Business Recovery Services

Insolvency in brief

A guide to insolvency terminology and procedure

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On your doorstep

PricewaterhouseCoopers LLP is the UK's largest provider of business recovery and restructuring services. With over 980 partners and staff working from 24 offices in the UK, including more insolvency practitioners than any other firm, we help clients find solutions for complex, time-critical, under-performance issues.

We work with colleagues across the entire breadth of the firm and particularly those within our Tax and Advisory Practices from areas such as Corporate Finance, Forensics, Performance Improvement and Transaction Services, as well as our colleagues in Strategy, ensuring we can provide you with the specialist situational knowledge you need.

Whether it's advising, restructuring or insolvency solutions, we have the resource, skills and experience on hand to help.

Introduction

Legislative background

The primary legislation governing **insolvency**, the **Insolvency Act 1986**, was modified by the **Enterprise Act 2002**, which has made radical changes to corporate and personal **insolvency.** The Government's intention was to create a shift in **insolvency** culture, with a greater emphasis placed on company rescue and rehabilitation, fairness for all **creditors** and making it tougher for offending directors.

In answer to those changes, we have seen the **insolvency** landscape transformed; **administrations** have now largely replaced **administrative receiverships** (in Scotland, simply receiverships) as the primary **insolvency** procedure, and many businesses have been preserved via this route. Furthermore, other solutions have evolved to facilitate the turnaround, restructuring and rescue of businesses. In this guide we attempt to demystify the often complex terminology, and sometimes misconceptions, around **insolvency** procedures, their definition, purpose and application.

The Insolvency Act 1986 does not cover personal **insolvency** in Scotland, which is primarily governed by **the Bankruptcy (Scotland) Act 1985**, as amended by the Bankruptcy and Diligence etc. (Scotland) Act 2007.

How to use this guide

Insolvency can appear to be a confusing area, with a large number of technical terms and a widening array of solutions and procedures in use – this guide provides a brief summary to the main terminology and procedures you may encounter.

We have used a question and answer format to explain the different procedures which exist and when, how and why they might be used. There is also a glossary of many of the relevant terms. **Bold type** indicates that the term is defined in the glossary.

Definitions have been kept simple but we are happy to provide more detailed technical explanations and information. The guide applies to England, Wales and Scotland only and reflects the law as at July 2009. Different **insolvency** regimes are in force in other parts of the British Isles and internationally.

This publication is prepared for the sole purpose of being a general guide to **insolvency** and may not be appropriate for any other purpose. In particular, the contents of this publication may not address your specific requirements, interests or circumstances; you should therefore seek professional advice when dealing with specific issues or situations. W
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Where applicable, the term 'he or his' referred to in this publication also represents 'she or her'.

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Section 1

Frequently asked questions

What is insolvency?

Insolvency arises when individuals or businesses have insufficient assets to cover their debts, or are unable to pay their debts when they are supposed to.

What is bankruptcy?

In England and Wales the term is used for the formal procedure for individuals (not companies) who are declared by the court to be insolvent. Insolvent individuals can sometimes avoid **bankruptcy** by means of an **individual voluntary arrangement (IVA)** or a **debt relief order (DRO)**. In the US, and many other countries, bankruptcy is also used to describe corporate **insolvency** procedures, unlike in the UK.

In Scotland, the term means the formal process of **sequestration**. The less formal **trust deed** process is also available to debtors in Scotland.

Do insolvency processes differ significantly throughout Europe?

Each country has its own law for **insolvency** procedures and there are significant differences in the opening of proceedings, who controls the proceedings, the flexibility and nature of proceedings, the priority of different classes of **creditor**, and the rights of other stakeholders such as employees, pension funds and regulators. These can make a significant difference to the prospects of saving the business or the return obtained by **creditors.** For an outline of the procedures in France, Germany and Spain please refer to page 22.

Corporate insolvency

Introduction to corporate insolvency

What is corporate insolvency?

A company becomes insolvent if it does not have enough assets to cover its debts and/or it cannot pay its debts on the due dates. It is the directors' responsibility to know whether or not the company is trading while insolvent and they can be held legally responsible for continuing to trade in that situation (see **wrongful trading**). The decision to appoint **receivers, liquidators** and **administrators** is the responsibility of the appropriate funding bodies (ie banks and lending institutions), **creditors**, the courts, the directors or the company itself, depending on the procedure.

What procedures are open to an insolvent company?

These fall into five main categories. The first three provide the potential for the rescue of the company or its business, while the last two do not:

- **Administrations**
- **Company voluntary arrangements (CVAs)**
- **Administrative receiverships**
- **Compulsory liquidations**
- **Creditors' voluntary liquidations (CVLs)**

What insolvency procedures are best to enforce debt recovery?

A **creditor** has a limited range of **insolvency** tools to enforce recovery – comprising court action against a **debtor's** assets and/or **liquidation** of the company or **bankruptcy** of the individual. In many cases this action can be counter-productive by forcing a business to cease trading and depressing the realisable value of the assets.

It is often preferable to ensure a business keeps trading to preserve value and future customers. This is dependent upon the directors co-operating in recognising financial difficulty and implementing a rescue procedure such as **administration** or **company voluntary arrangement (CVA).** This can require persuasion and negotiation with the **creditor**, who will sometimes use a threat to wind up the company as a lever. It is possible for a **creditor** to apply to court for an **administration** order against the directors' wishes. In practice, however, the court is unlikely to appoint without adequate information, which may be difficult to obtain in these circumstances.

How does rescuing the company differ from rescuing the business?

A rescue of the company through an **insolvency** process may happen through a **CVA**, which is often preceded by an **administration** in order to protect the company while the rescue takes place. The **CVA** will usually involve **creditors** writing off part of their debt in order to restore the company to solvency, which in turn preserves some value for the shareholders and enables control to be handed back to the directors.

A business is rescued through an **insolvency** process where the **IP**, whether **administrative receiver** or **administrator**, negotiates a sale of the business and assets to a new company, which may be owned by a management buy-out team, a competitor, or a new entrant to the business sector. Employment contracts are generally automatically transferred by law to the new company, but other contracts remain with the old company. The new company will then negotiate new trading relationships with customers and suppliers, and the **IP** in the old company distributes the sale proceeds to the **creditors** or passes the funds to a **liquidator** to distribute to the **creditors** in accordance with their legal entitlements.

Company rescue may take place before the onset of **insolvency** where all stakeholders agree with the company a financial restructuring which avoids an **insolvency** process. However, it is much rarer once the company has entered into an **insolvency** process, although one of the aims of the **Enterprise Act** reforms was to enable more company rescues.

How do I find out when a company, partnership or individual has become insolvent?

With the exception of voluntary arrangements and receiverships, all **insolvency** procedures or appointments are advertised in the London Gazette, a daily publication covering statutory notices of many kinds. In Scotland, the advertisements are in the Edinburgh Gazette, which is published twice weekly.

The Companies House register will show details of the **insolvency** process a company has entered into and the name and address of the **insolvency practitioner** involved. Companies House also retains a searchable register of disqualified directors.

The Insolvency Service website contains registers of **bankruptcies**, **BRO**s, **BRU**s, **DRO**s and **IVA**s in England and Wales. In Scotland, a limited Register of Insolvencies, both personal and corporate, is maintained by the **Accountant in Bankruptcy**.

Administrations and administrative receiverships

What is an administration?

The **administration** procedure, first introduced in the **Insolvency Act 1986** and substantially revised by the **Enterprise Act 2002**, is designed to hold a business together while plans are formed either to put in place a financial restructuring to rescue the company, or to sell the business and assets to produce a better result for **creditors** than a **liquidation. Administration** can also now be used where neither of these objectives can be achieved, simply as a mechanism to liquidate assets and distribute the proceeds to **secured** or **preferential creditors**, but this is not the primary purpose of **administration.**

Who appoints an administrator?

A company can go into **administration** in a number of ways. The company, directors, or one or more secured or unsecured **creditors**, can make an application to the court for an **administration.** The court requires evidence that the company is insolvent (unless the application is by a **floating chargeholder**) together with a statement from the intended **administrator**, who must be an **insolvency practitioner**, that the purpose of **administration** is likely to be achieved. Alternatively the directors or a **floating chargeholder** can appoint their own **administrator** without a court hearing, simply by filing papers at court which are not subject to judicial scrutiny.

What happens after the appointment of administrators?

The **administrators**, who will be **insolvency practitioners**, take over the day to day control and management of the company. It is their responsibility to formulate proposals and present these to the

creditors to vote on, although there may be no vote if there will be no funds available to meet unsecured debts.

Once a company is placed in **administration** it is protected and no **creditor** can take steps (without the **administrators'** agreement or the court's permission) to recover any assets or take certain other actions against the company.

What happens to the company at the end of an administration?

The **administrator** is able to have the company dissolved if all assets worth realising have been realised and distributed to **creditors**. An **administrator** needs the consent of the court to make a distribution to **unsecured creditors.** Otherwise the exit route from **administration** is for the company to go into a **company voluntary arrangement (CVA)** (or **scheme of arrangement**) or a **creditors' voluntary liquidation (CVL) or compulsory liquidation.** The result of a successful **CVA** is the rescue of the company with control being handed back to the directors. The end result of a **CVL, compulsory liquidation** or unsuccessful **CVA** is that the company is dissolved.

What is an administrative receivership?

An **administrative receiver** is appointed under a **charge** which covers the whole or substantially the whole of the company's assets, including its goodwill. This type of **charge** is referred to as a **floating charge** or **debenture.** The holder of the **charge**, ie the lender, is often referred to as the **debenture** holder. This may be one lender or sometimes a consortium of lenders.

Since September 2003, the **Enterprise Act 2002** introduced restrictions on the ability of **floating chargeholders** to appoint **administrative receivers.**

In Scotland, this type of **receivership** is known simply as **receivership** and the **charge** is referred to as a **bond** and **floating charge**, not a **debenture.**

It may seem that the **receiver** is simply a debt collector for the lender who appointed him and to whom he has a primary duty, with a few legal obligations to people such as **preferential creditors.** In fact, he will also seek to obtain the best value for all **creditors**, although not at the **floating chargeholder's** expense.

The **receiver** can continue trading and will often do so – at least for a limited period – in the hope of selling the business as a **going concern.** If successful, this will usually achieve a higher price than one would get by breaking up the assets. It also gives the business a chance to survive and succeed under new management. If the business is sold, the buyer receives the business free of debt and the money goes to the **receiver** to distribute to **secured** and **preferential creditors.** (Only a **liquidator** may distribute any remaining funds to **unsecured creditors.**)

Who appoints an administrative receiver?

Only a **floating chargeholder** can appoint an **administrative receiver.** A company cannot appoint its own **receiver.** There is no court involvement and the process can be invoked very quickly. The company directors, perhaps on professional advice, will often request the lender to make the appointment, hence the expressions 'calling in the **receivers**' and 'inviting the bank to appoint **receivers**'.

If a bank wishes to appoint receivers, how quickly does this happen?

When the end of the line is reached, **receivership** can normally be brought about in a matter of hours. It is simply a matter of preparing the appropriate documents. Banks, however, do not take such decisions lightly. Usually there will have been a fairly long process of trying to resolve the company's problems by other means.

What happens to the company at the end of a receivership?

At the end of a receivership, if the assets realised are insufficient to pay the chargeholder in full, there will be no money available for **unsecured creditors.** The Registrar of Companies will then take steps to strike the company off the register.

