The creditors may appoint a liquidation committee of up to five persons. It is often more convenient for the liquidator if a committee is appointed, since the liquidator then has a small group of people to whom they may turn for advice if necessary; and the liquidator will otherwise have to convene creditors' decision-making procedures to fix the liquidator's remuneration. As in administration, the committee has the power to fix the liquidator's remuneration and the process for so doing is effectively the same as for administrators.[24]

5.9.2.2 Winding up by the court

A compulsory liquidation is a winding up of a company by order of the court. "Compulsory liquidation" or "compulsory winding up" are the terms generally used, but the relevant legislation[25] refers to winding up "by the court". While compulsory liquidations are, generally speaking, intended to achieve the same purposes as voluntary liquidations there are some very important differences in the procedures, resulting in part from the fact that in fulfilling their functions the liquidator is acting as an officer of the court as well as an officer of the company.

As explained above at paragraph 5.3.2, the High Court has jurisdiction to wind up any company registered in England and Wales. If the paid-up share capital is GBP 120,000 or less, the county court has concurrent jurisdiction.

A petition may be presented to the court by a number of different parties (listed in section 124 of the Act) on a number of different grounds (listed in section 122 of the Act). The most frequent petitioner in practice is a creditor whose petition will be based upon the most frequent ground, that the company is unable to pay its debts (as defined in section 123 of the Act). A very small number of petitions are made by shareholders or directors on the "just and equitable" ground, usually where the company participators in a *quasi*-partnership company have fallen out and cannot continue to work together. The vast majority of compulsory liquidations involve companies which cannot pay their debts.

A company is deemed to be unable to pay its debts under section 123 of the Act if:

(a) a creditor to whom the company owes more than GBP 750 then due has served on the company at its registered office a demand requiring the company to pay the sum due and the company has for three weeks thereafter neglected to pay the sum or to secure or compound for it to the creditor's reasonable satisfaction;

(b) execution or other process issued on a judgment of any court in favour of a creditor of the company is returned unsatisfied in whole or in part;

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[24] See above at para 5.4.11.
[25] Insolvency Act 1986, s 73.

(c) it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due (cash flow insolvency); or

(d) it is proved 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 its contingent and prospective liabilities (balance sheet insolvency).

When the court makes a winding-up order, the Official Receiver (a Government employee) is usually appointed as the first liquidator. If the Official Receiver (or a majority of creditors) so decides, the Official Receiver may be replaced as liquidator by a private sector, licensed insolvency practitioner. Historically, the Official Receiver would look to hand over the liquidation of a company to a private sector liquidator whenever the company had sufficient assets to cover the fees of the private sector liquidator. If that was not the case, the Official Receiver would complete the liquidation and the costs of so doing would fall on the public purse. It is now the policy of the Official Receiver to hand over cases which require the specialist skills of a private sector liquidator, otherwise the Official Receiver will usually remain as liquidator unless the creditors resolve to replace them.

5.9.2.3 Cash flow insolvency

Section 123 of the Act contains the two tests of insolvency: (1) the "cash flow" or "commercial" test, and (2) the "balance sheet" test. The origins and development of these tests were examined in detail by the Supreme Court in *BNY Corporate Trustee Services Ltd v Eurosail-UK 2007-3BL plc*[26] covering the period from the Companies Act 1862 to the present day. The fundamental difference between the two tests is that in order to show "cash flow" insolvency, it must be shown that a company cannot pay its debts as they fall due. Even if a company is able to meet its current liabilities it may still be viewed as insolvent on the "balance sheet" test as it may have liabilities (including account being taken of the company's future and contingent liabilities) greater than it has assets. Section 123 of the Act permits either or both tests to be satisfied in order to show a company is unable to pay its debts to justify the court in making a winding up order.

Section 123(1)(e) of the Act provides that a company is deemed unable to pay its debts "if it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due". The main problem that the courts have experienced with this definition is deciding what debts it may take into account in deciding an inability to pay debts "as they fall due". For a long time, this was considered to include only debts currently owed with no element of futurity. This thinking has now changed and the court may consider both debts currently owed and those which will become due in the reasonably near future. The courts' recent line of decisions has therefore created a degree of uncertainty as to where the "cash flow" test ends and the "balance sheet" test begins when deciding upon a company's insolvency.

Lord Walker in *Eurosail* explained that the "cash flow" test "is concerned not simply with the petitioner's own presently-due debt, nor only with other presently-due debt owed by the company, but also with debts falling due from time to time in the reasonably near future. What

[26] [2013] UKSC 285.

is reasonably near future, for this purpose, will depend on all the circumstances, but especially on the nature of the company's business." His Lordship went on to explain that once the consideration of the company's financial condition requires the court to move on from the reasonably near future (whose duration will vary depending upon the company's individual circumstances) any attempt to apply the "cash-flow" test becomes merely speculative. It is at this point that a court must consider the "balance sheet" test, that is, whether a company's assets outweigh its liabilities (which test includes a requirement to take account of future and contingent as well as current liabilities).

5.9.2.4 Balance sheet insolvency

The Supreme Court in *Eurosail* explained that once the court looks beyond the reasonably near future, the "cash flow" test falls away and the court instead looks to the "balance sheet" test to compare the value of present assets with present, future and contingent liabilities (future debts are debts which will definitely become payable at a specific future date, whilst contingent liabilities may or may not even become payable). The balance sheet test is in itself not particularly difficult to apply where a company has only present liabilities. One can merely deduct the value of those liabilities from the value of the company's current assets.

The problem arises, as Lord Walker admitted, in deciding how a court must discount future and contingent liabilities to take account of deferment and probability. His Lordship stated the process was "very far from an exact test". On the facts of *Eurosail*, as some of the future liabilities may not have been fully determined for another 30 years, the court could not be satisfied that there would eventually be a deficiency. Little if any guidance was provided by the Supreme Court as to how future and contingent liabilities might be quantified for the purposes of section 123(2).

Although under the "balance sheet" test the court must take account of future (and contingent) liabilities, some discounting is required due to the long-term nature of some loans or other liabilities. Future profits are expected and these may be more than sufficient to enable the company to repay a long-term loan when it falls due, say in 10 years' time. With good management the company should be able to continue as a going concern for the foreseeable future, and so according to the Supreme Court's reasoning in *Eurosail*, it would not be reasonable for a court to decide that there would for sure, in 10 years' time, be a deficiency. Attempts to foresee the events of the next ten years would be "entirely speculative … incapable of prediction with reasonable confidence".

The consequence of the *Eurosail* case appears to be that any creditors relying upon debts falling payable in several years' time, or which are contingent, will need overwhelmingly convincing evidence that those future or contingent liabilities make the company insolvent today.

5.9.2.5 Hearing

At the hearing of a winding-up petition, the court has a wide discretion and may:

(a) make a winding-up order;

(b) dismiss the petition;

(c) adjourn the hearing conditionally or unconditionally;

(d) make an interim order; or

(e) make any other order it thinks fit.

If the debt due to the petitioning creditor is genuinely disputed, the court will normally dismiss the petition on the basis that a winding up hearing is not a convenient forum to determine disputes over debts. Where the company has a genuine cross-claim, which the company has not been able to litigate, which equals or exceeds the petition debt, the court will usually dismiss the petition.

If an administration order is considered to be preferable to a compulsory winding up of the company, those concerned should apply for an administration order as soon as possible, which will prevent a winding up order being made until the alternative application has been determined.

Under section 129 of the Act, where a winding-up order is made, the liquidation is deemed to have commenced at the date of the petition not the date of the winding up order.

5.9.3 Effect of opening liquidation proceedings

Under section 130 of the Act, as soon as a company enters compulsory liquidation, creditors are prevented from taking or continuing any legal action against the company without permission of the court. Under section 128 of the Act, any attachment or execution put in force against the company after the commencement of the liquidation, is void. Under section 127 of the Act, any disposition of the company's property, transfer of shares or alteration in the status of members after the commencement of the winding up is also void, except to the extent the court orders otherwise. Although these provisions do not explicitly apply in a voluntary winding up, a voluntary liquidator may apply to the court under section 112 of the Act to ask the court to apply any provision applicable to a compulsory winding up, in the voluntary winding up.

In all types of liquidation, the function of the liquidator is essentially the same. They will take over control of the company and get in its assets. They have a large number of powers scattered throughout the Act to require a statement of affairs, investigate the affairs of the company (including powers to examine former officers of the company in court), to compel delivery of assets or records belonging to the company and to take action against anyone who may be liable to the company. The liquidator has a number of specific actions available which are listed below at paragraph 5.10.

The liquidator is subject to similar reporting obligations as an administrator and effectively the same regime concerning the liquidator's remuneration.

Once the liquidator has realised the estate and distributed it according to the statutory order, the liquidator will make a final report to the creditors and deliver a final notice to the Registrar of Companies who will usually dissolve (strike off) the company from the Register of Companies three months later.

5.9.4 *Processes for claims and verification*

In order for a creditor to be able to vote in any creditor decision procedure, or to be paid a dividend in any distribution of the company's assets, the creditor must have proved their debt. They do this by delivering a proof of the debt to the liquidator. As with the case of an administrator, a liquidator may pay dividends to small value creditors based upon the information contained within the company's statement of affairs or accounting records. In such circumstances, a creditor is deemed to have proved for the purposes of determination and payment of a dividend where the debt is no greater than GBP 1,000.

Again, consistently with the administration regime, a liquidator may allow or reject a proof of debt (or reject it in part) and any creditor has the right to apply to court to ask it to review any decision by the liquidator to allow or reject a proof of debt. All debts owed prior to the commencement of liquidation (or which became payable after the commencement due to an obligation incurred prior to the commencement) are provable. This includes debts which are payable in the future or which are contingent. Future debts are discounted according to a statutory percentage whilst the liquidator has a discretion as to what value (if any) they place on a contingent debt.

