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Global Restructuring & Insolvency Guide

England and Wales

Overview and Introduction

England and Wales have a number of insolvency and general company law procedures which can be used either to restructure a company and its finances or, where restructuring is not possible, to maximise realisations for creditors. This Guide contains an overview of the restructuring and insolvency regimes which exist in England and Wales.

Applicable Legislation

The insolvency regime in England and Wales is principally governed by the Insolvency Act 1986 and the Insolvency Act 2000 (together the "**Insolvency Act**") and their associated rules and regulations. Much of the detail of the formal insolvency regimes discussed in this Guide can be found in the Insolvency Rules 1986 (the "**Rules**"). Both the Insolvency Act and the Rules have been the subject of much amendment since they initially came into force. It is currently envisaged that the Rules will be replaced by the Insolvency Rules 2015. These are currently available in draft form but remain subject to further review. The amendments are not always easy for the uninitiated to fit into the scheme of legislation, and when reading either set of legislative rules care should be exercised to ensure that the most up-to-date versions are being referred to. This legislation governs both personal and corporate insolvency though only corporate restructuring and insolvency is dealt with in this Guide. The Insolvency Acts and the Rules contain the statutory provisions relating to:

- Company voluntary arrangements ("CVAs");
- Administrations (both court-based and out-of-court appointments);
- All types of liquidations ("winding up"); and
- Administrative receiverships.

In addition to the rules relating to these procedures, the Insolvency Act and the Rules detail the law relating to wrongful trading, fraudulent trading and other matters which affect officers of companies (including shadow directors; see below) who run into financial difficulty.

Some important provisions that need to be considered in relation to any restructuring are contained in the Companies Act 2006 (the "**Companies Act**"). In particular Parts 26 and 27 of the Companies Act contain provisions relating to the scheme of arrangement procedure. Since 2007 and the start of the credit crisis this procedure has become an increasingly popular mechanism for both UK and non-UK based companies to restructure their finances. It is explained in more detail below.

In addition to these procedures a brief description will also be given of how certain secured creditor remedies fit into the restructuring and insolvency marketplace as these can sometimes be useful in achieving the objectives of a restructuring plan.

In relation to the international aspects of restructuring and insolvency law in England and Wales there are numerous important legislative provisions. The Cross-Border Insolvency Regulations 2006 implemented the UNCITRAL Model Law on Cross-Border Insolvency and provide for the recognition of non-UK insolvency office-holders in formal insolvency proceedings initiated overseas. The European Regulation on Insolvency Proceedings, Council Regulation (EC) No 1346/2000 (the "**EU Insolvency Regulation**") is applicable throughout the EU (except Denmark) and provides for a comprehensive EU-wide recognition regime in relation to insolvency proceedings (but not certain security enforcement proceedings which do not provide for collective action). The EU Insolvency Regulation is dealt with in a separate chapter.

A volume of secondary legislation exists in relation to the financial markets, partnerships and certain industry sectors (e.g., investment banks, insurers, credit institutions, railways) which is beyond the scope of this Guide.

The Test for Insolvency

It is helpful at the outset to understand the basis on which a company is considered to be insolvent under English law as this can act as a trigger for the application of the legislation, for example, the law relating to directors' personal liability for wrongful trading.

A company is considered to be insolvent under English law if it is unable to pay its debts. Section 123 of the Insolvency Act 1986 contains a definition of inability to pay debts.

The first is the cash-flow test, under which a company is insolvent if it is proven to the satisfaction of the court that the company is unable to pay its debts as they fall due. Section 123 of the Insolvency Act 1986 sets out the circumstances where a company is deemed unable to pay its debts. These include the failure of the company to meet a statutory demand for a sum of more than £750. If none of the specific grounds for cash-flow insolvency are proven then it is still possible to adduce other evidence showing an inability to pay debts as they fall due. This usually means providing the court with the relevant accounting evidence based not just on past statutory accounts but also the current financial position of the relevant company. It can be difficult for third parties to gain access to such information.

The second is known as the balance sheet test for insolvency. Under this test a company is deemed unable to pay its debts where it is proven to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities taking into account its contingent and prospective liabilities. Establishing balance-sheet insolvency without access to all company records can be difficult if there is a dispute, for example, over the proper valuation of assets or liabilities.

Classes of Creditor − A Brief Summary

It is helpful in understanding what follows in this Guide if a brief explanation of the broad categories of priorities attaching to creditor claims in insolvency cases is given. The priority of a creditor's claim may be influenced by a number of factors that are dependent on the circumstances of a case. For example, the time any relevant security is created (e.g., before or after any other security), the manner of registration, the giving of notice or, in a few cases, the conduct of the creditor may all affect the outcome of a dispute as to priority. A detailed review of the law in this respect is not appropriate here, but outlining three broad categories of claim will help demonstrate how different types of claims are affected by formal insolvency processes.