If there are funds available for **unsecured creditors** once the **receiver** has finished his work, the **receiver** will pass these funds over to a **liquidator** who will agree the claims of **unsecured creditors** and distribute the surplus to them. The company will only be struck off the register at the conclusion of the **liquidation.**

What is the difference between a receivership and administration?

Administrative receivers are appointed by the lender (or a consortium of lenders) which holds **security** in the form of a **floating charge. Administrators** are appointed either by the court, on the application of the company, directors or **creditors**, or out of court by **floating chargeholders** or the company or directors. Their role is temporarily to take charge of the company while proposals are drafted for approval by **creditors** and then to manage the property, affairs and business of the company in accordance with the approved proposals. These proposals may be either for the restructuring of the company's debts before returning it to the directors' control, or for the realisation of the assets of the company. Both processes are available to **floating chargeholders** who had existing floating charges prior to 15 September 2003; whether a **floating chargeholder** opts for a **receivership** or **administration** will depend on the circumstances of each case. However, for **floating chargeholders** whose charges were not created prior to 15 September 2003 **administrative receivership** is in most cases no longer an option.

The primary duty of a receiver is to recover the debt due to the holder of the charge who appointed him, although he has certain overriding duties to all **creditors** (eg a duty to get a proper price for the assets). An **administrator** is an officer of the court no matter who appointed him and has a duty to all **creditors.**

What other types of receivership are there?

There are three principal types of **receivership** in addition to **administrative receivership.** They are:

Fixed charge receivership: this is a process where the holder of a **fixed charge** over a specific asset (for example a property ts a **receiver** to realise that asset only. A **fixed charge receiver** need not be an **IP** and has no general power of management of the business. Where the appointment is over a property, the **fixed charge receiver** is sometimes known as an **LPA receiver**, because the appointment takes place under the terms of the Law of Property Act 1925. This process is only available in England and Wales.

Agricultural receivership: this is a specialist remedy under which an individual, who need not be an **IP**, is appointed by a lender with an agricultural charge, to take control of the assets of a farmer. It is governed by the Agricultural Credits Act 1928 and is a remedy only available where the farmer is an individual or partnership, not a limited company. This specialist remedy is not available in Scotland. In the case of farming companies, normal corporate **insolvency** remedies apply.

Court-appointed receivership: this arises where a court appoints a person, not necessarily a licensed **insolvency practitioner**, to take charge of assets, usually where they are subject to some legal dispute. It is not strictly an **insolvency** process, as the procedure may be used where a company is not insolvent but has a deadlocked board. It may also be used outside companies to settle a partnership dispute. The court can also appoint receivers under various statutes, eg under the Proceeds of Crime Act when a confiscation order has been made.

Voluntary arrangements

My customer has asked for a Voluntary Arrangement (VA) – what does this mean?

A **voluntary arrangement (VA)** is an **insolvency** procedure. It is a renegotiation, by a company **(CVA)**, partnership **(PVA)** or individual **(IVA)**, of the payments due to all of their **creditors**, or some other form of financial restructuring, and is subject to a **creditors**' meeting and vote. A **VA** must be supervised by a licensed **IP**, who acts as the **nominee** pending the approval of the arrangement and usually becomes the supervisor once it comes into effect.

A proposal for a **CVA** or **PVA** can also be proposed by an **administrator** or **liquidator** or, for a **PVA** only, by the **trustee** of the partnership.

Companies or individuals may also reach an informal arrangement with their **creditors**, for example, to seek more time to pay their debts. Such an arrangement may be with one or two **creditors**, or a number, although if the arrangement is proposed to extend to a large number of **creditors**, the need for the protection of a formal **insolvency** process is greater.

The **CVA** procedure is available in Scotland, but the **IVA** and **PVA** procedures do not apply there. Individuals or partnerships resident in Scotland may use a **Trust Deed** to enter into an arrangement with their **creditors.**

What is a Company Voluntary Arrangement (CVA)?

A **CVA** is effectively a 'deal' between a company and its **creditors** for repaying in full, or in part, the liabilities of that company. It is a formal **insolvency** procedure and involves a renegotiation by a company of the payments due to its **creditors** (often involving them accepting less than the full amount due to them) or some other form of financial restructuring. The 'deal' requires the approval of 75% of **creditors** present and voting at a meeting summoned to approve the proposals. Secured **creditors** are not bound by the **CVA** unless they have expressly agreed to the arrangement.

A **CVA** should be seen as a tool to offer a solution to companies which are currently in distress, but which have a sound underlying business. Once a **CVA** has been approved, all **creditors** will, under normal circumstances, be unable to take any alternative action to recover their debt in full.

When is it used?

A **CVA** can be used in a number of situations, namely:

a) to rescue a company as a **going concern**
b) to effect an orderly wind-down of a company (without the company first being put into **liquidation**)
c) following on from an **administration**

The directors of the company, a **liquidator** or an **administrator** of a company may all propose a **CVA.**

How does it differ from an administration or receivership?

A **CVA** can be very flexible. It is a 'deal' between the company and its **creditors.** Apart from being unable to change the rights of any secured or **preferential creditor** without their consent, a **CVA** proposal may take any form. If the aim of the **CVA** is to write off some of the unsecured liabilities then it must envisage a return to **unsecured creditors** (by way of a dividend or debt for equity swap); otherwise it will only serve as a temporary **moratorium** on recovery of the debt and the company will remain liable for the full amount of the debt at the end of the **CVA.**

The **IP** will send to all **creditors** notice of the meeting of **creditors** together with a copy of the proposals for their consideration. There will also need to be a meeting of the members for the **CVA** to become effective.

The proposals put to **creditors** at the meeting, may be modified by **creditors** who vote at that meeting, subject to obtaining sufficient support from other **creditors** to obtain the required majority to approve the proposed modification. This allows greater flexibility in the process and as a result **creditors** can be more involved in what is finally agreed.

In a **CVA**, the directors will normally remain in control of the company, unless it is also in **administration** or **liquidation.** The **supervisor** will act in a monitoring role to ensure that the company complies with its obligations under the terms of the **CVA** but will not be involved in the day to day management or ongoing trading activities of the company.

By contrast, in an **administration** or **receivership**, an **IP** will generally take over and manage the business and assets of the company.

In addition, in a **receivership**, the **receiver** is appointed by a **creditor** holding fixed and/or floating charges over some or all of the company's assets. The **receiver's** main duty is to act for the chargeholder although he may have some duties towards other classes of **creditors.**

An **administrator** may use a **CVA** as a means of rescuing a company as a **going concern** by restructuring the company's business, or to realise the company's assets and make a distribution to **creditors**.

What types of CVA are there?

There are three main types of **CVA.**

1) Rescue of a company as a going concern
   This type of **CVA** will be proposed where the underlying business is profitable but may, for example, have suffered an unusual loss such as a large bad debt, which has affected its ability to pay its **creditors** as their liabilities become due, or where an unprofitable business can be made profitable by restructuring it in a **CVA.** In this case the **CVA** will generally involve the company continuing to trade,

to enable it to make contributions into the **CVA** over a period of time which will then be distributed to its outstanding **creditors**, after the costs of the **CVA** have been met. Another example may be where a company finds that it is unable to service its current financial obligations to its lenders, and needs to formally restructure these liabilities in order to continue to meet its ongoing obligations. This could involve **creditors** accepting a debt for equity swap to ensure the ongoing survival of the company.

2) Effect an orderly wind-down of a company (without the company first being put into **liquidation**)
In some cases a **CVA** will be used to enable the directors to realise the assets of a business in an orderly fashion for distribution to **creditors**, without the threat of individual **creditors** taking individual action against the company whilst they are doing so. It can be a more cost-effective option than putting the company into **administration** or other **insolvency** procedure.

3) Following an **administration**
In some circumstances a company will be placed in **administration**, to provide protection from **creditors**, whilst the proposals are being drafted.

What is the effect of a CVA?

If approved, a **CVA** binds all **creditors** of the company, whether or not they actually decided to vote or attend the meeting. It will also bind **creditors** who voted against the proposals. **Creditors** who did not receive notice of the meeting are also bound by the **CVA** although they do have a short period of time after they became aware of the meeting to make application to the court to have the approval of the **CVA** overturned. However, it is unlikely that they would be successful unless they can prove that they have been unfairly prejudiced. This means that after the approval of the **CVA**, all **creditors** (apart from secured **creditors** unless they have agreed expressly ll, under normal circumstances, be unable to take any alternative action to recover their debt in full.

What is the role of an Insolvency Practitioner (IP) in a CVA?

A **CVA** must be supervised by a licensed **IP**, who acts as **nominee** pending the approval of the **CVA** and usually becomes the **supervisor** once it comes into effect.

The **nominee** will also normally assist the directors in drafting the proposals to be put to **creditors** and must report to the court whether or not he believes the proposals are likely to be approved by the **creditors.** The nominee should therefore contact the company's major **creditors** at an early stage, prior to the meeting summoned to consider the proposals, to obtain their views as to whether they are likely to support the proposed **CVA.**

Once the **CVA** is approved by the **creditors** the **supervisor** will administer the terms of the **CVA.** His role will be to monitor that the company complies with its obligations under the terms of the **CVA**, and often to distribute funds to the **creditors**, but he will not be directly involved in any ongoing trading activities, which will remain in the control of the existing directors of the company.

What is a Partnership Voluntary Arrangement (PVA)?

PVAs are modelled on the **CVA** procedure and give a business partnership the opportunity to resolve its financial difficulties with **creditors**' support. The **PVA** procedure allows trade to continue and partners retain day to day control of the business, whilst contributions are made to repay the partnership liabilities either in part or in full over a period of time. It can also be used as a mechanism for securing the orderly wind-down of a partnership business.

Approval of a **PVA** requires the agreement of at least 75% of **creditors** present and voting at a meeting summoned to approve the proposals. Once approved, **creditors** will not, under normal circumstances, be able to take any separate action to recover their debt in full.

Subject to certain conditions, the partners may be able to opt to seek the protection of a **moratorium**, preventing **creditors** from enforcing their claims in the period leading up to the **creditors**' meeting. Where this protection is not available, as the partners are personally liable for the debts of their business, it may be advantageous for the partners to propose separate but parallel **Individual Voluntary Arrangements (IVAs)** in relation to their personal assets and liabilities, to give them some protection until the **PVA** is approved.

When is it used?
The **PVA** procedure is most applicable to viable partnerships with a significant number of members who wish to avoid **bankruptcy** and to exclude their personal assets from any arrangement with **creditors**. The **PVA** procedure can be well suited to medium or larger sized professional practices trading as a partnership. However, it should be noted that partners will usually be expected to give full disclosure of all their personal assets and liabilities alongside the **PVA** proposals, and may be required to make a personal contribution to secure **creditors**' approval of the **PVA**.

A **PVA** may be proposed by the partners. Less usually, it may also be proposed by a **liquidator**, **administrator** or **trustee** where the partnership is already in **Liquidation**/Partnership Administration, or where the partners have jointly presented a petition to court for their **bankruptcies** and the winding-up of the partnership business.

How does it differ from other partnership insolvency procedures?
Where the members of an insolvent partnership believe that their business is viable and want to continue the business with or without some form of restructuring, there are three rescue tools available to them:

a) **PVA**
b) Interlocking Individual Voluntary Arrangements
c) Partnership Administration

With larger partnership structures, the use of interlocking **IVA**s for the partners may be significantly more complicated and cumbersome than a stand alone **PVA.** As a consequence, interlocking **IVA**s may also be more costly to administer.

