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INSOLVENCY LAW:

Insolvency Act 1986

Insolvency Rules 1986

Enterprise Act 2002

Company Directors Disqualification Act 1986

Statutory Instruments

Case Law

COPORATE INSOLVENCY PROCEDURES

1) Liquidations

There are three types of Liquidations:

- a) **Members Voluntary Liquidation**
- a) **Creditors Voluntary Liquidation**
- b) **Compulsory Liquidation**

2) Company Voluntary Arrangement

3) Administration

PERSONAL INSLVENCY PROCEDURES:

1) Individual Voluntary Arrangements

2) Bankruptcy

OTHER PROCEDURES

Phoenix Companies

Voluntary Striking Off and Dissolution of Companies

A) Members Voluntary Liquidation

This is only available to a solvent company. If it is not solvent, then the creditors' voluntary liquidation will be used.

A Members Voluntary Liquidation would be used under the following circumstances:

- a) The retirement of the Shareholder as there is no one for succession purposes or the company cannot be sold to any third party
- b) The shareholders have fallen out and wish to separate, thereby, wishing to take advantage of transferring assets without having to find the cash to buy them
- c) The company is solvent but the Liquidity/Cash flow is not there and the creditors are threatening Compulsory Winding Up
- d) Tax Advantages i.e. Capital Gains "Taper Relief" pre 05.04.08 or 18% after 06.04.08 as opposed to higher rates of tax on Dividends. A company can make an application to the Revenue under special concession to allow it to distribute assets which will allow the distribution to be treated as capital rather than a dividend distribution. Additionally, as from 1 October 2008 new company law enables companies to make capital reductions as long as the decision is supported by a Solvency Statement signed by all directors.

The basic procedure for this type of liquidation is as follows:

- a) The directors swear a Statutory Declaration of Solvency and convene a meeting of members
- b) At the meeting of members, which must be held, within five weeks of statutory declaration a Special Resolution is passed by members agreeing to the company being placed into liquidation and for the appointment of a liquidator. If the shareholders do not want to wait for the full period of Notice they can convene at Short Notice and place the company into Liquidation as long as 90% or more are present to sign the resolutions being passed.
- c) Both the Resolutions, the Statutory Declaration of Solvency and Notice of the liquidator's appointment are filed with the Registrar at Companies House.
- d) Additionally the Resolution and Notice of the liquidator's appointment must be advertised in the London Gazette and two local newspapers.
- e) Assets are realised and once creditor's claims have been approved, and after the liquidators fees and expenses have been deducted, the creditors are paid in order of priority together with statutory interest. Any surplus is then paid to the shareholders.

At times assets can be distributed to shareholders in Specie. Especially when there is a split between the shareholders and they wish to go their own way. A Special Resolution must be passed to this effect.

- f) Accounts of the company need to be prepared up to the date of the Liquidation and submitted to the Revenue to establish any tax liabilities that may arise to that date. Additionally tax liabilities have to be paid by the Liquidator that may arise on any sale of assets or of trading profits if the company is being traded during his period of appointment
- g) Final meeting of members held to approve the closure
- h) Final return filed with registrar
- i) Company dissolved three months later.

When the company is in liquidation the liquidator has duties as he would in any other type of liquidation. He must gather in the assets and distribute them in accordance with the statutory order. He is still under a duty to investigate past transactions and to look at the directors' behaviour prior to liquidation (except wrongful trading which only applies to insolvent companies). However, it is rare in practice that any detailed investigation is undertaken. Quite simply, the reason for this is that the whole nature of the members' voluntary liquidation is that all the creditors will be paid in full plus Statutory Interest. If creditors are paid in full there is usually very little to complain about.

In order to carry out his duties, the liquidator is given extensive powers under Sch.4 to the IA 1986. These include power to:

- a) sell assets or distribute them In Specie to the shareholders;
- b) use the company bank account;
- c) appoint agents;
- d) litigate and defend litigation on the company's behalf;
- e) carry on the company's business; and
- f) do all of the things necessary to facilitate the winding up.

It is important that this process is finalised within 12 months although, if necessary, the Liquidation can continue further than 12 months. A members meeting must be convened on the anniversary of the liquidation.

If it appears to the liquidator during the course of the members' voluntary liquidation that the company is insolvent, the liquidator must convert the liquidation to a creditor's voluntary liquidation.

B) Creditors' Voluntary Liquidation

Creditors' voluntary liquidation is initiated by the directors of the company and is then ratified by the creditors of the company. However, whilst the creditors' voluntary liquidation procedure is voluntary (in that the directors are not being forced to recommend liquidation), it is usually the result of either outside creditor pressure or professional advice to the directors that the company is insolvent.

A company is Insolvent if it is unable to pay its debts as and when they are due and payable.

Directors are usually unwilling to put the company into liquidation as they always think that better times are around the corner. However, the threat of potential actions against them for fraudulent and wrongful trading usually concentrates their minds.

Directors can be held personally liable for all liabilities incurred if they continue trading the company after they know or should have known that the company was Insolvent.

The basic procedure for a creditors' voluntary liquidation is as follows:

- a) A meeting of members and creditors are convened by giving minimum 14 days notice. Additionally the Notice must be advertised in the *London Gazette* and two local newspapers
- b) The directors prepare a Report and Statement of Affairs giving a brief history and reasons for the company's demise and of its financial position. This is given to the creditors at the creditors meeting and circularised to all creditors after the meeting.
- c) A director has to Swear an Affidavit confirming that the Estimated Statement of Affairs is to the best of his knowledge and belief true
- d) At the meeting of members they pass a Resolution to wind up the company and also nominate a liquidator
- e) Both the Resolutions and the Sworn Statement of Affairs are filed with Registrar at Companies House
- f) Additionally the above Resolutions are advertised in the *London Gazette* and two local newspapers within 14 days
- g) The creditors' meeting must be held within 14 days of the members meeting, although in practice the members meeting is held one hour before the creditors meeting:
 - there are minimum 7 days notice requirements for this meeting
 - creditors' choice of liquidator takes priority over that of the members unless they ratify the appointment and appoint a Creditors Committee to oversee the actions of the Liquidator.
- h) The appointment of liquidator is published in London Gazette and two local newspapers and filed with the Registrar at Companies House
- i) The company's assets are realised. Once creditor's claims are agreed the balance, after Liquidators fees and expenses, is distributed to creditors in required order
- j) A final meetings of creditors and members is held to approve the administration and the closure of the Liquidation.
- k) Final return filed with Registrar at Companies House
- l) Company is dissolved approximately three months later

