[9]www.gafta.com
[10]www.fosfa.org
[11]www.lmaa.org.uk
[12]www.lme.co.uk

Legal Information Management, 9 (2009), pp. 201–205
© The British and Irish Association of Law Librarians doi:10.1017/S147266960999034X

A Practical Guide to Insolvency

Abstract: In the current economic climate, many law librarians are having to deal with enquiries relating to various aspects of insolvency law with which they may not be familiar. Richard Fergusson, an insolvency specialist at Keeble Hawson in Leeds, has written an overview of the different types of insolvency and the processes involved in each.
Keyword: insolvency

Introduction

Insolvency, administration pre-packs and insolvency practitioners (IPs) are big news right now. Like most things that involve technical terms, some see the whole process as a dark art and indeed this summary may make matters worse! But there are some simple concepts that underpin the processes that operate in England and Wales. This is just a summary. Beware that much is omitted.

Overview

Key points

- To clear up the wreckage and apply any assets left fairly between the creditors by way of a 'dividend'.
- To protect other 'stakeholders' who are caught up in the process such as employees and pensioners.
- Where possible, to facilitate a rescue of the company or its business so as to promote an 'enterprise culture.'
- IPs have tremendous powers and as such they are closely regulated. IPs are usually accountants.
- The Government operates the Insolvency Service and there are local 'Official Receivers' (ORs) who act as liquidators in cases where there are few assets. They are officers of the court.

The statutory framework

The Insolvency Act 1986 and the Insolvency Rules 1986 provide the legal framework, but there have been many subsequent regulatory changes to address problems that arose from the last recession. It was felt that the banks could 'pull the plug' without regard to the people caught up in the process. That may be unfair: banks tended to appoint administrative receivers, who often sold the underlying businesses, thus preserving at least some jobs.

The Enterprise Act 2002 introduced new easier administration procedures to address this perceived issue and there is now a much greater emphasis towards 'reconstruction' and a desire to save what can be saved. The next few years may tell if this works any better.

Types of creditor

Creditors are not all equal. Their status determines their pecking order. Some creditors such as banks and other lenders have security. Security is classed as either fixed or floating, depending on the nature of the assets charged. Assets such as land, or assets which are affixed to land, or used permanently in a business, can be caught by a fixed charge. The fixed charge creditor is entitled to the proceeds.

Other assets, such as stock, can be caught by a floating charge. The floating charge creditor has priority, but only after preferential creditors and, in some cases, ordinary

https://doi.org/10.1017/S147266960999034X Published online by Cambridge University Press

creditors who are entitled to a top slice. Such creditors are in a better position than unsecured creditors.

Banks usually have a 'debenture' which combines fixed charges over relevant assets with a 'catch all' floating charge over the balance of the assets.

Preferential creditors are creditors who rank before the ordinary unsecured creditors and include HMRC for unpaid VAT and income tax, together with employee claims for redundancy and other payments due from the employer. And finally … the costs and expenses of the insolvency have to be met and they get paid first in most cases.

The legal definition of insolvency

A company is insolvent if:

- The value of its assets is less than the amount of its liabilities (balance sheet insolvency,) or
- It is unable to pay its debts as they fall due (cash flow insolvency)

Companies and their directors need to be mindful of this. Directors' duties now turn towards protecting their creditors, rather than the shareholders, and they can be personally liable if they trade whilst insolvent.

Types of procedure

In England and Wales these are:-

- Company voluntary arrangement (CVA)
- Administration
- Administrative receivership
- Creditors' voluntary liquidation (CVL)
- Compulsory liquidation

Each process has its own rules sitting above key basics, but they can be split into two main types:

- Those that allow for a business to be rescued (the first three procedures), and;
- Terminal processes (liquidations) where the assets are realised and distributed and the company is dissolved.

Rescue procedures

Company voluntary arrangement (CVA)

A CVA enables a company to enter into a binding arrangement with its creditors, which prevents them from taking proceedings to recover their debt. It is usual that creditors will be offered a percentage in the pound in respect of their debt from trading, often spread over up to five years. The arrangement cannot prejudice the rights of secured or preferential creditors without their agreement.

