

38. English Company Insolvency

Creditors' voluntary liquidation

A creditors' voluntary (insolvent) liquidation is initiated in the following manner. The directors recommend a proposal to the members (shareholders) to wind up on the basis that the company is unable to pay its debts. The shareholders' resolution authorises a meeting of the creditors. A statement of affairs is prepared. Fourteen days' notice must be sent to all members. This can be waived under certain circumstances.

The shareholders' meeting requires a special resolution (75% majority) to wind up the company and an ordinary resolution (50% in value) to appoint a member's liquidator. It must be advertised in the London Gazette and two newspapers circulating in the locality within 14 days. A copy must be sent to the Registrar of Companies within 15 days.

A meeting of creditors must be held within 14 days of the shareholders' meeting. Creditors must be given at least seven days' notice. The notice must identify the proposed insolvency practitioner and will furnish creditors with information regarding the company as they reasonably require. The meeting must be held in a convenient

place and locality. A list of names and addresses of company creditors must be available for inspection prior to the meeting.

A director of the company chairs the creditors' meeting. The directors must prepare a statement of affairs in the prescribed form. The resolutions to be passed by the meeting include appointment of the liquidator and establishment of the liquidation committee (if so chosen) and the basis of the liquidator's remuneration (time or commission). The meeting may be adjourned, if necessary, for up to three weeks.

The creditors are given an opportunity to appoint a liquidator. If there is a conflict between the members and creditors, the creditors' liquidator is appointed. If no liquidator is appointed by the creditors, the members' choice remains appointed.

If either group is unhappy with the liquidator appointed, an application can be made to Court within seven days for replacement. The nominated liquidator must provide the chair with a completed form confirming his qualifications and his consent to act.

The liquidator must then advertise his appointment in the London Gazette and send it to the Registrar of Companies within 14 days. He must advertise the appointment in one local newspaper and

file a statement of affairs to the Registrar of Companies.

Creditors' Committee

The creditors committee may be formed by the creditors at the initial creditors meeting or any subsequent meeting of creditors in order to assist the liquidator. The creditors committee acts on behalf of the creditors as a whole. It consists of at least three but not more than five creditors who have debts not fully secured. The liquidator must give a certificate once he is satisfied that the committee is properly constituted. This must be filed in Court and copies must be sent to the Registrar of Companies.

The committee represents the creditors as a whole. It must assist the liquidator and act as a sounding board. The liquidator has certain obligations to the committee. He must give them seven days notice of meetings and chair the meetings. He must report on all matters which appear to be or have been indicated by the committee as being of concern in the winding up. No report is required on matters which are not of concern. If the request for a report is unreasonable or the cost of complying excessive, no report is required.

The committee can sanction the continuing of the directors powers and

exercise certain powers of the liquidator. They can require the liquidator to report certain matters of concern. They can require the liquidator to convene a meeting. They can agree the liquidator's remuneration. They can resolve that costs, charges and expenses be payable out of the assets or as determined by the Court.

Compulsory Liquidation of Companies

A compulsory company liquidation is one that is ordered by Court. It commences with an application or so called "petition" to wind up the Company. The Official Receiver is appointed Liquidator.

For practical purposes, the inability of the Company to pay its debts is the principal ground relied on for a winding up. There are certain other grounds upon which a court may order the winding up of a Company. A winding up may be ordered if the Court is of the opinion that it is just and equitable to wind up.

As with bankruptcy, it is possible to base an application for winding up as an inability of the company to pay a debt. This can be shown in a number of ways. An "unsatisfied statutory demand" is sufficient to prove insolvency. An unsatisfied Court Order is not necessary. The debt must exceed £750 and be for a liquidated (i.e. certain) amount owed for a

single creditor. It must not be disputed on any substantial grounds and must not be reduced below £750 by any counter claim. The statutory demand must be left at the registered office.

The application for winding up can be taken by a number of different parties. Possible applicants include the company itself, directors, creditors, shareholders or the Secretary for State for Trade and Industry, the Official Receiver, Attorney General and certain other persons.

Provisional Liquidator

The Court may appoint a Provisional Liquidator before making a winding up order. The Provisional Liquidator may be appointed if the assets of a company are in jeopardy and it can be shown that unless one is appointed, there is a risk that the assets will not be available for distribution.

The normal function of the Provisional Liquidator is to protect the assets and records until the hearing of the winding up application. The powers of the Provisional Liquidator will be limited by the terms of the Court Order.

The Official Receiver or any other fit person may be appointed as Provisional Liquidator.

The remuneration of the Provisional Liquidator is fixed by Court on application. The appointment of Provisional Liquidator is terminated upon making of the winding up order or may be terminated by Court at any time.

Petition Procedure

A petition for winding up must be filed with Court and certain additional copies must be produced. It must be backed up by Affidavit setting out the relevant facts to the applicant's information and belief. The petition is issued by Court.

The petition is served on the company's registered office or last known address. It must be served at least 14 days prior to the hearing. It must be advertised in the London Gazette at least 7 days before the hearing unless the Court otherwise directs. Every director, shareholder and creditor is entitled to a copy of the Petition. There are certain other parties upon whom the petition must be served.