A Statement of Affairs provides creditors with the following information:

- a) Details of all the assets showing the cost and the amount to be realised
- b) Details of all secured creditors and the amounts owed to them
- c) The names and addresses of all other creditors stating whether they are preferential or unsecured and the amounts due to them

The duties of the liquidator in a creditors' voluntary liquidation are essentially the same as those in a members' voluntary liquidation. Again he is the agent of the company and the directors' powers cease (but the directors are not removed).

The Liquidator will investigate the following:

- a) The actions of the directors and then file his report with the DTI within 6 months of appointment. This will either be a "clean report" or an "adverse report". If it is an adverse report then the chances are the directors will be disqualified from acting as directors for a period of 2 to 15 years.
- b) Wrongful trading. If the directors were trading wrongfully and the liquidator can prove this then they may be sued for all the company's losses.
- c) Whether or not the directors continued trading the company whilst knowing or should have known that the company was insolvent. They would only be responsible for the liabilities created during that period.
- d) Sale of any assets at an undervalue. A liquidator can apply to court to have this overturned.
- e) Preference payments, thereby requesting for the monies to be paid back
- f) Illegal dividends. The shareholders will need to pay them back
- g) Overdrawn directors loan accounts.

The directors have a duty to assist the Liquidator otherwise he can apply to court to:

- have them orally examined under oath or
- obtain a court order forcing them to comply with the Liquidators requests. Failure to comply will be Contempt of Court which will result in their imprisonment

The liquidator will be concerned to attack any past transactions which he feels are a preference and to investigate the actions of the directors in order to swell the fund of assets available to creditors. This Liquidation takes place where a company is insolvent. Therefore the assets are certainly not going to be enough to pay off the creditors in full. The liquidator is concerned to increase the pool of assets to get as big a return as possible for the creditors.

The Liquidator has a duty to do a report on the directors to the DTI under the Directors Disqualification Act 1986.

Also please refer to notes below re Phoenix Companies

C) Compulsory Liquidation

Compulsory liquidation is normally a result of hostile process initiated against the company's wishes via the courts. This can lead to much litigation.

There are various grounds upon which a petition for liquidation can be filed. The most common of these grounds is that the company is unable to pay its debts as and when they are due and payable. There are four circumstances in which a company is unable to pay its debt. These are:

- a) ***neglecting to comply with a statutory demand made by a creditor for a sum of over £750*** – If a creditor is owed more than £750 he can serve a Statutory Demand upon the company. A Statutory Demand is a prescribed form detailing who the creditor and debtor is, what the debt is and the circumstances upon which the debt occurred. If the company does not respond or challenge such a Demand within 21 days then the creditor can issue a petition for winding up.

If the company challenges the Statutory Demand then a Court date is set for the matter to be brought to Court for the Court to decide whether or not the amount being claimed by the creditor is payable by the company
- b) ***An unsatisfied judgment*** – If a creditor has a judgment against the company they can file a petition based on that judgment.
- c) ***The company's assets are exceeded by its liabilities, including contingent and prospective liabilities*** – This is the 'balance sheet' test, and is not often used in practice.
- d) ***The company is unable to pay its debts as and when they fall due and payable*** – This is the cash-flow insolvency test. There are a number of indicators that a court can take into account as to whether a company may be unable to pay its debts when they fall due. These include failing to comply with creditors demand for money without reasonable excuse or admitting it cannot pay the debt (for example, in correspondence).

In this procedure the courts are involved, a court date is set for the Hearing of the Petition and, once again, if the amount owed is not paid before the Hearing the company will be Wound Up. If the company is going to pay this debt to avoid the Winding Up then it is imperative that this is done before the advertisement of the petition as others may join the action and then the company will have to find the monies to pay them as well.

In a compulsory liquidation, the company is always insolvent. Once the Petition is advertised the consequence of this is the company's bank account is frozen and the company must cease to trade. Should the company wish to continue to trade during the period between the issue of the Petition and the hearing of same then it must make an application to the Court to obtain a Validation Order whereupon the bank account will be unfrozen.

Once the company goes into compulsory liquidation the Official Receiver (a civil servant) is always appointed first and continues to be involved as it is his responsibility to investigate the actions of the directors rather than any Insolvency Practitioner appointed in place of the Official Receiver.

The basic procedure for a compulsory liquidation is as follows:

- a) A creditor will petition the court and then the petition is advertised in the *London Gazette*
- b) The court hearing
- c) The court makes order
- d) Official Receiver becomes liquidator

- e) Official Receiver advertises order in the *London Gazette* and local newspaper and notifies both the Registrar and the company
- f) The directors are asked to prepare a statement of affairs
- g) A meeting of creditors is convened to enable them to nominate a liquidator of their choice. The Official Receiver may decide not to convene a meeting as there are no assets to realise, but the creditors may request the Secretary of State to appoint a liquidator of their choice
- h) Assets are realised and distributed to creditors in required order
- i) Final meeting of creditors held
- j) Final return filed with court and Registrar
- k) company dissolved three months later

The powers of the liquidator in a compulsory liquidation are very similar to the powers of the liquidator in a Voluntary Liquidation. The only major difference is that if a Liquidator wants to conduct litigation or to carry on the business he needs the sanction of the Court.

Upon the making of a compulsory winding-up order, the Official Receiver is always appointed liquidator of the company. Directors' powers pass to the Official Receiver and (unlike voluntary liquidations) the directors' appointments are terminated. All legal actions against the company are stayed.