A secured creditor is one who has a security over, or proprietary interest in, the debtor's assets which must be respected in any formal insolvency. Fixed charges, security assignments and legal mortgages are generally the highest ranking security that can be obtained. A floating charge is the next highest ranking. The floating charge's major disadvantage on an insolvency of the debtor is that unlike a fixed charge it is postponed to the claims of preferential creditors and the expenses of the insolvency office-holder. Additionally, a portion of floating charge realisations is also set aside as a fund to be paid to unsecured creditors. This is sometimes referred to as the "prescribed part" fund.

A preferential creditor is one whose claim is afforded a priority over a floating-charge-holder's claim to the proceeds of sale of floating charge assets and the general body of unsecured creditors. The claim ranks behind the claims of fixed-charge holders insofar as sale proceeds of assets subject to that fixed charge are concerned. The most important preferential claim is that owed to employees of the insolvent company in respect of unpaid wages and holiday pay up to a statutory limit which changes from time to time. Other categories of preferential claim are listed in the Insolvency Act.

Finally an unsecured creditor ranks behind the creditors set out above, but ahead of a shareholder's claim for the return of his capital.

Thus, in a liquidation, the order in which the insolvent company's estate will be applied is:

- Fixed-charge-holders' claims;

- Expenses of the insolvency;
- Preferential claims;
- Prescribed part fund (paid to unsecured claimants pro rata out of floating charge proceeds);
- Floating charge claims;
- Unsecured claims; and
- Return of capital to shareholders in accordance with their rights.

Corporate Restructuring and Insolvency

The following formal insolvency regimes exist for UK companies:

- Company voluntary arrangements;
- Administration;
- Administrative receivership;
- Liquidation; and
- Schemes of arrangement.

Company Voluntary Arrangements

The directors of a company or, if the company is in administration or liquidation, its insolvency officer can propose a company voluntary arrangement ("**CVA**"). If the directors intend to implement a CVA they will need the help of a licensed insolvency practitioner from the outset. The proposal is made to the creditors and the shareholders of the company. The CVA may compromise the debts of the company and is similar in its effect to a scheme of arrangement (described below in "Scheme of Arrangement"). Indeed, the CVA proposal often follows the format of the scheme document for a scheme of arrangement, particularly in cases involving large companies. Subject to certain restrictions, the legislation governing CVAs allows for considerable flexibility. They may be used in appropriate circumstances to protect or preserve the value of shareholdings whilst at the same time removing a considerable amount of unsecured debt from the balance sheet. An important difference between CVAs and schemes of arrangement is that to undergo a CVA a company must be insolvent. This is not necessary in the case of a scheme of arrangement.

Procedure

It is necessary to prepare a CVA proposal document with the assistance of a suitable licensed insolvency practitioner, known at this stage as the nominee. The proposal details how existing difficulties have occurred, how they are to be overcome and why creditors should be expected to approve what is proposed. The provisions of any CVA may be tailored to fit the circumstances, subject to certain statutory criteria as to content. Typically, an arrangement may propose an investment by an existing or new shareholder for working capital purposes, partial forgiveness of unsecured creditor debt and/or a commitment by the company to make payments from future profits into a CVA fund for subsequent division amongst existing creditors. The process of collection and distribution of the CVA fund (and/or any other management of the fund required by the CVA) is conducted by a licensed insolvency practitioner known as a supervisor once the CVA has been approved.

The meetings of shareholders and creditors must be convened on at least 14 days' notice. The proposals are considered at these meetings and approval may be given or modifications made. Typically the shareholder and creditor meeting will take place on the same day. The CVA needs to be approved by a simple majority of shareholders and by 75% in value (of those present at the meeting in person or by proxy and voting) of unsecured creditors; there is a further requirement that at least

50% of those unsecured creditors voting to approve the CVA should not be connected with the company.

Secured and Preferential Creditors

The rights of secured and preferential creditors cannot be affected by a CVA unless they give their consent. This can be an important issue and needs to be addressed early in the process of putting together a CVA.

Creditor Moratoria

Small companies whose directors are considering a CVA proposal (as defined in the Companies Act 2006) may apply for a moratorium on certain creditor rights. Such a moratorium may last for between one and three months. The moratorium would prevent enforcement of security and other creditor action being taken and is designed to give the company a breathing space in which to put together a viable CVA proposal.

For larger companies the moratoria applicable to small companies is not available. For this reason, in cases where it is desirable to hold off creditor action pending implementation of a rescue plan the choice can be made to shelter a proposed CVA under the umbrella of an administration, which does impose wide-ranging moratoria. This is discussed below in “Administration”.

Effect of Approval

If the CVA is approved by the required majorities of shareholders and creditors it becomes effective, thereby binding dissenters and those who did not vote, as well as those who did not receive notice of the meeting. The nominee will typically become the supervisor of the CVA and set about managing its implementation. If a shareholder or creditor believes that the CVA unfairly prejudices its position there is a procedure whereby it may apply to the court for relief. The courts have a wide discretion to tailor relief to fit the particular circumstances of an application, or in extreme cases to order that the CVA not be implemented despite the results of the meetings held. The fact that a CVA has been approved must be filed at Companies House, and anybody searching the register of companies will become aware of its existence.

Note that a CVA does not result in a court judgment which can be enforced or recognised in other jurisdictions. The EU Insolvency Regulation may assist a supervisor to be recognised in the member states of the EU. In other jurisdictions local law must be assessed and applications made, if possible, for recognition of the supervisor.

