Director's Guide to Business Insolvency

Advice on Practical Issues and Suggestions

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Contents

For ease of use this guide is divided into 7 parts:

Part 1

Introduction

Insolvency practitioners take some very difficult professional exams in order to work in their chosen field. This guide would be 600 pages long if it covered the laws of liquidation comprehensively…

You might say, "well what chance have I got, as a normal Director who's just trying to drive a business and make a living, of understanding what constitutes insolvency and how rules operate?" Well, it's certainly true that if your company IS insolvent you're not likely to take the best detailed decisions without some specialist help.

So why this Guide

For Directors that are worried about falling foul of obligations and rules we have created this *"print off and keep"* Guide as a helpful Starting Point. It is designed to explain some basics for Directors that are worried about falling foul of their obligations

It's written in plain English and covers what we think you need to know, but, if there is a particular question you need answering, just telephone. We will be happy to chat through your particular problems in a friendly, "no-strings attached" way.

The Guide is also planned to assist your thought process at a time when you may not be "thinking straight…"

- It helps you decide if your company is insolvent
- It helps you work out what to do next and, crucially, what not to do so that you can steer clear of aggravation as far as possible
- It sets out what you have to pay to get the deal done
- It debunks a few pub myths in the FAQ section

Part 2

Is my Company Insolvent?

OK let's take a deep breath… here is what YOU have to consider... and we say you because, as Director, it is your legal responsibility…

Three Tests

Cash flow Test

Basically this test can be summarised as follows :

- Can the company pay its debts on the due date?
- If you are in arrears with VAT or PAYE/NIC payments then the company could be insolvent.
- If you are paying your trading partners later than agreed terms then the company could be insolvent.

Balance Sheet Test

Essentially this test can be summarised as follows:

On the face of the balance sheet of the latest management/financial accounts does it show that the company's liabilities exceed its assets?

If they do then the company could be insolvent.

When making this calculation you should adjust for:

- Contingent and potential liabilities not currently shown in the balance sheet
- Bad debts that should be removed from the trade and other debtor totals
- Obsolete and slow-moving stock that won't fetch the figure that it is carried at in the balance sheet
- Work in progress that you won't be able to finish / invoice / be paid for

Careful Note Even if the company is solvent on this basis, it could still be insolvent if it is failing the cash flow test

Judgment Test

In essence this test can be summarised as follows:

- Has a creditor obtained a County Court Judgment (CCJ) or issued a Statutory Demand against the company?
- Is any creditor threatening or actually petitioning to Wind Up the company?

If they are then – unless related claims can be immediately remedied - the Company is definitely heading for Insolvency.

Compulsory Liquidation - Petition to Wind Up the Company

This form of liquidation is usually commenced by a creditor and is dealt with by the Court and therefore not "Voluntary." Usually the creditor petitions the Court to wind up the company for unpaid debts. It isn't as quick a result for the creditor as you might think due to the fact that the Court has to deal with thousands of such applications (petitions) per year and Court time is limited. However as soon as the petition is advertised in the London Gazette, the company's bank account will customarily be frozen by the bank. Even if the debt is then paid the account will remain frozen until the advertised date of the hearing. This is because the Advert is effectively an invitation for all other creditors to join the action.

It is often beneficial for the Director to quickly place the company into Creditors Voluntary Liquidation (CVL). The CVL can then happen before there is time for the Compulsory hearing to occur, so that the Directors has direct control of the process.

Part 3

My company is insolvent!

What does this mean for me as a Director?

If your company has failed one or more of the above tests you should take Professional Advice right away .

This is because:

- By law, the Directors of the company should act and promptly deal with the insolvent company.
- The Director's duties flip from being owed to the Company and its Shareholders, to being owed to its Creditors.

There may be some **mitigating factors** which mean that the company isn't insolvent such as:

- There's additional capital or finance being injected to stabilise the balance sheet
- The company has a formal or informal arrangement with its creditors
- The company has realistic prospects of turning the corner e.g. it has a new acquisition or product that's going great guns
- You have taken advice and have a plan that says it's all going to work out fine

If you don't do what a reasonable Director would have done in your specific circumstances a number of unpleasant things that could happen:

- The Director may be accused of wrongful trading. It's a term frequently bandied about by disgruntled creditors, but its pursuit can often be averted by the right professional assistance.
- Disqualification from acting as a Director if you are unfortunate enough to attract the attention of Insolvency Service investigators.
- Dividends cannot be validly drawn, so money taken from the company could be treated as a loan and be repayable.
- Potentially becoming personally liable for the company's debts

Part 4

So what should I do now?