The Official Receiver is under a duty to investigate the affairs of the company and the reasons for the company's failure and the actions of the directors. Even if an independent Insolvency Practitioner is appointed, the Official Receiver is the one that carries out the investigation necessary under The Directors Disqualification Act.

Once he has investigated the affairs of the company and the reasons for failure he may report to the court, if necessary. He must also report to the creditors at least once during the course of the liquidation on the results of his investigations, but not in respect of his investigations of the directors actions re disqualification.

The Official Receiver has power to call officers of the company for public examination before a Court for them to answer questions regarding the affairs of the company and reasons for the company's failure. The creditors can compel the Official Receiver to call officers for public examination if half the creditors in value wish public examination to take place.

An independent Insolvency Practitioner can be appointed in place of the Official Receiver in the following ways:

- a) the Official Receiver can call a meeting of creditors to enable creditors to appoint the Insolvency Practitioner of their choice or:
- b) by the Secretary of State. If there are assets in the liquidation the Official Receiver can request the Secretary of State to appoint an Insolvency Practitioner off of the Rota or the creditors can request that such an appointment to be made.

This and the fact that the liquidation is brought about by a Court Order makes it slower than voluntary liquidation, generally more expensive, more formal and more rigorous in terms of examination of the directors and reasons for failure of the company.

The reasons why it is a more expensive procedure are:

- a) The original cost of the Petition is payable as an expense of the liquidation. Additionally if the

- petition is challenged then both solicitors and barristers need to be engaged, which push up the costs tremendously.
- b) An Ad-Valorem Fee of 14% is payable to the Insolvency Service on all realisations
 - c) The bank account must be held with the Insolvency Service and they charge for every transaction whereas in a Voluntary Liquidation Liquidators negotiate with banks for the bank account to be interest bearing and free of charges.

Company Voluntary Arrangements

Company voluntary arrangement ('CVA') is a potential rescue mechanism and is therefore an alternative to Liquidation, Receivership or Administration. A CVA will require the support of anyone entitled to appoint a Receiver or Administrator. CVA is an easy and comparatively low-cost procedure for rescuing the company.

A CVA can also be proposed by a Liquidator or an Administrator.

A CVA is available for solvent companies as well as insolvent ones. Although a CVA is for the benefit of the company only the directors can apply on its behalf.

During the preparation of the Proposal any creditor can take precipitous actions against the company which could bring it to its knees i.e. Bailiffs.

The big disadvantage of a CVA was the lack of a Moratorium (a 'freeze' on debts) but this is now available for small companies. One has to apply to court to obtain such a Moratorium. See b) below for the disadvantage of this procedure.

Third parties are not subject to the CVA, so a creditor could pursue a director who has given that creditor a personal guarantee. (See b) below)

Perhaps the downside of a CVA for creditors is that it may simply be postponing the inevitable - the liquidation of the company.

The procedure for a CVA is as follows:

- a) The directors make a written proposal; they are normally assisted by the Nominee (an Insolvency Practitioner) to prepare this proposal, which is then circularised to all the creditors. It will identify an insolvency practitioner, known as the Nominee at this point. The Nominee has 28 days to look at the proposal and to report to the Court on its viability. If it is viable, then he decides to call meetings of members and creditors. Creditors must be given minimum 14 clear days form date of receipt of the notice of the meeting.
- b) It is possible to have a Moratorium on actions by the creditors in the case of small companies by applying for one to the Court. It will last for 28 days after filing the proposal at the Court. It can be extended for up to a further two months, that is giving a total period of almost three months. Floating Charges cannot crystallise during the Moratorium. This procedure is not used frequently because the Nominee can be held personally liable for any liabilities incurred during this period even though he has no control over the day to day running of the company. Nowadays, if the company needs a Moratorium the Administration procedure will be used. (See notes below re this procedure)
- c) The proposal will be offering contributions to be paid monthly to the Supervisor which will give creditors a dividend from 0 – 100p in the £.

At the creditors meeting, a majority of more than 75% in value of the creditors present and voting is required to approve the proposal. Creditors may put forward modifications which, if approved, will supersede Terms in the proposal.
- d) Also at the Members meeting the Proposal must also be approved by the majority of Members.
- e) The chairman of the meeting must report its outcome to the Court, members and creditors and the Registrar at Companies House. Unsecured creditors who had notice of the meeting, and those creditors who have not had notice of the meeting, are bound by the proposal as regards past debts but not as regards future debts.
- f) Secured creditors are not bound by the CVA. They could find that assets which are subject

to their charge are dealt with in a way they disapprove of, or are even impressed with a quasi trust in favour of the unsecured creditors. The company must continue with any arrangements that it has made with the Secured Creditors.

- g) Once a Proposal has been approved creditors have up to 28 days, from the date the Report is filed into Court, to challenge the decision of acceptance of the arrangement either because the proposal or the Chairman made decisions that were prejudicial against them.
- h) The Supervisor (previously the Nominee) must be handed control of the assets that are subject to the CVA. In the majority of the cases the “assets” are contributions being made over the duration of the voluntary arrangement, normally 5 years or earlier if creditors are paid in full beforehand.
- i) On completion of the CVA, the supervisor must make a final report to the creditors and members within 28 days.
- j) Should the company fail to comply with the Terms of the proposal the Supervisor must fail the arrangement and Petition for the compulsory winding up of the company. In the majority of the cases the Supervisor will be appointed Liquidator unless the court receives objections from the creditors.

The proposal should be comprehensive and must cover such matters as:

- a) The reasons/history that has caused the company to apply for the Arrangement
- b) Statutory Information
- c) Particulars of the company’s assets, and how they are to be dealt with
- d) The manner in which the liabilities are to be dealt with, particularly secured creditors, preferential creditors, unsecured creditors and debts due to associates of the company
- e) A Statement of Assets and Liabilities
- f) The company’s last or up to date management accounts, if available
- g) A Cash Flow
- h) Contributions payable and any assets that will be included
- i) Dividend payable to creditors
- j) A Comparison of the dividend payable to creditors compared between a CVA and liquidation
- k) The duration of the Arrangement
- l) The name, address and qualifications of the Nominee and proposed Supervisor
- m) The fee of the Nominee and remuneration of the Supervisor
- n) Whether the business is to continue, and if so, on what terms
- o) The Supervisors banking arrangements
- p) Powers and duties of the Supervisor.