The costs involved in a **PVA** are also likely to be significantly lower than for Partnership Administration, under which an **IP** has control of the partnership business.

PVAs in effect provide a flexible mechanism for securing an agreement between the partnership and its **creditors.** Whilst it will not allow the rights of secured or preferential **creditors** to be varied without their explicit consent, in general the terms of the **PVA** can be tailored to the partnership's particular circumstances. This could include, for example, certain essential suppliers being paid outside the **PVA** to ensure the partnership business can continue to trade.

Once the partners have agreed upon the terms of their proposal, approval of the **PVA** requires the **IP** acting as nominee to convene a meeting of **creditors**, and to circulate to them notice of the meeting and a copy of the proposals. **Creditors** may attend the meeting in person or by **proxy.** They may also seek modification to the proposals provided they obtain sufficient support from other **creditors** to secure the required majority for approval.

In contrast to Partnership Administration, where the **IP** will be responsible for the management and control of the business and its assets, in a **PVA** the partners will normally continue to trade the business themselves. The role of the supervisor is to monitor trading and ensure the partners comply with their obligations under the terms of the **PVA.**

What is the effect of a PVA?
Once a **PVA** is approved by **creditors**, it binds all **creditors** whether or not they voted or attended the **creditors**' meeting**. Creditors** who did not receive notice of the meeting are also bound by the arrangement although they do have a short period of time after they became aware of the meeting to make application to the court for the approval of the **PVA** to be reversed. Such an application is unlikely to be successful unless the **creditor** can prove that they have been unfairly prejudiced. As a consequence, once the **PVA** is approved, **creditors** will be unable to take any alternative action to recover their debt in full.

What is the role of an Insolvency Practitioner (IP) in a PVA?
A **PVA** must be supervised by a licensed **IP.** Initially the **IP** acts as nominee, and once the proposals have been voted through by **creditors**, the **IP** becomes supervisor of the arrangement.

The **nominee** is often called upon to assist the partners in preparing their proposals. He is also required to submit a report on the proposals to court, setting out whether he believes they have a reasonable prospect of being approved by **creditors.** Early contact with the partnership's major **creditors** is therefore essential to enable their views to be canvassed and any necessary provisions incorporated.

The supervisor's role following approval of the **PVA** is to fulfil the duties specified in the proposals, including ensuring the partnership complies with its obligations under the terms of the **PVA.** This will not usually involve any direct involvement in trading activities, but may require close monitoring of the partnership's ongoing financial position and ensuring funds are distributed to **creditors** at the earliest opportunity.

Pre-packaged administrations (pre-packs)

What is a pre-pack?

Pre-pack is a shortened form of the phrase "pre-packaged administration". A **pre-pack** is a deal to sell the assets of a failed company, agreed prior to **insolvency**, which completed almost immediately after the appointment of **administrators** (or occasionally **receivers**.)

Why do a pre-pack?

A **pre-pack** can be the best means of preserving value for the business, **creditors** and shareholders. If a business enters into traditional **insolvency**, it may result in disruption, uncertainty and a real prospect that the business would cease to operate, meaning losses for all stakeholders.

However, an accelerated disposal process, which ends in a **pre-pack insolvency** transaction, can mean a smooth transition with enhanced realisations for **creditors** and preservation of value for the goodwill and brands of a business. In addition, employees are also usually better off.

How does a pre-pack work?

In a **pre-pack** situation, the **IP** and his firm are engaged by the company or its stakeholders for a number of weeks prior to the sale taking place. There can be more than one firm involved, depending on the case.

During that time, the **IP** takes on a role which is usually the remit of the corporate financier – researching interested parties, preparing an information memorandum, agreeing confidentiality letters, seeking initial offers, undertaking due diligence and negotiating a contract.

The only differences between this and a standard corporate finance deal are that it is typically done much quicker and an **insolvency** process commences immediately before the contract is completed.

Is a pre-pack usually a sale back to company directors?

Naturally, if a sale process is rigorous, you cannot exclude directors from bidding to buy the business. The duty of an **IP** is to test the market as thoroughly as possible and obtain the best deal for **creditors.**

There is nothing inherently wrong with people associated with the business acquiring it via a **pre-pack**, providing it is the right deal for **creditors.**

Will creditors lose out in a pre-pack?

The objective of a **pre-pack** is to facilitate a smooth transition for survival of the business, enhanced realisations for the **creditors** (from the sale proceeds), preserved value and rescued jobs. A **pre-pack** is an **insolvency** process and, as such, a practitioner has to account for his actions to all **creditors**: secured, preferential and unsecured. A pre-packaged sale of a business does not absolve the **IP** from his duty to obtain the best price for the business in question.

The introduction by the insolvency regulatory authorities, with effect from 1 January 2009, of a Statement of insolvency Practice (SIP 16), on pre-packaged sales by **administrators,** means **IP**s have an obligation to provide to the **creditors** a detailed explanation and justification of why the sale was undertaken as a pre-pack, so that **creditors** can be satisfied that the **administrator** has acted with due regard to their interests. This includes a special mention of circumstances where connected parties purchase the business out of the **pre-pack** process.

It also encourages the **IP** to inform the **creditors** and hold the first meeting of **creditors** as soon as possible after appointment. This is the time when there are likely still to be a large number of open questions in the minds of **creditors** about what happened and why. It is important to remember that **insolvency** causes **creditors'** loss, not **pre-packs**.

CVA vs Pre-pack

What is the principal difference between a CVA and a pre-pack?

A **pre-pack** transfers ownership of the business and assets to a new corporate entity usually leaving the liabilities behind, whereas a **CVA** can enable a company to be kept intact and continue to trade, often under its existing management which is sometimes a good thing, sometimes not.

Why do we hear more about pre-packs than CVAs?

CVAs are not advertised and as all **creditors** are involved in the process, they feel more engaged than they might in a **pre-pack** where the business is perceived as being sold "behind closed doors".

Is there any merit in the common perception that CVAs often do not succeed?

Generally, where a **CVA** is proposed to preserve a company as a **going concern**, management's proposal is based upon making contributions to the **CVA**. The cash flow forecasts on which these are based can be up to five years in length; even the most prudent cash flows cannot predict with certainty general economic conditions over this period of time. Therefore, a number of **CVA**s tend to be rejected on such grounds.

Why would management choose a CVA over a pre-pack?

CVAs are largely proposed by owner-managed businesses where owner-managers are seeking a second chance to restructure the business, which is suffering from genuine financial difficulties which can be overcome in the future.

In a **CVA** the board and shareholders generally remain in control of the company, whereas in a **pre-pack**, the **IP** is under a duty to maximise realisations for the general body of **creditors**; therefore the owners and managers may lose control. There is also no requirement for a report to be prepared on the conduct of directors in a **CVA**.

CVAs can be a powerful tool to restructure a company as employment contracts, leases and onerous supply contracts can be terminated as part of the **CVA** and if the **creditors** allow debt forgiveness, this can have the effect of tidying up the balance sheet.

Why may an unsecured creditor support a CVA?

In a pre-pack, the return to **creditors** is likely to be lower than in a **CVA**. Unsecured trade **creditors** may also choose to benefit from future revenues if they support the company, and a **CVA** proposal can often enhance relationships between a company and its suppliers where suppliers have offered support for the survival of the company. Essentially, the prospect of something, as compared to the certainty of zero, is often persuasive.

Why may secured creditors support a CVA?

Again, in a **CVA**, the secured **creditor**(s) may receive a higher return than in a **pre-pack**. Continuation of the business may also allow the debt to be serviced and generate future revenues. Supporting a **CVA** can potentially involve less reputational risk for a **secured creditor** than being seen to have brought the company down by putting it into administration.

If a CVA is proposed and is not agreed by creditors, can the company still be sold through a pre-pack?

It is possible that if a **CVA** is proposed and not approved, the business can be sold through a **pre-pack**.

What generally prevents management from proposing a CVA in every situation as opposed to a pre-pack?

The main issues that prevent a company proposing a **CVA** are timescale and future viability. **CVA** documents can be complicated to draft and may require legal input. **Creditors** are then served the documents with a minimum of 14 days' notice before the **creditors'** meeting. During this time a company is unprotected, as no **moratorium** from legal proceedings is currently generally available (although the Government is considering whether to change the law to provide for a moratorium); therefore the business can still be put into liquidation by any **creditor** owed more than £750. Once notice has been served on **creditors**, the business is also likely to require funding as supplies will need to be paid for on a "cash on delivery" basis, and the business could decline further if key staff are poached during this period of uncertainty. Further, it is often difficult to convince management, when they may have created the problem, that they have the potential to deliver the solution.

What happens if a CVA fails?

It is usually a standard term of the arrangement that the company is immediately placed into **liquidation** if the **CVA** fails. As liquidation can take a number of weeks to arrange, management may have the opportunity to consider **administration.**

Liquidations

What is a liquidation?

As the word suggests, **liquidation** means turning a company's assets into cash and then distributing this to the **creditors**. The most commonly used procedure for insolvent companies, **liquidation** is the end of the road for a company. After the assets are sold and the proceeds distributed, the company is struck off the register, or dissolved. It literally ceases to exist. Most companies which go into insolvent **liquidation** have already stopped trading and it is therefore very unusual for a **liquidator** to be able to carry on the business. Even where a company is still trading when it goes into insolvent **liquidation,** the **liquidator** will rarely trade on in the hope of salvaging something of the business because his powers to do so are limited.

There are different types of **liquidation**. In a **members' voluntary liquidation ("solvent liquidation")** the company is able to pay its debts in full, together with interest. This may arise when the company has fulfilled its purpose, when the shareholders wish to realise their investments or when a group is reorganised and companies which are surplus to requirements need to be tidied away.

Insolvent liquidation, which entails the distribution of assets to **creditors** who will not be paid in full, can arise in several ways. It may follow on from a **receivership** or **administration** as a vehicle for distributing funds. Or, recognising that it is insolvent, the company itself may resolve to go into **liquidation (creditors' voluntary liquidation).** Finally, a court can make a **winding-up order (compulsory liquidation)** on the **petition** of an unpaid **creditor** or the company itself, its directors or shareholders.

A **liquidator** should act in the best interests of all **creditors.** When he follows a **receiver** he will also review the acts of the **receiver** (eg check the validity of the **receiver's** appointment and ensure the **receiver** has properly disposed of the assets under his control).

A **liquidator** also has the power to investigate suspected misconduct by the directors or others involved in the company and to bring appropriate proceedings. **Creditors** are, however, often disillusioned because a **liquidator** who has no funds to cover the cost of an investigation may ask them to finance the legal action themselves.

Who appoints liquidators?

In a **creditors' voluntary liquidation (CVL)** the shareholders (referred to as the **members**) pass a shareholders' resolution (75% majority required) to wind up the company and appoint a **liquidator** who must be a licensed **insolvency practitioner.** The **creditors** then meet and either confirm the **liquidator's** appointment or appoint another one of their choosing. Voting is by a majority (by value) of **creditors.**

In practice, **compulsory liquidation** is the only **insolvency** procedure which *any* **creditor** can instigate unilaterally regardless of the company's wishes. In all other procedures the company has to participate to some extent in the process. It tends, therefore, to be a last resort for frustrated **creditors** when the company cannot or will not co-operate in any other procedure.

