



Understanding Insolvency

October 2008

Introduction

This guide has been prepared by R3 – The Association of Business Recovery Professionals. It defines and explains most insolvency procedures and terms, but should only be regarded as an introduction to a complex subject. If you require advice about insolvency you should either speak to your professional adviser or a licensed insolvency practitioner. The information in this guide is correct at date of publication: August 2008.

Note: Italicised terms in the text of this guide are defined in the Glossaries in Sections 7 and 8.

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Section 1 – What is Insolvency?

Insolvency is legally defined as follows:

A company is *insolvent* (unable to pay its debts) if it either does not have enough assets to cover its debts (ie value of assets is less than amount of liabilities), or if it is unable to pay its debts as they fall due.

An individual is insolvent if he or she is unable to discharge his or her debts as they fall due.

Once a company or individual has become insolvent, several courses of action are open, sometimes resulting in a return to solvency. These are different for individuals and companies (see *Section 2 – What Happens in an Insolvency?*).

Once insolvency is recognised, the insolvent company or individual must ensure that there is no further depletion in of assets (or increase in liabilities). In any insolvency procedure, the insolvency practitioner takes control of the all of the assets and ensures that all creditors are treated fairly and equally, in proportion to their claims. In addition, in most company insolvency procedure, the insolvency practitioner must report to the Department of Trade and Industry (DTI) about the conduct of directors.

An insolvent company goes into *administration*, *administrative receivership* or *liquidation*, whereas an individual becomes *bankrupt*. Companies are never described in law as bankrupt. Insolvent individuals and companies alike can enter *voluntary arrangements*.

Insolvency procedures and terminology are similar in England, Wales and Northern Ireland, but differ in Scotland.

Surveys conducted by R3 have consistently shown that many insolvencies could be avoided if professional advice had been sought earlier. The longer a company waits before seeking help, the more likely it becomes that the company or its business will not be rescued.

Likewise, the longer an individual waits before seeking advice, the greater that individual's debts are likely to be.

There are a number of reasons why a company might become insolvent. R3's research shows that the most common reasons for corporate insolvency are:

- loss of market: where companies have not recognised the need to change in a shrinking or changing marketplace, because their margins have been eroded or because their service has been overtaken technically

- management failure to acquire adequate skills, either through training or buying them in, over-optimism in planning, imprudent accounting, lack of management information
- fraud
- loss of long term finance, over-gearing, lack of working capital/cashflow
- other reasons include excessive overheads, new venture/expansion/acquisition.

Company directors' responsibilities are increasingly emphasised, largely because of the huge numbers of corporate failures during the early 1990s. One of those responsibilities is to ensure that the finances of a company are properly handled and understood.

The DTI's Disqualification Unit is becoming increasingly active. If directors knowingly cause a company to trade when it is insolvent and when there is no real prospect of improvement in its finances, they are increasingly liable to disqualification. In fact, new 'fast track' laws to disqualify directors of insolvent companies whose conduct makes them unfit for management were introduced in April 2001.

Sometimes, all that is needed is a third party to point out how a company can improve its financial condition. There may be serious underlying problems, but it is always worth speaking to a *licensed insolvency practitioner* or other member of R3. They will usually not charge for a first consultation. R3 is very happy to provide details of licensed insolvency practitioners and members of R3 in any area of the UK.

For individuals, the choice of procedures is more limited (see *Section 2 – What Happens in an Insolvency?* and *Section 6 – Personal Insolvency*). As with companies, the sooner a problem is identified and addressed, the sooner it can be rectified and the best outcome achieved.

Naturally, the causes of insolvency for individuals are often different from those for companies. Although many personal insolvencies involve sole traders or self-employed people, insolvencies for purely 'domestic' reasons have featured heavily in R3's research over the last few years, especially with easily available credit and personal finance.

Section 2 – What Happens in an Insolvency?

The objective of any insolvency procedure is to maximise returns to creditors. The mechanism used to achieve that goal will depend on circumstances and the availability of assets, but in many cases a licensed insolvency practitioner will attempt to rescue the business if this will provide a better return for the creditors.

Once a company or individual is recognised as being insolvent, or thinks it may become insolvent, there are a number of alternatives available to the insolvent party (the debtor) or its creditors. The options have varying degrees of formality, from less restrictive voluntary arrangements for both individuals and companies, to more structured and restrictive procedures such as liquidation, administration and administrative receivership for companies and bankruptcy for individuals.

England, Wales and Northern Ireland

The process of corporate insolvency may be initiated by one of several parties.

- The directors and/or shareholders themselves are able to initiate several forms of insolvency process if they believe the company is (or is about to become) insolvent. They may appoint an *administrator* or apply for an *administration order*, or they may *liquidate* a company by means of a *creditors' voluntary liquidation (CVL)*. Alternatively, they may advise a charge holder (usually a bank) of the situation who may then appoint an *administrator* or an *administrative receiver* (but it is generally not possible to appoint an *administrative receiver* where the charge has been created after 15 September 2003).
- Creditors may apply for the company to be liquidated via the courts, a *compulsory liquidation*.
- A *debenture* holder – if a bank, or other creditor, holds a *charge* or *mortgage* over the assets of a company, it may appoint an *administrator* or an *administrative receiver* if it feels that repayment of a loan or its security is threatened and if the borrower has breached the loan covenants (again, an *administrative receiver* cannot generally be appointed where the charge was created after 15 September 2003).
- The Secretary of State for Trade and Industry may *petition* the court for the *winding up (compulsory liquidation)* of a company if he believes it is acting against the public interest.
- As far as individuals are concerned, either the debtor or one of his creditors can begin the insolvency process by presenting a petition for bankruptcy to the court.
- Alternatively, with the assistance of a licensed insolvency practitioner, the debtor may prepare a proposal for an *individual voluntary arrangement (IVA)*.

Scotland

The effect of an insolvency procedure in Scotland is the same as in the rest of the UK, unless expressly stated otherwise. However, Scotland has a quite separate system of property law, and therefore also a different set of legislation dealing with the insolvency procedures. Accordingly, it cannot be assumed that because something happens a certain way in England and Wales or Northern Ireland it will be the same in Scotland.

In Scotland the corporate insolvency processes are much the same as in England and Wales, but the procedures differ slightly. This will be considered further in *Section 5 – Corporate Insolvency*.

Individuals and partnerships in Scotland are *sequestered*. This is the equivalent of bankruptcy. The *Trust Deed* replaces the IVA. This is considered further at *Section 6 – Personal Insolvency*.

Insolvency Procedure

More details of what is involved in each insolvency procedure are given in *Section 5 – Corporate Insolvency* and in *Section 6 – Personal Insolvency*.

In an insolvency procedure, control of the assets of the debtor business, or individual, rests with the licensed insolvency practitioner, except in voluntary arrangements where control of the assets will often remain with the company or the debtor. The licensed insolvency practitioner may in some cases also exercise extensive control over the running of a business.

Once the assets of the individual or company are realised, or as they become available from income streams, they are distributed in a strict order of priority:

- Any individual or organisation holding *fixed charge* security over a company's assets is paid first, after the costs of realisation.
- The next group of creditors to receive funds, if there are any remaining, are *preferential creditors*, which consist mainly of employees' arrears of wages and holiday pay to specified limits.
- Third in line are holders of *floating charge* securities (except for a proportion which may need to be set aside for unsecured creditors).
- Fourth are *unsecured creditors* (eg trade creditors) to the extent that they are not discharged as above. In insolvency cases this may result in a percentage return by way of dividend or possibly no return at all for this class of creditor, depending on the realisations and classes of creditor making a claim in the proceedings.
- Last the queue are the shareholders, or in the case of a bankrupt, himself or herself.

Section 3 – The Business of Rescue

The task presented to R3's members is always to extract from a company the greatest value for the benefit of its creditors.

Usually, the greatest returns to creditors are achieved by maintaining a business as a going concern. Surveys have shown that creditors of all classes generally get much better returns from rescues and reconstructions than they do from liquidations. The most widely used mechanism for achieving business rescue is the administration procedure, the use of which has been encouraged by recent legislative reforms. Company voluntary arrangements (CVAs) have also seen reforms making them more useable rescue vehicles.

However, the majority of corporate insolvency cases are liquidations in which there may be little to rescue and the licensed insolvency practitioner is likely to be left with little alternative but to sell off the company's assets on a break-up basis.

This may be necessary because, for example, the business is beyond rescue, the prime assets may be the employees who have left (in service companies for example), the company could simply be a shell company, or because creditors will not approve a voluntary arrangement.