There is no register of company voluntary arrangements; details are filed with the Registrar at

Companies House.

The above procedure is also available to Partnerships as they are treated the same as company's. In many instances though, due to individual circumstances of Partners, many Individual Voluntary Arrangements will be entered into.

Administration

Administration is one of the alternatives to liquidation of a company. It is only available for insolvent companies (IA 1986, Sch. B1, para 11). It is intended as a rescue mechanism.

The advantage of Administration is that there is a Moratorium ('freeze') on creditor actions. This is a major factor as it gives the Administrator the time to try to rescue the company, if that is in fact possible.

The purpose of an Administration Order must achieve one of the following:

- a) rescuing the company as a going concern; or
- b) 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 in administration); or
- c) realising property in order to make a distribution to one or more secured or preferential creditors.

The revised regime for Administration, introduced by the Enterprise Act 2002, was implemented on 15 September 2003. The revised regime replaces Administrative Receivership for charges coming into existence on or after that date, and radically remodels the old form of Administration. The reasons for the reform are twofold:

- a) Administrative receivership was seen to be too slanted toward the interests of the secured creditor who appointed the Administrative Receiver. This was at the expense of other creditors, and hampered the 'rescue' of a company in financial difficulty.
- b) The old model of Administration was unwieldy, expensive and often of indeterminate duration.

Receivership (including Administrative Receivership) still exists for charges created before 15 September 2003 but will become less important as time passes. Even though banks may appoint Administrative Receivers they now choose to appoint Administrators instead.

Key features of the new Administration regime include the following:

- a) the company or directors are empowered to appoint an Administrator without petitioning the Court, though the Court route still exists. This is known as "Out of Court Appointment".

If there is a Qualifying Floating Charge Holders ("QFCHs"), then the directors must serve them with a Notice of Intention to Appoint an Administrator and the QFCHs has 5 days to challenge such an appointment. If they do nothing then the appointment goes ahead. Additionally the same notice must be served on any Petitioning creditor.

Qualifying Floating Charge Holders ("QFCHs") is a creditor who has the benefit of a Floating Charge created after 15 September 2003. A QFCH, which was created before 15 September 2003 has the choice of appointing either an Administrative Receiver or an Administrator

- b) Creditors, other than QFCHs, can petition the court for an Administration Order.
- c) A QFCH can apply to court for an Order for its own Administrator to replace the one proposed or appointed by the creditor or directors. This would apply when the QFCH receives notice that creditors have applied to court for the appointment of an Administrator or that directors have appointed an Administrator. The QFCH must receive 5 days notice before any appointment can be made but only when a QFCH exists.
- d) The Administrator is under a duty to act in the interests of all creditors, unlike the situation under Administrative Receivership. This applies even where a QFCH has appointed the Administrator.

- e) Administrators do not have the powers to make payments to unsecured creditors without court permission. The normal procedure would be to move the company into Voluntary Liquidation and then distribute.

The upshot of Administration is that it is a process to rescue the company or the business rather than being a precursor to liquidation. This can be done by a CVA or by sale of the business as a going concern.

Invariably most Administrations are dealt with by a Pre-Pack sale. The business is valued beforehand and on the appointment of the Administrator the business is sold on to "New Company".

The Administrator has to perform his duties in the interests of the company's creditors as a whole

An Administrator is an Officer of the Court, no matter which route is used to appoint him. He has to be such in order to comply with EC Regulation on insolvency proceedings. He has to be an Insolvency Practitioner and will almost always be an accountant.

Once the Administrator is appointed the main Moratorium comes into effect and protects the company whilst the administrator tries to rescue it.

The Administrator will put forward his proposals to a creditors' meeting which must be held within 10 weeks of his appointment. Creditors can seek further details or can amend the proposals. It is important to remember that the Administrator could have been appointed by the directors and the creditors may regard him as the directors' stooge.

The initial creditors' meeting can be dispensed with if:

- a) the creditors are likely to be paid in full;
- b) the unsecured creditors are unlikely to be paid at all; or
- c) only the third purpose applies (realising property in order to make a distribution to one or more secured or preferential creditors).

The Administrator is required to convene further meetings of the creditors if the court orders him to do so or creditors holding 10% or more of the debts request it.

The creditors may establish a creditors' committee. The effects of the Administration Order are that:

- a) The company's affairs is managed by the Administrator and he acts as it's agent;
- b) The directors' powers cease, though they are still in office;
- c) The Moratorium continues. No action can be brought against the company without the Administrator's or the courts consent;
- d) The Administrator controls the company's assets (but does not own them); and
- e) The Administrator carries out his proposals, which have been approved by the creditors.

The Administrator has statutory powers under Sch 1 to the IA 1986. He is, however, an Officer of the Court and obstruction of him could constitute Contempt of Court.

An Administrator acts as an agent for the company and is not personally liable on contracts made by him. He has 14 days to reject the existing contracts of employment otherwise it is deemed that he has adopted them.

In addition to these powers, he has the power to do anything necessary or expedient for the

management of the affairs, business and property of the company. He is required to exercise his powers for the purpose of the Administration.

An administrator also has the power to:

- a) Remove and appoint directors;
- b) Call a meeting of creditors or members;
- c) Apply to the court for directions;
- d) pay money to a creditor, but only with court's permission if it is to an unsecured creditor;
- e) Pay money to any party if it is likely to assist the administration;
- f) deal with property that is subject to a Floating Charge;
- g) Deal with property subject to a Fixed Charge, subject to the permission of the Fixed Charge Holder or of the court; and
- h) Deal with property that is the subject of hire purchase agreements.