5.9.5 *Order of asset distribution in liquidation*

5.9.5.1 Introduction

A liquidator may only realise assets which belong to the company. If debts have been effectively assigned to a receivables financier or assets are subject to hire purchase or retention of title contracts, the liquidator will have no right to those assets. Depending upon the circumstances, the holder of a qualifying floating charge may choose to enforce its charge by appointing an administrator which will usually prevent a liquidator being appointed until the administration is completed. It is possible for such a charge holder to consent to the appointment of a liquidator rather than an administrator, in which case the liquidator may realise the charged assets as part of the liquidation and pay out the floating charge holder according to the charge holder's priority.

5.9.5.2 Expenses of winding up, including the liquidator's remuneration (section 115)

Under section 115 of the Act (and rules 6.42 and 7.108 of the Rules) a number of expenses are given priority over the company's preferential creditors, any holders of floating charges and the company's unsecured creditors. The following are the main expenses which are payable in priority to those creditors and are payable in the following order of priority:

(a) expenses that are properly incurred by the liquidator in preserving, realising or getting in any of the assets of the company (including the conduct of any legal proceedings);

(b) the cost of any security provided by the liquidator;

(c) any amount payable to a person to assist in the preparation of a statement of affairs or accounts;

(d) any necessary disbursements by the liquidator in the course of the winding up (including, for example, any expenses incurred by members of the liquidation committee);

(e) the remuneration of any person who has been employed by the liquidator to perform any services for the company;

(f) the remuneration of the liquidator (which is subject to effectively the same rules as those which apply to administrators, specifically including the fees estimate regime where a time cost basis for the liquidator's fees is adopted);

(g) the amount of any corporation tax on chargeable gains accruing on the realisation of any asset of the company; and

(h) any other expenses properly chargeable by the liquidator in carrying out the liquidator's functions in the winding up.

It is notable that the liquidator's own remuneration lies behind a number of categories of expenses.

5.9.5.3 *Preferential creditors, as defined in sections 386, 387 and Schedule 6: section 175*

The preferential debts regime applies to all insolvency procedures under the Act, even though the present discussion is limited to liquidation. It should therefore be remembered that administrators (and administrative and other receivers) must act in accordance with the preferential debts regime and that the terms of CVAs cannot alter the priority of preferential creditors.

Once the expenses of the liquidation have been paid in full, the assets of the company are then used to pay preferential creditors (before any payment may be made to holders of floating charges or to unsecured creditors). The category of preferential creditor largely comprises limited claims of employees and some taxation liabilities but there are some other types of liability. It has always been a characteristic of the statutory preferential debts regime that employees' remuneration (and later contributions to their pension schemes) has been given some priority. There are significant limits on such claims. In most insolvencies, the statutory protection afforded to employees under the Employment Rights Act 1996 provides a much more extensive protection for employees and it has been questioned why the Act retains this historic employee protection provision.

Prior to 2002, the class of preferential creditors included a number of liabilities owed in respect of outstanding tax to the Crown (the Government). Although this Crown preference was abolished by the Enterprise Act 2002, it has, to a large extent, been reintroduced by section 95 of the Finance Act 2020.

There are two classes of preferential debts, ordinary and secondary. Ordinary preferential debts are paid before secondary preferential debts. Preferential debts, in their respective classes, rank equally amongst themselves and so abate in equal proportion if the company's assets are insufficient to pay them all.

The following debts are listed as preferential under Schedule 6 of the Act:

(1) any sum owed on account on an employee's contribution to an occupational pension scheme, being contributions deducted from earnings of the company's employees paid in the period of four months prior to the commencement of the winding up;

(2) any sum owed by the company on account of an employer's contribution to an occupational pension scheme in the period of 12 months before the relevant date;

(3) remuneration owed by the company to a person who is or has been an employee of the debtor and is payable in respect of the whole or any part of the period of four months prior to the commencement of the winding up to a maximum total figure which is currently GBP 800 (a figure that has remained unchanged since 1976);

(4) any amounts owed by the company by way of accrued holiday remuneration in respect of any period of employment before the winding up;

    Any remuneration payable by the company to a person in respect of a period of holiday or absence from work through sickness or other good cause, is deemed to be wages.

(5) claims for monies advanced to pay wages or holiday remuneration will rank as preferential. This provision is designed to protect lenders where their money has been used to pay wages or holiday remuneration of the employees of their customer, and allows them to take over the benefit which the employees would have had, had the lender not made the monies available for the specific purpose of seeing them paid.

(6) levies on the production of coal and steel referred to in article 49 and article 50 of the European Coal and Steel Community Treaty (as there are very few independent producers of coal and steel remaining in the UK such preferential claims are extremely rare);

(7) claims for so much of any amount which is ordered to be paid by the company under the Reserve Forces (Safeguard of Employment) Act 1985, and is so ordered in respect of a default made by the company in the discharge of its obligations under that Act (again such claims are extremely rare).

In recent years a number of additional preferential debts have been added to the regime which relate to payments which may have been made to those with deposits, where the financial institution holding those deposits has become insolvent and compensation payments have been made by the Financial Services Compensation Scheme to those depositors. In such cases, the following are now preferential debts:

(8) So much of any amount owed by the company in respect of an eligible deposit as does not exceed the compensation that would be payable in respect of the deposit under the Financial Services Compensation Scheme to the person or persons to whom the amount is owed.

(9) So much of any amount owed by the company to one or more eligible persons in respect of an eligible deposit as exceeds any compensation that would be payable in respect of the deposit under the Financial Services Compensation Scheme to that person or those persons.

(10) An amount owed by the company to one or more eligible persons in respect of a deposit that–

(a) was made through a non-UK branch of a credit institution authorised by the competent authority of the UK, and

(b) would have been an eligible deposit if it had been made through a UK branch of that credit institution.

In addition to the above, the UK has reintroduced a form of Crown preference for certain debts owed to the taxation authority (His Majesty's Revenue and Customs):

(11) PAYE income tax deductions, national insurance deductions, VAT payments, Construction Industry Scheme deductions and student loan repayments.

The debts listed above at points (9), (10) and (11) are defined as secondary preferential debts under section 386 of the Act and are paid after the "ordinary" preferential debts which includes all the other preferential debts explained above.

5.9.5.4 Floating charge holder and the "prescribed part"

After preferential creditors have been paid, the next creditor to be paid will be any floating charge holder. There may be more than one floating charge holder and if that is the case, priority between them usually turns upon which floating charge was created first.

Before any payment can be made to any floating charge holder, the liquidator must first consider the application of section 176A of the Act. Section 176A applies to a company with a floating charge created on or after 15 September 2003 and the company has gone into liquidation (or administration).

The liquidator (or administrator) is under a duty to make a "prescribed part" of the company's net property available for the satisfaction of unsecured debts and must not distribute any of this prescribed part to a floating charge holder except insofar as it is in excess of the amount required to satisfy all the unsecured debts. For this purpose, "net property" is the amount of the company's property which otherwise would be available for the satisfaction of debts of floating charge holders. It is thus calculated after the liquidation expenses and preferential debts have been paid.

Where the company's net property does not exceed GBP 10,000, the prescribed part is 50% of that property. However, in such circumstances, where the property is less than the "prescribed minimum" of GBP 10,000 and the liquidator (or administrator) thinks that making a distribution to unsecured creditors would be disproportionate to the benefits, then the duty to make the distribution of the prescribed part does not apply.

Where the company's net property exceeds GBP 10,000, the prescribed part is the sum of 50% of the first GBP 10,000 in value, plus 20% of the excess in value above the GBP 10,000, subject to a maximum amount of the prescribed part of GBP 800,000.

A floating charge holder (or indeed any secured creditor), who may have an outstanding unsecured balance owing to it, is not permitted to participate in the distribution of the prescribed part.[27]

5.9.5.5 Unsecured creditors

Creditors with no security, often ordinary trade creditors, are paid out last in the statutory order. Frequently, once the expenses of the liquidation have been paid and distributions have been made to secured and preferential creditors, there is little or nothing left to pay a dividend to unsecured creditors.

5.9.5.6 Shareholders

If there are sufficient funds to pay all the creditors (and interest on their debts) any surplus is distributed amongst the shareholders according to the company's constitution, which will normally permit a distribution *pro rata* the shareholders' respective shareholdings.

5.9.6 Subordination

A subordination agreement is an agreement between creditors whereby they agree, between themselves, to vary their priority. It may be the case that a prospective lender will only lend money to a company if it is to have the highest ranking priority. If the current highest ranking secured creditor is one of the company's directors, that director may agree to subordinate their priority to the bank. Such agreements are valid as they do not affect the priority of other creditors. They merely act as a contractual agreement between two or more creditors.

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27 *Thorniley v Harris* [2008] EWHC 124 (Ch).

5.9.7 Phoenix trading

The concept of "phoenix" trading comes from the image of a phoenix rising from the ashes. It is used to describe the practice where a company has been wound up insolvent and the old business is bought by the previous management group of the company and trades under a new name (which is often similar to the old company's name), often from the same premises using the same assets. The practice is frowned upon as it is used often to take advantage of the reputation of the old company so as to encourage people to do business with what appears to be a longstanding company. Such companies have been known to rise from the ashes on successive occasions always leaving a string of unpaid unsecured creditors.

Although phoenix trading bears some similarity to pre-packaged administrations, they are rather different in that there are a number of provisions in place to ensure that pre-packs are used to safeguard value for creditors of the old company and to ensure, as far as possible, that the business of the new company has a reasonable chance of success. There are no real restraints on a company's directors engaging in phoenix activity beyond some limitations on the use of a name which is the same or similar to that of the company which has been wound up insolvent. This protection is found in sections 216 and 217 of the Act and is considered below at paragraph 8.5.