Section 4 – The Insolvency Practitioner

Only licensed insolvency practitioners are authorised to take insolvency appointments in England, Wales and Northern Ireland as *Administrators, Administrative Receivers, Liquidators, Trustees in Bankruptcy, Nominees and Supervisors of Voluntary Arrangements*, and *Trustees under Deeds of Arrangement*, and in Scotland as *Scottish Receivers, Liquidators, Administrators, Trustees in Sequestration* and *Trustees under Protected Trust Deeds*.

All these terms are defined and explained in the glossary and in the section on each specific procedure.

Licensed insolvency practitioners are uniquely well qualified to advise people and businesses in financial difficulties. It is always advisable to ensure that advice is sought from people who are properly qualified.

All practising insolvency practitioners in the United Kingdom must be licensed by one of the bodies listed in *Section 9*, and only these licensed insolvency practitioners are permitted to take insolvency appointments. The process of becoming a licensed insolvency practitioner is arduous. Most licensed insolvency practitioners have qualified as accountants or lawyers and have been practising for several years before being able to qualify.

As investigating accountants to troubled businesses, licensed insolvency practitioners are required to give objective advice on financial viability, usually by or at the behest of a concerned lender or other creditor, or in advance of increased lending requirements. This generally requires a subjective appraisal of the skill and integrity of the managers of the business as well as of the prevailing commercial environment. It is a skill that licensed insolvency practitioners are uniquely qualified to provide.

Licensed insolvency practitioners will seek to make positive recommendations which will assist the enterprise to avoid insolvency and to prosper. Many businesses do survive given such intensive care, provided that help is sought early enough.

The unique skills and experience that R3 members are able to draw on means that they are frequently involved in reorganisations and work-outs outside formal insolvency, which will also depend on the cooperation and support of the lenders.

Section 5 – Corporate Insolvency

England, Wales and Northern Ireland

There are five categories of insolvency procedure for companies in England, Wales and Northern Ireland. These are:

- Company Voluntary Arrangement (CVA)
- Administration
- Administrative Receivership
- Creditors' Voluntary Liquidation (CVL)
- Compulsory Liquidation (winding up by the court)

Receivers may also be appointed under fixed charges (fixed charge receiverships) on specific assets owned by a company. These are not technically insolvency appointments as such appointments may be made irrespective of the solvency of the company. There is also members' voluntary liquidation (MVL), but this only applies to solvent companies and is instituted by the shareholders. Companies involved in this procedure are, by definition, able to pay all their creditors, and are often wound up simply because they have outlived their usefulness.

Insolvent partnerships in England, Wales and Northern Ireland are subject to compulsory liquidation, not CVLs, but the partners, because of the relationship between them and the partnership may individually be made bankrupt or enter individual voluntary arrangements (see *Section 6 – Personal Insolvency*).

In addition, a partnership may enter a modified CVA or an administration.

Of the above procedures, the first three may be used as vehicles for business rescue, whereas liquidation is a terminal process for the company and usually marks the end of the business activities as well. Each procedure is explained in further detail on the following pages. Fixed charge receiverships and Members' Voluntary Liquidations are explained under 'Other Procedures' at the end of this section, together with details of a further procedure, the *scheme of arrangement*.

Scotland

The following insolvency procedures operate for Scottish companies:

- Company Voluntary Arrangement (CVA)
- Administration
- Receivership (Scotland)
- Creditors' Voluntary Liquidation (CVL)
- Compulsory Liquidation

A Scottish partnership is sequestrated, and will therefore be dealt with under the personal insolvency section in *Section 6 – Personal Insolvency*.

Rescue Procedures

When a company reaches the stage where formal insolvency procedures must be instituted, the primary objective for the licensed insolvency practitioner is to realise the greatest return for the company's creditors. Depending on the stage at which the company realises it is in trouble, the best return is almost always most successfully achieved by keeping the company's business operating. This enables two possibilities: either the business can continue to operate and generate cash for the creditors, or it can be sold on as a going concern. Companies with businesses that can be sold on as going concerns almost always have a much higher realisable value than the liquidated assets of the company or its businesses, and therefore provide greater returns for the creditors. Often however a company is hopelessly insolvent and beyond saving. In such cases, liquidation is the only option, and this is discussed further below.

A number of procedures are available to enable the continuation of a company's business or businesses:

- Company Voluntary Arrangement (CVA)
- Administration
- Administrative Receivership
- Receivership (Scotland)

Company Voluntary Arrangement (CVA)

A company voluntary arrangement is a procedure which enables a company to put a proposal to its creditors for a composition in satisfaction of its debts or a scheme of arrangement of its affairs. A composition is an agreement under which creditors agree to accept a certain sum of money in settlement of the debts due to them. The procedure is extremely flexible and the form which the voluntary arrangement takes will depend on the terms of the proposal agreed by the creditors. For example, a CVA may involve delayed or reduced payments of debt, capital restructuring or an orderly disposal of assets.

The proposed arrangement requires the approval of at least 75% in value of the creditors, and once approved is legally binding on the company and all its creditors, whether or not they voted in favour of it. There is limited involvement by the court, and the scheme is under the control of a licensed insolvency practitioner acting as a supervisor.

The CVA procedure was introduced by the Insolvency Act 1986 and was designed primarily as a mechanism for business rescue. The procedure is also often used instead of liquidation as a means of distributing funds on the conclusion of (and, occasionally, during) an administration.

A modified CVA may also be applied to insolvent partnerships.

PROCEDURE FOR CVA

- 1. Proposal**
May be made by directors, administrator or liquidator.
- 2. Nominee**
Insolvency practitioner nominated under terms of proposal to supervise its implementation. Where the company is in administration or liquidation, the administrator or liquidator may act as nominee.
- 3. Where nominee is not administrator or liquidator**
Nominee notifies the court whether, in his opinion, a meeting of creditors should be held in order to consider the proposal.
- 4. Where nominee is administrator or liquidator**
Nominee proceeds directly to convene creditors' meeting.
- 5. Creditors' meeting**
Usually held within eight weeks of the notice of proposal to nominee. May approve, modify or reject proposal and may choose another nominee. Requires a majority of 75 % in value of the creditors present and voting. The proposal may not affect the rights of secured or preferential creditors without their assent.
- 6. Supervisor**
If the proposal is approved, the nominee becomes the supervisor and implements the arrangement in accordance with the terms of the proposal.

Administration

Administration is a procedure available to a company that is insolvent, or is likely to become so, which places the company under the control of an insolvency practitioner and the protection of the court with the following objectives:

- rescuing the company as a going concern
- achieving a better result for the creditors as a whole than would be likely if the company were wound up without first being in administration

or, if the administrator thinks neither of these objectives is reasonably practicable

- realising property in order to make a distribution to secured or preferential creditors.

While a company is in administration creditors are prevented from taking any actions against it except with the permission of the court.

Reforms were introduced by the Enterprise Act 2002 to encourage the use of administration as the preferred vehicle for company and business rescue within formal insolvency.

An administrator may be appointed:

- by an order of the court, on application by the company, its directors, one or more creditors, or, if it is in liquidation, its liquidator
- without a court order, by direct appointment by the company, its directors or a creditor who holds comprehensive security of a type which qualifies him to make such an appointment.

A secured creditor who is qualified to make an appointment may also intervene where the company has made an application to the court. This means that the secured creditor's choice of administrator will prevail.

An administrator's powers are very broad. They include powers to carry on the company's business and realise its assets. The administrator displaces the company's board of directors from its management function and has the power to remove or appoint directors. The administrator must prepare proposals for approval by the creditors setting out how he intends to achieve the purpose of administration.

There is a one year time limit within which the administration must be concluded, but this period can be extended with the agreement of the creditors or the permission of the court if more time is needed to achieve the purpose of administration. The administration may also come to an end if the administrator thinks the purpose of administration has been achieved or cannot be achieved.

On conclusion of an administration:

- the company may be returned to the control of its directors and management
- the company may go into liquidation
- the company may be dissolved (if there are no funds for distribution to unsecured creditors)
- if a voluntary arrangement has been agreed during the administration, the arrangement may continue according to its terms. (It is possible for a voluntary arrangement to run concurrently with an administration).

PROCEDURE FOR ADMINISTRATION

A. *Appointment by court order*

1. Company is, or likely to become, unable to pay its debts

2. Application to the court

Presented by company, directors, creditors or liquidator, with supporting statement by proposed administrator that the purpose of administration is reasonably likely to be achieved. Notice given to charge holder qualified to appoint an administrator, who thereby has an opportunity to apply to the court for the appointment of an alternative administrator.

3. Administration Order

Administrator appointed. Winding-up petition (if any) dismissed.

B. *Appointment by company or directors without court order*

1. Company is, or is likely to become, unable to pay its debts

2. Notice of intention to appoint

Notice filed at court. Notice (five days) given to charge holder qualified to appoint an administrator, who thereby has an opportunity to appoint an administrator of his choice.