One of the problems of the old Administration procedure was the difficulty of exiting without an application to Court. The revisions brought in by the EA 2002 have greatly simplified the procedures.

The procedures for ending Administration are:

- a) automatic end of the administration after one year from the date the administration took effect, unless extended by the court or by prior approval of the creditors;
- b) on application by the Administrator to the Court, if:
 - He thinks the purpose of Administration cannot be achieved in relation to the company;
 - He thinks the company should not have entered Administration;
 - A creditors' meeting requires him to make an application;
 - He thinks that the purpose of administration has been sufficiently achieved in relation to the company;
 - to bring the Administration to an end and ask the Court to place the company into Compulsory Liquidation
- c) Termination where the object has been achieved (for Administrator appointed by the Out of Court route);
- d) The court ending the administration on the application of a creditor;
- e) The court converting the Administration into Liquidation, in the public interest;
- f) The Administrator converting the Administration into a Creditors' Voluntary Liquidation;
- g) The Administrator dissolving the company where he believes there is no property which might permit a distribution to creditors; and
- h) The administrator resigns, is removed, ceases to be qualified or is replaced by those who appointed him in the first place.

Individual Voluntary Arrangement

The Insolvency Act of 1986 (amended by the Insolvency Act 2000 and the Enterprise Act 2002) introduced a new procedure whereby a debtor could come to an arrangement with his/her creditors to pay the debts in full or in part over time as an alternative to bankruptcy. This arrangement is known as an individual voluntary arrangement (IVA) and may be entered into either before or after a bankruptcy order has been made.

There are two types of IVA's. There are the ones for those trading and the ones for persons who only have credit card liabilities, known as consumer credit IVA's.

Partnership Voluntary Arrangements (PVA's) exist for those who trade in partnerships, but as stated previously, unless the partnership is going to pay 100p in the £ or the fact that the individual partners have no assets, IVA's are done for each partner incorporating the partnership liabilities within their individual IVA.

An IVA begins with the debtor drafting a formal proposal to be put to his/her creditors to pay part or all of the debts. The debtor may even propose that the creditors agree to a deferment or postponement of their debts to some future time.

The debtor may make an application to the court for an Interim Order at an early stage but it is not compulsory. The Insolvency Act 2000 amendments which came into force on 1 January 2003 removed the requirement to apply for an Interim Order in every case to cut down on costs and delays in the IVA procedure. Applications for Interim Orders are now only done when creditors are in the process of taking precipitous actions. The main effect of an Interim Order is to prevent a bankruptcy petition being presented or proceeded with. It will also prevent other proceedings such as, execution being commenced or continued without leave of the Court.

An Interim Order will only be granted if no previous application has been made in the last 12 months. The Official Receiver, any Trustee and the Nominee should be given at least 2 days notice of any Interim Order application. The hearing will usually be in chambers before the District Judge or Registrar.

Once prepared the proposal will then be considered by the Nominee (usually an Insolvency Practitioner) who will make a recommendation to the Court as to whether the proposal is acceptable and viable. In practice the majority of proposals are prepared by the Nominee's firm.

Once the proposal is final then this will be lodged with the Court to obtain a special number, unless an Interim Order is in place. Once the special number is obtained the proposal will then be put to a meeting of creditors. Creditors must be given 14 clear days Notice from day of receipt of such Notice convening the meeting. At the meeting the proposal must be approved by more than 75% of creditors voting. Additionally creditors may put forward modifications which if approved will supersede Terms in the proposal.

If the proposal is accepted at the meeting, the Nominee will then become Supervisor of the IVA and oversee its operation. Any agreement reached with the creditors will be legally binding.

If a person has been made bankrupt then he can still make a proposal to his creditors and should the proposal be approved then they will apply to the Court to have the Bankruptcy Order Annulled.

A voluntary arrangement with creditors offers flexibility to the debtor. It may include assets not normally available in bankruptcy, for example, the use of third party funds or income from the debtor's continued trading or employment. It gives the debtor more say in how his/her assets are dealt with, for instance, creditors may allow the debtor to exclude and retain certain assets such as his/her home. Also the restrictions which apply to a bankrupt are avoided.

The proposal must be comprehensive and must cover such matters as:

- a) An explanation why the debtor considers that the voluntary arrangement is desirable;
- b) give reasons why creditors may be expected to concur with the arrangement;
- c) The reasons/history that has caused the individual to apply for the Arrangement
- d) Particulars of the individual's assets and how they are to be dealt with, if appropriate
- e) The manner in which the liabilities are to be dealt with, particularly secured creditors, preferential creditors, unsecured creditors and debts due to associates of the individual
- f) A Statement of Affairs showing the debtor's Assets and Liabilities
- g) If the individual is trading their last or latest management accounts
- h) A Cash Flow
- i) Contributions payable and any assets that will be included
- j) Dividend payable to creditors
- k) A Comparison of the dividend payable to creditors compared between an IVA and Bankruptcy
- l) The duration of the Arrangement
- m) The name, address and qualifications of the Nominee and proposed Supervisor
- n) The remuneration of the Supervisor
- o) Whether the business is to continue, and if so, on what terms
- p) The Supervisor's banking arrangements
- q) Powers and duties of the Supervisor.

In order to make it likely that the creditors will accept the proposal, it should be credible and provide an acceptable alternative to bankruptcy.

The proposal will set out clearly the debtor's obligations particularly as to the time and amount of contributions, so that there is no dispute over whether he/she has complied with the terms of the arrangement.

The Nominee must exercise professional independent judgment in making his/her report to Court or he/she can be made personally liable for the costs of any proceedings where the IVA is challenged successfully.

The debtor is required to give the Nominee access to his/her accounts and records so that the Nominee may consider the proposal. It is important for the debtor to provide the Nominee with accurate records of all his/her creditors' names and addresses.

The approved arrangement is deemed to be in force and effective from the date of the meeting. Any aggrieved creditor may make an application to Court and challenge the approval of the arrangement. This must be done within 28 days of the filing of the chairman's report in Court.