This arrangement is used on relatively few occasions and has often proved difficult to implement because, as a condition of continued trading, key supplier creditors will often impose requirements to have their old debt repaid. In some cases a CVA can provide a cheaper, quicker and less complicated procedure for a company in difficulty.

Creditors are given 14 days' notice of a creditors meeting and will receive:-

- Notice convening the meeting
- The company's proposals
- The insolvency practitioner's comments on the proposal
- A proxy form to be completed which needs to be completed to enable the creditor to vote on the proposal. Creditors can attend the meeting, but it is usual these days for creditors to vote by post.

A CVA is accepted if 75% of voting creditors vote for the arrangement. Creditors themselves can put forward modifications to the arrangement and, depending on their voting power, these may or may not be accepted by the company.

Administration

Administration is the main rescue procedure, and is designed to give a 'breathing space' from creditors while plans are formulated either to rescue the company or to dispose of the assets to achieve maximum realisations. It is not usual for creditors to receive payment under this procedure, so either the company goes into another procedure (CVA or liquidation) or is returned to its directors.

The administrator has a great deal of power at his disposal, as he can hire and fire employees and directors and enter into contracts on the company's behalf, unlike the supervisor of a CVA, who merely supervises the directors' running of the debtor company. He is an officer of the court and must ensure fairness between the parties.

Administrations have been revamped since 2003 to replace administrative receiverships which were felt to be too biased in favour of the banks. They are only now available to creditors who hold a floating charge created before 15 September 2003 and are therefore now less frequent.

How is a company placed into administration and by whom?

- By the directors preparing the necessary documents which are then stamped at the court (but without any court oversight)
- By the holder of an enforceable floating charge (i.e. a debenture holder) preparing the necessary

https://doi.org/10.1017/S147266960999034X Published online by Cambridge University Press

documents, which are again 'rubber stamped' by the court

- By the court dealing with an administration petition that may be issued by a creditor or, if a winding up petition has been issued, by the company, or its directors

Where the directors seek to make the appointment, they must serve details on any floating charge creditor, who has the right to appoint an IP of his choice and this is a not infrequent situation.

Basics of an administration

- They last for one year unless extended by creditor or court approval
- Once the administration commences, there is a moratorium on creditor action against the company
- Within eight weeks the insolvency practitioner (known as the 'IP') must prepare an initial report explaining the background and making his proposals for the future of the company. He must call a creditors' meeting but this can be avoided in certain circumstances (where unsecured creditors will be paid in full, or not at all, so there is no benefit in having one)
- Creditors can approve or reject the proposals or seek to modify them
- Creditors can seek to appoint a creditors committee
- The administrator's fees should be agreed by any committee, by the creditors generally, or by the court
- The IP must issue progress reports every six months

Pre-packs and abuse of the system

A "pre-pack" is where an insolvency practitioner agrees, before administration, a sale of the business, usually to the management and then proceeds with it immediately after administration. The (strong) argument runs that the system preserves jobs and the value of assets realised. These would otherwise erode if there was any cessation of trading.

Administration is meant to be a temporary process and can be followed by a CVA or by liquidation, which would lead to some opportunity for the creditors to have a meeting to consider what has happened. Alternatively, if the IP concludes that there is no prospect of a dividend, he can dissolve the company by filing a return at Companies House. This can all happen without a creditors' meeting.

A company can therefore enter administration, and be sold back to the management, without a creditors meeting, and then be dissolved, without the creditors being able to have any real input.

One day one limited company runs the business, the next there is a new limited company, the same directors, the same intrinsic business, often the same or a similar name, but none of the old debt for which creditors receive no recompense. The other criticism is that there is no exposure of the assets to competitive tender so there is no guarantee that a better deal could not have been achieved for the creditors.

What protection is there for creditors? The insolvency practitioners' trade body 'R3' has adopted a Statement of Insolvency Practice (being a guidance note to best practice) SIP16 putting in place measures to ensure as much transparency as possible. Nevertheless the publicity continues and high profile 'pre-packs' continue.