3. Appointment

Notice of appointment filed at court, together with statement by administrator that the purpose of administration is reasonably likely to be achieved.

C. *Appointment by secured creditor without court order*

1. Security must be enforceable

2. Notice of intention to appoint

Notice (two days) given to holder of any prior floating charge. Copy of notice may also be filed at court to obtain interim protection.

3. Appointment

Notice of appointment filed at court, together with statement by administrator that the purpose of administration is reasonably likely to be achieved. Winding-up petition (if any) suspended.

D. Following appointment

4. Consequences of appointment

No administrative receiver can be appointed. Security over assets cannot be enforced without consent of the secured creditor. Administrator can sell property subject to hire-purchase, mortgage, and retention of title, with court's permission.

5. Duties of Administrator

Manages the business. Proposal for future conduct. Calls meeting of creditors.

6. Creditors' Meeting

Held within 10 weeks of company entering administration. Proposal approved, modified or rejected. Majority in value of those voting required to approve proposal. In some circumstances a meeting is not necessary.

7. Implementation

Administrator reports back to court. Proposal implemented.

Administrative Receivership (England, Wales and Northern Ireland)

Administrative receivers are normally appointed by a bank or other lending institution which has as security for a loan (under a floating charge) the whole, or substantially the whole, of a company's property. This is often abbreviated simply to receivership. The ability to appoint normally arises when the company is in default or in breach of the terms of its borrowing.

The charge is contained in a document known as a debenture, which will frequently also include *fixed charges* and the lender is often referred to as a debenture holder. This does not have to be just one bank; it could be, and often is, a consortium of banks or other lenders.

The administrative receiver has similar powers to the administrator described above. He can continue to operate the business, and often does, whilst trying to sell it as a going concern. If he manages to do this he will usually achieve a higher price than if the company's assets were disposed of on a break-up basis. The money realised by the receiver is distributed to the creditors in the manner described in *Section 2 – What Happens in an Insolvency*, above.

It should be noted that an administrative receiver has no authority to deal with the claims of unsecured creditors (eg trade creditors). If sufficient funds become available for distribution to the general body of creditors they must be dealt with by a separately appointed liquidator.

It is longer possible to appoint an administrative receiver under a security instrument created after 15 September 2003. Instead, creditors with floating charge security can appoint an administrator (see above).

PROCEDURE FOR ADMINISTRATIVE RECEIVERSHIP

- 1. Only available to a lender with a floating charge security (usually a bank)**
- 2. When to Appoint**

When the borrower is in default or in breach of terms of the security document. Usually follows a demand for repayment, frequently at request of directors (although only the lender can actually appoint a receiver).
- 3. Appointment**

Made by the secured lender. A receiver may be appointed with maximum speed and minimum formality. The appointor notifies Companies House, the receiver notifies the company and creditors. The receiver also advertises the appointment in the London Gazette and an appropriate newspaper.
- 4. Powers and Capacity of Receiver**

Depend on the security document, but will normally enable the receiver to carry on a company's business and realise its assets. The receiver acts as the agent of the company unless and until it goes into liquidation.
- 5. Information to Creditors**

Within three months of appointment, the receiver must send a report to the creditors and convene a creditors' meeting to receive the report (unless a liquidator has been appointed in the meantime, in which case the report goes only to the liquidator). The meeting may also appoint a creditors' committee.
- 6. Conclusion of Receivership**

The receiver ceases to act when he has realised the security or repaid his appointor and notifies Companies House accordingly.

Receivership (Scotland)

Whereas the process has only a slightly different name in England and Wales (administrative receivership as opposed to receivership in Scotland), there are a number of important differences in procedure and terminology between the two. The appointment of a receiver is at the instance of a bank or other lending institution which has as security for a loan (under a floating charge) the whole or

substantially the whole of the company's property. A receiver's appointment may also be by the court on application from the holder.

It is not possible for the holder of what is termed a *Standard Security* (a fixed charge over a heritable property) to appoint a receiver, unless they also hold a floating charge. A floating charge can be granted over any of the assets of a company, not just the heritable assets. The property owned by the debtor at the time the receiver is appointed determines what is subject to the floating charge.

The instrument creating the floating charge will usually specify the events which give rise to the right to appoint. If not specified in the charge document, the following circumstances also enable appointment to be made:

- the expiry of a period of 21 days or as defined within the floating charge, failing which after the making of a demand for payment of the whole or any part of the principal sum secured by the charge, without payment having been made
- the expiry of a period of two months during the whole of which interest due and payable under that charge has been in arrears
- the making of an order or the passing of a resolution to wind up the company
- the appointment of a receiver by virtue of any other floating charge created by the company.

The Scottish receiver has similar powers to the administrative receiver described above. Generally, his powers are as wide as those given to the board of directors, enabling him to carry on the company's business, to raise money using the company's assets as security and to sell those assets covered by the charge.

As in the case of an administrative receiver, a Scottish receiver will often continue to operate the business as a going concern in order to achieve the best outcome.

It is no longer possible to appoint a receiver under a security instrument created after 15 September 2003. Instead, creditors with floating charge security can appoint an administrator (see above).

PROCEDURE FOR RECEIVERSHIP (SCOTLAND)

1. Only available to a lender with a floating charge security (usually a bank)

2. When to Appoint

When the borrower is in default or in breach of terms of the security document. Usually follows a demand for repayment, frequently at request of directors (although only the lender can actually “call in the receivers”).

3. Appointment

Made by the floating charge lender. A receiver may be appointed with maximum speed and minimum formality. The appointor notifies the Registrar of Companies, the receiver notifies the company and creditors. The receiver also advertises the appointment in the Edinburgh Gazette (if a Scottish registered company) and an appropriate newspaper.

4. Powers and Capacity of Receive

Depend on the security document, but will normally enable the receiver to carry on a company’s business and realise its assets. The receiver acts as the agent of the company.

5. Information to Creditors

Within three months of appointment, the receiver must send a report to the creditors and convene a creditors’ meeting to receive the report (unless a liquidator has been appointed in the meantime, in which case the report goes only to the liquidator). The meeting may also appoint a creditors’ committee.

6. Conclusion of Receivership

The receiver ceases to act when he has realised the security or repaid his appointor and notifies the Registrar of Companies accordingly.

Liquidations

Regrettably, it is often not possible to sell a business, perhaps because in a ‘people business’ everyone has left or because that type of business is not seen as viable under current economic conditions. It is also often the case that the directors of a company do not seek help in sufficient time to allow the company to be saved, and by the time they do so it is hopelessly insolvent. Any of these reasons can lead to a company being placed into liquidation and its assets sold off. The proceeds of the sale are then distributed to the creditors, in a defined order of priority. Liquidation is, with very few exceptions, the end of the road for a company and it will then be removed from the companies register.

A liquidation may be solvent or insolvent. A solvent liquidation is known as a members' voluntary liquidation (MVL), in which the liquidator is appointed by the shareholders and the company's assets are sufficient to settle all its liabilities, including statutory interest, within twelve months. An insolvent liquidation will be either a creditors' voluntary liquidation (CVL), which is begun by resolution of the shareholders, or a compulsory liquidation, which is instituted by petition to the court.

Liquidation may occur in a number of ways. It may occur following a receivership or administration. The company's directors or shareholders may recommend that the company be put directly into liquidation via either a CVL or MVL.

Alternatively, a court can make a winding-up order for a compulsory liquidation on the application of a creditor or of the company itself. The company itself is simply a legal entity, and may not be sold with the business, which will frequently be transferred to another company. Therefore, if the company's business has been sold on the company will be liquidated and the creditors will be given their share from the proceeds of the sale.

In an MVL the liquidator is appointed by shareholders. In a CVL the appointment is made by the shareholders subject to confirmation or replacement at the creditors' meeting by the creditors, and in a compulsory liquidation the creditors nominate the liquidator. MVLs are explained at the end of this section, under 'Other Procedures'.

Compulsory Liquidation (England, Wales and Northern Ireland)

A compulsory liquidation (or compulsory winding up) is a liquidation which is ordered by the court, usually on the petition of a creditor, the company or a shareholder.

There are a number of possible reasons for making a winding-up order. The most common is because the company is insolvent.

Insolvency can be established by failure to comply with a statutory demand requiring payment within 21 days, or by an execution against the company's goods which remains unsatisfied.

A winding-up petition may also be presented by the Secretary of State for Trade and Industry on the grounds of public interest.

The company to be liquidated is first referred by the court to the official receiver, who is a civil servant and an officer of the court, and usually becomes liquidator on the making of the winding-up order. If the assets are likely to cover the administrative costs, the official receiver will usually call a creditors' meeting to appoint a liquidator, otherwise he will remain in office. In some cases, the official receiver may, using powers delegated to him by the Secretary of State for Trade and Industry, appoint a professional liquidator direct. The official receiver retains responsibility for investigating the conduct of directors and other officers as well as any other investigation work required.