An application to annul the bankruptcy order may not be made until 28 days after the chairman's report of the creditors' meeting has been made to Court or whilst a challenge against the meeting's decision is pending.

The Insolvency Act 1986 identifies default by a debtor in connection with a voluntary arrangement as a ground for a bankruptcy order. A bankruptcy petition on this ground may be presented by the Supervisor or any other person bound by the arrangement (other than the debtor).

If the Supervisor is without funds, he may circulate to creditors a “Certificate of Non-Compliance” which states that the debtor has defaulted and the arrangement is at an end. This will leave the creditors or the debtor with the option of presenting a bankruptcy petition.

The debtor commits an offence if he/she deliberately misleads creditors, the Nominee or the Court for the purpose of obtaining approval of a voluntary arrangement. A person found guilty of such an offence is liable to imprisonment, a fine or both.

BANKRUPTCY

WHAT IS BANKRUPTCY?

Bankruptcy is an insolvency procedure in which an individual enters when one cannot pay their creditors.

The bankruptcy proceedings free the individual from overwhelming debts so that they can make a fresh start, subject to certain restrictions and make sure their assets are shared out fairly amongst their creditors.

Anyone can be made bankrupt, including individual members of a partnership.

There are different procedures for dealing with Companies and for partnerships themselves.

HOW IS ONE MADE BANKRUPT?

A Court makes a Bankruptcy Order only after a bankruptcy petition has been presented.

A petition is usually presented either:

- a. By the debtor himself
- b. By one or more of his creditors who are owed at least £750 and that amount is unsecured.

In many instances a Statutory Demand will be issued prior to the presentation of a petition and the debtor will have 21 days in which to respond, ie pay or dispute the amount. If no dispute is made, then a petition will be presented for the person's bankruptcy.

If the creditors claim is disputed, then the debtor should try and reach a settlement before the bankruptcy petition is heard or apply to the Court to have it dismissed.

WHERE IS THE BANKRUPTCY ORDER MADE?

Bankruptcy petitions are usually presented either at the High Court in London or a County Court near where the debtor lives.

A petition can be presented against anyone, even if they are not present in England or Wales at the time of presentation of the petition. This can happen when the debtor normally lives in or within the previous three years has had residential or business connection within England and Wales. Also if the debtor owes money or income tax for any business they have carried on in England and Wales before leaving the Country.

Most Government Departments commence bankruptcy proceedings in the High Court of London. If the debtor does not trade or live in the London area, the case will usually be transferred to the appropriate local Court and dealt with by the local Official Receiver.

Once a Bankruptcy Order has been made, it is advertised in "The London Gazette" and in a local or national newspaper.

WHO WILL DEAL WITH THE BANKRUPT'S CASE?

- a. The Official Receiver

The Official Receiver is a Civil Servant in the Insolvency Service and an Officer of the Court. The Official Receiver has the responsibility of administering the bankruptcy and protecting the bankrupt's assets from the date of the Bankruptcy Order and will act as Trustee of the Estate unless an Insolvency Practitioner is appointed.

The Official Receiver is also responsible for looking into the bankrupt's financial affairs for the period before and during their bankruptcy. The Official Receiver will report to the Court and to the creditors. Also there will be a need to report any matters which indicate that the debtor may have committed criminal offences in connection with their bankruptcy.

b) An Insolvency Practitioner

An Insolvency Practitioner is a person who is qualified and authorised to act as same. They can be appointed Trustee instead of the Official Receiver and they will then be responsible for disposing of the debtors assets and making payment to the creditors. The Insolvency Practitioner will also carry out the duties of the Official Receiver as mentioned above.

WHAT ARE THE DUTIES OF A BANKRUPT?

When a Bankruptcy Order has been made, the debtor must go to the office of the Official Receiver and provide information about their financial affairs. Nowadays the Official Receiver conducts a number of interviews by telephone rather than face to face.

Usually, before the interview, the bankrupt will be sent or given a questionnaire for completion to fully document assets and liabilities of the bankrupt.

The bankrupt will also be required to hand over the books and records, bank statements etc to the Trustee in Bankruptcy and any insurance policies and other papers relating to their financial affairs.

The bankrupt has a duty to report to the Trustee details of all the assets and increases in income that he obtains during his bankruptcy. This also includes such property as lump sum cash payments that may be received from redundancy payments or money left in a will.

Once adjudicated bankrupt, the bankrupt must immediately cease using bank or Building Society or credit cards or similar accounts straight away and will not be allowed to obtain credit of more than £250 without first disclosing the fact that they are bankrupt.

If the bankrupt does not assist the Trustee in every way, the Trustee can apply to the Court to have him arrested.

HOW WILL BANKRUPTCY AFFECT THE DEBTOR?

1) In Relation To His Creditors

Once made bankrupt, they must not make any payments direct to their creditors, as the creditors need to lodge a claim with the Trustee.

There are some very limited exceptions to this, the main ones being:

- a) Creditors who have a mortgage or charge on the house, if mortgage payments are not made, the lender may sell the home.
- b) Court fines and other obligations arising under an order made in family proceedings or under a maintenance assessment made under the Child Support Act 1991.

Obviously certain payments are still made by the bankrupt from the date of his bankruptcy such as rent, electricity, gas etc and these are basically the essentials required to live.

2. The Bankrupt's Assets

The assets of the bankrupt rest and come under the control of the Trustee in Bankruptcy. If the bankrupt has a business, this will normally be closed and the employees dismissed or the Trustee may obtain authority to trade the business until it is sold

The bankrupt can keep the following items, unless their individual value is more than the cost of a reasonable replacement: -

- a) Tools, books, vehicles and other items of equipment which are needed to use personally in employment, business or vocation.
- b) Clothing, bedding, furniture, household equipment and other basic items that are needed by the bankrupt and his family in the home.

The above items must be disclosed to the Official Receiver/Trustee who will then decide whether the bankrupt can keep them.