It is worth mentioning another protection here. The IP can sell all of the company's assets, and this will include its name or trading style, so the new company can even trade using the same name. Unless he takes certain steps, a director who uses a similar name to trade a new company is liable for that new company's debts personally. The usual get-out is that a director who acquires the business from an IP can serve prescribed notices on the old company creditors, but there is little that those creditors can then do. Alternatively, the director must apply to the court to absolve himself of liability for his new phoenix company. Therefore protection is afforded only by "after the event" disclosure.

Terminal procedures – liquidations

There are three different types of liquidation. Where the company is solvent, the liquidation is known as a **members' voluntary liquidation** (MVL.) Creditors will be paid and this is a process which winds the company up. If it subsequently turns out to be insolvent, a creditors' meeting will be convened and the creditors can choose the liquidator.

If, on the other hand, the company is insolvent it will be either a **creditors' voluntary liquidation** (CVL), which is begun by resolution of the shareholders, or a **compulsory liquidation** which is instituted by a petition to the court (a winding-up petition).

Compulsory liquidation

A petition is presented to the court, usually by a creditor, although it may also in certain circumstances be presented by the company itself or the shareholders. The petition is advertised in the *London Gazette* before the court hearing. The date of presentation is critical, because it triggers the commencement of liquidation and this is a key date in terms of any subsequent investigation and action by the IP. Banks scour the *London Gazette* for any petitions against customers so, once advertised, the bank is likely to freeze its customer's account and this usually sounds the death knell for the company.

https://doi.org/10.1017/S147266960999034X Published online by Cambridge University Press

A deposit must be paid by the creditor to the Official Receiver (via the court) to cover the initial costs of the winding up and this will be refunded if the order is not made.

The Official Receiver automatically becomes the liquidator by virtue of the winding-up order. He has a duty to investigate the company's affairs and send a report to the creditors. He advertises the order in the *London Gazette* and a local newspaper.

Where there are substantial assets, or matters requiring investigation, the Official Receiver may call a meeting of the creditors to appoint an outside IP as liquidator in his place. In practice, compulsory liquidations happen where there are few assets, so they remain with the OR and the company is given a decent burial.

Duties of the liquidator

- To get in and realise the assets and then agree the creditors' claims and distribute funds by way of a dividend.
- To investigate the causes of failure and set aside any transactions contrary to the insolvency legislation (i.e. transactions at an undervalue, preferences).

Creditors voluntary liquidation (CVL)

A CVL is a liquidation begun by the company, but the creditors have the final choice of liquidator. A CVL is the most common way for directors and shareholders to deal voluntarily with their company's insolvency where there are assets to pay for the process. This is because it is in the interests of the directors to take action at an early stage in order to minimise the risk of personal liability for wrongful trading.

Procedure for CVL

Notice, proxy and proof of debt forms (i.e. a statement of claim) are sent to all shareholders and known creditors by the IP. They must be returned within the stipulated time in order for the holders to be able to vote. The creditors' meeting is advertised in the *London Gazette* and two appropriate newspapers.

An extraordinary resolution is required to wind up the company and an ordinary resolution is required to appoint a liquidator. Usually this is immediately before the creditors' meeting, which is often referred to as a "Section 98" meeting.

A statement of affairs, i.e. a document setting out the known assets and liabilities of the company and a report is presented to the meeting of creditors. The shareholders' nominee remains as liquidator, unless a majority by value of the voting creditors appoints an alternative liquidator. The creditors can appoint a liquidation committee to assist the liquidator.

Other useful information

Director disqualification

Liquidators, administrators and administrative receivers are required to report on the conduct of failed companies' directors to the Department for Business Innovation & Skill (BIS). These confidential reports are considered by the Disqualification Unit. Disqualification proceedings are brought by BIS generally on the basis of the director's unfitness to be concerned in the management of a company.

Disqualification orders can be imposed for periods between one and 15 years and prevent the offender taking part directly or indirectly in the management of companies. They also place liability on those who act on an offender's instructions without leave of the court. Disqualification orders are rare and usually only the most persistent breaches are pursued, despite frequent "adverse reports" by IPs.

BIS can require a director to undertake not to act as a director for an agreed period on the basis that, if the director agrees, they will not take proceedings. This is an increasingly common situation.