Where a compulsory liquidation follows immediately on an administration, the court may appoint the former administrator to act as liquidator. In these cases, the official receiver does not become liquidator, but retains an investigative duty.

A compulsory liquidation is the only form of liquidation that may be applied to insolvent partnerships in England, Wales and Northern Ireland. Such circumstances may result in individual partners entering bankruptcy or individual voluntary arrangements.

PROCEDURE FOR COMPULSORY LIQUIDATION – ENGLAND, WALES AND NORTHERN IRELAND

1. Petition

Usually presented by a creditor on grounds of insolvency. May also be presented by the company itself or the shareholders. Petition is usually advertised in the Gazette.

2. Winding-up order made by the court

3. Official receiver

Becomes liquidator by virtue of the winding-up order (unless the court appoints a former administrator). Has a duty to investigate the company's affairs and send a report to the creditors. Advertises order in Gazette and appropriate newspaper. The official receiver may call a meeting of the creditors to appoint an insolvency practitioner as liquidator in his place.

4. Creditors' meeting

Convened by the official receiver within four months of the winding-up order. Liquidator is appointed by a straight majority, in value, of the creditors. Meeting may also establish liquidation committee.

5. Duties of liquidator

Realise assets. Agree creditors' claims and distribute funds by way of dividend. Call final meeting of creditors. Creditors receive an account and report of the liquidation.

Compulsory Liquidation (Scotland)

In Scotland compulsory liquidation is often referred to as 'court liquidation'. The procedure is similar to the process of compulsory liquidation in England, Wales and Northern Ireland, but there are important differences. In Scotland there are no official receivers, so all liquidations are dealt with by licensed insolvency practitioners. In granting the winding-up order the court appoints an insolvency practitioner as interim liquidator. The interim liquidator then convenes a meeting

of creditors to appoint a liquidator, who may or may not be the same person as the interim liquidator.

PROCEDURE FOR COMPULSORY LIQUIDATION – SCOTLAND

1. Petition

Usually presented by a creditor on grounds of insolvency. May also be presented by the company itself or the shareholders. Petition is usually advertised in the Edinburgh Gazette and an appropriate newspaper.

2. Winding-up order made by the court

3. Interim liquidator (Scotland)

Appointed by the court on the granting of the winding-up order, with the job of convening a meeting of creditors which will appoint a liquidator.

4. Creditors' meeting

Convened by the interim liquidator within 42 days of the winding-up order. Liquidator is appointed by a straight majority, in value, of the creditors. Meeting may also establish liquidation committee.

5. Duties of liquidator

Realise assets. Agree creditors' claims and distribute funds by way of dividend. Call final meeting of creditors. Creditors receive an account and report of the liquidation.

Creditors' Voluntary Liquidation (CVL)

A CVL is a liquidation begun by resolution of the shareholders, but is under the effective control of the creditors, who can appoint a liquidator of their choice. Because of changes in legislation placing greater onus of responsibility on the directors of a company, the CVL is the most common way for directors and shareholders to deal voluntarily with their company's insolvency. 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. Furthermore, unlike a compulsory liquidation, a CVL does not bring the directors' conduct under the scrutiny of the official receiver, although the liquidator is required to report to the DTI on the conduct of the directors.

It is also possible for a liquidation to proceed as a CVL without the need for a creditors' meeting, where it follows immediately on the conclusion of an administration and there are funds available for the unsecured creditors. The liquidator will be the administrator, or other person previously approved by the creditors.

PROCEDURE FOR CVL

- 1. Directors consult a licensed insolvency practitioner**
- 2. Calling of meetings**
Notice and proxy forms sent to shareholders and creditors. Creditors' meeting advertised in the Gazette and two appropriate newspapers.
- 3. Shareholders' meeting**
Extraordinary resolution to wind up and an ordinary resolution to appoint a liquidator. (95% in value of shareholders can agree to short notice).
- 4. Creditors' meeting**
Must be within 14 days of shareholders' meeting (but usually follows immediately).
- 5. Statement of affairs and report on history of business and causes of failure presented to meeting**
- 6. Shareholders' nominee remains as liquidator unless majority by value of creditors voting appoint an alternative**
- 7. Appointment of liquidation committee**
- 8. Duties of liquidator**
Realise assets. Investigate company's affairs. Agree creditors' claims and distribute funds. Hold annual meetings of creditors. Call final creditors' meeting. Creditors to receive an account and report of the liquidation.

Other Procedures

Fixed Charge Receivership (England and Wales)

Receivers may also be appointed by secured creditors over specific assets covered by a fixed charge, such as properties, aircraft, machinery or book debts. The appointment of receivers over properties is partly governed by the Law of Property Act 1925 (LPA) and such receivers are sometimes known as LPA receivers. Receivers under fixed charges have more restricted powers than administrative receivers, with no general powers of management over the company. Such receivers do not need to be licensed insolvency practitioners and such procedures are not generally suitable for company rescue. Fixed charge receiverships are not used in Scotland. Secured creditors simply repossess the subjects of their mortgage.

Scheme of Arrangement

A term normally used to describe a compromise or arrangement between a company and its creditors or members or any class of them under section 425 of the Companies Act 1985, which may involve a scheme for the reconstruction of the company. If a majority in number representing three fourths in value of the creditors or members or any class of them agree to the compromise or arrangement it is binding, provided it is sanctioned by the court. Section 425 may be invoked where there is an administration order in force in relation to the company, where there is a liquidator or provisional liquidator in office, or where the company is not subject to any insolvency proceedings.

Members' Voluntary Liquidation (MVL)

An MVL can only be used for a solvent company, and is under the control of the shareholders, who appoint the liquidator. There may be a number of reasons for closing down a solvent company. The proprietors may wish to unlock their capital and retire, or a group of companies may wish to close down a subsidiary which has outlived its usefulness and only exists on paper. MVLs are also used in corporate restructurings.

PROCEDURE FOR MVL

- 1. Declaration of solvency**
Directors must swear the declaration within five weeks preceding the resolution to wind up. It must embody a statement of the company's assets and liabilities and a statement that all creditors have been paid in full, with interest, or will be within twelve months. It is a criminal offence to swear a false declaration.
- 2. Resolution to wind up**
Extraordinary meeting of members on 21 days' notice to pass resolution to wind up. No meeting of creditors required.
- 3. Appointment of liquidator**
By ordinary resolution of members immediately after the passing of the resolution to wind up.
- 4. Duties of liquidator**
Realise assets. Settle and pay creditors' claims plus statutory interest. Distribute surplus to members. Hold final meeting of members.

Section 6 – Personal Insolvency

There are several types of insolvency procedure available to the individual, depending on their circumstances. These are:

- bankruptcy (England and Wales and Northern Ireland)
- individual voluntary arrangement (IVA) (England and Wales and Northern Ireland)
- sequestration (Scotland)
- trust deed or protected trust deed (Scotland)

Note: The official receiver has no concern with the insolvency of individuals in Scotland.

Bankruptcy – England and Wales and Northern Ireland

Bankruptcy is the administration of the affairs of an insolvent individual by a trustee in the interests of his creditors generally. The trustee's function is to realise the assets and distribute them among the creditors in a prescribed order of priority.

Bankruptcy proceedings commence with the making of a bankruptcy order by the court. Immediately on the making of the order, an official called the official receiver becomes receiver and manager of the bankrupt's estate, pending the appointment of a trustee. The official receiver is an officer of the court and a member of the Insolvency Service, an executive agency within the Department of Trade and Industry. Where there are significant assets, an insolvency practitioner will usually be appointed to act as trustee, either by a meeting of creditors or by the Secretary of State for Trade and Industry. Where no insolvency practitioner is appointed, or where there is a vacancy in the office of trustee, the official receiver acts as trustee.

An application for a bankruptcy order may be made by any creditor owed more than £750, or by the individual himself. Subject to certain exemptions, once the order is made, control of the bankrupt's assets pass to the official receiver and then to the trustee. The bankrupt loses any rights to his property apart from any equipment needed by him for use in his business, and basic domestic equipment such as clothes, bedding and furniture, and certain pension rights.

There are special rules regarding the bankrupt's home. Generally speaking, if the bankrupt has equity in a house, it may have to be sold. However, the law discourages a trustee from taking steps to force a sale through the court during the first 12 months of the bankruptcy where the bankrupt is married or has young children living with him. New rules introduced in April 2004 give the trustee three years from the date of the bankruptcy order to sell the house or otherwise deal with the bankrupt's interest in it. If he does not do so within that time, the property will revert to the bankrupt. And if the value of the equity is less than £1,000, the trustee will not be able to sell it at all.