Self-Assessment Exercise 3

Question 1

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For commentary and feedback on self-assessment exercise 3, please see APPENDIX A

5.10 Insolvency litigation

5.10.1 Introduction

One of the main functions of a liquidator (and to some extent an administrator) is to investigate the affairs of the company and to uncover any activity that might require further action. There is frequently a suggestion that directors may have breached their duties to the company whilst it was a going concern. The liquidator can bring an action on behalf of the company to sue such a director. In addition to a breach of duty (or misfeasance) action, the liquidator has a number of specific statutory powers to bring actions against former directors or others whereby certain transactions may be attacked and reversed. In addition, a liquidator (and administrator) has a statutory duty to report any directors who may be "unfit" to be directors under the Company Directors Disqualification Act 1986. The Secretary of State may decide, based upon such a report, to take action against directors whereby the court may disqualify them from being directors of companies for up to 15 years. It is also possible that based upon evidence of unfitness that those directors may be ordered to compensate creditors who suffered loss at the hands of the directors.

In addition to suing directors (or others) a liquidator has, under section 246ZD of the Act, wide powers to assign such causes of action to a third party funder who itself may then sue the defendant. One of the great obstacles often facing a liquidator who wishes to take legal proceedings to swell the assets of the company, is a lack of funding. The company itself may have been left with few or no assets and the creditors may be reluctant to risk losing more money by funding an action. If the liquidator can find a funder to take over the action, they will usually be paid a fee upfront with the promise of a percentage of any damages if the action is ultimately successful. It is becoming increasingly common for liquidators to assign causes of action as an efficient and effective way of realising the value of such a cause of action.

The following are examples of actions that may be taken which may swell the assets available to the liquidator in attempting to make a distribution to creditors of the company.

5.10.2 Misfeasance

A liquidator will be interested in looking closely at how a company in liquidation conducted its business, especially towards the end of its trading life. It is extremely common for there to be circumstances or transactions that might be attacked. A great many actions taken by liquidators will involve allegations against the previous officers of the company (usually its directors) for some form of breach of duty. Even when specific actions are being taken against a director, perhaps under section 238 of the Act (see below at paragraph 5.10.8), it is usual to see the liquidator also include a more general "misfeasance" claim as part of the action being brought.

Section 212 of the Act contains a procedural provision which is intended to simplify actions brought against former officers of the company by overcoming what would otherwise be increased costs and delay in such an action. It creates a summary procedure. Although referred to as the "misfeasance" section, it creates no new causes of action. It merely creates a simplified procedure for causes of action which could have been enforced by the company prior to liquidation.

Under section 212 the court may consider the conduct of certain persons and, if there has been any misfeasance or breach of duty in relation to a company now in liquidation, it may order the restoration, repayment or accounting of money or property or the contribution of such sum to the company by way of compensation in respect of the misfeasance or breach of duty. "Misfeasance" includes an action where the wrongdoer is alleged to have "misapplied, retained or become accountable for money or property of the company, or [is] guilty of misfeasance or breach of any fiduciary or other duty". It therefore includes an action for the breach of the duty or care and skill (negligence) which is not a fiduciary action but falls within the category of "other duty" as well as fiduciary duties such as the duty to act in the best interests of the company and not to act where the director has a conflict of interest and duty. In circumstances where the company is insolvent (or is close to insolvent), if directors continue to trade on, the duty owed by the directors shifts from one owed to the company, taking into account what would be in the best interests of its members, to one owed to the company taking into account the interests of its creditors.

In addition to a liquidator being able to bring an action under section 212, the Official Receiver or any creditor or contributory of the company may also bring an action (although in practice section 212 actions are nearly always brought by a liquidator).

Under section 212, the following may have an action brought against them: a past or present officer of the company (which would include directors); a former liquidator of the company; an administrative receiver of the company; and any other person who is or has been concerned, or taken part, in the promotion, formation or management of the company.

Nearly all cases under section 212 are brought by a liquidator against a director of the company.

There is a separate provision found in paragraph 75 of Schedule B1 of the Act which allows a misfeasance action to be brought against an administrator.

If a case is successfully made out, an order for repayment or contribution will ordinarily be made. Courts are permitted to grant relief to a respondent to misfeasance proceedings under section 1157 of the Companies Act 2006, which permits a court to relieve a director from liability in relation to proceedings for negligence, default, breach of duty, or breach of trust where the court believes the director acted honestly and reasonably and that, having regard to all the circumstances of the case, ought fairly to be excused.

5.10.3 Wrongful trading

Sections 214 and 246ZB of the Act make directors of insolvent companies liable for wrongful trading, and thereby making them, in certain circumstances, liable for some of the debts and liabilities of the company. Fraudulent trading, an older remedy which was intended to be replaced by wrongful trading but remains as a possible alternative cause of action to wrongful trading, is found in sections 213 and 246ZA of the Act (and is considered below at paragraph 5.10.4). Both wrongful trading and fraudulent trading actions have historically only been available to a liquidator of a company under, respectively, sections 214 and 213 of the Act. The Small Business, Enterprise and Employment Act 2015 introduced wrongful trading and fraudulent trading to administration (under new sections 246ZB and 246ZA respectively of the Act). The following commentary on wrongful and fraudulent trading is based upon considering directors of companies which enter insolvent liquidation, but it is important to note that effectively the same provisions are available in an insolvent administration.

Wrongful trading is aimed at ensuring that, when directors become aware that an insolvent liquidation (or administration) is in prospect, they do everything possible to minimise the potential losses to the company's creditors.

Section 214 gives the court a discretion to declare that a director of a company which is in insolvent liquidation should make a contribution to the company's assets. The application to the court can only be made by the liquidator, not a creditor or contributory. The court must be satisfied that the following conditions are satisfied:

(1) that the company has gone into insolvent liquidation;

(2) that at some point before the commencement of the winding up of the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation; and

(3) that at the time the person reached that conclusion or ought to have reached that conclusion that person was a director of the company.

The defence available to a director under section 214 is that once they knew or ought to have known that insolvent winding-up was inevitable, they took every step with a view to minimising the potential loss to the company's creditors as (assuming them to have known that there was no reasonable prospect that the company would avoid going into insolvent liquidation) they ought to have taken. The burden of proof is on the liquidator to prove that the director in question knew or ought to have known that there was no reasonable prospect of avoiding an insolvent liquidation. Once this is shown, the burden of proof shifts to the director to show that what they did was to take every step to minimise loss to creditors.

Section 214(4) provides that, for the purposes of the three conditions and for the purposes of the statutory defence, the facts which a director of a company ought to know or ascertain, the conclusions which they ought to reach and the steps which they ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both:

(a) a general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company (this includes any functions which the director does not carry out but which have been entrusted to them); and

(b) the general knowledge, skill and experience that that director has.

The first part of the test is objective which requires a general minimum standard of knowledge, skill and experience required of all directors. It is no defence to claim subjectively that the director was lacking this basic minimum range of ability. The second strand of the test is subjective which allows for a higher standard of knowledge, skill and experience to be required in circumstances where the director is particularly knowledgeable, skilful or experienced. In such cases the director is judged by the higher standard they have set for themselves.

The general knowledge, skill and experience to be expected of directors of small companies with limited operations will be less than for those managing large sophisticated concerns, although there will still be minimum objective standards applied to all directors of all companies.

The statutory defence only applies if the court is satisfied that "every step" was taken by that director with a view to minimising the potential loss to the company's creditors. In practice this is usually satisfied if a director of a company which is heading towards insolvent liquidation either immediately takes steps to put the company into liquidation, or at least takes expert advice and follows that advice.

If a company continues to trade and to increase its net liabilities once the directors know, or ought to conclude, that there is no reasonable prospect of avoiding insolvent liquidation, the court will usually make an award for the directors to compensate the company in an amount broadly in line with the increase in liabilities during that time. The compensation is aligned to the cost to the company's creditors of the decision to continuing to trade once insolvent liquidation could not reasonably be avoided.

The relief afforded to officers of a company from liability for breach of duty by section 1157 of the Companies Act 2006, is not available in an action for wrongful trading.

5.10.4 Fraudulent trading

Wrongful trading was introduced into the Act as the Cork Committee had pointed out that the existing fraudulent trading provisions, which had been around since 1928, did not adequately deal with abuses of limited liability by those who controlled some companies. Despite recommendations to replace the civil liability under fraudulent trading with wrongful trading, the Act adds wrongful trading, leaving the fraudulent trading regime untouched.

Fraudulent trading may lead to both (or either) criminal liability (under section 993 of the Companies Act 2006) and civil liability (under section 213 of the Act). As mentioned previously, the Small Business, Enterprise and Employment Act 2015 introduced the possibility of a fraudulent trading action to administration (with the new section 246ZA of the Act). A civil application for fraudulent trading can be brought by a liquidator or administrator who brings it for the benefit of all creditors and not merely for the benefit of the actual victims themselves. Individual creditors cannot bring an action for fraudulent trading.

The civil remedy is contained in sections 213 and 246ZA of the Act. These sections provide that, if, in the course of the winding up or administration of a company, it appears that any business of the company has been carried on with intent to defraud its creditors or the creditors of any other person, or for any fraudulent purpose, the court may, on the application of the liquidator (or administrator), declare that any persons who were knowingly parties to the carrying on of the business in that manner are to be liable to make such contribution to the company's assets as the court thinks proper. In order to fall within section 213 (or section 246ZA), the behaviour must amount to real moral blame. Some positive step on the individual's part is required. There must be an element of intent or recklessness, the presence of which is tested subjectively, not objectively. Fraudulent trading may include actions such as continuing to take customer deposits for goods ordered with the knowledge that there is no reasonable prospect that the goods will ever be delivered.

If a court finds a person liable for fraudulent trading under the Act, it may order the person concerned to make a contribution to the company's assets in the same way as in the case of wrongful trading to compensate the company for loss, but the court may also add a punitive element to the amount ordered to emphasise the culpability of the person.