Initial Key Steps

- Take notes of any major decisions you make in case you are asked later. Remember that Insolvency gives you a duty to the Creditors.
- Meet with any other Directors, Shareholders and Management to discuss the situation – consider staff redundancy rules and notice requirements
- File all outstanding PAYE, VAT and tax returns, P11Ds etc with HMRC, regardless of whether they can be paid
- **Take early advice.** You are probably brilliant at doing whatever it is you do but can't know everything about insolvency. **Please call us. We will advise you, free and with no hidden obligations**

Creditors' Voluntary Liquidation (CVL)

This is the most likely route to discuss. The company stops trading and its assets are "liquidated" into cash. The company's liabilities, including staff and landlord liabilities are frozen and eventually written off less any dividend the creditors receive from the Liquidator. Whilst liquidation is "curtains" for the company the business of the company could survive in a new form. The liquidator may be able to sell it on to a 3rd party or even to you, should you wish to continue its trading.

The CVL process is started by the Directors deciding the company cannot go on and recording this decision. They then ask the shareholders to pass a resolution to liquidate the company.

When the shareholders of the company agree, the Directors ask a licensed insolvency practitioner to call a meeting of the creditors as soon as possible. The law says that you need to give creditors 7 days' notice of the meeting and that at least one of the Directors must attend the meeting to answer questions and help creditors understand what has happened.

Normally this meeting will be a ***Virtual Meeting (VM)*** by telephone, but creditors with substantial owings can sometimes insist on a subsequent attended meeting

The meeting of creditors votes to confirm the liquidator's appointment.

Once the liquidator is appointed you are free of your responsibilities as a Director. You are obliged to cooperate in answering whatever questions may arise from the Liquidator's own due diligence investigations or representations made to them by creditors. Largely, though, you are now free to get on with your new life/business.

You will be asked to fill in Questionnaire to provide information to the Insolvency Service. You also have to give the liquidator all the books and records of the company, either physically or by giving on-line access.

When all statutory work is finished the liquidator will finally dissolve the company

Part 5

What process will you need to complete

If you think that a CVL is the right thing for you and your company then here is the likely process that will be followed:

1. Call us to help you decide if liquidation is appropriate to the company's situation.

2. We review your financial and legal situation, to advise on having your affairs in best order before you formally cease to trade

3. Will assist you to appoint a Proposed Liquidator for your company who will :
   - convene a meeting of creditors
   - prepare a statement of affairs (the liquidation balance sheet of the company)
   - convene and manage the meeting of creditors
   - become the actual Liquidator so long as creditors confirm this

4. If appropriate we can appoint an independent Valuer to appraise any assets of the company. This is either at the company's, or Director's expense, but our group of Valuers keep these costs very low. Many Directors wish to buy back the company assets for use in their next project. Obviously, the price of used equipment, particularly where you are the previous owner, can compare favourably with buying new. If you don't need, or want, equipment the valuer will dispose of it for the benefit of the company in liquidation.

5 The Proposed Liquidator will of course need a fair amount of information and there are rules to follow: They will:

   (a) request a list of names, addresses and amounts for the creditors of the company so they can write to them all and invite them to the meeting and also compile the company's statement of affairs. Hopefully the creditors will stop contacting you directly at this point.

   (b) ask for other information relating to the company and he will give you a list of what he needs. These will be things like the books and records and minute book of the company (if there is one).

   (c) arrange for the company's shareholders to pass a resolution by a 75% majority to cease trading and liquidate the company and to nominate them to be liquidator. This resolution can be held at short notice if members agree but usually liquidators schedule a meeting for just before the meeting of creditors.

5 Creditors Meeting

The meeting of creditors normally takes place by telephone -a "Virtual Meeting" (VM). The company Director must attend and Chair the meeting (actually the Liquidator runs the show on the day and will guide you through the process). Creditors frequently do not attend the meeting even by phone and instead vote with a proxy post or email.

6 Once their appointment is confirmed at the meeting the Liquidator will:

- Sell the assets of the business to realise all possible monies
- Verify and agree creditor claims for amounts they are owed
- Distribute any dividends to creditors where possible
- Report on the conduct of the Directors to the Insolvency Service.

Part 6

And is there anything I should not do?

Here's a checklist of things you shouldn't be doing:

1. Ignore the situation and not take advice!
2. Try to strike a company off the record with unpaid debts
3. Liquidate a company that is actually viable, or can be restructured
4. Take on customer deposits or new staff
5. Take further credit.
6. Discriminate between creditors (pay one but not others)

Next Action?

To succeed – especially with Insolvency -"the Devil is in the Detail" !

So if - after reading this Guide -you think that a CVL may be the right path, feel free to ring and discuss you situation fully, in strict confidence and with no hidden obligations.

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Part 7

Some frequently asked questions

Q1 What are the main advantages of creditors' voluntary liquidation?