There are certain restrictions of bankruptcy which usually last until the bankrupt is discharged (although his assets remain with the trustee).

If the bankrupt has surplus income above his needs and those of his dependants, he may be required to make contributions to his creditors for up to three years. Until his discharge, the trustee may also claim any property acquired by the bankrupt after the bankruptcy order, such as assets left to him in a will.

During the bankruptcy the bankrupt is subject to certain restrictions. For example he must not obtain credit of more than £500 from anyone without telling that person that he is an undischarged bankrupt, he must not carry on business under a name different from that under which he was declared bankrupt without disclosing the fact that he is an undischarged bankrupt, and he may not act as a company director without the court's consent. His credit rating will also be affected.

The bankrupt will usually be discharged from bankruptcy automatically after one year, or even sooner if the official receiver decides to close his file early. Once discharged, the bankrupt is released from his bankruptcy debts, with some exceptions such as court fines, matrimonial debts and certain student loans. After he has been discharged, the bankrupt does not have any right to take back from the trustee any property that was part of his estate in the bankruptcy, and the trustee will remain in office for as long as is necessary to sell the property and distribute the proceeds to the creditors.

The disabilities of bankruptcy may remain if the official receiver applies to court to impose a bankruptcy restrictions order or the bankrupt agrees to sign a bankruptcy restrictions undertaking. These can last for up to 15 years.

PROCEDURE FOR BANKRUPTCY

1. Petition

Presented by a creditor or the debtor on grounds of insolvency, or by the supervisor of a voluntary arrangement in appropriate circumstances.

2. Bankruptcy order made by the court

3. Official receiver

Becomes the receiver of the bankrupt's estate by virtue of the bankruptcy order. He has a duty to investigate the bankrupt's affairs and send a report to the creditors. May call a meeting of creditors to appoint a licensed insolvency practitioner as trustee.

4. Creditors' meeting

Convened by the Official Receiver within three months of the bankruptcy order. A trustee is appointed by a simple majority in value of the creditors. The meeting may also establish a creditors' committee.

5. Duties of trustee

Realise assets comprised in the bankrupt's estate. Agree creditors' claims and distribute any funds by way of a dividend. Call final meeting of creditors at which the creditors receive an account and report on the administration of the estate.

Individual Voluntary Arrangement (IVA)

The IVA is a less formal procedure open to insolvent individuals (even those who are already subject to bankruptcy proceedings). The procedure is flexible and its exact nature varies from case to case depending on the terms of the proposal. By entering into an IVA with the agreement in excess of 75% by value of the creditors who vote on it at a creditors' meeting, the debtor may be able to order his affairs in a way which benefits his creditors but would not be possible under bankruptcy: for example, by an orderly disposition of assets, introduction of third-party funds, contributions from future earnings, or debt rescheduling. The agreement is overseen by a supervisor, and is binding on all creditors, whether they voted for it or not.

Except where the debtor is bankrupt when he makes the proposal, only a licensed insolvency practitioner can act as supervisor of an IVA. If the debtor is bankrupt, the official receiver can act as supervisor, and a simplified procedure called a 'fast track' can be used, which does not involve a creditors' meeting. It still requires a 75% majority by value of creditors to approve the proposal.

An IVA cannot affect the rights of secured (eg mortgagees) or preferential creditors except with their express agreement.

The IVA's benefits are its flexibility, its lack of publicity compared with bankruptcy, and the fact that it may be cheaper to administer for the creditors than a bankruptcy and is therefore likely to increase returns to the creditors.

The procedure, introduced in the 1986 Insolvency Act, has been growing in popularity and now accounts for about one in three personal insolvencies.

PROCEDURE FOR IVA

A. Non 'fast-track' cases

1. Proposal

Prepared by debtor with assistance from a licensed insolvency practitioner.

2. Interim order (optional)

Application to court. Court may stay all other legal procedures. No bankruptcy petition can be heard, nor other legal action against debtor or property. A debtor may not apply for an interim order within 12 months of a previous one.

3. Nominee's report

Nominee must be a licensed insolvency practitioner. If nominee's report is adverse, any interim order ceases. If nominee's report is positive, recommends meeting of creditors.

4. Creditors' Meeting

Held between 14 and 28 days of nominee's report. Proposal, statement of affairs, and nominee's report considered by creditors. Proposal accepted by creditors if approved by in excess of 75%, by value, at meeting. Supervisor appointed (must be a licensed insolvency practitioner).

5. Duties of Supervisor

Reports to court. Implements proposals.

B. 'Fast-track' cases

1. Debtor must be undischarged bankrupt

2. Proposal

Agreed by debtor with official receiver.

3. Agreement of creditors

Official receiver sends proposal to creditors for approval or rejection by correspondence. Proposal accepted if approved by 75% in value of creditors responding.

4. Implementation

If approved, official receiver reports to court and becomes supervisor.

Sequestration - Scotland

The principle of a formal personal insolvency procedure under the control of the court is similar in Scotland, where it is known as sequestration. It is governed by the Bankruptcy (Scotland) Act 1985 as amended by the Bankruptcy (Scotland) Act 1993. The court representative is the Accountant in Bankruptcy who will act as trustee in small insolvencies where there are unlikely to be funds to pay a private insolvency practitioner. The Accountant in Bankruptcy is also responsible in all cases for overseeing the licensed insolvency practitioners appointed as trustees and all sequestrations.

Debtors (bankrupts) are automatically discharged from the debts after three years, and property comprised in the estate remains with the trustee until his discharge. The trustee or any creditor can apply for deferments of the discharge to a maximum of two years, on cause shown. This application must be made before the end of the three year period. Further applications may be made on expiry of the existing deferment.

Partnerships in Scotland have a separate legal personality, unlike English partnerships, and are subject to the same insolvency regime as individuals. They are therefore sequestrated too, and none of the corporate insolvency processes are applicable.

PROCEDURE FOR SEQUESTRATION

1. Petition

The application to the court for commencement of bankruptcy is done by way of a petition to the court presented by a creditor or the debtor on grounds of insolvency. Once a trustee is appointed, any further order for exercise of powers can be dealt with by further application to the court by petition. This might be used, for example, to reduce a gratuitous alienation or unfair preference.

2. Interim Trustee

Appointed by the court to preserve the estate and to call the first meeting of creditors.

3. Permanent Trustee

Elected by meeting of creditors. Where there is no such election the Interim Trustee may be appointed as Permanent Trustee by the court. Commissioner(s) (creditors' committee) may be appointed. The Accountant in Bankruptcy acts where insufficient funds are available to cover the costs of bankruptcy.

4. Duties of Trustee

Realise assets and distribute between the creditors in order of priority, in the same way as under a Protected Trust Deed (see below).

Trust Deed or Protected Trust Deed

In Scotland the less formal procedure, loosely equivalent to the IVA and available to individuals and partnerships, is the Trust Deed. By signing a simple document the debtor vests in the trustee his/her assets for behoof of the creditors and empowers the trustee to apply for sequestration if necessary. This is a more informal procedure and allows the option of bringing the trust deed to a close when the creditors' proposals are met. Because there is an incentive for the

debtor to meet the terms, creditors are likely to benefit from increased income-based contributions and level of cooperation. Administration costs can also be much reduced.

The procedure has gained much popularity since the 1993 amendments to the Bankruptcy (Scotland) Act 1985, which resulted in restrained access to publicly funded sequestration.

PROCEDURE FOR TRUST DEED OR PROTECTED TRUST DEED

1. Trust Deed

Signed by debtor in favour of a licensed insolvency practitioner.
Witnessed by one person.

2. Trustee

Puts a proposal to creditors and advertises for objections in the Edinburgh Gazette. He may or may not call a meeting of creditors.

3. Protected Trust Deed

Status gained if five weeks expire without objections from a majority in number or one third in value of creditors. Minority objectors bound by terms of Trust Deed.

4. Duties of Trustee

Realise assets, collect contribution from debtors' income, agree creditors' claims and distribute funds by way of a dividend. Account to creditors for intromissions before closing Trust Deed.

Note: If the Trust Deed fails to become protected, the Trustee, the debtor or the creditors are free to petition for sequestration.

Section 7 – Glossary of Insolvency Expressions for England and Wales

Note: The definitions and explanations are not intended to be exhaustive summaries of the law. If you require assistance with any insolvency related matter, R3 members are available to advise you. Italicised expressions are defined elsewhere in the glossary.

Administration

Administration is a process which places a company under the control of a licensed insolvency practitioner and the protection of the court to achieve a specified statutory purpose. The purpose of administration is to save the company, or if that is not possible, to achieve a better result for creditors than in a liquidation, or if neither of those is possible, to realise property to enable funds to be distributed to *secured* or *preferential* creditors.