The **creditor** starts the process by **petitioning** the court for a **winding-up order.** This will be made as long as the court is satisfied that the **creditor** is owed over £750 and that the company is insolvent. In most cases, **insolvency** can be established by the **creditor** issuing a **statutory demand** for payment and the company failing, within 21 days, to pay the debt demanded.

In England and Wales, the case is first referred by the court to the **Official Receiver.** If the assets are likely to cover the administrative costs of **liquidation**, the **Official Receiver** will call a **creditors' meeting** to appoint a **liquidator** other than himself. If not, he remains in office or can apply to the Secretary of State to appoint someone else as liquidator.

In Scotland, as there is no **Official Receiver,** the court will appoint a nominated **insolvency practitioner** as **interim liquidator** when it grants the **winding-up order.** Before that, where the **debtor** company is continuing to trade, the court may appoint a **provisional liquidator** whose primary function is to preserve the company's assets. (lthough the court in England and Wales can also appoint a **provisional liquidator,** this is far more common in Scotland.) The **interim liquidator** must call a **creditors' meeting** to appoint a **liquidator.**

From this point on, the legal and practical consequences of **compulsory liquidation** are not dissimilar to **creditors' voluntary liquidation.** However, a court order has been necessary to begin the process and there are some additional requirements to fulfil in terms of court process.

Creditors' recovery

Is it worth attending a creditors' meeting?

A **creditors' meeting** can be a useful forum to learn about the reasons for an **insolvency** and pass on information to the appointed practitioner that can be useful in guiding his approach. On the other hand, most practitioners should distribute a detailed report before or after the meeting (depending on the procedure) and they will be receptive to **creditors** contacting them subsequently.

There are formal votes at most meetings. It is not necessary for a **creditor** to attend to vote. A company can nominate an individual to attend on its behalf (known as a **corporate representative**) and any **creditor** (including a company) can vote by sending in a **proxy** form or appointing an individual to attend as his proxy. Where a **company voluntary arrangement**, **partnership voluntary arrangement**, or an **individual voluntary arrangement** is proposed, or an **administrator** puts his proposals to a meeting of **creditors,** there is scope to vote on substantial changes to the proposal and it can be useful to attend in person to consider these.

What is a proxy and how does it work?

A **proxy** is a formal instruction to an individual (who may be the chairman of the meeting or anybody else) to vote on behalf of the **creditor** at a meeting. The **creditor** may instruct the **proxyholder** to vote in a particular way or to use his discretion. In a **liquidation,** the resolutions upon which a **creditor** votes at a **creditors' meeting** normally involve:

- the choice of **liquidator**;
- in some cases, the formation of a **liquidation committee** to work with the **liquidator**; and
- if no committee is formed, agreeing the basis of fees.

The **proxy** form should be completed in accordance with the instructions on the **proxy** form, giving details of the **proxyholder**, and returned to the convener of the meeting by the time specified in the notice of the meeting. A statement of claim, which is the basis for valuing a **creditor's** vote, will also have to be produced. A **creditor's** say in the decisions of the meeting depends upon his share of the total claims of those voting at the meeting.

What is the pecking order for assets?

Any individual or organisation holding a **fixed charge** over a company's assets is paid first out of the sale proceeds of those assets (after the costs of realisation). Then, after the payment of other costs and expenses, the next group to receive funds, if there are any left, are **preferential creditors. Preferential creditors** primarily comprise employees' claims for arrears of pay and accrued holiday pay, and unpaid contributions to occupational pension schemes and state scheme premiums, all within certain specified limits. Then, if there is a **floating charge** created on or after 15 September 2003, a proportion of the remaining funds (called the **prescribed part**), subject to a maximum of £600,000, is made available for **unsecured creditors.** Next comes any **creditor** with a **floating charge.** Fourth in line are **unsecured creditors** and finally the shareholders.

When a company is insolvent, how much return are creditors likely to get?

There is no magic formula – every case varies. However, **creditors** will *usually* get a better return in cases where the directors recognised the problem at an early stage and took appropriate steps to minimise the losses to **creditors.**

How long is it before creditors see a return or turnaround?

This can vary from a few months to several years. Cases which involve litigation can last a long time. It can also take time to agree all **creditors'** claims, especially matters such as tax, liquidated damages on failure to complete a contract, and pension fund claims against the company.

Are shareholders likely to see a return?

Unless there is a rescue of the company or it is a solvent liquidation, shareholders will not usually see any return on their investment. In the pecking order for asset realisations shareholders are last in the queue.

Insolvency practitioners

What are the duties of an insolvency practitioner (IP)?

In simple terms, an **IP** answers to the **creditor(s).** In a **receivership** his primary duty is to the **creditor** who appointed him, but in other procedures his duty is to all **creditors.** Even in a **receivership** he has certain overriding duties to all **creditors** (eg a duty to get a proper price for the assets). In some proceedings such as **administrations, compulsory liquidations and bankruptcies,** he also acts as an officer of the court and is obliged to observe high standards of fairness to all parties. If he acts negligently or in breach of his duties the **IP** can be held personally liable and can be sued.

Who pays the IP?

The **IP** is paid from the company's or individual's assets. In **receiverships** the fees are negotiated by the lender who appoints the **receiver.** In all other types of **insolvency**, they are agreed by the **creditors' committee** or **creditors**, or failing that, by the court.

The fees normally take account of time spent by the **IP** and his staff, the value of the assets realised and the complexity of the case.

How can a creditor or director ensure they get satisfaction from an insolvency practitioner's services and complain if not?

If a **creditor** or director has concerns it is important to raise them with the practitioner directly at an early stage so that there is the opportunity for the **IP** to remedy them or explain the course of action. If the result is unsatisfactory, most firms have a formal complaints procedure involving an internal review by a professional unconnected with the case.

If necessary, a complaint to the licensing body that has authorised the practitioner can be made. These may have the power to levy fines or revoke **IP** licences in extreme cases. The licensing body cannot take any action which affects the course of the **insolvency;** their only role is to ensure that the **IP** is a fit and proper person to hold office.

The final step available to **creditors** is to implement the statutory provisions that **creditors** have; to apply to the court to replace the practitioner with another individual, or to order him to act in a particular manner.

Employees and directors of an insolvent company

What happens to the employees of an insolvent company?

The fate of the employees is largely determined by the type of procedure which is used for the insolvent company. If the company is rescued or all or part of the business is sold as a **going concern,** the jobs of employees working in the business at the time of rescue or sale may be saved.

If an insolvent company is closing down, do the employees get any redundancy money?

Yes. The Government will meet various employee entitlements, but subject to limits which are periodically revised. These claims are all paid by the Department for Business Innovation and Skills (BIS) which then claims as a **creditor** in the **insolvency** for the sums paid out.

What happens to the directors of an insolvent company?

Very little happens by way of an automatic process – much depends on the type of **insolvency.** In a **liquidation** a director will have no continuing role in managing the company but in an **administration, administrative receivership** or **company voluntary arrangement** he may have. If he has given personal **guarantees** to any **creditors,** he may well be called upon to pay them. A director is usually also an employee of the company, and is subject to the same processes and claims as employees generally.

Does the conduct of directors automatically get investigated?

In all cases other than **voluntary arrangements** and **solvent liquidations,** the **insolvency practitioner** has a duty to report to BIS on the conduct of each director to help them determine whether **disqualification** proceedings should be started. Except in **liquidations**, this report is based on information which is brought to the **IP**'s attention, and he is not required to make a general investigation into the director's dealings. In general, only a **liquidator** in an insolvent liquidation has a duty to investigate the conduct of directors.

Can the insolvency practitioner disqualify a director?

No. This is a matter for the Secretary of State to take up. If he does so, he may accept a **disqualification** undertaking from the director or apply to the court for a **disqualification** order.

Why don't insolvency practitioners spend more time investigating the conduct of directors?

Often they do, but there are several reasons why they may not investigate further. Perhaps there are inadequate funds in the estate and **creditors** are not willing to spend more money themselves. Sometimes further enquiries are unlikely to show any real benefit, (eg if the director is known to have no assets worth chasing or if the police have already exercised other remedies). Major enquiries in large cases can cost hundreds of thousands of pounds and, even if resources were not an issue, it would not always be appropriate to investigate on this scale. Indeed, **insolvency practitioners** could justifiably be accused of acting oppressively if they sought to do so. The vast majority of failures do not involve fraud or serious misconduct.

Why aren't all directors of insolvent companies disqualified?

The fact that they have been a director of an insolvent company does not, in itself, make them unfit to act as directors. Unless there has been misconduct, **insolvency** is not meant to be a punitive process but rather an opportunity for a fresh start. Many businessmen learn from their mistakes and go on to run successful ventures. It would not be in the interests of the national economy to deny them all the opportunity to do so.

What is wrongful trading?

In short, continuing to trade, and causing avoidable losses to **creditors,** after the point at which the **insolvent liquidation** of the company becomes inevitable. A director who does so can be held personally liable for those losses. The law does not mean the company ought to cease trading immediately if it reaches this point, because this would prevent many successful rescues. It does mean that the directors have to take 'every step' to minimise the losses to **creditors.** In some cases, closing the doors could well maximise these losses! The best protection for a director in these circumstances is voluntarily to take professional advice from an **insolvency practitioner** to help ensure that these risks are minimised. To date, no director who has done so has been obliged to meet a **wrongful trading** claim, as far as we are aware.

Cross-border insolvency

A French liquidator is dealing with the assets of my UK customer – is this allowed?

Under **the European Regulation on Insolvency Proceedings (ERIP)** there is a co-ordination of **insolvency** proceedings around Europe. If your UK customer has his **centre of main interests (CoMI)** in France then it is quite possible for a French **liquidator** to be allowed to deal not only with the assets of the French business but also the assets of the UK business. This is most likely if the UK business is a division of a French company but it is also possible when the UK business is separately incorporated in the UK if its **CoMI** lies in France. **Insolvency** proceedings may still be instigated in the UK, but the main proceedings, in the countr the **CoMI** is located, will take precedence.

Can an overseas company be subject to a UK insolvency proceeding?

In May 2002 **ERIP** came into effect in every European Union country (apart from Denmark). If it can be demonstrated that the **CoMI** of a company lies in the UK then it is possible for that company to be subject to a UK **administration, CVA** or **liquidation** proceeding. If the **debtor** is an individual it is possible for that individual to be subject to an **IVA** or **bankruptcy** proceeding. If the company has a **CoMI** elsewhere in the EU but has a branch in the UK then that branch can be subject to **liquidation** (but not **administration or CVA**) in the UK. That **liquidation** will be a **secondary proceeding** behind that taking place in the **CoMI** of the company. Other foreign companies with a sufficient connection with the UK can also be wound up here.

What are the insolvency processes in France, Germany and Spain?

France: there are three proceedings available to troubled companies;

- Safeguard (Sauvegarde) is a procedure available to companies which are solvent on a cash flow basis, enabling the restructuring of the business as a preventative measure; this was most famously used in the restructuring of Eurotunnel.
- Rehabilitation proceedings are available to an insolvent company provided its rescue appears possible. The aims of rehabilitation in order of priority are first to save a company's activities; secondly to protect jobs; and thirdly to pay creditors. A rehabilitation plan is prepared by management and must be approved by different classes of creditors and the court.
- The most common procedure in France, however, is judicial liquidation, controlled by the court and run by a court appointed liquidator, who may continue to trade and sell the business as a going concern, or liquidate the assets. Priority is given to saving the business and jobs, and employee and tax creditors rank ahead of other creditors, so returns to ordinary creditors can be poor.