That's an easy one. The principal benefits are:

- avoiding the risk of "wrongful trading" claims
- the debt situation is crystallised so that the unsecured amounts owed to creditors are fixed as at the date of liquidation (good for all sides in the long run)
- peace of mind and an end to creditors pressing for payment
- the creditors have the satisfaction that the Director's conduct will be independently reviewed creditors know that the assets will be sold for true value and legally

Q2 What about the bank account? I think I guaranteed it! Wait a minute I may have guaranteed my trade accounts too!

Generally speaking the "veil of incorporation" means that the company's debts are the company's problem. In certain circumstances creditors will have reduced their exposure to bad debts by taking some form of security.

For example, if the company has borrowed money from a bank, it is very common to give some form of security. This is usually by way of a debenture, which will mean that their debt ranks higher in the order of priority than normal creditors, but it is often backed up with personal guarantees from the Directors.

Nowadays banks are extremely careful with about making sure personal guarantees are properly enforceable against the guarantor. Where the assets realised by the liquidator are not likely to be sufficient to repay the bank in full then the bank will probably seek to enforce the personal guarantee you have given for the shortfall. Banks will often negotiate and settle for less than the total liability and there are specialist advisors we can recommend to assist in this regard.

Q3 Do HM Revenue and Customs have any special rights compared to other unsecured creditors?

HM Revenue & Customs has special status as a creditor for some claims, which comprise taxes paid by customers and employees. These include VAT, PAYE and NIC deductions, student loan deductions and CIS payments. Technically failure to "correctly operate a PAYE scheme" is a criminal offence and on rare occasions Directors can face personal liability for amounts they have collected on behalf of HMRC and deliberately not paid over. Directors are generally unaware of this.

It may be important to realise that under the most recent rules preferential claims by HMRC rank ahead of claims secured by floating charges, such as bank loans backed up with debentures. Anyone who has given a personal guarantee of such a loan should be aware that assets in a liquidation will first be applied to pay outstanding taxes before the bank's charge applies. Also, where a Director has supported their loans to the company by a floating Debenture charge, their claim ranks after Employee entitlements for wages and holiday arrears and all HMRC claims except Corporation Tax.

In addition, HMRC can and often do take legal action to wind the company up for unpaid taxes. Even when trading has ceased, s and strike off action at Companies House can be blocked if it is believed that a tax liability is outstanding.

Although time to pay arrangements for accrued taxes will often be considered, if properly prepared, these can be burdensome on a company that is facing continuing difficulties and poor performance.

Most company Directors do not encounter this problem because the PAYE or VAT underpayments have not been allowed to build up for too many months and/or the debt is relatively small. However, the amount and proportion of tax debt in a liquidation or administration is a specific factor considered by the Insolvency Service in identifying potential director disqualification proceedings.

Q4 What if I sell the company assets to my brother-in-law for £100

Well if that's what they're worth then it is fine. If they're worth more, then, that would be, in insolvency terms, a "transaction at undervalue",

It probably won't surprise you know that it's a "bad thing" which can result in:

- The transaction being reversed
- Negative comments on the Director's conduct report
- It's a breach of Directors duty to the company and indicative of bad faith

It's a lot simpler and safer to buy the assets for fair value from the Liquidator, He will probably offer you deferred terms if you don't have the cash on the hip to buy them.

Q5 There are a couple of family members/suppliers/employees I want to look after…

This sounds like a preference. This occurs when a company pays a creditor, and by doing so makes that creditor "better off" than the majority of other creditors, before going into liquidation. The company has to want the creditor to be better off for this to be a problem, so, for example, paying under duress when somebody is threatening to remove goods might not be a preference. Desire to prefer is assumed in payments to connected parties (like family members).

We understand that certain suppliers or employees may be key to your next business, while others are not, and that, naturally, you want to make liquidation as painless as possible for them. Basically, what you do with your own money is up to you but you shouldn't use the company's money to "prefer" a particular creditor over the others.

It probably won't surprise you know that it's also a "bad thing," as in 7 above, which can result in identical consequences.

- The transaction being reversed and action against beneficiary
- Negative comments on the Director's conduct report
- It's a breach of Directors Duty to the company and indicative of wrongful trading

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Q6 I have sailed close to the wind on a few matters, you had better give me the low-down on wrongful trading.

Wrongful trading is basically where the Director(s) of the company failed to act as they should, when they knew (or reasonably ought to have known) that the company was insolvent. When a Director realises his company is insolvent he/she should:

- Take steps to protect the creditors' position, treat them equally too
- Not take further credit that will worsen the position of the company overall and that cannot be repaid
- Bring the HMRC and Companies House filings up to date as far as possible
- Document what they have done and why
- Seek advice

He/she shouldn't:

- Undertake transactions at undervalue
- Make preferences
- Draw dividends where there may not be reserves to cover them
- Take credit from suppliers where there is no "reasonable prospect" of paying them problems.