Administration Order

An administration order is:

- (1) a court order placing a company that is, or is likely to become, insolvent under the control of an *administrator* in order to achieve the purpose of *administration*, following a petition by the company, its directors, its liquidator or a creditor.
- (2) the administration of the insolvent estate of a deceased debtor
- (3) county court process permitting an individual with modest debts to pay off by instalments; no *licensed insolvency practitioner* is involved.

Administrative Receiver

An administrative receiver is a *licensed insolvency practitioner* appointed by the holder of a floating charge covering the whole, or substantially the whole, of a company's property. He can carry on the company's business and sell the business and other assets comprised in the charge to repay the *secured* and *preferential creditors*. Sometimes abbreviated to *receiver*.

Administrative Receivership

Administrative receivership is the term applied when a person is appointed as an *administrative receiver*. Commonly abbreviated to *receivership*.

Administrator

An administrator is a *licensed insolvency practitioner* appointed to *manage the affairs of a company* to achieve the purpose of administration set out in the *Insolvency Act 1986*. The *administrator* will need to produce a plan, known as his proposals, for approval by the creditors to achieve this.

Agricultural Receivership

Agricultural receivership is a specialist remedy available to a secured creditor to take control of the assets of a farmer under the Agricultural Credits Act 1928.

Associates

Associates of individuals include family members, relatives, partners and their relatives, employees, employers, trustees in certain trust relationships, and companies which the individual controls. Associates of companies include other companies under common control (see also *connected persons*).

Bankrupt

A bankrupt is an individual against whom a *bankruptcy* order has been made by the court. The order signifies that the individual is unable to pay his/her debts and deprives him/her of his/her property, which is then realised for distribution amongst his creditors.

Bankruptcy

Bankruptcy is the process of dealing with the estate of a *bankrupt*.

Bond

A bond is Insurance cover to protect the uncharged assets of an estate, needed by a person who acts as a *licensed insolvency practitioner*.

Break-up Sale

A break-up sale is the dismantling of a business. Trading ceases and the assets are sold off piecemeal.

Charge

A charge is a right given to the creditor to have a designated asset of the debtor appropriated to the discharge of the indebtedness, but not involving any transfer either of possession or ownership.

Charging Order

A charging order is a court order placing restrictions on the disposal of certain assets, such as property or securities, given after judgement and gives priority of payment over other creditors.

Company Directors Disqualification Act (1986)

The Company Directors Disqualification Act (1986) is an act concerning the disqualification of persons from being directors or otherwise concerned with a company's affairs.

Company Voluntary Arrangement (CVA)

A company voluntary arrangement is a voluntary arrangement for a company is a procedure whereby a plan of reorganisation or *composition* in satisfaction of its debts is put forward to creditors and shareholders. There is limited involvement by the court and the scheme is under the control of a *supervisor*.

Composition

A composition is an agreement between a debtor and his creditors whereby the compounding creditors agree with the debtor and between themselves to accept from the debtor payment of less than the amounts due to them in full satisfaction of their claim.

Compulsory Liquidation

A compulsory liquidation of a company is a *liquidation* ordered by the court. This is usually as a result of a *petition* presented to the court by a creditor and is the only method by which a creditor can bring about a *liquidation* of its debtor company.

Connected Persons

Connected persons are directors or *shadow directors* and their *associates*, and *associates* of a company.

Cork Report

The Cork Report is a of the Insolvency Law Review Committee, chaired by Sir Kenneth Cork, upon which the *Insolvency Act 1986* is substantially based (Command Paper 8555, 1982).

Court-appointed Receiver

A court-appointed receiver is a person, not necessarily a *licensed insolvency practitioner*, appointed to take charge of assets usually where they are subject to some legal dispute. Not strictly an *insolvency* process, the procedure may be used other than for a limited company, eg to settle a partnership dispute.

Creditors' Committee

A creditors' committee is a committee formed to represent the interests of all creditors in *administrations*, *administrative receiverships* and *bankruptcies*. The exact functions of the Committee depend on the type of procedure (cf *Liquidation Committee*).

Creditors' Voluntary Liquidation (CVL)

A creditors' voluntary liquidation relates to an insolvent company. It is commenced by resolution of the shareholders, but is under the effective control of creditors, who can choose the *liquidator*.

Debenture

A debenture, broadly speaking, a document which either acknowledges or creates a debt. The expression is commonly used to denote a document conferring a *fixed* and *floating charge* over all the assets and undertakings of a company.

Deed of Arrangement

A deed of arrangement is a method for an individual (not a company) to come to terms with creditors outside formal *bankruptcy*. The procedure is governed by the Deeds of Arrangement Act 1914 and is now almost completely replaced by *voluntary arrangements*.

Disqualification of Directors

A director found to have conducted the affairs of an insolvent company in an 'unfit' manner will be disqualified, on application to the court by the DTI, from holding any management position in a company for between two and 15 years.

Extortionate Credit Transaction

An extortionate credit transaction is a transaction by which credit is provided on terms that are exorbitant or grossly unfair compared with the risk accepted by the creditor. Such a transaction may be challenged by an *administrator*, a *liquidator* or a *trustee in bankruptcy*.

Financial Services Compensation Scheme

The Financial Services Compensation Scheme was established under the Financial Services and Markets Act 2000 to provide compensation for certain claims in the event of the default of a regulated financial services business. From 1 December 2001 it replaced the previous compensation schemes for investment business, banking, building societies and insurance. The maximum levels of compensation are:

- Deposits – 100% of the first £50,000.
- Investments – 100% of the first £30,000, 90% of the next £20,000.
- Insurance – 100% of the first £2,000, 90% of the remainder of claim or value.
Claims under certain policies of the compulsory insurance are paid in full.

Fixed Charge

A fixed charge is a form of security granted over specific assets, preventing the debtor from dealing with those assets without the consent of the *secured creditor*. It gives the secured creditor a first claim on the proceeds of sale, and the creditor can usually appoint a *receiver* to realise the assets in the event of default.

Floating Charge

A floating charge is a form of security granted to a creditor over general assets of a company which may change from time to time in the normal course of business (eg stock). The company can continue to use the assets in its business until an event of default occurs and the charge crystallises. If this happens, the *secured creditor* can realise the assets to recover his debt, usually by appointing an *administrative receiver*, and obtain the net proceeds of sale subject to the prior claims of the *preferential creditors*.

Fraudulent Trading

Fraudulent trading involves a company which has carried on business with intent to defraud creditors, or for any fraudulent purpose. It is a criminal offence and those involved can be made personally liable for the company's liabilities.

Going Concern

A going concern is the basis on which *licensed insolvency practitioners* prefer to sell a business. Effectively it means the business continues, jobs are saved, and a higher price is obtained.

Guarantee

A guarantee is a legal commitment to repay a debt if the original borrower fails to do so. Directors may give guarantees to banks in return for the bank giving finance to their companies.

Individual Voluntary Arrangement (IVA)

A voluntary arrangement for an individual is a procedure whereby a scheme of arrangement of his affairs or *composition* in satisfaction of his debts is put

forward to creditors. Such a scheme requires the approval of the court and is under the control of a *supervisor*.

Insolvency

Insolvency is defined as having insufficient assets to meet all debts, or being unable to pay debts as and when they are due. If a creditor can establish either test, he will be able to present a *winding-up petition*. For a *bankruptcy* petition, inability to pay is the only available ground.

Insolvency Act 1986

The Insolvency Act 1986 is the primary legislation governing insolvency law and practice. Nevertheless, many other statutes and statutory instruments are also relevant.

Insolvency Services Account

The Insolvency Services account is an account maintained at the Bank of England by the Department of Trade and Industry, for handling funds in liquidations and bankruptcies.

Insolvent Liquidation

A company goes into insolvent liquidation if it goes into *liquidation* at a time when its assets are insufficient for the payment of its debts and other liabilities and the expenses of liquidation.

Insolvent Partnerships Order 1994 (IPO)

The Insolvent Partnerships Order 1994 is an Order setting out the procedures for dealing with insolvent partnerships. The order provides for winding up an insolvent partnership as an unregistered company, with or without concurrent insolvency proceedings against individual partners; for the joint *bankruptcy* of individual partners, without winding up the partnership as an unregistered company; and for the application of the *administration* and *company voluntary arrangement* procedures to insolvent partnerships.

Insolvency Practitioner (IP)

See *Licensed Insolvency Practitioner*.

Insolvency Rules

The Insolvency Rules 1986, as amended, provide the detailed working procedures for the provisions of the *Insolvency Act 1986*.

Interim Order

An individual who intends to propose a *voluntary arrangement* to his creditors may apply to the court for an interim order which, if granted, precludes *bankruptcy* and other legal proceedings while the order is in force.