Germany: there is a unified insolvency procedure in Germany. Directors must file in court within three weeks of a company becoming illiquid (or over indebted – but this requirement is temporarily suspended until January 2011) – these strict rules mean that Germany has a much higher rate of company failure than other European states. The court will then start an observation period where a preliminary administrator enquiries into the financial status of the company. The German state will provide finance for wages in this period and it is common practice for the preliminary administrator to obtain powers from the court to trade on and sell the business and assets as a going concern. The insolvency proceedings are then formally opened and an administrator appointed – the court will only appoint persons as administrator who have no prior connection with the debtor or its creditors – this means that pre-packed sales are virtually impossible. The administrator agrees an insolvency plan, which could either provide for the rescue of the debtor or liquidation of its assets and distribution to creditors. The administrator has wide powers to use secured assets and collect in financed debts. There are no preferential creditors in a German insolvency, but group company claims are subordinated to rank behind other creditors.

Spain: There is one type of insolvency proceeding (concurso) which can end in either a composition or liquidation. The overriding aim of the proceeding is the payment of creditors rather than the rescue of the debtor. The court will usually appoint three receivers – a lawyer, an economist or auditor, and a creditor (usually represented by an economist or auditor); the receiver's duties are to assist the debtor in safeguarding its assets, report on the circumstances of the debtor and assess proposals submitted for a composition. Creditors must submit their claims within one month. A composition proposal requires the support of more than half in value of the creditors and then it must be approved by the court. If no proposal is made or the proposal rejected, the debtor goes into liquidation. Most proceedings end in liquidation with a low rate of payment to creditors. Those that do result in a composition are mostly where an advance proposals for composition procedure is used, allowing much of the work in preparing proposals to be undertaken pre-insolvency. Creditors ranking preferentially include employees, withholding taxes and half of other taxes due to the government. Amounts due to directors, group companies or arising from interest or fines or claims submitted late are subordinated to the other creditors.

Pension fund deficits

What is the pension scheme creditor?

In the UK any defined benefit pension scheme (ie one that pays a defined level of benefits which have been promised to members) will usually need to be considered as being a potential **creditor** of its sponsoring employer.

If the employer enters **insolvency** the pension scheme will usually have a claim in the **insolvency** under section 75 of the **Pensions Act 1995**, and/or under the terms of the scheme's rules. Under section 75 the scheme's liabilities are valued as the cost of securing all the members' benefits on an insurance company annuity basis; this will normally give rise to a higher deficit (and therefore a higher claim) than might exist under the scheme on an ongoing funding basis.

What is the Pensions Regulator?

The **Pensions Regulator** was created by the **Pensions Act 2004**; the Regulator's role is to protect pension schemes and the **Pension Protection Fund**. The Regulator has a number of statutory powers, including the ability to impose Financial Support Directions and Contribution Notices, which in certain circumstances can impose pension liability on, for example, other companies which are associated with the pension scheme's employer.

For more information please see the website www.thepensionsregulator.gov.uk

What is the Pension Protection Fund (PPF)?

In brief, the **PPF**'s main function is to provide compensation to members of eligible defined benefit pension schemes, when there is a qualifying **insolvency** event in relation to the employer, and where there are insufficient assets in the pension scheme to cover the **PPF** level of compensation.

For more information please see www.pensionprotectionfund.org.uk

What if a company can no longer meet its pension obligations?

There are several options open to a company which is struggling to meet its obligations to make deficit payments to its defined benefit pension scheme. These require careful investigation to ensure the correct path is chosen. The most common options are to:

- renegotiate a lower level of deficit payments until the company's position has improved
- take action, in co-operation with the scheme's trustees, aimed at reducing the scheme deficit
- seek to compromise the company's liabilities to its pension scheme with the scheme trustees and/or the **PPF**
- at worst, enter into full **insolvency**

How can companies renegotiate scheme funding?

The Regulator has encouraged defined benefit pension scheme trustees to be flexible with employers during the downturn, and take into account the level of deficit payments that can be afforded when negotiating on scheme funding. Therefore, companies that are struggling for cash should be open to discussing with the trustees what can be done to ensure that the company's obligations to its pension scheme do not unnecessarily threaten the company's viability.

How does a PPF restructuring work?

In simple terms, this is a mechanism to allow the employer to separate its onerous pension liability, while allowing the business to trade on. The reality is rather more complex.

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/or **CVA** procedures to compromise the pension scheme **creditor** and effectively "soft land" it into the **PPF**. In these circumstances the company will continue to trade, having exited the **insolvency** procedure almost immediately. An essential ingredient in this process is that the business of the employer is viable without the burden of the pension scheme.

The **PPF** requires that certain criteria are met for it to agree to such a proposition. This is detailed on their website and in summary is as follows:

a) need to be assured that **insolvency** is inevitable
b) will require a mitigation payment that is demonstrably better than would be recovered in **insolvency**
c) will require a shareholding in the ongoing business

A number of **PPF** restructuring exercises have been completed. This has allowed businesses that would otherwise have been wound up to continue, attract new funding and quality management thereby maintaining employment and funding new defined contribution pension schemes.

What happens to the pension scheme in a normal insolvency?

If the employer of a defined benefit pension scheme enters **insolvency** the pension scheme will usually be wound up (unless, depending on circumstances, the scheme also has other employers which are not insolvent).

The **insolvency** event will usually trigger the start of an assessment period with the **PPF.** During the assessment period the financial position of the scheme is established. Broadly, if the scheme has sufficient assets to provide at least **PPF** compensation levels of benefits by buying annuities for its members, it will wind up outside the **PPF.** If the scheme is not adequately funded on this basis, it will enter the **PPF** fully and members will receive compensation payments from the **PPF.**

The pension scheme will usually be a **creditor** of the insolvent company. The **PPF** will usually take over the **creditor** rights of the pension scheme while the scheme is in an assessment period.

Schemes of Arrangement

What is a Scheme of Arrangement (Scheme)?

Essentially a **Scheme** is a compromise or arrangement under Part 26 of the Companies Act 2006 between a company and its **creditors** (one or more classes of them), which becomes legally binding on all **creditors** (or the relevant class or classes) if the necessary majority of **creditors** vote in favour and the Court approves it.

When might a Scheme be suitable?

A **Scheme** can be applied to solvent and insolvent entities where there is a need to formalise a compromise with **creditors.**

Restructuring

A **Scheme** can be a useful tool during a restructuring process, to formalise an arrangement between a company and its **creditors.**

The decision in relation to the IMO car wash group (IMO) is an excellent example of the utility of a scheme; in that case to achieve a way forward in a dispute over the value of the companies and accordingly which classes of **creditors** had an economic interest in them.

A **Scheme** might be applied to a hedge fund, as a hedge fund may invest in financial instruments with long maturity dates, a number of its assets on its balance sheet may be illiquid in the short term. When winding down, the fund may experience significant cash flow issues arising from its inability to use these “long-tail assets” to settle current debts. A **Scheme** could be used to formalise a compromise with **creditors**, whereby the fund agrees to settle outstanding debts when certain investments mature, thereby avoiding **insolvency.**

Long-tail liabilities

Long-tail liabilities may mean that it is difficult for a company to quantify claims in the short term. In this scenario, it may be a number of years into the future before the value of all **creditors**’ claims can be determined. A **Scheme** might be used as a mechanism for valuing and paying present and future claims by a set date. In an **insolvency** situation, this means that a final dividend might be paid in a significantly reduced timeframe.

A **Scheme** may be suitable for solvent companies which also have long-tail liabilities on their balance sheet. For example, an otherwise healthy business may be facing long-tail liabilities arising from historic trading. Such liabilities could include those arising from asbestos-related exposures or even product mis-selling. The existence of such exposures can have a dramatic impact on share price. The difficulties in assessing these sorts of financial obligations mean that it is very hard for finance managers to predict future cash flows and liabilities. One possible solution to this problematic scenario is for the entity to ring-fence its long-tail liabilities from its current business activities by setting up a new entity to take over the obligations in respect of these claims. The transfer of the obligation to pay these claims from the original entity to the new one might be achieved via a **Scheme**.

Uncertainty surrounding the creditor population
Although it is necessary to make every reasonable effort to give **creditors** notice of a **Scheme**, a **Scheme** binds all **creditors**, even if they have received no notice. Therefore, a **Scheme** can be useful where there is uncertainty regarding the **creditor** population.

What are the key features of a Scheme?
A **Scheme** can provide a pragmatic dispute resolution mechanism without costly court involvement. If agreement regarding some aspects of a claim cannot be reached, then an independent adjudicator can be called upon, whose decision would be binding.

Can an insolvency process run alongside an insolvent Scheme?
A **Scheme** can be used in conjunction with an **insolvency** process. In particular, an **administration** can be used to provide protection from creditors while a **Scheme** is being put in place.

What process must be followed in order for a Scheme to be put in place?
A meeting of the Scheme **creditors** will be convened at the direction of the court to consider and, if thought fit, approve the **Scheme.** The **Scheme** is approved if the resolution is passed by more than 50% in number representing 75% in value of those Scheme **creditors** or each class of them who attend and vote in person or by **proxy.** Once this majority is reached, Court sanction of the **Scheme** is required. The relevant court order is then delivered to the Registrar of Companies and on its registration the **Scheme** becomes effective i.e. operational. If there are significant US assets involved, recognition of the **Scheme** in the US can be obtained through Chapter 15 of the US Bankruptcy Code.

What are the common issues to consider when formulating a Scheme?
As **Schemes** are a flexible mechanism for the submission and payment of claims, there is a need to consult with stakeholders/**creditors** in order to ensure that the **Scheme** is tailored to meet the requirements of the specific situation and that support for the proposals can be achieved.

How does a Scheme differ from a CVA?
A **Scheme of Arrangement** has the benefits of being able to compromise the claims of secured **creditors**, which a **CVA** cannot unless they consent, and of binding all **creditors** including any unknown **creditors** who receive no notice of the scheme but subsequently come forward. By contrast, in a **CVA**, where a creditor does not receive notice of it, the creditor may mount proceedings to challenge the **CVA** within 28 days of becoming aware of it on the grounds that the **CVA** unfairly prejudices his interest, or that there was a material irregularity in relation to the meetings at which the **CVA** was approved. If a company has a potentially large number of **creditors**, there is a possibility that some **creditors** may not receive notice notwithstanding the company's best efforts to reach them. The supervisors of the **CVA** would, therefore, never be certain the **CVA** would not be challenged. In addition the company would be liable to pay those **creditors** the same dividend as those who had received proper notice of the **CVA** even if the **CVA** has been completed. The company would not therefore achieve the same finality as afforded by a **Scheme** as mentioned above.

Personal insolvency – bankruptcy

Introduction to personal insolvency

Who decides that an individual is bankrupt?
In England and Wales the courts are officially responsible for making a **bankruptcy** order against an individual. From 1 April 2008, in Scotland, an award of **sequestration** can be granted either by the court or by the **Accountant in Bankruptcy.** This is done at the request of either a **creditor** or the individual (**debtor's petition**). Requesting the court to make someone bankrupt is referred to as **petitioning** the court for a **bankruptcy order**/award of **sequestration.**

What happens when an individual is made bankrupt?
When an individual is declared bankrupt by the court in England and Wales, all his assets come under the control of the **Official Receiver.** If there are enough assets to cover the costs of the proceedings, he will call a meeting of **creditors** who

may nominate an **insolvency practitioner** to act as the bankrupt's **trustee**, or the Secretary of State may appoint a **trustee.** The **trustee** is then responsible for realising the assets and passing the proceeds to **creditors.**

The bankrupt can normally keep assets such as household contents and his motor vehicle.