Antecedent transactions and misfeasance and wrongful trading

It is not uncommon for directors to plan for a company's demise and so they may transfer assets, or pay some creditors in preference to others, for a variety of reasons. A common example is where the bank requires directors' personal guarantees for the company's overdraft. It is not unusual for the bank's overdraft to be dramatically reduced before the insolvency, whilst other creditors remain unpaid. In this situation IPs in their capacity as liquidators or administrators have statutory claims to redress these issues.

When assets have been transferred, they can be recovered on the basis that a transaction at an undervalue had taken place.

Where creditors have been paid early (or their guarantee obligation is reduced) preference proceedings can be started. These are aimed at the beneficiaries who then join the ranks of unsecured creditors.

In such cases, the IP can take proceedings against the directors for their misapplication of the company's funds in making these transactions and these are described as "misfeasance" or breach of duty proceedings.

Frequently the IP will fail to receive co-operation from the directors, who are anxious to cover their tracks. The IP therefore has statutory powers to apply to the court requiring delivery up of assets and records. There is also the power to examine directors in court.

The IP as liquidator has further statutory claims available against directors to require them to make up the deficiency to creditors, if he can establish that they have been guilty of wrongful trading. The director's defence is that he has taken every step to avoid loss to creditors. These powers are

https://doi.org/10.1017/S147266960999034X Published online by Cambridge University Press

even wider where there is evidence of fraudulent trading, but this is rarely used, as the relief is the same, but the evidential burden of proving fraud is much higher.

Employees and pensioners

Employees are often the last to know about the potential insolvency of the company and, unless a buyer is in the wings, redundancy is likely to follow. They gain some protection as the IP will help them to submit claims to the Redundancy Payments Office (part of BIS) which meets element of the money owed to them in unpaid wages, holiday pay and pay in lieu of notice from the National Insurance Fund. The sums payable are small.

Another 'hot topic' is pension deficits. When the company becomes unable to meet its pension liability, pensioners receive some cover from the Pension Protection Fund (PPF). It has a procedure to deal with such claims and there is an obligation on the IP to notify them.

Additionally recent accountancy changes mean that pension deficits have to be recognised in a company's accounts. This can lead to technical insolvency and has resulted in some interesting efforts by companies to evade liability and therefore the PPF has powers to order third parties to make good the loss suffered by the pensioners. This is fairly new territory but no doubt 'watch this space.'

Conclusion

Insolvency law and practice touches people personally. Owners of failing businesses often liken it to bereavement. Employees can suffer long term unemployment, pensioners can lose a large part of their pensions and creditors can see rogue directors manipulate the system. Inevitably we shall see this all too often over the next few years and regulatory reform will spring up to shore up the system as we recover.

Resources

Try:

www.R3.org.uk – the Association of Business Recovery Professionals.
www.insolvency.gov.uk – The Insolvency Service (several glossaries and guidance notes.)
www.companieshouse.gov.uk – several Guidance notes.
www.landregistry.gov.uk – Guidance notes for property insolvency issues.

Each of these sites has links to a myriad of other useful sites – too many to mention here.

Legal Information Management, 9 (2009), pp. 205–220
© The British and Irish Association of Law Librarians
doi:10.1017/S1472669609990351

SLS/BIALL Academic Law Library Survey 2007/2008

Abstract: This is the latest report analysing the results of the Society of Legal Scholars and BIALL Survey. It has been written by Peter Clinch, Senior Subject Librarian for Law, Cardiff University.
Keywords: academic law libraries; surveys

1. Introduction

The following report outlines the activities and funding of academic law libraries in the UK and Ireland in the academic year 2007/2008. The figures have been taken from the results of a postal questionnaire undertaken by Information Services staff at Cardiff University on behalf of the Society of Legal Scholars (SLS).

This survey has been run on an annual basis since 1996 and reported in *The Law Librarian* and latterly in *Legal Information Management*. It is sponsored either by the British and Irish Association of Law Librarians (BIALL) or by SLS.

https://doi.org/10.1017/S147266960999034X Published online by Cambridge University Press