Judgment

A judgement is:

1. recognition of a debt by a court
2. decision given by a court at the conclusion of a trial.

Law of Property Act 1925

The Law of Property Act 1925 governs transactions in law and property. Contains statutory powers of *receivers* appointed under a *fixed charge*.

LPA Receiver

Law of Property Act 1925 receiver is a person (not necessarily an *insolvency practitioner*) appointed to take charge of a mortgaged property by a lender whose loan is in default, usually with a view to sale or to collect rental income for the lender. Common in the case of the failure of a property developer, whose borrowings will largely be secured on specific properties.

Licensed Insolvency Practitioner (IP)

A licensed Insolvency Practitioner (IP) is a person licensed by one of the Chartered Accountancy bodies, the Law Societies, the Insolvency Practitioners' Association or the Secretary of State for Trade and Industry. The only person who may act as an *office holder* in an insolvency. Persons claiming to be insolvency practitioners, but who do not hold a licence may not be able to help you. The status of anyone claiming to be a licensed insolvency practitioner can be confirmed by calling R3 or one of the regulatory bodies listed in *Section 11 – Useful Contacts*.

Lien

Lien is the right to retain possession of assets or documents until the settlement of a debt.

Liquidation

Liquidation is the process whereby a company has its assets realised and distributed to satisfy, insofar as it is able, its liabilities and to repay its shareholders. The term *winding up* is also used. Liquidation is usually a terminal process, followed by the dissolution of the company.

Liquidation Committee

A liquidations committee is a committee which receives information from the *liquidator* and sanctions some of his actions. Usually consists entirely of creditors, but may also comprise shareholders (see *Creditors' Committee*).

Liquidator

A liquidator is a *Licensed insolvency practitioner* appointed to *wind up* a company.

Mareva Injunction

A Mareva Injunction is a court order preventing the disposal of assets.

Members' Voluntary Liquidation (MVL)

A members' voluntary liquidation is a *solvent liquidation* where the shareholders appoint the *liquidator* to realise assets and settle all the company's debts, plus interest, in full within 12 months.

Misfeasance

Misfeasance is a breach of duty in relation to the funds or property of a company by its directors or managers.

Mortgage

A mortgage is a transfer of an interest in land or other property by way of security, upon the express or implied condition that the asset shall be reconveyed to the debtor when the sum secured has been paid.

Nominee

A nominee is a *Licensed insolvency practitioner* nominated in a proposal for an *individual* or *company voluntary arrangement* to act as *supervisor* of the arrangement.

Office Holder

An office holder is a *liquidator, provisional liquidator, administrator, administrative receiver, supervisor of a voluntary arrangement, or trustee in bankruptcy*.

Official Receiver (OR)

An official receiver (OR) is an officer of the court, civil servant, member of the Department of Trade Insolvency Service and deals with bankruptcies and *compulsory liquidations*.

Onerous Property

The term onerous property in the context of a *liquidation* or *bankruptcy*, applies to unprofitable contracts and to property that is unsaleable or not easily saleable or that might give rise to a continuing liability. Such property can be disclaimed by a *liquidator* or a *trustee* in *bankruptcy*.

Partnership Voluntary Arrangement

The term used informally to describe the *company voluntary arrangement* procedure as applied to partnerships under the provisions of *The Insolvent Partnerships Order 1994*.

Petition

A petition is a written application to the court for relief or remedy.

Preference

A preference is a payment or other transaction made by an insolvent company or individual which places the receiving creditor in a better position than they would have been otherwise. A *liquidator*, *administrator* or *trustee* in *bankruptcy* may recover sums which are found to be preferences, if the transactions took place within a period of either two years (where the creditor is a connected person) or six months (in other cases) of the insolvency.

Preferential Debts

Defined in Schedule 6 of The Insolvency Act 1986. They have priority when funds are distributed by a *liquidator*, *administrator*, *administrative receiver* or *trustee* in *bankruptcy*.

Proof of Debt

Proof of debt is a document submitted by a creditor to the *licensed insolvency practitioner* or *Official Receiver* giving evidence of the amount of the debt.

Provisional Liquidator

Provisional liquidator is the name usually given to a *licensed insolvency practitioner* appointed, to safeguard a company's assets after presentation of a *winding-up petition* but before a *winding-up order* is made.

Proxy

A proxy is a document by which a creditor authorises another person to represent him at a meeting of creditors. The proxy may be a general proxy,

giving the *proxy holder* discretion as to how he votes, or a special proxy requiring him to vote as directed by the creditor. A body corporate can only be represented by a proxy.

Proxy holder

A proxy holder is a person who attends a meeting on behalf of someone else.

Receiver

A receiver is often used to describe an *administrative receiver*, who may be appointed by a *secured creditor* holding a *floating charge* over a company's assets. More accurately, a receiver is the person appointed by a *secured creditor* holding a *fixed charge* over specific assets of a company in order to take control of those assets for the benefit of the secured creditor.

Receivership

A receivership is the general term applied when a person is appointed as a *receiver* or *administrative receiver*.

Recognised Professional Body (RPB)

A recognised professional body is an organisation recognised by the Secretary of State for Trade and Industry as being able to authorise its members to act as *licensed insolvency practitioners*.

Relevant Date

A relevant date is the date by reference to which preferential claims are reckoned.

Reservation of Title (or Retention of Title)

Reservation of title (or retention of title) is a provision under a contract for the supply of goods which purports to reserve ownership of the goods with the supplier until the goods have been paid for. A complex and continually evolving area of law.

Scheme of Arrangement

A scheme of arrangement is a term normally used to describe a compromise or arrangement between a company and its creditors or members or any class of them under section 425 of the Companies Act 1985, which may involve a scheme for the reconstruction of the company. If a majority in number representing three fourths in value of the creditors or members or any class of them agree to the compromise or arrangement it is binding if sanctioned by the court. Section 425 may be invoked where there is an

administration order in force in relation to the company, where there is a *liquidator* or *provisional liquidator* in office, or where the company is not subject to any insolvency proceedings.

The term is also used in Section 1 of the Insolvency Act 1986 in relation to *company voluntary arrangements*.

Secured Creditor

A secured creditor is a creditor with specific rights over some or all of a debtor's assets. A secured creditor gets paid first out of the proceeds of sale of the security.

Security

A security is a *charge* or *mortgage* over assets taken to secure payment of a debt. If the debt is not paid, the lender has a right to sell the charged assets. Security documents can be very complex. The commonest example is a mortgage over a property.

Shadow Director

A shadow director is a person who is not formally appointed as a director, but in accordance with whose directions or instructions the directors of a company are accustomed to act. However, a person is not a shadow director merely because the directors act on advice given by him in a professional capacity.

Special Manager

A special manager is a person appointed by the court in a *compulsory liquidation* or *bankruptcy* to assist the *liquidator*, *Official Receiver* or *trustee* in managing the insolvent's business. He does not need to be a *licensed insolvency practitioner*.

Statutory Demand

A statutory demand is a formal notice requiring payment of a debt exceeding £750 within 21 days, in default of which *bankruptcy* or *liquidation* proceedings may be commenced without further notice. Cannot be used where the debt is disputed.

Supervisor

A supervisor is the *licensed insolvency practitioner* appointed by creditors to supervise the way in which an approved *voluntary arrangement* is put into effect.

Transaction at an Undervalue

A transaction at an undervalue can describe either a gift or a transaction in which the consideration received is significantly less than that given. In certain circumstances such a transaction can be challenged by an *administrator*, a *liquidator* or a *trustee* in *bankruptcy*.

Trustee

Quite apart from its common usage (eg under the Trustee Act 1925) this is a term used for a variety of insolvency appointments, including the *licensed insolvency practitioner* appointed in an English *bankruptcy*, a Scottish *sequestration*, a *deed of arrangement*; a Scottish *trust deed* and an *administration order* (of the affairs of a deceased debtor).

Undervalue Transaction

See *Transaction at an Undervalue*.

Unsecured Creditor

An unsecured creditor, strictly, is any creditor who does not hold security. More commonly used to refer to any ordinary creditor who has no preferential rights, although, in fact *preferential creditors* will almost always also have an element that is unsecured. In any event, they are the last in the queue, apart from shareholders.

VAT Bad Debt Relief

VAT bad debt relief is the relief obtained in respect of the VAT element of an unpaid debt. Previously available only when the debtor became insolvent, relief is now available where debt is six months old at the relevant date.

Voluntary Arrangements

See Individual Voluntary Arrangement (IVA) and Company Voluntary Arrangement (CVA).

Voluntary Liquidation

See *creditors' voluntary liquidation* and *members' voluntary liquidation*.

Winding up

See *liquidation*.