In Scotland, as there is no **Official Receiver,** the **petitioning creditor** or **debtor** may nominate an **insolvency practitioner** to act as **trustee.** If no **insolvency practitioner** is nominated, the role of **trustee** falls to the **Accountant in Bankruptcy**, a Government appointed official who has overall supervisory powers for **sequestration.**

Who has first claim on the assets of a bankrupt individual?

A person or organisation such as a bank or building society which holds **security,** for example a mortgage, over a bankrupt's assets has first claim on the asset(s) subject to any such mortgage.

Does a bankrupt have to sell his home?

If a bankrupt owns all or part of a house, one way or another his share of the property must normally be realised. In many cases a forced sale is avoided because a friend or relative is able to make an acceptable offer. The law in England and Wales encourages a 12-month 'breathing space' before any attempt is made to force a sale, during which time the bankrupt, or his friends and relatives, can make attempts to raise finance to avoid a sale.

The **trustee** is obliged to take steps within three years to realise the bankrupt's interest in his home, otherwise it returns to the bankrupt's ownership (in Scotland this applies to sequestrations that started on or after 1 April 2008). Where the value is minimal, the **trustee** may not be able to sell the interest at all.

Once someone is bankrupt, are they deemed to be so for life?

In England and Wales a bankrupt will normally be discharged within 12 months of the **bankruptcy** order and any unpaid balance of debts is then written off. The precise date of discharge will be determined by the date that the **Official Receiver** reports to the court that there are no matters requiring further investigation. In Scotland the discharge normally takes effect at the end of the 12-month period.

The Secretary of State, the **Official Receiver** or in Scotland the **Accountant in Bankruptcy** can, however, apply to court for a **bankruptcy restrictions order (BRO)** in cases where the bankrupt's conduct prior to or during the **bankruptcy** fell below a certain standard. A **BRO** may last from a minimum of two years to a maximum of fifteen. An individual subject to a **BRO** will face restrictions on borrowing, or acting as a company director. Alternatively, a bankrupt may give a **bankruptcy restrictions undertaking (BRU)** to the Secretary of State, or in Scotland to the **Accountant in Bankruptcy**, which has the same effect as a **BRO** made by the court.

Is bankruptcy the only procedure open to insolvent individuals?

No, there are other **insolvency** solutions that have been introduced for individuals, namely an **individual voluntary arrangement (IVA)** or the new **debt relief order (DRO)**.

What is an IVA?

In England and Wales, any person owing money, whether or not he is bankrupt, can put forward a scheme to his **creditors** to pay off all or part of his debts. This is called an **individual voluntary arrangement (IVA).** If **creditors** agree, some of the assets which would be sold in the event of **bankruptcy** may be excluded from an **IVA.** For an **IVA** to be accepted, a majority in excess of 75% (by value) of **creditors** need to agree. This only needs to be 75% of those **creditors** represented at the **creditors' meeting**. An **IVA** is administered by the **supervisor** who must be an **insolvency practitioner.**

The **IVA** procedure does not apply in Scotland, where the only alternative to **sequestration** is for the **debtor** to sign a **trust deed** in favour of an **insolvency practitioner**.

What is the role of an insolvency practitioner in an Individual Voluntary Arrangement (IVA)?

If someone wishes to make an offer to his **creditors** by means of an **IVA** he needs to contact an **insolvency practitioner (IP).** This will often be on the advice of his lawyer. Before the **creditors** meet to decide whether to accept the scheme, the **IP** is referred to as the **nominee.** After the scheme is implemented the **nominee,** or another **IP,** becomes the **supervisor,** responsible for supervising the smooth running of the scheme.

What is the role of an insolvency practitioner in a trust deed?

The job of the **trustee** is broadly similar to that of a **trustee** in **sequestration,** namely to realise the **debtor's** assets and distribute the money amongst the **creditors.**

A trust deed may become protected provided that it complies with Regulations 4 to 10 of the **Protected Trust Deeds** (Scotland) Regulations 2008. Once protected, **creditors** can take no further action against the **debtor,** including presenting a **petition** for his **sequestration.** The provisions of a trust deed can be varied to exclude certain assets or provide different ranking of **creditors**, but a **trust deed** with these provisions could not become protected and is very rarely used.

What are the benefits of IVAs?

IVAs can offer significant advantages over bankruptcy for those concerned. They are not advertised formally (although information is readily available to members of the public upon enquiry), the involvement of the court is minimal and the **Official Receiver** is not involved. The **nominee** is responsible for informing the **creditors** and calling a meeting.

The **creditors** themselves can also benefit from the lower administration costs and the fact that the **debtor** is co-operating in fulfilling his part of the bargain. However, they are only appropriate where the debtor is genuinely capable of achieving the proposals he has put to his **creditors.** If he fails then he can be made bankrupt, and the outcome for **creditors** may be worse due to the wasted costs of the IVA.

What are the benefits of trust deeds?

Generally, the administration of a **trust deed** is cheaper than sequestration as there are fewer statutory requirements. There are no court processes involved and less restrictions on the **debtor.** The assets covered by the **trust deed** and the **debtor's** discharge from liability to **creditors** will depend on the terms of the **trust deed.**

What is a Debt Relief Order (DRO)?

DROs came into force in England and Wales on 6 April 2009 and are designed to be an individual **insolvency** solution aimed at debtors who have relatively low liabilities (not exceeding £15,000), no real assets (not exceeding £300), and little or no disposable income (not exceeding £50 per month) with which to make contributions to **creditors.**

In many respects they mirror **bankruptcy** legislation. As with other forms of personal **insolvency**, a **DRO** debtor's credit rating will be affected and there will be civil and criminal penalties for those who abuse the system. The Official Receiver is able to investigate, either on his own account or as the result of an objection from **creditors**, and is able to revoke the order if the debtor is found to have failed to provide a full and accurate account of their financial affairs (for example, an understatement in their assets or income). Failure to provide such an account may result in civil and criminal sanctions.

How is a DRO different to bankruptcy?

DROs are not available for individuals who have an interest in a property, even if that property is in negative equity. The £300 limit on assets is based on their gross, not net, value. There is an exemption for cars with a value of less than £1,000, which is not the same as the rules for cars in **bankruptcy** (where there is no set amount below which a debtor is entitled to retain a car; it is based on their needs unless they are of 'excess value').

So what are the implications for creditors of a DRO?

By definition, the vast majority of individuals who enter into a **DRO** are unable to repay their debts in the short term. **Creditors** lose the ability to recover these debts over an extended period, perhaps when an individual's circumstances improve.

Does a DRO apply in Scotland?

In Scotland, debtors who meet prescribed criteria may be in a position to make an application for their own sequestration to the Accountant in Bankruptcy where they do not own any land or property and their assets and income are less than a prescribed minimum. Such cases are known as LILA ("Low income, low asset") sequestrations and are administered by the Accountant in Bankruptcy. Further details can be obtained from the Accountant in Bankruptcy (www.aib.gov.uk).

Section 2

Glossary of insolvency terms

- **Accountant in Bankruptcy.** (AiB) An Agency of the Scottish Government responsible for administering the process of personal **bankruptcy** and recording corporate insolvencies in Scotland. Can act as **trustee** in **sequestrations.**
- **Administration.** (1) One of the main corporate **insolvency** procedures. It can be a precursor to a **company voluntary arrangement (CVA)** or **scheme of arrangement** under which the company is restructured and passed back to its directors. In an **administration**, the **insolvency practitioner,** as officer of the court, takes over powers of management of the business (but is able to delegate these back to management). His objective is to rescue the company or if that is not possible or the result would be better for **creditors**, to achieve a better result for **creditors** than a **liquidation** (often through rescuing the business as a **going concern**) and provide protection from actions by **creditors** while doing so. A partnership can also be subject to **administration** and this can be as a prelude to a **partnership voluntary arrangement.** (2) Name given to a personal **bankruptcy** where the **debtor** has already died. (3) County Court process permitting an individual with modest debts to pay off by instalments and in which no **insolvency practitioner** is involved.
- **Administrative receiver.** (In Scotland simply 'a **receiver**'). **Insolvency practitioner** appointed in an **administrative receivership.** The **administrative receiver** is commonly known as the **'receiver'**. Not to be confused with **Official Receiver.**
- **Administrative receivership.** (Usually contracted to '**receivership**'). Non-court procedure whereby an **insolvency practitioner** takes control of the whole of a company's assets under the terms of a lender's **floating charge security** arrangements.
- **Administrator. Insolvency practitioner** appointed in an **administration.**
- **Agricultural receivership.** A specialist remedy to take control of the assets of a farmer under the Agricultural Credits Act 1928.
- **Bankruptcy.** Formal **insolvency** procedure for individuals.
- **Bankruptcy Restrictions Order (BRO).** An order of court following an application by the **Official Receiver**, or the **Accountant in Bankruptcy** in Scotland, extending the restrictions of **bankruptcy** for a period of between two and fifteen years. A bankrupt may give a **bankruptcy restrictions undertaking (BRU)** to the Secretary of State or, in Scotland, to the **Accountant in Bankruptcy**, which has the same effect as a **BRO** made by the court.
- **Bankruptcy (Scotland) Act 1985.** Primary legislation governing personal **insolvency** law and practice in Scotland. Certain parts of this Act have been amended by the Bankruptcy & Diligence etc. (Scotland) Act 2007, which came into effect on 1 April 2008.
- **Bond.** Insurance cover needed by a person who acts as an **insolvency practitioner.**
- **Bond and floating charge.** Scottish equivalent of a **debenture.**
- **Break-up sale.** Dismantling of a business. Trading ceases and the assets are sold off piecemeal. **Insolvency practitioners** prefer to sell as a **going concern** if possible as this almost always generates greater value for **creditors.**
- **Charge.** A **security** over the assets of a borrower.
- **Centre of main interests (CoMI).** Defined by the European Regulation on **Insolvency** Proceedings **("ERIP")** as the place where the **debtor** conducts the administration of his interests on a regular basis. The presumption is that this is in the same country as the **debtor's** registered office but this is not necessarily the case.
- **Commissioner.** A **creditor's** representative appointed in a **sequestration** in Scotland to work with the **insolvency practitioner** in similar fashion to a **committee.**
- **Committee.** Known as the **creditors' committee** or, in **liquidations** only, the **liquidation** committee. This is a representative group of **creditors** appointed to work with the **insolvency practitioner** and, in some types of procedure but not all, to exercise a degree of supervision (eg in approving the **insolvency practitioner's** fees). There is no requirement to appoint a **creditors' committee** – it is up to the **creditors** whether they wish to appoint one.
- **Company voluntary arrangement (CVA).** A proposal by the directors for payment in full or in part of their company's debts. If the company is in **liquidation** or **administration,** either the **liquidator** or the **administrator** may put forward such proposals. It is a rescue procedure aimed at preserving the company and maximising the potential **dividend** for **creditors.**