The criminal penalty under section 993 of the Companies Act 2006 is, in the case of a prosecution on indictment, a term of imprisonment of up to 10 years or a fine or both and, on a summary conviction, a term of imprisonment of up to 12 months or a fine up to the statutory maximum or both. There is a distinction between the burden of proof required to prove the criminal offence under section 993 of the Companies Act 2006 and that required to prove civil liability under section 213 (and section 246ZA) of the Act. Liability may be proved in accordance with the civil standard of proof on a balance of probabilities under sections 213 and 246ZA in circumstances where the same evidence would not be sufficient to secure a criminal conviction under section 993, where the standard of proof is one of beyond reasonable doubt. It is often the case, that if the Secretary of State is bringing criminal proceedings for fraudulent trading, the liquidator will await the outcome of those proceedings and, assuming they are successful, will then bring civil proceedings which are highly likely to succeed as the definition of fraudulent trading is the same whether the proceedings are criminal or civil.

5.10.5 Director disqualification

Disqualification of directors has been possible since it was first introduced into legislation in 1928. At that time, a finding of fraudulent trading was required for a court to order the disqualification of a director. Since 1928, the grounds for disqualification have increased significantly and most grounds were consolidated in the Company Directors Disqualification Act 1986 (CDDA). The main purpose of the disqualification regime is to protect the public and to act as a deterrent to wrongdoing directors so as to assist in raising the standards of behaviour of directors. An application to the court for a disqualification order will be made by the Secretary of State (or the Official Receiver on the instructions of the Secretary of State where the company in question has been wound up by the court).

A disqualification order means that, for a specified period, the person against whom the order is made shall not:

(a) be a director of a company, act as a receiver of a company's property or in any way, whether directly or indirectly, be concerned or take part in the promotion, formation or management of a company, unless (in each case) they have the leave of the court; or

(b) act as an insolvency practitioner (section 1 of the CDDA).

In addition to the court making a disqualification, in order to save court time and costs, it is possible for the Secretary of State to accept a disqualification undertaking. This procedure has the same consequences as if a disqualification order had been made by the court

For some grounds, such as persistent breaches of companies legislation, the term of disqualification is five years maximum,[28] whereas if a court has held that a director of an insolvent company is unfit to hold office, the term is a minimum of two years and a maximum of 15 years.[29]

The court must make a disqualification order against a person whenever the requirements of section 6 CDDA are satisfied. Section 6, which is the most commonly used ground under the CDDA by far to seek disqualification, deals with findings of unfitness against directors of insolvent companies. Under section 6 of the CDDA, the court is required to make a disqualification order against a person in any case where it is satisfied:

(a) that the person is or has been a director of a company which has at any time become insolvent (whether while they were a director or subsequently); and

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[28] Company Directors Disqualification Act 1986, s 3(5).
[29] *Idem*, s 6(4).

(b) that their conduct as a director of that company (either taken alone or taken together with their conduct as a director of one or more other companies or overseas companies) makes them unfit to be concerned in the management of a company.

It is usual for section 6 cases to be based upon evidence that directors permitted a company to trade whilst insolvent, often using money collected on behalf of the Crown by way of taxation and often paying themselves excessive remuneration. Allegations of fraud or engaging in preferential treatment of creditors who might be family members are also common.

The CDDA also gives the court a discretionary power of disqualification in the following circumstances:

(1) under sections 2 and 5A of the CDDA, where a person is convicted of an indictable offence in Great Britain or overseas in connection with the promotion, formation, management, liquidation or striking off of a company, or with the receivership or management of a company's property. The disqualification order may be made by the convicting court as part of the sentencing process;

(2) under sections 3 and 5 of the CDDA, where a person has been in default in relation to provisions of the companies legislation requiring any return, account or other document to be filed with, delivered or sent, or notice of any matter to be given, to the Registrar of Companies;

(3) under section 4 of the CDDA, where in the course of a winding up of a company it appears that a person has been guilty of an offence of fraudulent trading; or has been guilty of any fraud in relation to the company or of any breach of duty;

(4) under section 8 of the CDDA, where the conduct in relation to a company (whether or not the company has entered a formal insolvency process) of a person who is or has been a director makes that person unfit to be concerned in the management of a company or, in circumstances where a person who has been disqualified based upon their unfit conduct, if that person acted in accordance with another person's directions or instructions, that other person may be disqualified;[30] and

(5) under section 10 of the CDDA, where the court makes a declaration under sections 213 or 214 of the Act that a person is liable to make a contribution to a company's assets, then the court may also make a disqualification order against that person.

In addition, under section 11 of the CDDA, an undischarged bankrupt is automatically disqualified under the CDDA.

The Court of Appeal in *Re Sevenoaks Stationers Ltd*[31] broke down the potential maximum period of 15 years disqualification into three brackets:

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30 *Idem*, ss 8ZA–8ZE.
31 [1991] Ch 164.

(a) the top bracket of over 10 years is reserved for particularly serious cases and may include cases where a director, who has already had one period of disqualification imposed, falls to be disqualified again;

(b) the middle bracket of six to 10 years should apply to serious cases which do not merit the top bracket; and

(c) the minimum bracket of two to five years should be applied where, although disqualification is mandatory, the case is, relatively, not very serious.

As well as being disqualified, a director of an insolvent company may under section 15A of the CDDA be made subject to a compensation order whereby they will be liable to make a payment to specified creditors, or contribute to the assets of the insolvent company where the conduct of that director caused loss to one or more creditors. The Secretary of State will not apply for a compensation order if the liquidator (or other office-holder) has already decided to take alternative enforcement action.

5.10.6 Restriction on re-use of company names

Under sections 216 and 217 of the Act, there are restrictions on directors of a company which goes into insolvent liquidation using or being concerned in another company which uses the name by which the company was known at any time in the period of 12 months before the company went into liquidation (or a name similar to that name so as to suggest an association with that company).

A director falls within these provisions if they were a director at any time in the period of 12 months before the company went into insolvent liquidation.

The prohibition is that, except with the leave of the court (amongst other exceptions) a director is not permitted for a period of five years from the date of commencement of the relevant liquidation to do any of the following:

(a) to be a director of any company that is known by a "prohibited name"; or

(b) in any way, whether directly or indirectly, to be concerned or take part in the promotion, formation or management of any such company; or

(c) in any way, whether directly or indirectly, to be concerned or take part in the carrying on of a business carried on (otherwise than by a company) under a prohibited name.

The prohibition is very wide and not only prevents the formation or operation of a limited company under a prohibited name, but also any form of trade or business using such a name. The abuse which this section seeks to cure is the formation of a succession of "phoenix" companies each failing after incurring credit, but each carrying on similar businesses run by the same people.

A prohibited name for these purposes is, in respect of a relevant person:

(a) a name by which the company which went into insolvent liquidation was known at any time during the 12 months prior to commencement of liquidation; or

(b) a name so similar to the name under (a) above as to suggest an association with the company in insolvent liquidation.

The sanctions for acting in contravention of these provisions are:

(1) criminal liability can be imposed. On a conviction a person is liable to imprisonment for a term of up to two years or a fine, or both; and

(2) the director will be personally liable jointly and severally for the debts of the second company.

The great weakness of these provisions is that a director of a company which has entered insolvent liquidation may quite easily avoid any liability by publishing a notice of their intention to re-use a company in the London Gazette (under rule 22.4 of the Rules). Such a director will not thereafter be liable under sections 216 and 217. The mischief of "phoenixing" is therefore not in practice prevented by these statutory provisions.

5.10.7 Disposition void unless validated (section 127)

One of the main purposes of liquidation is to ensure that a company's property, which it owns when the liquidation commences, is distributed to its creditors according to the statutory order. The commencement of a winding up does not affect the company's ownership of its property, but its powers of dealing with that property are limited significantly. In a compulsory winding up, section 127 of the Act avoids any disposition of property of the company made after the commencement of winding up, unless the court otherwise orders. The commencement date will be the date of the presentation of the petition to wind up and so the avoidance provision acts in a backdated manner. It is common for a company which is subject to a winding up petition to carry on trading with the intention of defending the petition. If it does carry on trading, and fails to defend the petition, the winding up order which may be made months after the petition, will avoid any dispositions of company property which has happened in the interim period. The liquidator will often therefore take steps to enforce section 127 in order to retrieve company assets disposed of during the period between the petition and the winding up order.

The words "disposition of property" in section 127 of the Act are given a wide meaning and affect any payment of money as well as assets being sold or transferred. They include any type of transaction where property ceases to be vested in a company, such as by way of sale, gift, assignment, mortgage, charge, lease, loan or exchange.

It should be noted that the impact of section 127 is not absolute. The court has a discretionary power to declare that dispositions shall not be void. Such an order is called a validation order and applications for such orders are reasonably common. Anyone applying for a validation order has the burden of proving that the order should be made. The court has a wide discretion whether or not to make an order. The rationale for making an order is that where a company is trading, if transactions in the ordinary course of business which are entered into *bona fide* are not permitted, the parties interested in the assets of the company could be prejudiced. A validation order (or sanction order where the disposition has not yet occurred) will only be made in relation to an insolvent company where the circumstances indicate that the disposition will be or has been made for the benefit of the general body of unsecured creditors.

In deciding whether or not to permit dispositions the court will consider the following general guidelines:

(1) The court will be reluctant, save in exceptional circumstances, to depart from the basic principle of *pari passu* distribution among creditors in order to validate payments or transfers made in relation to pre-liquidation transactions where the effect is to give a preference to a pre-liquidation creditor over other creditors;[32]

(2) Payments are likely to be sanctioned where necessary to ensure continued supplies enabling the company to continue trading in cases where the court considers that the continuance of trading was in the best interests of creditors;

(3) Transactions which do not diminish the company's net assets (such as post-petition transactions for full value), which increase the value of the company's assets or preserve assets from harm, will normally be validated;

(4) In cases where the parties are unaware that a petition has been presented and so the disposition is in good faith and in the ordinary course of business, the transaction is likely to be sanctioned as long as it was likely to be for the benefit of creditors generally;

(5) Where goods have been paid for on terms of cash on delivery the court will consider the benefit to the company including whether the payment will enable further supplies to be received and so enable the business to continue;

(6) Although the court can authorise or validate a particular disposition it may also authorise a general continuance of trading.