If the Court makes a winding up order, the Official Receiver is appointed the liquidator, unless the winding up follows administration or voluntary arrangements. The winding up is usually deemed retrospective to the date of presentation of the petition.

The effect of a winding up order is that no legal proceedings may be commenced nor

may enforcement be made against the property about leave of Court.

Duties of Official Receiver

The Official Receiver has a duty to investigate the causes of a company's failure and generally to examine the dealings and the affairs of the company. An Official Receiver may carry out inspections, take custody of deeds and call directors for interviews. He can require statements to be submitted by the company's officers.

The Official Receiver may apply to the Court for a public examination of present or past directors or any other person who has taken part in the promotion, formation or management of the Company.

One half of the value of the company's creditors or 75% of the company shareholders may require the Official Receiver to apply for public examination. This takes place in court.

The Official Receiver has a duty to decide whether to call a meeting of the company creditors and members in order to choose an Insolvency Practitioner to become liquidator in place of the Official Receiver. There is 12 weeks following the date of the order to call such meeting. If the meeting is not called, notice must be given to the Court, the creditors and the members.

The company creditors can require the Official Receiver to call a meeting. It must be called within 3 months of the request. A meeting called by the Official Receiver must be called within 4 months of the winding up order.

Notices must be filed in court and 21 days notice must be given. The notice should contain details of the time and place of the meetings together with proofs and provision for proxies. Details of the meeting must be advertised in the local press.

The business of the meetings is the same as that of a normal or voluntary creditors meeting. Both the creditors and members (shareholders) meetings may nominate a liquidator. If the creditors nominate a liquidator, this has preference. If the creditors do not nominate a liquidator, then the members may appoint a liquidator. Every creditor can objectively appoint a liquidator within 7 days. The Court may make the appropriate order on foot of such objections.

If neither meeting nominates a liquidator, the Official Receiver must apply to the Secretary of State for a Liquidator to be appointed in his place. The Secretary of State has a discretion whether to appoint a liquidator or not.

The Official Receiver must report to the creditors and members in respect of

proceedings and the state of affairs of the company. A copy of that report must be filed with the court.

Insolvency investigations

The Official Receiver has an obligation in a compulsory liquidation to investigate if the company has failed, and if so to investigate the causes of the failure. He must also investigate the dealings and affairs of the company generally. He must make an application to Court on the outcome of the investigations if he sees fit.

The liquidator has no specific duty to carry out an investigation in a voluntary liquidation. However, he must carry out such investigations as are necessary to determine the assets and liabilities of the company, to review the decisions and actions of the directors, to determine whether transactions may be set aside and to identify any rights of legal action which the company or liquidator may have against third parties.

A liquidator is obliged to take appropriate steps to investigate what assets are available to the company in a winding up. This will include inviting creditors to bring matters to his attention, enquiring of officers and management verifying the statement of affairs against audited, filed and management accounts, reviewing books, accounts and papers and identifying possible legal action.

If there are grounds for further investigation or action, he should discuss the matter with the liquidation committee. Funding issues should be discussed with them. If the liquidator comes across evidence that the company or an officer has been guilty of an offence, the matter should be reported.

In the case of an insolvent liquidation, the liquidator must report to the Secretary of State on the conduct of past and present directors, where it appears that their conduct is such as to make them unfit to be concerned in the management of a company.

Disqualifying Directors

The Official Receiver, the Liquidator, Administrators and Administrative Receivers are required to report on directors' conduct. They are obliged to make a return within six months of the start of the relevant process. They are required to file a D1 report for directors whose conduct has been unfit and a D2 report for directors whose conduct is deemed to be fit. They must cover all directors and shadow directors in office within three years before the commencement of the process.

The Secretary of State must make an application for disqualification within two years. The Courts can make a

disqualification order where a director has been director of a firm which became insolvent and the conduct as director makes him unfit to be concerned in the management of a company. The minimum period for disqualification is three years with a maximum of fifteen.

Under a disqualification order, a person may not act as a director or be otherwise involved, directly or indirectly in a promotion, formation and management of a company, without the leave of Court. Anybody acting in contravention of a disqualification order is guilty of an offence and is jointly and severally liable for the company's debts.

SIP4 gives guidance to Insolvency Practitioners in relation to disqualification orders. If an insolvency practitioner has not found any unfit conduct within six months or his information is insufficient he should make an interim return. If relevant conduct is found at a later date, a further report can be made. The reports must be made within one year and the applications must be made to Courts within two years. If Liquidators cannot make any specific investigation into directors' conduct, they can act on the basis of what comes to light in the ordinary course of investigation.

An isolated technical failure should not be looked at. Rather, the director's overall conduct to be assessed.

The following types of misconduct are relevant to assessing the overall position:-

- ❖ loans to directors to purchase shares of the company;
- ❖ personal benefits obtained;
- ❖ criminal convictions;
- ❖ breach of duty;
- ❖ misapplication of funds;
- ❖ voidable transactions;
- ❖ prejudicing of creditors such as by dishonoured cheques, delaying tactics, retention of monies to finance trading, undervalue transactions, preferences;
- ❖ overstating assets in accounts, misconduct in factoring, responsibility for insolvency, responsibility for non delivery of goods, responsibility for preference.