- **Compulsory liquidation.** A **liquidation** brought about by order of court, usually because an unpaid **creditor petitions** the court having exhausted all other remedies. In England and Wales, the **Official Receiver** first takes control but, if there are assets to pay the costs, an **insolvency practitioner** may later be appointed by **creditors** or by the Secretary of State. In Scotland, an **interim liquidator** is always appointed at the same time as a **winding-up order** is granted; however, an interim appointment may be preceded by the appointment of a **provisional liquidator** if the court is shown cause.
- **Corporate representative.** An individual appointed by a company to represent that company at a meeting of **members** or **creditors.** Representation by **proxy** is more common.
- **Court appointed receiver.** A person, not necessarily a licensed **insolvency practitioner,** appointed to take charge of assets usually where they are subject to some legal dispute or under statutory provisions such as the Proceeds of Crime Act. Not strictly an **insolvency** process, the procedure may also be used other than for a limited company (eg to settle a partnership dispute).
- **Creditor.** Person owed money.
- **Creditors' committee.** See **Committee.**
- **Creditors' meeting.** A meeting of **creditors,** often convened with the primary purpose of deciding which **insolvency practitioner** is to be appointed to deal with a case (eg **liquidations** and **bankruptcies**), or to consider proposals (eg **administration** and **voluntary arrangements**). **Creditors**' meetings may also be held for a variety of other purposes.
- **Creditors' voluntary liquidation (CVL).** Winding up of an insolvent company, brought about by a resolution of shareholders. At a subsequent **creditors' meeting** the **liquidator** will either be confirmed in office or replaced by the **creditors'** choice.
- **Crystallisation.** The process whereby a **floating charge** attaches to the assets subject to the **charge,** thus becoming a **fixed charge** on those assets. Crystallisation is triggered by events specified in the **debenture** or, more commonly, by the onset of **liquidation** or the appointment of a **receiver.**
- **Debenture.** This term has no precise meaning. One definition is a document acknowledging a debt, usually issued by a company. Debentures may be secured or unsecured, but the term is commonly used to describe a document containing a **floating charge** and possibly also some sort of fixed **security.**
- **Debtor.** Person owing money.
- **Debt Relief Order (DRO).** An individual **insolvency** solution introduced in April 2009 in England and Wales, aimed at debtors who have relatively low liabilities (not exceeding £15,000), no real assets (not exceeding £300), and little or no disposable income (not exceeding £50 per month) with which to make contributions to **creditors.**
- **Deed of arrangement.** An archaic method governed by the Deeds of Arrangement Act 1914 for an individual (not a company) to come to terms with **creditors** short of formal **bankruptcy.** Now effectively replaced by **individual voluntary arrangements.**
- **De facto director.** Individual who acts as, or holds himself out to be, a director of the company even though he has not been appointed by the board and is not recorded at Companies House as a legal director. Distinguished from **shadow director,** as a **shadow director** does not hold himself out to be a director to those dealing with the company. A **de facto director** has all the obligations and responsibilities of any other director.
- **Discharge.** The release from liability granted to a bankrupt, usually within 12 months from the date of the **bankruptcy** order in England and Wales, or at the end of the 12 month period in Scotland. It does **not** return assets to a bankrupt, unless they are acquired after the date of discharge.
- **Disqualification.** On application to the court by the Department for Business Innovation and Skills (BIS), a director found guilty of 'unfit' conduct may be disqualified from holding any management position in a company for between two and 15 years. Alternatively, a director may be disqualified by giving a disqualification undertaking to the Secretary of State which has the same effect as a disqualification order by the court.
- **Dividend in insolvencies.** Distribution of funds to **creditors** in an **administration, liquidation, bankruptcy, CVA or IVA.**
- **Enterprise Act 2002.** Legislation intended to facilitate company rescue and the swift rehabilitation of **debtors.** The Act introduced a streamlined administration procedure and faster rehabilitation for bankrupts by importing new and revised sections

into the **Insolvency Act 1986,** which remains the primary piece of legislation for UK **insolvency.**

- **ERIP.** The European Regulation on Insolvency Proceedings applies to all companies whose **centre of main interests (CoMI)** is in the EU (other than Denmark). It regulates **insolvency** proceedings which cross borders and can make proceedings in one country subordinate to proceedings in another.
- **Financial Services Compensation Scheme.** A statutory compensation scheme, accountable to the Financial Services Authority (FSA), to provide compensation within specified limits to consumers (mainly private individuals but also small businesses) if an authorised insurance company, deposit-taker or investment business is unable or likely to be unable to pay claims against it.
- **Fixed charge.** **Security** over specific assets such as goodwill, property or shares. No fixed charge can be created in Scotland other than over property assets. Such a charge is referred to in Scotland as a Standard Security.
- **Fixed charge receiver.** A **receiver**, who need not be **an insolvency practitioner,** appointed by the holder of a **fixed charge** to realise the charged asset.
- **Floating charge.** An equitable **charge** on property that may change from time to time in the ordinary course of business (for example, stock). Such a **charge** can be converted (or **crystallised**) into a **fixed charge** over those assets.
- **Fraudulent trading.** A more severe test than **wrongful trading** in that it must be demonstrated that the director intended to cause losses to **creditors.** This can be a criminal offence resulting in a fine or imprisonment. The civil remedy is personal liability for the losses incurred.
- **Going concern.** Basis on which **insolvency practitioners** prefer to sell a business. Effectively, it means the business continues, jobs are saved and a higher price is obtained.
- **Guarantee.** A legal commitment to repay a debt if the original borrower fails to do so. Directors often give guarantees to banks in return for the bank giving finance to their companies.
- **Individual voluntary arrangement (IVA).** A proposal of settlement of all or part of an insolvent individual's debts. An IVA is an alternative to **bankruptcy** and **dividend** prospects are often greater because administrative costs are less. Not applicable to Scotland.
- **Insolvency.** Defined alternatively as having insufficient assets to meet all debts, or being unable to pay debts as and when they fall due. If a **creditor** can establish either test, he will be able to present a winding-up **petition** (in England and Wales or Scotland) or a **bankruptcy petition** (in England and Wales) as long as the debt is over £750. In Scotland, the **creditor's** debt must be at least £3,000 to present a **petition** for **sequestration**
- **Insolvency Act 1986.** Primary legislation governing **insolvency** law and practice. Nevertheless, many other statutes are also relevant.
- **Insolvency Act 2000.** The Act which introduced special **moratorium** arrangements for **small companies** whilst steps are taken to put in place a **CVA.**
- **Insolvency practitioner (IP).** A person authorised ('licensed') by one of the recognised professional bodies to act in **insolvency** matters, including the winding-up of a solvent company. **IP**s must pass an examination before they are able to apply for a licence.
- **Insolvent Partnerships Order 1994 (IPO 94).** Secondary legislation specific to partnerships in England and Wales.
- **Intensive care.** **Insolvency practitioners** are often appointed, either by companies or lenders, to assist a company outside any formal procedures in the hope of rescuing the company or business and avoiding **insolvency.** Also known as turnaround work, corporate recovery or workouts. This work need not be carried out by **IP**s but tends to be done by those who have a good working knowledge of **insolvency** and distressed businesses.
- **Interim liquidator.** A licensed **IP** appointed on the granting of a **winding-up order** in Scotland.
- **Interim order.** The first stage of an **individual voluntary arrangement,** a court order protecting a **debtor** from any **creditors'** remedies while arrangements are made to put a voluntary arrangement in place. Can be made for an initial 14-day period only but may be extended by the court, and will be extended if the court is satisfied following receipt of the **nominee's** report that a **creditors'** meeting should be held, to allow the protection from **creditors** to continue pending the meeting. Applies only to individuals, not companies. Under the **Insolvency Act 2000** an interim order is no longer essential where protection from **creditors**

is not required pending the meeting of **creditors.**

- **Interim Trustee.** A licensed **IP** appointed pending an award of sequestration, with powers to preserve (but not sell) the estate of an insolvent individual or partnership in Scotland.
- **IP.** See **Insolvency Practitioner.**
- **Joint estate.** The partnership property of an insolvent partnership in England and Wales.
- **Judgment.** (1) Recognition of a debt by a court. (2) Decision given by a court at the conclusion of a trial.
- **Judicial factory.** Little-used Scottish procedure for winding up estates, whether solvent or insolvent. Most commonly used for the estates of deceased individuals and on disagreements within, or dissolution of, partnerships.
- **Liquidation.** Process which eventually brings a company's existence to an end after distributing its assets to **creditors**/shareholders.
- **Liquidator.** The **Official Receiver** or a licensed **IP** appointed to wind up the affairs of a company.
- **LILA sequestration.** Low income, low asset sequestration. A route to **bankruptcy** for debtors who meet the prescribed criteria. **LILA sequestrations** are administered by the **Accountant in Bankruptcy**, who acts as the **Trustee** (Scotland only .
- **LPA receiver** ('Law of Property Act 1925' **receiver**). A person, not necessarily an **IP**, appointed to take charge of a mortgaged property or other asset by a lender whose loan is in default. In practice, this term is often (inaccurately) used interchangeably with **fixed charge receiver.**
- **Main proceedings.** A term introduced by **ERIP** for an **insolvency** proceeding carried out in the country of a company's **CoMI.** The proceeding extends to all assets within the EU except those subject to a **secondary proceeding.**
- **Member.** (1) In relation to an insolvent company, a member is a shareholder or subscriber. (2) In relation to an insolvent partnership in England and Wales, a member is any partner in the partnership.
- **Members' voluntary liquidation (or solvent liquidation).** Winding-up of a company which is able to pay its debts in full, together with interest. Surplus assets are distributed to shareholders **(members).** The **liquidation** must still be carried out by a licensed **IP.**
- **Misfeasance.** Breach of duty in relation to the funds or property of a company by its directors or managers, An **administrator**, liquidator or administrative receiver can also be liable for misfeasance.
- **Moratorium.** A suspension of **creditors'** legal rights to take action against a company or individual. A short moratorium will come into force where a company or its directors seek to appoint **administrators**, which continues once **administrators** are appointed and for a **small company**, to allow such a company time to reach an arrangement with its **creditors** for debt renegotiation or write-off via a **CVA.** For individuals seeking an **IVA**, a moratorium will come into force on the making of an **interim order.**
- **Nominee.** Title given to an **IP** acting in a **voluntary arrangement**, prior to the **creditors** approving (or rejecting) the scheme. Occasionally used in the non-technical sense (eg: 'ABC Limited is going for **administration** with Mr X as the nominee', meaning he is the proposed **administrator**).
- **Official Receiver.** A civil servant and also a court officer attached to the Insolvency Service (an executive agency of BIS). The **Official Receiver** is first on the scene in any **bankruptcy** or **compulsory liquidation** in England and Wales but not in any other form of **insolvency.** Not to be confused with **administrative receiver.**
- **Partnership voluntary arrangement (PVA).** A scheme of arrangement or composition in satisfaction of the debts of a partnership in England and Wales.
- **Pensions Act 1995, section 75.** Provision requiring the scheme's liabilities to be valued as the cost of securing all the members' benefits on an insurance company annuity basis; this will normally give rise to a higher deficit than on an ongoing funding basis.
- **Pension Protection Fund (PPF).** Provides compensation to members of eligible defined benefit pension schemes where there is a qualifying **insolvency** event in relation to the employer.
- **Pensions Regulator.** Created by the Pensions Act 2004, its role is to protect pension schemes and the Pension Protection Fund.
- **Pension scheme creditor.** Any defined benefit pension scheme will usually need to be considered as being a potential creditor of its sponsoring scheme in the event the employer enters **insolvency.**
- **Petition.** A document presented to the court to request the commencement of compulsory

liquidation or bankruptcy. The document used to request an administration order is now called an application.