Where payments are made honestly, in the ordinary course of business and for the benefit of the company, such as the payment of wages of employees or payments on supplies to enable the company to fulfil a contract that appeared to be profitable, the payment is likely to be authorised. If the transaction allows the company to continue to trade, it will generally be validated. But the court has refused to grant validation orders where the disposition was going to benefit only one creditor to the detriment of other unsecured creditors of the company.

[32] See, for example, *Re Changtel Solutions UK Ltd* [2022] EWHC 694 (Ch).

5.10.8 Transactions at undervalue

As part of the underlying policy of the Act to treat all unsecured creditors fairly and equally, the Act permits certain transactions which were entered into shortly before the company entered formal insolvency to be open to attack. Under section 238 of the Act, a liquidator (or administrator) may attack a transaction which was entered prior to the company entering liquidation or administration where the transaction was at an undervalue.

Under section 238, the liquidator or administrator must show that the company:

(1) made a gift to another person; or

(2) entered into a transaction with another person on terms that provided for the company to receive no consideration; or

(3) entered into a transaction with another person for a consideration which, in money or money's worth, was, at the date of the transaction, significantly less than the value, in money or money's worth, of the consideration provided by the company.

In order to be attacked, the transaction must have taken place at a "relevant time" which is in the period of two years prior to the commencement of the liquidation or administration.

The idea of a "transaction" is defined widely, to include any gift, agreement or arrangement. There is little difficulty in discerning those transactions which are by way of gift or where the company receives no consideration. It is sometimes more difficult to decide whether the consideration received by the company from a particular transaction is, in money or money's worth, significantly less than the consideration provided by the company. The difficulties are usually practical ones involving problems of valuation, especially where there are linked transactions involving a number of parties.[33]

Whether or not the transaction was with a connected person, it is a prerequisite of liability under section 238 that, at the time the transaction was entered into, either the company was unable to pay its debts as they fell due within the meaning of section 123 or became unable to pay its debts within the meaning of that section in consequence of the transaction. In the case of a transaction with a connected person, however, the company is presumed to have been insolvent, or to have become insolvent as a result of the transaction, unless the contrary is proved.

If the respondent to an application satisfies the court that the transaction was entered into by the company in good faith and for the purpose of carrying on its business, and that at the time it did so there were reasonable grounds for believing that the transaction would benefit the company, then the court shall not make an order under section 238.

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[33] For an example of which, see the leading case of *Phillips v Brewin Dolphin Bell Lawrie Ltd* [2001] UKHL 2.

The overriding power of the court, if it concludes that there has been a transaction at an undervalue or a preference, is to make an order restoring the position to what it would have been if the preference had not been given, or the transaction not entered.

Protection is afforded, however, to certain persons by section 241 which provides that an order shall not prejudice any interest in property which was acquired from a person other than the company, and which was acquired in good faith and for value.

5.10.9 Preferences

As part of the transaction avoidance provisions of the Act, section 239 relates to preferences which may be avoided by the court on the application of a liquidator or an administrator. Section 239 of the Act has a number of defined terms in common with section 238 of the Act and the wide range of possible orders available to the court under section 238 of the Act also apply to section 239 of the Act. The underlying purpose of section 239 of the Act is to prevent a company, shortly before entering a formal insolvency procedure, from placing one of its creditors in a better position than others. It prevents such preferences such as a payment in full where the creditor could have expected only a dividend as an unsecured creditor. It will also open up to attack a security given to a creditor, or other property of the company made available to the creditor, who previously only had priority as an unsecured creditor.

An application may be made only if the company has gone into liquidation or administration. In order to succeed on an application under section 239 must show that:

(a) the person whom it is alleged has been preferred was, at the time of the transaction, a creditor of the company (or a surety or guarantor for any of the company’s debts or liabilities);

(b) something was done, or suffered to be done, by the company which had the effect of putting that person in a better position, in the event of the company going into insolvent liquidation, than the position they would have been in if that thing had not been done (that is, that the person has been preferred);

(c) the company was, in giving the preference, influenced by a desire to produce the effect referred to in (b) above (the desire to prefer) in relation to the person preferred; and

(d) the preference was given at a relevant time.

The burden of proof in relation to each of the above matters normally rests with the office-holder. However, if the person to whom the preference was given is connected with the company (otherwise than by reason merely of being an employee of the company), then there is a presumption that the company was influenced by a desire to prefer that person. This shifts the burden onto the connected person to rebut that presumption.

In determining whether the thing done amounts to a preference, the fact that pressure was applied by the creditor (whether in requiring the company to do something, or in preventing the company from stopping the creditor exercising a self-help remedy) is not relevant. Pressure should be considered relevant only to whether there is the requisite desire.

The relevant time within which a preference needs to have been given to come within section 239 of the Act differs depending upon whether or not the preference is given to a connected person (such as a director or an associate of such director). A person is not connected to a company, for this purpose, by reason only of being its employee. For a preference to be actionable, it must have occurred within the two years prior to the onset of insolvency (if in favour of a connected person) or within the six months prior to the onset of insolvency (if in favour of a person not connected to the company).

Whether or not the preference was given to a connected person, it is a prerequisite of liability under section 239 of the Act (as it is for transactions at an undervalue under section 238 of the Act) that, at the time the preference was given, either the company was unable to pay its debts as they fell due within the meaning of section 123 of the Act or became unable to pay its debts within the meaning of that section in consequence of the preference.

The requirement which is the most difficult to establish, is the need to show the company was influenced by a desire to prefer the creditor. The company must have been influenced by the desire to put the preferred party into a position which, in the event of the company going into insolvent liquidation, would be better than the position they would have been in if the preference had not been given. Guidance as to the meaning of the relevant desire was provided by Millett J. in the leading case, *Re MC Bacon Ltd*.[34] Millett J drew a distinction between intention, which is an objective concept, and desire, which is a subjective one: "A man is taken to intend the necessary consequences of his actions [but a] man can choose the lesser of two evils without desiring either". Therefore, an intention to grant security to a creditor necessarily involves an intention to prefer that creditor in the event of insolvency. However, even though the granting of the security must necessarily prefer the creditor in the event of insolvency this will not, by itself, amount to a desire to prefer. In *MC Bacon* it was contended by the liquidator that the granting of a debenture in favour of the company's bank to secure past indebtedness was a preference. Millett J found that, where the company was entirely dependent upon bank support for continued trading, such that if the debenture were not granted the bank would withdraw its support, and where, if the bank withdrew its support, the company would be forced into immediate liquidation, the granting of the debenture was motivated, not by a desire to prefer the bank, but by the desire to avoid the calling in of the overdraft and the continuation of trading by the company.

In subsequent decisions, it has been held that where the company was influenced solely by commercial considerations, specifically attempts to ensure that the company continued trading, there could be no desire to prefer.

The desire to prefer is presumed unless the contrary is shown, where the preference is given to a person connected with the company. The presumption is often very helpful and it is rare for

34 [1990] BCC 78.

an action to be brought under section 239 of the Act unless the person whom it is alleged has been preferred is a connected person. Its effect is to reverse the burden of proof.

5.10.10 Floating charge avoidance

Section 245 of the Act applies only to floating charges, not any other type of security. It applies where a company is in administration or liquidation and the provision is aimed at preventing pre-existing unsecured creditors obtaining the security of a floating charge shortly before a company enters a formal insolvency procedure. It does not prevent lenders who are providing fresh funding to the company from taking a floating charge for that new funding. It renders invalid floating charges given by a company at a relevant time, except to the extent, in substance, that "new" consideration is provided for the charge.

Where the person in whose favour the floating charge is created is connected with the company, the relevant time is any time within the period of two years prior to the onset of insolvency. Where the person in whose favour the floating charge is created is not connected with the company, the relevant time is any time within the period of 12 months prior to the onset of insolvency, but only if at the time of the creation of the charge the company was either unable to pay its debts (within the meaning in section 123 of the Act) or became unable to do so in consequence of the transaction.

There are two main categories of "new" consideration set out in section 245 of the Act, which, if satisfied mean the floating charge will not be invalid:

(1) the value of so much of the consideration for the creation of the charge as consists of money paid, or goods or services supplied, to the company at the same time as, or after, the creation of the charge. The consideration must be given at the same time as or after the creation of the charge. Where an agreement is made to execute a charge, followed by payments made to the company, followed in turn by the formal execution of the charge, any delay between the making of the payments and the execution of the charge must be minimal, such as the time to take a coffee-break.[35]

(2) the value of so much of that consideration as consists of the discharge or reduction, at the same time as, or after, the creation of the charge, of any debt of the company. In *Re Fairway Magazines*,[36] it was suggested that consideration by way of payments by directors to the company for a specific purpose which was for the benefit of the directors, in helping to release their personal liability under guarantees, were not within the exemption in section 245. This category, however, specifically provides that a floating charge is not to be invalidated to the extent of consideration by way of discharge or reduction of a debt of the company. If, therefore, the payments in *Fairway Magazines* had been made directly to the bank, rather than to the company for the purpose of repaying the bank, the payments would have fallen within this category.

[35] See *Re Shoe Lace Ltd* 1993] BCC 609.
[36] [1992] BCC 924.

If a floating charge is caught by section 245 then, save to the extent of any new consideration as discussed above, it is rendered invalid. The invalidity can only arise, however, in the event that the company goes into liquidation or administration. It does not invalidate anything done under the authority of the vulnerable floating charge prior to the commencement of the winding up. Although the floating charge is invalidated, the underlying debt remains valid.

5.10.11 Transactions defrauding creditors

Under section 423 of the Act, the following parties have the right to attack transactions which are designed to defraud creditors: (i) where the company is being wound up or is in administration, the official receiver, the liquidator, the administrator and (with the leave of the court) any victim of the transaction such as a creditor, (ii) where a victim is bound by a CVA, the supervisor of the CVA or any victim of the transaction (whether bound by the CVA or not), or (iii) in any other case, by a victim of the transaction.