All other assets will be disposed of by the Trustee in Bankruptcy in order to pay the fees, costs and expenses of the bankruptcy and make a distribution to the creditors.

The trustee can look at transactions made in the last two years to establish as to whether any transfers were carried out at an undervalue and try to restore same and will look at any transactions over a five year period that have been entered into with connected parties.

The Trustee may also ask the Court to make an Order that the bankrupt has to pay part of his wages or salary if the income is more than needed to live on.

3. Pension Scheme

The effect of the bankruptcy on the Pension Scheme rights will depend on a number of factors. These include whether or not the bankrupt is a member of an Occupational Pension Scheme or have a personal pension.

In a recent case it was decided that the Trustee in Bankruptcy has the right to “cash-in” Pension Schemes, whereas prior to this case, it was generally believed that a Trustee in Bankruptcy had no right whatsoever over Pension Schemes.

4. Life assurance Policies

The Trustee will be able to claim any interest held in a life assurance policy. The Trustee is entitled to sell or surrender the policy and collect any proceeds on behalf of creditors. Where the life assurance policy has been charged to any person, eg an endowment policy used as security for the mortgage on the home, the rights of the secured creditor will not be affected by the making of a Bankruptcy Order. Consequently, the Trustee would not be able to surrender same.

WHAT HAPPENS TO THE HOME'?

This is the most asked question by any individual who seeks advice as to whether they should go into bankruptcy or consider a Voluntary Arrangement.

The bankrupt's interest in the home, whether Freehold or Leasehold, solely or jointly, mortgaged or otherwise, will form part of their Estate, which will be dealt with by the Trustee. The home may have to be sold to go towards paying creditors.

If the husband, wife or children are living with the bankrupt, it may be possible for the sale to be put off until the end of the first year of bankruptcy. This gives time for other housing arrangements to be made.

The husband, wife, partner, a relative or friend, may be able to buy the bankrupt's interest in the home. This may be so even if that interest is very small, worth nothing or in a negative situation. Such a disposal would prevent a sale by the Trustee at a future date. The spouse or any other interested party should be encouraged to take legal advice about the home as soon as possible.

One of the reasons why it is important that the transaction relating to the property is dealt with

immediately, especially where there is negative equity, as if one waits until near the end of the bankruptcy to deal with this matter, then it is possible that, with property values increasing, the bankrupt's share of the equity could rise substantially.

If the Trustee is unable to sell the home, he may obtain a Charging Order on the interest, which must be paid from the bankrupt's share of the proceeds when the property is eventually sold, even if the home is sold some time after the bankrupt's discharge.

Since the Enterprise Act which came into force in April 2003 the Trustee must sell the House within 3 years otherwise the interest in the house reverts to the bankrupt. This does not apply to other property owned by the bankrupt.

WHAT ARE THE RESTRICTIONS ON A BANKRUPT?

The Enterprise Act introduced The Bankruptcy Restriction Order. A Bankruptcy Restriction Order will last for a minimum of 2 and a maximum of 15 years. A person subject to such an order may not:

- a) Obtain credit of £250 or more either alone or with another person without disclosing the fact that he is subject to such Order.
- b) Engage in any business under a name other than that in which he was adjudged bankrupt without disclosing that he is subject to such an order.
- c) Act as a director of a limited company or take part in its management.
- d) Act as receiver or manager of a company on behalf of a debenture holder.
- e) Act as an insolvency practitioner.
- f) Will be disqualified from sitting as a Member Of the House of Commons or sitting or voting in the House of Lords or any committee of the House of Lords.

Additionally, because of the bankruptcy, if they are professionals they will lose their Licence during the period of their bankruptcy but may reapply once discharged from bankruptcy.

The Secretary of State or the Official Receiver may apply to the Court for a Bankruptcy Restrictions Order. In considering whether to make the Order the court must take into account the conduct of the bankrupt including:

- The failure to keep or produce records
- Giving a preference or entering into a transaction at an undervalue
- Failure to supply goods or services paid for in advance
- Trading at a time when the bankrupt knew, or ought to have known, that he was unable to pay his debts
- Incurring a debt which the bankrupt had no reasonable expectation of being able to pay
- Failure to account for loss of property
- Gambling, and rash and hazardous speculation
- Neglect of business affairs of a kind which may have materially contributed to or increased the extent of the bankruptcy
- Fraud or fraudulent breach of trust
- Failure to cooperate with the Official receiver or Trustee.

An application must be made within one year or the permission of the Court will be required to make a late application.

A bankrupt may offer a bankruptcy restriction undertaking which will have the same effect.

BECOMING FREE FROM BANKRUPTCY

Generally a bankrupt will automatically be freed from bankruptcy (known as “discharge”) after one year unless an application is made by the Official Receiver for the postponement of the discharge due to the lack of co-operation of the bankrupt..

One can also become free from bankruptcy if an application is made to Court for the Annulment of the Bankruptcy Order. This would normally be where the debts, fees and expenses of the bankruptcy proceedings have been paid in full or the bankrupt has entered into a Voluntary Arrangement.

If the bankrupt has not carried out his duties under the bankruptcy proceedings, the Official Receiver/Trustee may apply to the Court for this discharge to be postponed until such time as full compliance is carried out.

Once a bankrupt has been discharged, he must ensure that all future liabilities are paid as and when they become due and payable, as this could result in a further Bankruptcy Order being issued against them and the whole procedure commences once again.

ALTERNATIVES TO BANKRUPTCY

There are alternatives to bankruptcy and the main procedure used is known as “Individual Voluntary Arrangement”, which will negate bankruptcy proceedings.

As stated above, one can still enter into a Voluntary Arrangement once they have been declared bankrupt and then apply for the Bankruptcy Order to be annulled.

WHERE TO GO FOR HELP AND ADVICE

Any person who is unable to meet their liabilities as and when they become due and payable should immediately seek advice from a licensed Insolvency Practitioner or a person who is duly qualified who is able to give proper advice.