- **Preference.** Commonly, when an insolvent individual or business has deliberately chosen to make sure that some **creditors** are paid to the disadvantage of everyone else. If the payments were made simply to better that **creditor's** position, then the **IP** may be able to recover and share the sum among all **creditors**. A typical example is a company repaying an unsecured bank overdraft in the run-up to **insolvency** because directors have personally **guaranteed** the bank's debt.
- **Preferential creditor. Creditor** given special rights as a matter of public policy, to be paid ahead of the ordinary **creditors.** Preferential status for certain Crown debts such as PAYE, NIC and VAT was abolished by the Enterprise Act 2002, and preferential debts are now (with some obscure exceptions) restricted to employees' claims for arrears of pay and accrued holiday pay, and unpaid pension contributions in certain circumstances.
- **Pre-packaged administration.** A deal to sell the assets of a failed company, agreed prior to **insolvency**, and then completed almost immediately after the appointment of **administrators** (or occasionally receivers).
- **Prescribed part.** Introduced by the Enterprise Act 2002, this is an amount set aside out of **floating charge** assets, to be made available to **unsecured creditors.** Only applies in insolvencies where there is a **floating charge** created on or after 15 September 2003.
- **Protected Trust Deed.** A **trust deed** that has complied with the conditions set out in Regulations 4 to 10 of the Protected Trust Deeds (Scotland) Regulations 2008. **Creditors** are prevented from taking further action to recover debts.
- **Provisional liquidator.** In England and Wales, on rare occasions, an **IP** or the **Official Receiver** may be appointed between the presentation of a **winding-up petition** and the court hearing. This is usually a 'caretaker' role, employed only where there is some perceived risk to the company's assets. The provisional **liquidation** route may be used to afford protection to the company trying to set up a **scheme of arrangement.** In Scotland, the appointment of a **provisional liquidator** is often sought at the time the **petition** is presented where the **debtor** company is continuing to trade, to preserve the company's assets and allow proper control of its affairs.
- **Proxy.** Document by which a **creditor** authorises another person to represent him at a **creditors' meeting.** The proxy may be a general proxy, giving the **proxyholder** a discretion as to how he votes, or a special proxy requiring him to vote as directed by the **creditor.**
- **Proxyholder.** Person holding a **proxy** given by a **creditor.** A limited company must either give a **proxy** to an individual (eg to an employee, or to the chairman of the meeting) or appoint a **corporate representative.** Proxyholders are also very commonly **IPs** who represent their clients at **creditors' meetings.**
- **R3.** The Association of Business Recovery Professionals is better known as R3 (standing for Rescue, Recovery and Renewal). It provides a network for **insolvency** professionals, represents the views of its members to government and the media, and provides information to members on **insolvency** technical and legal issues.
- **Receiver/receivership.** See **administrative receiver/receivership.**
- **Reservation of title (or retention of title).** Complex area of law whereby suppliers of goods try to frame their terms of business so as to retain ownership of the goods and give them a right to recover them if they are not paid for.
- **Scheme of arrangement (Scheme).** A compromise or arrangement between a company and its **creditors,** or any class of **creditors,** or its **members,** carried out under Part 26 of the Companies Act 2006. A useful rescue vehicle where **Insolvency Act** remedies are not available or not appropriate (eg until recently in relation to insurance companies, which had been excluded from the **administration** regime until 2002). It can be preceded by the appointment of an **administrator** or **provisional liquidator** to create a breathing space during which proposals can be drafted.
- **Secondary proceedings.** A term introduced by **ERIP** for a winding-up procedure which is under way in a European country other than that of the company's **CoMI** when there are also **main proceedings** in the country of the **CoMI.** Only assets situated in the country of the secondary proceedings are subject to the secondary proceedings.
- **Secured creditor.** A **creditor** with **security** over

some or all of the **debtor's** assets. In essence, he is paid before ordinary **creditors.**

- **Security.** A **charge** (which may be a **fixed charge** or a **floating charge**) or mortgage over assets taken to secure repayment of a debt. If the debt is not paid, the lender may have a right to sell the **charged** assets and/or the right to appoint a **receiver** (or **administrator**, if the charge is a floating charge over substantially the whole of the debtor's assets).
- **Sequestration.** Scottish word used for a personal **bankruptcy** under the **Bankruptcy (Scotland) Act 1985.** The process differs from an English **bankruptcy** in significant respects.
- **Shadow director.** A person who, although not a director of a company, gives directions or instructions which the directors are accustomed to following. A shadow director has all the obligations and responsibilities of any other director. Distinguished from a **de facto director**, as a shadow director does not hold himself out as a director to those outside the company.
- **Small company.** A small company for the purposes of establishing entitlement to a **moratorium** prior to seeking a **CVA** is a company which has two of the following:
  - Turnover of not more than £6.5 million.
  - A balance sheet total, ie gross assets, of not more than £3.26 million.
  - No more than 50 employees.
- **Solvent liquidation.** See **Members' voluntary liquidation.**
- **Statutory demand.** A formal notice requiring payment of a debt within 21 days, in default of which **bankruptcy** proceedings may be commenced against an individual by a **creditor** without further notice in England and Wales provided the debt is at least £750. In Scotland, **sequestration** proceedings may be commenced by a **creditor** without further notice provided the debt is at least £3,000. Alternatively, such a notice can be served on a company, and in default of payment **liquidation** proceedings may be commenced by the **creditor** without further notice in England and Wales or Scotland, provided the debt exceeds £750.
- **Supervisor.** Title given to an **IP** appointed in a voluntary arrangement, whether for an individual or for a company or partnership.
- **Trust deed.** An extra-judicial arrangement between a **debtor** and his **creditors** in Scotland whereby the **debtor** conveys (transfers effective title to) his assets to a **trustee** (who must be a licensed **IP**) for realisation and distribution to **creditors.** (See **Protected Trust Deed**).
- **Trustee.** Quite apart from its common usage (eg under the Trustee Act 1925) this is the term used for a variety of **insolvency** appointments including the **IP** appointed in an English **bankruptcy;** a Scottish **sequestration;** a **deed of arrangement**; a Scottish **trust deed** and an **administration order** in respect of the affairs of a deceased **debtor**).
- **TUPE Regulations.** The abbreviated term for the Transfer of Undertakings (Protection of Employment) Regulations 2006 (or the previous 1981 Regulations), under which employees of a company at the time of a business sale have their employment contracts automatically transferred to the purchaser.
- **Unsecured creditor.** Strictly, 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** invariably will also be unsecured. In any event, almost the last in the queue, ahead only of shareholders.
- **Voluntary Arrangement (VAs).** A **voluntary arrangement (VA)** is an **insolvency** procedure. It is a renegotiation, by a company **(CVA)**, or in England and Wales only partnership **(PVA)** or individual **(IVA)**, of the payments due to all of their **creditors**, or some other form of financial restructuring, and is subject to a **creditors**' meeting and vote.
- **Voluntary liquidation.** A **liquidation** initiated by the company, not one imposed by the court. It may be a **members' voluntary liquidation** (solvent) or a **creditors' voluntary liquidation** (insolvent).
- **VAT bad debt relief.** 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 on any debt unpaid for more than six months.
- **Winding-up order.** Order made by the court for a company to be placed into **compulsory liquidation.**
- **Wrongful trading.** When a company continues to trade beyond the point where insolvent **liquidation** becomes inevitable and further losses to **creditors** occur after that point. The directors may be personally liable for the losses unless they took 'every step' to minimise those losses. No criminal or fraudulent intent is necessary. (See also **fraudulent trading.)**

Section 3

Quick reference table

Procedure	Applies to	Appointor	Administered by	Objective	Typical results
Administrative receivership	Companies	Lender holding **floating charge security** over assets	**Insolvency practitioner (IP)** as **administrative receiver**	To recover lender's debt	Business sold as **going concern,** jobs may be preserved; or assets sold piecemeal
Administration	Companies Partnerships	(1) Court, on application by a **creditor**, the company or directors (or partners in the case of a partnership) or (2) **floating chargeholder** or directors or company can appoint out of Court (agricultural floating chargeholder or partners in the case of a partnership)	**Insolvency practitioner (IP)** as **administrator**	(1)To rescue the company, often by approval of a **CVA** or **scheme of arrangement** or (2) to achieve a better result for the **creditors** than if the company were wound up, or (3) to realise assets to make a distribution to secured or preferential **creditors**	Reconstruction of company / partnership (rare), or as above. If company is rescued it will be returned to directors, otherwise likely to go into liquidation or be dissolved following the administration
Accelerated M&A (AMA)	Companies Partnerships	Directors (can be at the insistence of shareholders)	Experienced corporate finance team	To sell the company or business and assets	Sale of business
Bankruptcy	Individuals (England and Wales)	Initially the Court	**Official Receiver; creditors** or Secretary of State may subsequently appoint **insolvency practitioner (IP)** as **trustee**	Realisation of assets to help discharge debts	Assets sold, bankrupt discharged usually within 12 months
Creditors' voluntary liquidation (CVL)	Companies	Shareholders' resolution (subsequently needs **creditors'** confirmation)	**Insolvency practitioner (IP)** as **liquidator**	Winding-up of an insolvent company	Company ceases trading and is wound up. Its assets are realised and distributed to **creditors** by way of a dividend
Company voluntary arrangement (CVA)	Companies	**Directors** appoint nominee. Subsequently **creditors' meeting** appoints supervisor	**Insolvency practitioner (IP)** as nominee and **supervisor**	To rescue the company	Achievement of restructuring plan (often preceded by the protection of **administration**)

Procedure	Applies to	Appointor	Administered by	Objective	Typical results
Compulsory liquidation	Companies Partnerships	Initially the Court	**Official Receiver; creditors** or Secretary of State may subsequently appoint **insolvency practitioner (IP)** as **liquidator**	Winding-up of an insolvent company/ partnership	Company ceases trading and is wound up. Its assets are realised and distributed to **creditors** by way of a dividend
Individual voluntary arrangement (IVA)	Individuals (England and Wales)	**Debtor** appoints nominee. Subsequently **creditors' meeting** appoints supervisor	**Insolvency practitioner (IP)** as **nominee** and **supervisor**	To enable an individual to agree proposals concerning his debts	An alternative to **bankruptcy** allowing the individual to settle his debts over time and/or pay less than the full amount
Partnership voluntary arrangement	Partnerships (England and Wales)	**Partners** appoint nominee. Subsequently **creditors' meeting** appoints supervisor	**Insolvency practitioner (IP)** as **nominee** and **supervisor**	To enable the partnership to agree proposals concerning its debts	If successful, formal **bankruptcy** of the partners and the winding-up of the partnership is avoided
Pre-pack	Companies Partnerships	(1) Court, on application by a **creditor**, the company or directors (or partners in the case of a partnership) or (2) **floating chargeholder** or directors or company can appoint out of Court (agricultural floating chargeholder or partners in the case of a partnership)	**Insolvency Practitioner** as **administrator**	To maximise realisations for **creditors**	Sale of business
Sequestration	Individuals and partnerships (Scotland)	Court, **creditors' meeting** may follow	**Accountant in bankruptcy** or **insolvency practitioner (IP)** as **interim trustee** or **trustee**	The realisation of the debtor's estate for the benefit of **creditors**	Objective achieved
Trust deed	Individuals, partnerships (Scotland)	**Debtor**	**Insolvency practitioner (IP)** as **trustee**	The realisation of the debtor's estate for the benefit of **creditors.**	Formal **bankruptcy** is avoided.

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