There are two requirements to satisfy under section 423 of the Act:

(1) it is necessary to show that the company entered into a transaction with another person at an undervalue (which is defined in the same way as under section 238 of the Act, that is, that the company has received no consideration or significantly less consideration than it has provided); and

(2) it is necessary to show that the company entered into the transaction for the purpose either of putting assets beyond the reach of a person who is making, or may at some time make, a claim against the company, or of otherwise prejudicing the interests of such a person in relation to the claim which they are making or may make.

Unlike section 238 of the Act, there are no time limits in respect of which the transaction must have been entered. The applicants need not be insolvency office-holders, nor does the company need to be insolvent or subject to insolvency proceedings.

An application may be made under the section by any person who is a victim of the transaction. If, however, the company is being wound up or is subject to an administration, the liquidator or administrator will usually make the application. Irrespective of the identity of the person making the application, the application is treated as being made on behalf of every victim of the transaction.

Applications are quite common in liquidation and often attack gifts made by a company many years prior to the insolvent liquidation when financially the company was still strong. If gifts are made to connected parties in order to ensure some assets are kept for a "rainy day", such gifts will be capable of attack under section 423 of the Act.

5.10.12 Anti-deprivation rule

The anti-deprivation principle operates to prevent an insolvent estate from being deprived of an asset which would otherwise be available for the benefit of creditors. In order to be avoided by the court the deprivation must be triggered by the insolvency proceedings. The origins of the principle are ancient. The principle, which is also the foundation for the avoidance provisions such as sections 238 and 239 of the Act, is the public policy that parties to a contract are not permitted to agree terms which deprive a subsequently insolvent party of assets which would otherwise have been available to the insolvent party's creditors. The deprivation must be triggered by the insolvency. If another event is the trigger, the principle will not avoid.

In addition, if the contract is a *bona fide* transaction which does not have as its predominant purpose, or one of its main purposes, the deprivation of the insolvent party's property, the principle will not apply. This "commercial good faith" argument is the main defence against such an allegation. Most recent attempts to attack modern commercial agreements under the principle have tended to fail due this defence. Lord Collins, in the leading case *Belmont Park Investments PTY Ltd v BNY Corporate Trustee Services Ltd*,[37] where the "commercial good faith" defence was successful, explained the types of factor the court should consider in deciding whether to apply the principle:

> "[I]t is the substance rather than the form which should be determinant. Nor does the fact that the provision for divestment has been in the documentation from the beginning give the answer, nor that the rights in property in question terminate on bankruptcy, as opposed to being divested. Nor can the answer be found in categorising or characterising the property as 'property subject to divestment on bankruptcy'… the anti-deprivation is essentially directed to intentional or inevitable evasion of the principle that the debtor's property is part of the insolvent estate, and is applied in a commercially sensitive manner, taking into account the policy of party autonomy and the upholding of proper commercial bargains."

Self-Assessment Exercise 4

Question 1

Under which provision can a liquidator (or administrator) assign office-holder actions to a third party?

Question 2

How are the decisions made by a director under section 214 judged by the court?

Question 3

How is a wrongful trading contribution quantified by the court?

37 [2011] UKSC 38.

Question 4

What is the standard of proof for fraudulent trading?

Question 5

What are the consequences to a director of a company which has entered insolvent liquidation of being a director of a company with the same or similar name?

Question 6

What is the effect of a director disqualification order or undertaking?

Question 7

Can a disqualified director also be ordered to contribute financially to the company's assets?

Question 8

During which period must a transaction at an undervalue have to occur for it to be actionable?

Question 9

During which period must a preference have to occur for it to be actionable?

Question 10

What is the effect of the recipient of a transaction under section 238 being a person connected to the company?

Question 11

What is the effect of the recipient of a preference under section 239 being a person connected to the company?

Question 12

During which period must a floating charge have to have been executed for it to avoided under section 245?

Question 13

Must a company be unable to pay its debts at the time of the transaction for it to be attacked under section 423?

Question 14

Can a transaction entered into after a petition for a company's winding up but before the winding up be attacked under section 238?

Question 15

True or False? A term in a contract which states that a company's interest in an asset will automatically be forfeited if it enters liquidation is likely to be void.

For commentary and feedback on self-assessment exercise 4, please see APPENDIX A

6. CROSS-BORDER INSOLVENCY LAW

England and Wales (and the rest of the UK) has three (possibly four) approaches to cross-border insolvency proceedings. Which one will apply or be of assistance to any particular proceedings will depend upon the nature of the proceedings and which other jurisdiction(s) are involved. The issue is complicated by the impact of the UK leaving the EU and so the effect of "Brexit" will also be considered below.

Cross-border insolvency proceedings which involve companies with their centre of main interests (COMI) within any EU Member State (apart from Denmark) are governed by the EU Regulation on Insolvency Proceedings[38] which is a recast (and slightly amended) version of the original Regulation.[39] The approach of the EU Regulation is not to harmonise the different insolvency regimes within the EU but instead it provides rules for deciding which of the individual jurisdictions' insolvency regime applies in a particular case. For example, where a company has its COMI (typically its registered office or main place of business) in France, only the courts in France have jurisdiction to open main proceedings. If, therefore, a company with its COMI in France enters a formal insolvency procedure, it will be the rules laid down by French legislation which govern the process across the EU (with some exceptions involving the rights of secured creditors and employees). Other EU jurisdictions will automatically recognise the procedure and the office-holder will be able to exercise all his powers over assets situated in other Member States.

The EU Regulation does not harmonise insolvency law across Member States, but rather establishes rules on the jurisdiction to commence insolvency proceedings and the law which applies to such proceedings. If proceedings commenced in the UK prior to Brexit (that is prior to 11 pm UK time on 31 December 2020) the EU Regulation will continue to apply to those proceedings. In such cases, where a company had its COMI in the UK, only the UK will have the jurisdiction to open main insolvency proceedings, such as administration or liquidation. These

[38] EU 2015/848.
[39] EC 1346/2000.

insolvency proceedings would be governed by UK law in all respects, save for some exceptions including security interests and rights under contracts of employment in other Member States. Additionally, but significantly, any appointment made prior to Brexit will be recognised automatically in all EU Member States and the insolvency practitioner will be able exercise all powers, subject to limited exceptions. The great benefit of having one main proceeding recognised in all EU jurisdictions is that it allows a single concerted approach to the insolvency, which is likely to encourage any possible rescue and will usually cut down on costs so as to realise assets in the most beneficial way. If the company has an establishment in another Member State, it is possible for secondary proceedings to be commenced in that Member State and for assets belonging to the company in that other Member State to be ring-fenced for the benefit of creditors in that other Member State.

One of the great benefits of the EU Regulation was that it worked across the EU for both "inward-bound" (where a Member State office-holder was automatically recognised in the UK) and "outward-bound" (where a UK office-holder was recognised in other Member States) insolvencies. The EU Regulation does not apply to UK insolvencies after Brexit. Therefore, the previous automatic recognition across the EU of UK insolvency proceedings no longer applies to insolvencies commenced on or after 1 January 2021.

The75second possibility for dealing with cross-border insolvency proceedings is under the UNCITRAL Model Law on Cross-Border Insolvency (Model Law). This was incorporated into UK law, with only minor amendments, by the Cross Border Insolvency Regulations 2006 SI 2006/1030 (CBIR). There are no reciprocity provisions in the CBIR and so there is no real limit on the "inward bound" consequences for cross-border insolvency. Insolvency practitioners from any overseas' jurisdiction may apply to the court in England and Wales to be recognised in the jurisdiction. The "outward-bound" benefits for the UK are limited to other States who have adopted the Model Law (at the date of writing there are 44 countries who have adopted). One significant weakness which the Model Law suffers from as compared with the EU Regulation, is that under the Model Law recognition of foreign insolvency proceedings is not automatic. It requires an application to a local court to gain recognition and relief. Amongst EU Member States, only Greece, Poland, Romania and Slovenia have so far adopted the Model Law. Therefore, any UK office-holder who wishes to be recognised in other EU Member States cannot claim the benefit of the Model Law in order to be recognised. Any attempt to be recognised by the courts of other EU Member States now therefore involves an application to the local court in accordance with the local law on recognition of overseas office-holders.[40] Unfortunately, there is no consistent approach across EU Member States for such recognition which necessarily now involves increased time and costs. Such additional delay and expense did not happen whilst the UK was in the EU.

Section 426 of the Act contains provisions for UK courts to provide assistance to overseas courts from certain listed jurisdictions. The origins of section 426 date back to the British Empire and provisions which permitted recognition and assistance to court orders made in the former

[40] The UK's Insolvency Service has provided an outline guide to office-holders seeking recognition across the EU following Brexit. The guide is titled: *Cross-border Insolvencies: Recognition and Enforcement in EU Member States* and may be found at https://www.gov.uk/government/publications/cross-border-insolvencies-recognition-and-enforcement-in-eu-member-states.

colonies. Under section 426 court orders made in insolvency matters by a court in the United Kingdom are strictly enforceable in all parts of the United Kingdom. In addition, there is a positive obligation on the courts of the United Kingdom to assist each other, and also the courts of "any relevant country or territory". These other countries or territories consist of the Channel Islands and the Isle of Man, and any other country or territory specified by the Secretary of State. Countries who currently benefit from the "inward-bound" effect of section 426 include Australia, Canada, Hong Kong, Ireland, Malaysia, New Zealand and South Africa. It remains in the court's discretion to determine whether any assistance should be granted. It has, however, been said that they should provide assistance unless it would be improper to do so in the circumstances. Courts in the UK may apply UK law or the law of the overseas territory in providing assistance to the overseas' court.

The fourth possibility is the common law jurisdiction to grant assistance to foreign insolvency proceedings. Case law at one point suggested that UK courts had a power at common law, similar to the power under section 426 of the Act, to exercise any powers which would be available to the overseas jurisdiction requesting assistance in a domestic insolvency. This approach has subsequently been disapproved and a restrictive interpretation has been placed on the UK courts' common law cross-border jurisdiction. English common law has traditionally taken the view that fairness between creditors requires that, ideally, insolvency proceedings should have universal application. There should be a single insolvency in which all creditors are entitled to prove. A system of "modified" universalism would avoid the need for office-holders to be appointed in parallel proceedings in multiple jurisdictions. It would recognise the overseas' office-holder and provide the same remedies to that office-holder as if such equivalent proceedings had commenced in the UK.