Just making a mistake does not result in wrongful trading unless you didn't act in good faith when making it.

Q7 There is, or soon will be, a petition to wind up (or liquidate) the company. Shall I just let it go through and save myself a few bob?

The company Directors don't get to choose and suggest who will be the liquidator following a Court winding up. Initially a government official called the Official Receiver (OR) will be appointed to deal with the company and, thereafter, the company's creditors, if they hold sufficient voting rights, can replace the OR with a liquidator of their choice.

Now theoretically it doesn't matter who is the liquidator of a company because they are all professional people, with the same duties, but many Directors feel more comfortable knowing that the liquidation is proceeding with somebody that they have spoken to and discussed their concerns with.

A compulsory liquidation can also be a lot more expensive than a CVL because the government takes a percentage of every realisation to help pay for the Insolvency Service. This means there can be less for creditors and, the fact is, a lot of Directors are actually creditors themselves.

Q8 Hang on, my accounts say that I owe the company some money.

If you have what is known in accounting circles as an overdrawn Director's current account it usually arises as a result of drawing funds in anticipation of dividends, often on the advice of the company's accountant. Only later does it transpire that, because the company is loss-making, there are insufficient retained reserves to actually declare the dividend.

We're not going to pull the wool over your eyes. You may have ended up with a serious problem.

An overdrawn Director's current account is:

- a potential exposure to personal and corporate tax
- repayable by the Director to the company in liquidation
- NOT a reason to not liquidate an insolvent company

If you can't afford to repay all of the debt then the liquidator will doubtless reach a settlement figure with you, particularly if you don't have many personal assets. The liquidator can do this because it is a sensible deal which is the best result for creditors in the circumstances.

Q9 I have been told that I can't be a Director again if I liquidate my company

Well that's not true either unless, of course, you have been disqualified from acting as a Director following the report on your conduct or made bankrupt as a result of any personal guarantees you have given.

Q10 Can we use the same name again?

There are a lot of sections of insolvency statute dedicated to this topic and setting out what is a prohibited name. The best way of dealing with this is to buy the trading style as in Question 1 above. After this there are a few notifications to deal with but they're not too stressful.

If you do use a prohibited name the sanctions are tough. Essentially you are committing a criminal offence which renders you liable to fine, imprisonment or both and you can become personally liable for the new company's debts.

Q11 A guy in the pub told me I can "phoenix" my business. What is that?

The liquidator has a duty to maximise realisations for the benefit of the company's creditors. This could be, if certain formalities are observed, by way of a disposal of the company's business and assets, including its trading style (name) to a connected party, including the Directors of the company in liquidation.

In order to protect the position of the Director, the liquidator and purchaser the assets being sold would be professionally valued so that everyone can be pretty certain that a fair price is being obtained.

In certain circumstances it may also be advisable to market the business and assets to ensure that there is no better offer available.

Whilst you can acquire a trading style as part of the acquisition, the actual company name should not be the same or similar to the liquidated company.

For example if your liquidated company was called Metro Widgets Ltd, and you traded as "Metro Widgets", your new company should not be called, for example, Metro Widgets (UK) Limited. You could, however, be Tablechair Limited T/as Metro Widgets once you acquired the trading style.

The price of the trading style would normally reflect that you are receiving the benefit of goodwill within the name and, for example, any advertising that "Metro Widgets" has out there which directs to the Director's mobile phone!

Generally speaking Directors also like to acquire the web site and domains which are also valued and realised by the liquidator.

Another point to consider is that by acquiring the former business you may be taking on certain employee liabilities. Employees are protected by a law called Transfer of Undertaking Protection of Employment Regulations (TUPE) and usually move to the new business purchaser who then has to decide whether to keep them or not. Neither www.voluntaryliquidation.london nor the Liquidator can give advice on employment law so we recommend you take your own legal advice before entering into a transaction where existing employees are transferred.

Any sums paid for company assets must be given to the liquidator or proposed liquidator and should not be paid into the company bank account.

Before embarking on a "phoenix," as this in known, you should also confirm that suppliers will continue to trade with you or that there are alternative suppliers available.

Q12 A bloke in the pub says I should strike off my company and keep the business and assets…

He doesn't sound like a trained insolvency professional. It's very likely that any attempt to dissolve the company through the Companies House process will be met with objections from creditors. As far as "keeping the business" is concerned that is, how can we put this, stealing from the company! You would be defrauding the creditors of the company. If you do get away with this you will spend the next few years looking over your shoulder wondering whether a creditor will restore your company to the register and wind it up. We are sure you can imagine what the liquidator of the restored company is going to think of how you acted! Why don't you just do the job properly in the first place? Liquidate it and buy the business for value.

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