Private Edge Knowledge Bank

Guide to corporate insolvency in the UK

DIRECTORS & OFFICERS

Where companies face financial difficulties, it is important to be aware of the laws that govern insolvency to help reduce legal risk. This guidance note summarises the key features of various corporate insolvency processes and offers some practical considerations for directors to bear in mind if your company is insolvent.

1 Insolvency of the Company

A company is insolvent if its assets are insufficient to discharge its debts and liabilities or it is unable to pay its debts as they fall due. There are various options available to the company, creditors and other interested parties upon insolvency.

Liquidation (or "winding up"): Liquidation is a procedure by which the assets of a company are placed under the control of a liquidator (a qualified insolvency practitioner). In most cases, a company in liquidation ceases to trade immediately on being placed into liquidation.

A company can be wound up using either:

Compulsory liquidation – is a court-based procedure through which the assets of a company are realised to satisfy the company's debts and liabilities as far as is possible. The procedure starts with the presentation of a winding-up petition at court. A company is most likely to be placed into compulsory liquidation on the petition of one of its creditors. Once a winding-up order has been made, the Official Receiver initially appointed as liquidator until and unless the company's creditors appoint their own liquidator.

Voluntary liquidation:

- **Creditors' voluntary liquidation** ("CVL") - typically in response to creditor pressure or as a result of professional advice to the directors. The directors of the company do not give a statutory declaration of solvency. A CVL commences when the members of a company pass a special resolution to the effect that the company should be wound up.
- **Members' voluntary liquidation** ("MVL") – only available to a solvent company that wishes to cease trading and wind itself up. For example, in the case of a small company where the directors, who are the only shareholders, wish to retire. The directors of the company swear a statutory declaration of solvency. An MVL commences by the members passing a special resolution.

Administration: In Administration a company is protected from creditors enforcing their debts while an Administrator (a qualified insolvency practitioner) takes over the management of the company's trading and affairs. The Administrator operates the company with a view to reorganising it, or selling some or all of its business or assets as a going concern. In some cases, a deal to sell the company's business and assets is negotiated before the administrator is appointed and completed immediately on appointment.

Company voluntary arrangements ("CVA"): A CVA is an agreement between a company and its creditors, by which the company compromises its debts or agrees an arrangement for their discharge. If the necessary majority of creditors approve the CVA at a creditors' meeting, then the CVA will bind all creditors (except those with security over the company's assets.

Receivership: This is an out-of-court enforcement mechanism for secured creditors. If the debtor defaults under the relevant security documents, the secured creditor can appoint a receiver over secured assets to satisfy its debt. A receiver will take possession of the charged property and deal with it for the benefit of the secured creditor only. Any duty the receiver owes to the company, its directors, other creditors and shareholders is secondary to the receiver's duty to realise the charged assets on behalf of the appointing secured creditor.

Part1 A Moratorium ("Moratorium"): A Moratorium is a process designed to give a company in financial distress some limited "breathing space" from certain of its creditors under the supervision of a "monitor" (a qualified insolvency practitioner). It lasts initially for 20 days but is extendable.

2 Practical considerations and steps to take if your company is facing financial difficulties

Consider carefully whether the company is continuing to trade insolvent. This is significant because in the ordinary course of business a director's duties are primarily to the company and its shareholders. Once the directors know or ought to know that the company is insolvent or bordering on insolvency (that insolvency is imminent), that an insolvency is probable or that an action would have the effect of putting the company into that position, they have a legal duty to consider the best interests of the company's creditors. Failure to comply with this duty could leave the directors exposed to the risk of personal liability for losses sustained by the creditors.

Directors who are concerned that the company is facing, or may or will probably face, financial difficulties, should keep matters continually under review, monitor the financial position, future cash flow and seek to reduce expenditure.

Directors should hold frequent board meetings for the purpose of reviewing the company's financial situation, keeping minutes of those meetings, recording decisions taken and the reasons they were made.

Directors should ensure that the company's financial records are in order and up to date.

Remember that if an insolvency practitioner is appointed, the circumstances which led to the company's insolvency including each director's role, decisions taken and any transactions entered into by the company in the lead up to the insolvency, will be investigated.

It is recommended that the directors take professional advice on the company's current financial state, whether an insolvency procedure is inevitable and if so, the most appropriate procedure for the company in its circumstances.

This article is not intended to constitute a definitive, up-to-date, or complete statement of the law, nor is any part of it intended to constitute legal advice for any specific situation. You should take specific advice when dealing with specific situations and jurisdictions outside England & Wales.

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