In a case which has subsequently been largely discredited, the principles of "modified" universalism were expounded and extended by the Privy Council in *Cambridge Gas Transport Corp v The Official Committee of Unsecured Creditors of Navigator Holdings Plc*.[41] Three main principles came out of Lord Hoffman's leading judgment: (1) a domestic court has a common law power to assist a foreign insolvency office-holder (so far as it properly can subject to domestic law and domestic public policy), (2) a domestic court has a common law power to assist a foreign court by doing whatever it could have done in a domestic insolvency, including exercising any domestic statutory powers, and (3) a domestic court has jurisdiction over the parties in an insolvency simply by virtue of its power to assist, and that the absence of jurisdiction *in rem* or *in personam* according to ordinary common law principles is not relevant.

Although the first principle remains intact, the extent of the ability of the common law to assist has been significantly reduced by subsequent case law. The second principle has been held to be wrong by the subsequent (and now leading) case of *Singularis Holdings Ltd v PricewaterhouseCoopers*.[42] The third principle has been held to be wrong by the Supreme Court in *Rubin v Eurofinance SA*.[43] The effect of this case law is that there remains little of "modified universalism" in the common law which will assist an overseas' office-holder looking

[41] [2006] UKPC 26.
[42] [2014] UKPC 36.
[43] [2012] UKSC 46.

for the assistance of the UK courts. They would usually be better advised to consider using one of the legislative provisions as explained above.

The effect of Brexit is that the EU Regulation is no longer be available for UK office-holders when their insolvencies, which commence after Brexit, involve assets in other Member States. The "outward-bound" aspect of the EU Regulation has been lost. To similar effect, the flipside of this is that "inward-bound" EU office-holders, in relation to proceedings commenced after Brexit, are no longer automatically recognised by the UK courts although recognition is relatively straightforward under the terms of the CBIR.

7. RECOGNITION OF FOREIGN JUDGMENTS

The recast Brussels Regulation,[44] usually referred to as the Judgments Regulation, requires the courts of any EU Member State to recognise and enforce (subject to some relatively minor exceptions) the judgments of courts in other Member States. Prior to Brexit this had both an "inward-bound" and an "outward-bound" element in that the English and Welsh courts would recognise and enforce judgments from other Member States and the courts in those other Member States would do the same with English and Welsh court judgments. Again, the effect of Brexit is that these reciprocal rights have been lost. Again, any UK office-holder wishing to enforce a UK judgment in any Member State will have to follow the local laws for enforcement and EU Member State office-holders will have similar challenges in asking the UK courts to enforcement their judgments.

The Foreign Judgments (Reciprocal Enforcement) Act 1933 relates to any judgment made by a "recognised court". The 1933 Act only applies to judgments of courts in jurisdictions which have entered into a reciprocal arrangement with the UK. These include, amongst others, Australia, parts of Canada, India and Israel. The 1933 Act operates by permitting a judgment creditor (for a sum of money) from a recognised court overseas to register the judgment with the High Court. Once registered it has the same status as, and may be enforced as, a judgment of the English and Welsh court.

Self-Assessment Exercise 5

Question 1

In what ways might an overseas office-holder ask for the assistance of the courts in England and Wales?

Question 2

Is recognition of an overseas insolvency procedure automatic under the EU Regulation?

[44] 1215/2012.

Question 3

Is recognition of an overseas insolvency procedure automatic under the CBIR?

Question 4

Can an overseas judgment creditor ask the English and Welsh courts to enforce the creditor's judgment?

For commentary and feedback on self-assessment exercise 10, please see APPENDIX A

8. INSOLVENCY LAW REFORM

The UK Insolvency Service keeps insolvency law and practice under continuous review. Although plans remain preliminary, it is likely that, in the near future, the Insolvency Service will take over as the single regulator of insolvency practitioners from the Recognised Professional Bodies.

It is likely that the UK will, at some time in the future, implement two further "model laws" adopted by UNCITRAL: the Model Law on Recognition and Enforcement of Insolvency-Related Judgments which deals with cross-border recognition of judgments that are associated with insolvency proceedings; and The Model Law on Enterprise Group Insolvency which provides tools to manage and co-ordinate insolvencies within corporate groups, while respecting that each company within the group remains a separate legal entity. These two model laws are intended to complement the Model Law on Cross-Border Insolvency, which the UK adopted when passing the CBIR.

9. USEFUL INFORMATION

For Government publications and announcements relevant to insolvency see the Insolvency Service website:

- https://www.gov.uk/government/organisations/insolvency-service.

For reliable commentary by the insolvency trade body, see The Association of Business Recovery Professionals (R3) website (and for access to Statements of Insolvency Practice):

- https://www.r3.org.uk/.

For access to legislation (NB which is not always completely up-to-date):

- http://www.legislation.gov.uk/.

For access to cases with neural citations (where possible case citations given above contain their neutral citations):

- http://www.bailii.org/.

APPENDIX A: COMMENTARY AND FEEDBACK ON SELF-ASSESSMENT EXERCISES

Self-Assessment Exercise 1

Question 1

Must all "receivers" be licensed insolvency practitioners?

Question 2

True or False? It has not been possible to appoint Administrative Receivers since 15 September 2003.

Question 3

Name one of the recognised professional bodies.

Question 4

True or False? Creditors' meetings remain an integral and compulsory part of all Insolvency Act 1986 procedures.

Question 5

True or False? The deemed consent procedure may be used to fix the remuneration of an office-holder.

Question 6

What percentage of unsecured creditors must approve proposals by an administrator?

Question 7

What percentage of unsecured creditors must approve a company voluntary arrangement?

Question 8

Why can an office-holder not usually realise assets subject to the interests of a receivables financier or hirer under a hire purchase contract or the supplier under a retention of title contract?

Feedback and Commentary on Self-Assessment Exercise 1

Question 1

No. The Official Receiver is a Government employee and is not required to be a licensed insolvency practitioner. A non-administrative receiver such as a fixed charge or LPA receiver need not be a licensed insolvency practitioner and in practice is frequently a surveyor or estate agent.

Question 2

False. It is still possible to appoint an Administrative Receiver as long as the debenture under which they are appointed was executed prior to 15 September 2003.

Question 3

One of either: the Institute of Chartered Accountants in England and Wales or the Insolvency Practitioners Association.

Question 4

False. A physical creditors' meeting is rare nowadays. Creditors decisions are made by creditors' decision procedures or the deemed consent procedure. A creditors' meeting may only be held if it is requested by a minimum number of creditors. That minimum number is 10% in value of the creditors, 10% in number of the creditors or 10 creditors.

Question 5

False. A decision of the creditors is needed by way of one of the creditors' decision procedures. If there is a creditors' committee, it will be the creditors' committee which sets the basis for the office-holder's remuneration.

Question 6

Over 50% in value.

Question 7

75% or more in value.

Question 8

Such assets do not belong to the company. They belong to the receivables financier, the hirer or the supplier and can usually be repossessed and realised by those parties without an office-holder having an power to prevent such action.

Self-Assessment Exercise 2

Question 1

What the three statutory objectives for administration?

Question 2

In what ways may an administrator be appointed and by whom?

Question 3

List at least four elements of the administration moratorium on actions?

Question 4

How long does an administration last unless it is extended?

Question 5

Who decides on how the administrator is remunerated?

Question 6

Can the administrator make a distribution to unsecured creditors?

Question 7

Can an administrator ever sell assets which are held under a retention of title clause contract?

Question 8

How does a pre-pack administration differ from a traditional administration?

Question 9

In what circumstances can a company move directly from administration to dissolution?

Question 10

Who is entitled to "super priority" in administration and what does this mean?

Question 11

Who can propose a CVA?

Question 12

On what grounds can a creditor object to the court about an approved CVA?

Question 13

What form must a CVA take?

Question 14

True or False? There is no requirement for any court approval for a CVA.

Question 15

True or False? There is no requirement for any court approval for a scheme of arrangement under the Companies Act 2006.

Question 16

True or False? In order for a company to enter a Moratorium the proposed monitor must state that the company will be able to pay all debts which fall due during the Moratorium?

Question 17

How do Part 26A Restructuring Plans differ from Part 26 Schemes of Arrangement?

Question 18

Which reorganisation procedures may be described as debtor-in-possession and which require the appointment of an outsider to take over the company's management?

Commentary and Feedback on Self-Assessment Exercise 2

Question 1

Para.3 of Sch.B1 lists the statutory objectives in order of primacy: i) to consider rescuing the company; 2) achieving a better result for the company's creditors as a whole than would be likely if the company were wound up (without first being placed into administration); and 3) realising property in order to make a distribution to one or more secured or preferential creditors.

Question 2

1) the court on the petition of various parties; 2) out of court by the holder of a qualifying floating charge; or 3) out of court by the company or its directors.

Question 3

The purpose of the moratorium is to provide a wide ranging stay on actions which includes: no resolution may be passed for the winding up of the company; no winding-up order may be made against the company (other than on public interest grounds); no step may be taken to enforce security over the company's property except with the consent of the administrator or the permission of the court; no step may be taken to repossess goods in the company's possession under a hire-purchase agreement (which term includes retention of title contracts) except with the consent of the administrator or the permission of the court; a landlord may not exercise a right of forfeiture by peaceable re-entry in relation to premises let to the company except with the consent of the administrator or the permission of the court; no legal process (including any legal proceedings or execution of any judgment) may be instituted or continued against the company or property of the company except with the consent of the administrator or the permission of the court; and no administrative receiver may be appointed.

Question 4

Twelve months.

Question 5

If there is a creditors' committee, it decides, otherwise the decision is one for the unsecured creditors. If the unsecured creditors are not going to receive any payment apart from under s.176A, the decision is one made by the secured creditors (and if they are to be paid a dividend, the preferential creditors).