It is imperative that this advice is taken sooner rather than later, as it is always easier to reconstruct and rescue a business at the outset, than it is when it’s “knocking at death’s door”.

Phoenix Companies

A phoenix company is where the assets of one Limited Company are moved to another legal entity. Often some or all of the directors remain the same and in some cases, the new company has the same or a similar name to the failed business. The phoenix company will operate in the same sphere as its predecessor. In other words, these companies are companies which have failed, but are trying to be successful at the same business using same directors, staff, customers and assets.

It is perfectly legal to form a new company from the remnants of a failed company. A director of a failed company can become a director of a new company unless he or she:

- a) is subject to a disqualification order or undertaking, or
- b) is personally adjudged bankrupt, or
- c) is subject to a bankruptcy restrictions order or undertaking.

It is possible to see many faults in allowing the set-up of Phoenix companies.

In the past, some directors have deliberately forced their companies into insolvency in order to buy back the assets at a reduced price while absolving their responsibility for the liabilities.

The Insolvency Act 1986 has made it far more difficult for directors to do this, with stricter rules over the insolvency process and who can become a liquidator. The liquidator must ensure that the best price is obtained for a business and its assets.

In a minority of cases, directors abuse the phoenix company arrangement by transferring the assets of a failing business at less than market value before insolvency, thereby reducing the funds available to creditors when the original company becomes insolvent.

The Insolvency Act 1986 gives the liquidator a number of powers to stop those who are abusing the system. These include allowing a liquidator to take recovery action where the failed company has entered into a sale at a lower than market value at a time when the company was unable to pay its debts. In addition, the Act makes it an offence for a director of a company which has gone into insolvent liquidation to be a director of a company with the same or a similar name, or concerned in its management, without leave of the court within 5 years after the winding up. A director who contravenes the Act may be made liable for the debts of the original company after he/she became director.

Under the 1986 Company Directors Disqualification Act (CDDA), the courts can disqualify directors whose companies have failed as a direct result of their misconduct, for periods up to 15 years. This will disqualify the person from being a director of a company; acting as receiver of a company's property and being concerned or taking part in the promotion, formation or management of a company. It also disqualifies them from being a member of a limited liability partnership or taking part in the promotion, formation or management of such a partnership.

An application can be made to the court to enable a disqualified director to become a director of another company under special circumstances.

It is important to note that the term "director" applies to anyone in the position of a director of a company, whether they are called a director or not. It includes those who give instructions on which the directors or a company are accustomed to act, known as De Facto or Shadow Directors.

Similarly, when a bankruptcy order has been made against an individual, he or she must get the court's permission before becoming a member of a limited liability partnership or acting as a director of, or directly or indirectly taking part in or being concerned in the promotion, formation or management of a company for the duration of the order. For the duration of the order, the person is known as an undischarged bankrupt.

Legislation introduced in April 2004 gave the Official Receiver power to apply to the court for a bankruptcy restrictions order against any bankrupt who he believed to have been dishonest or in some other way to blame for his position. These orders can last for between 2 and 15 years and have the effect of continuing to apply the restrictions of bankruptcy after discharge.

These safeguards mean that it is relatively safe to trade with Phoenix companies. The majority of phoenix companies are perfectly legitimate businesses, but as with all new customers, suppliers should carefully vet them first and in particular follow up trade references and check the directors themselves. One should find out why the previous business failed and ensure that the directors are not serial abusers of the phoenix company arrangement. This information can be found out from Companies House or from a status report from a credit ratings agency.

Voluntary Striking Off and Dissolution

A private company that is not trading may apply to the Registrar to be struck off the register (Companies Act 1985, s.652). It can do this if the company is no longer needed. For example, the active directors may wish to retire and there is no-one to take over from them; or it is a subsidiary whose name is no longer needed; or it was set up to exploit an idea that turned out not to be feasible and that the company is no longer trading.

This procedure should only be used if the company has no assets and liabilities. If the company is struck off and it owns assets then those assets vest in the Crown.

The procedure is not an alternative to formal insolvency proceedings where these are appropriate, as creditors are likely to prevent the striking off. Even if the company is struck off and dissolved, creditors and others could apply for it to be restored to the register.

A private company can apply to be struck off if, in the previous three months, it has not:

- a) traded or otherwise carried on business;
- b) changed its name;
- c) for value, disposed of property or rights that, immediately before it ceased to be in business or trade, it held for disposal or gain in the normal course of its business or trade (for example, a company in business to sell apples could not continue selling apples during that three-month period but it could sell the truck it once used to deliver the apples or the warehouse where they were stored);
- d) engaged in any other activity except one necessary or expedient for making a striking-off application, settling the company's affairs or meeting a statutory requirement (for example, a company may seek professional advice on the application, pay the costs of copying the Form 652a, etc). However, a company can apply for striking off if it has settled trading or business debts in the previous three months.

A company cannot apply to be struck off if it is the subject, or proposed subject, of:

- a) any insolvency proceedings (such as liquidation, including where a petition has been presented but has not yet been dealt with); or
- b) a CVA.

Any loose ends should be dealt with before applying to be struck off as numerous people who have an interest in the business can object to the application (such as members or creditors). The company should basically only exist on paper by the time the application is made. It is important to note that from the date of dissolution, any assets held by the dissolved company will belong to the Crown. As such, all bank accounts should be closed and all assets sold before the application is made.

The application is made on Form 652a which needs to be signed by the majority of directors (if there are more than two) or all the directors (if there are two or less). This form should then be submitted to the Registrar with a £10 fee.

The following parties should be informed within seven days of submitting the form as they have the right to object:

- a) members
- b) creditors
- c) employees

- d) managers or trustees of any employee pension fund
- e) any directors who have not signed the form.

When the Registrar receives the application he will advertise and invite objections to the proposed striking-off in the *London Gazette*. The Registrar will strike the company off the register not less than three months after the date of this notice if he sees no reason to do otherwise and the application has not been withdrawn. The company will be dissolved when the Registrar publishes a notice to that effect in the *London Gazette*.