A disqualification undertaking may be given by an individual that he will not act as director for a specified time. The minimum and maximum times are per the disqualification periods. An undertaking may be accepted in lieu of an application for disqualification order.

Review and Set Aside of Past Transactions

Liquidators (and other officers such as administrators) are entitled to look at transactions which have dissipated the company's assets. The purpose is to take back assets which have been wrongfully

removed from the company so that they are available for payment to the creditors generally.

Liquidators have powers to apply to set aside voidable transactions undertaken by the company within certain time periods before liquidation. Action can be taken against directors and others to recover the funds for the benefit of the liquidation. There are a number of distinct grounds upon which liquidators can seek to undo transactions and recover money.

Where company assets have been given away by a gift or for less than full value when the company was insolvent or about to become insolvent or became insolvent as a result, then under certain circumstances the transaction can be set aside. The liquidator or administrator can apply to Court to have the transaction set aside. If the transaction was entered into in good faith with a reasonable grounds of believing it would benefit the company, this is a defence.

An unlawful preference is a transaction with a creditor, a surety or guarantor by which the company puts the creditor or guarantor in a better position than they would have been in, without the act concerned. The company must be insolvent at the time or as a result of the preference, in order for it to be challenged. It must take place within a certain timeframe before insolvency. The Liquidator/Administration must apply to the

Court to have it restored to the prior position. It is presumed that there is a desire or intention to prefer if the parties are connected.

An extortionate credit transaction which, having regard to the risks and rewards, is grossly out of line with ordinary principles of fair dealing. The provision of credit must take place in the relevant time and liquidator and administrator must apply to Court to have the Agreement varied or set aside.

Transactions that are at undervalue can be set aside within 2 years. Unlawful preferences with unconnected parties can be set aside within 6 months and 2 years in the case of connected parties. Extortionate transactions can be set aside within 3 years. A connected party is a director or an associate of any such person. Associates include most relations, business associates, trustees, and companies connected with such individuals.

A floating charge granted over a company's assets is invalid except to the extent that new value is given. A floating charge within the relevant time period is invalid. The Liquidator/ Administrator must make an application to show the floating charge is invalid and that the assets purported to be covered by it can be taken free of it.

Fraudulent and Wrongful Trading

Fraudulent trading is where directors or other controllers of the company knowingly carry on business with the intent of defrauding creditors. Persons who knowingly are party to fraudulent trading can be made liable to contribute the company's assets as the Court decides i.e. can be made personally liable for the company's debts. Fraudulent trading is also a criminal offence.

Wrongful trading is where a director of an insolvent company knows that a company is not able to pay debts and does not take steps to minimise losses to creditors. This is a civil claim. The Court can order that a director contributes to the company's assets as it thinks fit.

Wrongful trading is easier to prove than fraudulent trading. It need only be show that the directors should have known that the company was insolvent.

A director may have breached his duty to the company. He may have misapplied company funds. Legal action can be brought against a director, past directors or other parties. The Court will require the Defendant to reimburse monies as it sees fit or as appropriate.

A director or a "shadow" director (a director in fact but not in name) of a company in insolvent liquidation may be prohibited or restricted from being a director of a company within 5 years. Involvement need not be just as director but could apply to anybody involved directly or indirectly in the promotion or formation of the company. The person in breach becomes liable for debts incurred during the period in which they are involved with the company.

If the insolvency practitioner transfers the business to a successor company, notice must be given to the Creditors by the successor. The notice must give details of the prohibited name, company and the full circumstances of the acquisition.

Lavelle Coleman is an Irish firm of solicitors with an England and Wales legal practice. Our England and Wales qualified and regulated solicitors provide a wide range of legal services from our Dublin offices. We have written legal guides in relation to a broad range of England and Wales legal matters as they relate to Irish based individuals and businesses. These guides are available on our website at <http://www.lavellecoleman.ie/England-Wales-Law.aspx>

This is an extract from our “Legal Guide to the Management and Enforcement of Security in England and Wales for Irish Lenders (2009). The Guide is intended as an overview and broad outline of the matters covered in it. Its purpose is to inform and raise awareness. We are happy to offer specific legal advice on particular circumstances. It should not be relied on as a substitute for comprehensive legal advice with reference to the particular circumstances. While we have taken due care in the preparation of this publication, we do not accept legal liability as a result of any reliance placed on anything in it. The reader should rely only on specific legal or taxation advice. This extract is based on the law as of 1st August 2009.

© Paul McMahon, Lavelle Coleman 2009

CONTACTS

Paul McMahon

pmcmahon@lavellecoleman.ie

Phone: (353) 1 6445800

Fax: (353) 1 6614581

Lavelle Coleman
Solicitors
20 On Hatch
Lower Hatch Street
Dublin 2
Ireland

www.lavellecoleman.ie