Question 6

A payment may not be made by way of distribution to a creditor of the company who is neither secured nor preferential unless the court gives permission apart from where the payment is a distribution to unsecured creditors under the prescribed part deduction from floating charge proceeds provision in s.176A of the Act.

Question 7

Only with consent of the court. This is a potentially useful power which may assist in the sale of a business with all the assets it uses in its business. If the owner of the assets in question refuses to consent to the sale, the court may do so and if it does will assess the value which the assets should realise. It will be this amount that the administrator will need to give to the owner after the sale. If the price set by the court is not achieved, the administrator will have to make up the loss from the company's other assets.

Question 8

In a pre-pack, there is never any intention to have a meaningful creditor vote on the proposal to sell the company's business as the sale takes place immediately after the administrator is appointed according to a pre-arranged deal. There is consequently no period of trading by the company during the administration.

Question 9

If the company's assets have been realised and if, once payments have been made to secured and preferential creditors, there is nothing remaining (apart from under s.176A) to be distributed to the unsecured creditors, there is no sensible reason to put the company into liquidation as there are no assets left to realise. In such circumstances, the most cost effective way of bringing the company to an end is to file the requisite notice allowing the company to move straight from administration to dissolution.

Question 10

Any employees whose contracts are adopted by being kept on by the administrator for at least 14 days are entitled to super priority for sums owed them for the period after the adoption. Any party who has contracted with the company in administration, such as a lender who has provided funding, is also entitled to super priority. Super priority means that these liabilities are paid out ahead of the administrator's own remuneration.

Question 11

The directors will usually do so, but an administrator or liquidator may also propose a CVA.

Question 12

That the terms of the CVA are unfairly prejudicial to the creditor's interests or that there was a material irregularity in the decision approving the CVA.

Question 13

It must be either a scheme of arrangement or a composition of debts (or a combination of the two).

Question 14

True.

Question 15

False.

Question 16

False. The monitor must state that the company is an eligible company and that, in their view, it is likely that a moratorium for the company would result in the rescue of the company as a going concern. Once the Moratorium is in force the monitor must terminate the Moratorium if they think that the company is unable to pay any of its Moratorium debts (or pre-Moratorium debts for which the company does not have a payment holiday) but such a view is not needed at the commencement of the Moratorium.

Question 17

There are three main differences: Part 26A is only available to a company which has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern; a majority in number of each class of creditors must approve a Part 26 Scheme (as well as 75% in value) whilst a Part 26A Plan only requires 75% in value; Part 26A contains provision for a cross class cram down which is not available under Part 26.

Question 18

Debtor-in-possession procedures, which provide for a company's directors to remain in control of the company include CVA, Moratorium, Schemes of Arrangement and Restructuring Plans. Administration involves an outsider (an administrator) taking over the management of the company from the directors.

Self-Assessment Exercise 3

Question 1

In what ways can a liquidator be appointed?

Question 2

What is the difference between a members' voluntary and a creditors' voluntary liquidation?

Question 3

When is a liquidation deemed to commence?

Question 4

Who is usually appointed as the first liquidator in a compulsory liquidation?

Question 5

How does a creditor show a company is unable to pay its debts?

Question 6

What is the difference between the balance sheet and the cash flow test?

Question 7

What is the effect of a company entering liquidation? Can it carry on its business as usual?

Question 8

In what order are debts paid in a liquidation (or other insolvency)?

Question 9

Who are the most commonly encountered preferential creditors?

Comment and Feedback on Self-Assessment Exercise 3

Question 1

A liquidator may be appointed by the court in a compulsory liquidation or out-of-court in a voluntary liquidation by the company's members or creditors.

Question 2

Both begin with a resolution of the members but a members' voluntary liquidation is a solvent winding up where the directors must make a statutory declaration of solvency. All the creditors will be paid in full so the members decide who is to be the liquidator. In a creditors' voluntary liquidation the creditors will not be paid in full so have the power to decide who is to be the liquidator.

Question 3

A compulsory liquidation commences upon the petition to the court. A voluntary liquidation commences with the members' resolution to wind up the company.

Question 4

The Official Receiver

Question 5

By showing under section 123 that the company has failed to satisfy a statutory demand for an unsecured debt of at least GBP 750, that a judgment creditor has attempted to execute the judgment and the execution has come back wholly or partly unsatisfied or that there is other evidence of either cash flow or balance sheet insolvency.

Question 6

A Balance sheet insolvency is where a company's assets are worth less than its liabilities (taking into account future and contingent liabilities as well as present liabilities) and cash flow insolvency is where a company cannot pay a currently owed debt (or one payable in the reasonably near future).

Question 7

There is a general prohibition on creditor actions against the company. It may only carry on its business as far as that is necessary for a beneficial winding up of the company.

Question 8

Those with fixed security will usually enforce their security outside any formal insolvency. The statutory order will be expenses (including the remuneration of the office-holder); preferential creditors; floating charge holders (subject to section 176A); unsecured creditors.

Question 9

The company's employees and HMRC regarding taxes collected by the company but not paid over to the Government.

Self-Assessment Exercise 4

Question 1

Under which provision can a liquidator (or administrator) assign office-holder actions to a third party?

Question 2

How are the decisions made by a director under section 214 judged by the court?

Question 3

How is a wrongful trading contribution quantified by the court?

Question 4

What is the standard of proof for fraudulent trading?

Question 5

What are the consequences to a director of a company which has entered insolvent liquidation of being a director of a company with the same or similar name?

Question 6

What is the effect of a director disqualification order or undertaking?

Question 7

Can a disqualified director also be ordered to contribute financially to the company's assets?

Question 8

During which period must a transaction at an undervalue have to occur for it to be actionable?

Question 9

During which period must a preference have to occur for it to be actionable?

Question 10

What is the effect of the recipient of a transaction under section 238 being a person connected to the company?

Question 11

What is the effect of the recipient of a preference under section 239 being a person connected to the company?

Question 12

During which period must a floating charge have to have been executed for it to avoided under section 245?

Question 13

Must a company be unable to pay its debts at the time of the transaction for it to be attacked under section 423?

Question 14

Can a transaction entered into after a petition for a company's winding up but before the winding up be attacked under section 238?

Question 15

True or False? A term in a contract which states that a company's interest in an asset will automatically be forfeited if it enters liquidation is likely to be void.

Commentary and Feedback on Self-Assessment Exercise 4

Question 1

Section 246ZD of the Act.

Question 2

Both subjectively and objectively.

Question 3

The court will identify a date when the wrongful trading began and will quantify a wrongful trading contribution by deciding how much the net liabilities of the company increased from that moment onwards. Effectively, the court quantifies the cost to the creditors of the decision to continue to trade when the directors should have concluded that insolvency was inevitable.

Question 4

Fraudulent trading is both a criminal offence, where the standard of proof is beyond reasonable doubt, and a potential civil liability, where the standard of proof is on the balance of probabilities.

Question 5

Unless the director can show that they fall within one of the exceptions, the director may have committed a criminal offence and be personally liable for the second company's debts (jointly and severally with the company).

Question 6

A person may not be a director of a company, act as a receiver of a company's property or in any way, whether directly or indirectly, be concerned or take part in the promotion, formation or management of a company, unless (in each case) they have the leave of the court; or act as an insolvency practitioner (which is an absolute prohibition which cannot be consented to by the court).

Question 7

A disqualified director may be liable under a number of specific actions brought by an office-holder, such as for misfeasance or wrongful trading but these may have no direct link to the disqualification. Under section 15A, a director of an insolvent company who is subject to disqualification may be ordered to compensate any creditors (or creditors in general) for the loss caused by the behaviour which led to the director's disqualification.

Question 8

In the two years prior to the onset of insolvency which in a liquidation will be the date of the petition (for a compulsory liquidation) or the date of the members' resolution in a creditors' voluntary liquidation. The company must have been insolvent at the time (or it must have become insolvent due to the transaction).

Question 9

In the two years prior to the onset of insolvency (as defined above) where the recipient of the preference is a connected party, otherwise in the six months prior to the onset of insolvency. The company must have been insolvent at the time (or it must have become insolvent due to the preference).

Question 10

There is a presumption that the company was insolvent at the time of the transaction. This presumption is capable of being rebutted by evidence of solvency.

Question 11

There is a presumption that the company was influenced by a desire to prefer the connected person which is capable of being rebutted by evidence to the contrary (in contrast to section 238, there is no presumption of insolvency).

Question 12

Within the 12 months prior to the onset of insolvency (as defined above) and the company must be insolvent at the time or 2 years prior to the onset of insolvency where the floating charge holder is a connected person (in which case there is no need to show the company was insolvent at the time).

Question 13

No - there is no such need, nor is there any time limit in which the transaction must have occurred prior to the insolvency.

Question 14

No - but any disposition of company's property after the petition will be void under section 127. A transaction under section 238 must occur in the two years before the commencement of winding up, that is, in the two years prior to the petition. Transactions entered into after the date of the petition are therefore outside section 238 but fall within the provisions of section 127.

Question 15

True - due to the anti-deprivation principle.

Self-Assessment Exercise 5

Question 1

In what ways might an overseas office-holder ask for the assistance of the courts in England and Wales?

Question 2

Is recognition of an overseas insolvency procedure automatic under the EU Regulation?

Question 3

Is recognition of an overseas insolvency procedure automatic under the CBIR?

Question 4

Can an overseas judgment creditor ask the English and Welsh courts to enforce the creditor's judgment?

Commentary and Feedback on Self-Assessment Exercise 5

Question 1

There are four possibilities – under the EU Regulation if the insolvency commenced prior to Brexit, the CBIR, section 426 of the Act or at common law.

Question 2

Yes if it applies.

Question 3

No, an application to the court for recognition and assistance is required.

Question 4

Yes but only if the creditor falls within either the Brussels Regulation (that is, the judgment is from an EU Member State court and the judgment was made before Brexit) or the Foreign Judgments (Reciprocal Enforcement) Act 1933.

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