Winding-up Order

A winding-up order is an order made by the court for a company to be placed in *compulsory liquidation*.

Winding-up Petition

A winding-up petition is a *petition* presented to the court seeking an order that a company be put into *compulsory liquidation*.

Wrongful Trading

Wrongful trading is a term applied to companies in *liquidation* where a director allowed the company to continue trading in circumstances where he should have concluded that there was no reasonable prospect that the company would avoid going into *insolvent liquidation*. The directors involved may be made personally liable to make a contribution to the company's assets.

Section 8 – Glossary of Insolvency Expressions for Scotland

Accountant in Bankruptcy

An accountant in bankruptcy is the court official appointed to monitor the *sequestration* procedures. He will generally act, where no insolvency practitioner is nominated on a petition or elected at a meeting of creditors, as *interim trustee* and as *permanent trustee* in very small estates, or on any estate if so appointed by the creditors. He may sub-contract certain duties to any authorised *licensed insolvency practitioner*. He will also act as a Commissioner if no appointments are made by the creditors.

Apparent Insolvency

Apparent insolvency is the point at which in given circumstances it is appropriate to present a petition for the *winding-up* of a company or an individual's estate.

Arrestment

Arrestment is a legal process whereby a creditor stops payment by a third party holding funds due to the debtor. Release of funds effectively arrested requires the granting of a mandate by the debtor or the obtaining of a Decree of furthcoming from the court.

Diligence

Diligence is the legal processes by which a creditor may pursue a debtor for recovery of a claim, once having obtained a Court Decree (which legally establishes the amount of his claim).

Floating Charge

A floating charge is a charge over assets of a company that cannot be secured by a *standard security*. The assets caught by the charge are those held by the debtor at the time the receiver is appointed. A receiver realises assets only for the benefit of a floating charge holder.

Gratuitous Alienation/Sale at Undervalue

Gratuitous Alienation/Sale at Undervalue is the disposal of property prior to insolvency for less than full value, and reducible by the *trustee* in certain circumstances.

Inhibition

Inhibition is a legal process whereby a creditor registers an interest in heritable property owned by a debtor, thereby barring the debtor from disposing of the property without discharging the creditor's claim.

Interim Liquidator

An interim liquidator is appointed by the court on the granting of the winding-up order. His job is to convene a meeting of creditors who will appoint a liquidator.

Interim Trustee

An interim trustee is the trustee appointed by the court to deal with the safeguarding and administration of the debtor's estate pending the creditors' meeting. In the majority of small cases, the *Accountant in Bankruptcy* will be the appointee.

Permanent Trustee

A permanent trustee is the trustee subsequently appointed by the creditors or the court following upon the creditors' meeting to deal with the realisation and distribution of the debtor's estate. In small cases, the *Accountant in Bankruptcy* will generally be the appointed permanent trustee.

Protected Trust Deed

A protected trust deed is the same as a *trust deed*, but approved by creditors binding minority creditors. To defeat 'protection' within five weeks of intimation of the *trust deed* in the *Edinburgh Gazette*, creditors in excess of one third in value are required to notify the trustee that they will not accede.

Provisional Liquidator

A provisional liquidator is the *licensed insolvency practitioner* who may be appointed by the court to preserve a company's assets pending the appointment of an *interim liquidator* and following immediately upon the service of a *winding-up petition*.

Receiver

A receiver is the *licensed insolvency practitioner* appointed by a *secured creditor* holding a charge over specific assets of a company in order to take control of those assets for the benefit of the secured creditor.

Sequestration

Sequestration is the distribution of an insolvent estate of an individual or partnership.

Standard Security

A standard security is a fixed charge over heritable property.

Summary sequestration

A summary sequestration is a *sequestration* where the Assets do not exceed £2,000 and the Liabilities do not exceed £20,000. The procedure in a summary sequestration is curtailed to minimise costs.

Trust Deed

A trust deed is the deed which allows a debtor to transfer his estate voluntarily to a trustee for behoof of his creditors. The *trustee* will deal with the estate as provided for by statute. This means of administering an estate is unlikely to be used unless it is anticipated that there will be sufficient funds to meet the costs of the administration and pay a dividend to creditors.

Unfair Preference

Unfair preference is a transaction between a debtor and a creditor which has the effect of creating a preference in favour of that creditor to the prejudice of the general body of creditors other than in the normal course of trade, and thus is usually reducible by the *trustee* if the transaction took place within six months of insolvency.

Section 9 – R3 – The Association of Business Recovery Professionals

R3 was founded in 1990 to represent the professional interests of licensed insolvency practitioners in England, Scotland, Wales and Northern Ireland, of whatever relevant professional background.

In 2000, R3 amended its constitution to allow professionals to become members who specialised in business reorganisation and recovery but were not licensed insolvency practitioners.

R3 has become the voice of the business recovery and insolvency profession. All licensed insolvency practitioners throughout the UK are eligible for membership. In practice, at least 90% of all licensed practitioners have taken up membership of R3.

R3 provides more than just a unified and influential voice for business recovery and insolvency professionals, it also plays a major role in constantly improving already high standards of business recovery and insolvency expertise.

Increasingly, R3 is becoming a vital forum for anyone who needs to network with the business recovery and insolvency profession, both at national level and within their own business community.

There are many benefits to membership. R3 offers an unparalleled variety of courses and conferences and publishes a wealth of technical literature:

Technical Bulletins – technical updates and news of legislative developments.

Statements of Insolvency Practice – best practice guidelines issued for the benefit of all practitioners.

Recovery – quarterly magazine, featuring technical articles, news for and from members and students, committee issues, recent publications and course and conference updates.

In addition, much of this material is also published on R3's internet sites; <http://www.r3.org.uk> , which has sites for members only and the general public.

For those who are not eligible for membership, subscriber status still offers the opportunity to attend meetings, courses and to receive R3 publications.

R3's objectives are to:

- represent the business recovery and insolvency profession to the government, the media and the public at large

- advance the theory and practice of business recovery and insolvency administration
- promote high standards of practice and professional conduct of licensed insolvency practitioners and other members of R3
- recruit a body of persons who are skilled and experienced in business recovery and insolvency administration and to train those who wish to attain skill and experience in these areas
- facilitate an exchange of views and opinions on, to promote a better understanding of, and to inform public and professional opinion on, the subject of business recovery, insolvency administration and connected problems.

R3 members come from a number of professional backgrounds and include insolvency practitioners who are licensed by the following professional bodies:

- [The Association of Chartered Certified Accountants](#)
- [The Institute of Chartered Accountants in England and Wales](#)
- [The Institute of Chartered Accountants in Ireland](#)
- [The Institute of Chartered Accountants of Scotland](#)
- [The Insolvency Practitioners' Association](#)
- [The Law Society](#)
- [The Law Society of Northern Ireland](#) (for Northern Ireland only)
- [The Law Society of Scotland.](#)

Section 10 – Other R3 Publications

- [The R3 Insolvency Practitioners Directory](#) – updated annually.
- [Making a Career as an Insolvency Practitioner](#)
- [Recovery magazine](#) published quarterly.
- Insolvency Proceedings in the United Kingdom – A Guide for Overseas Practitioners.
- Technical Bulletins, Technical Releases, Technical Reminders and Statements of Insolvency Practice (SIPs) are also issued by R3 for the guidance of insolvency practitioners.

R3 continually makes more information available for the benefit of creditors and debtors alike. Please contact R3 for further information.

Section 11 – Useful Contacts

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The Insolvency Service
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21 Bloomsbury Street
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Tel: 020 7291 6772
www.insolvency.gov.uk/

The Association of Chartered Certified
Accountants
29 Lincoln's Inn Fields
London WC2A 3EE

Tel: 020 7242 6855
<http://uk.accaglobal.com/>

Insolvency Practitioners Association
Valiant House
4-10 Heneage Lane
London
EC3A 5DQ

Tel: 020 7623 5108
www.insolvency-practitioners.org.uk/

The Institute of Chartered Accountants
In England & Wales
P O Box 433
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Tel: 020 7920 8100
www.icaew.co.uk/

Institute of Chartered Accountants
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CA House
21 Haymarket Yards
Edinburgh
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Tel: 0131 347 0100
www.icas.org.uk

The Law Society
Ipsley Court
Berrington Close
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Worcester
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Tel: 0152 751 7141
www.lawsociety.org.uk

The Institute of Chartered
Accountants in Ireland
Chartered Accountants House
87/89 Pembroke Road
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Tel: 00 353 1 637 7200
www.icai.ie

Insolvency Practitioner Licensing
Section
The Insolvency Service
Fermanagh House
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Tel: 02890 548531
www.detini.gov.uk

The Law Society of Scotland
The Law Society's Hall
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Tel: 0131 226 7411
www.lawscot.org.uk