Implementation

The CVA proposal document will normally set out the scheme and timeline for implementing the CVA. It may contain detailed rules for the submitting and assessment of claims and may also provide for undertakings to be given by the company in respect of assets disposals, etc. It will also normally contain protective provisions for any supervisor. Criteria may be contained in the CVA proposal document that allow the supervisor to terminate the CVA if certain events occur or payments are not made.

Administration

Administration is a process which can lead either to the restructuring and eventual return to health of a company, or to it winding up after the realisation of its assets in a more efficient manner than would be possible under a liquidation or administrative receivership. An administration may run in parallel with some other procedures described in this Guide such as a CVA or a scheme of arrangement. Where a restructuring is considered it is likely that an administration will be used to impose a moratorium while a CVA, scheme of arrangement or pre-packaged sale is put in place. More is said about pre-pack administrations, which have become a popular restructuring tool, at the end of this section.

Application for an Administration Order

There are two separate routes for a company to enter into administration, but in both cases it must be established that a company is unable to pay its debts or, where the appointment of the administrator is by the holder of a qualifying floating charge (i.e., one which, together with other security, extends to the whole or substantially the whole of the relevant company's property), that the security has become properly enforceable.

An administrator may be appointed out of court by a company, its directors, or a holder of a qualifying floating charge. The appointment is made by filing, with the court, a notice of intention to appoint an administrator together with certain prescribed papers. The filing of these papers can be done very quickly in urgent cases, and there is normally no court hearing necessary for an order appointing the administrator.

Alternatively an application can be made to court for an administration order by directors, shareholders or a creditor of the company. In such cases a court hearing will take place on the merits of the application. In urgent cases the hearing can be expedited.

Moratorium on Creditor Rights

Once the notice of intention to appoint (the out-of-court route) or application to the court (the court route) is filed, an interim moratorium automatically comes into effect. This prevents a wide range of creditor enforcement action from being taken against the relevant company. Once the administration has commenced, the interim moratorium becomes a permanent statutory moratorium and prevents creditors from enforcing rights against the company without first obtaining the consent of the administrator or the leave of the court. It prevents the company from being wound up, security over its assets from being enforced or the goods held under leases or hire purchase agreements from being repossessed. The moratorium does not extend to the exercise of set-off rights although difficult questions may arise where steps need to be taken against the company before such rights become effective. In addition, the holder of certain qualifying floating charges or floating charges pre-dating 15 September 2003 may appoint an administrative receiver if he so wishes, which means he effectively has a right of veto over an administration. These rights are explained in more detail in "Administrative Receivership" below.

The moratorium subsists for the duration of the administration.

Purposes of the Administration

In all administrations the prospective administrator must file papers with the court that indicate his willingness to act and his opinion that the purposes for which the administration order is made are capable of being fulfilled.

The objective of an administration is primarily to try and achieve a rescue of the company. If that is not reasonably practicable, the aim is to achieve a better realisation of assets than would be effected on a winding up of the company; and only if that is not reasonably practicable, to realise assets in order to make a distribution to one or more secured or preferential creditors. At all times, the administrator has a duty to act in the best interests of the creditors as a whole.

Effect of an Administration

On appointment the administrator becomes responsible for the management of the company and the powers of the directors cease. The administrator has wide powers of management and disposal over the assets of the company. He may in certain cases sell assets used by the company but which it does not own, or which are subject to fixed security interests where this is required to maintain the viability of the business. The rights of the owner of the asset can be adequately protected in some other manner, for example, by payment over of the proceeds of a sale. The administrator also has access to the assets of the company which are subject to a floating charge (primarily stock in trade and possibly book debts) in order to fund the administration and pay his costs and expenses. The administrator has the power to cause the company to continue to pay the salaries/wages of employees. However if he subsequently decides that the company no longer requires the services of any individual, he will be able to dismiss that person, leaving only an unsecured claim in damages against the company which cannot be proceeded on unless the moratorium is lifted. (If the business is sold the relevant employees' rights may be enforceable against the purchaser under certain employment protection legislation.)

The administrator is obliged to convene a meeting of creditors as soon as reasonably practicable and no later than ten weeks after the company enters administration. At the meeting he must explain how he proposes to achieve the objectives of the administration. The creditors can vote to approve these proposals or suggest modifications. An administrator must act in accordance with the proposals or seek further approval from the creditors or in some circumstances directions from the court. The proposals put forward by the administrator at the meeting are normally general in nature, for example, stating that a scheme of arrangement will be put forward and outlining the broad parameters of the scheme.

When the objective of the administration has been achieved or 12 months after appointment, whichever occurs first, the administrator is obliged to vacate office. He may vacate office earlier if it becomes apparent the purposes for which the administration was made cannot be achieved. The initial 12-month duration of an administration can be extended once, for up to six months, by creditor consent or for longer time periods by the court upon application if necessary. If the administration succeeds in rescuing the company once the administration ends the company is returned to its directors and shareholders. If no rescue is implemented the company may be wound up after the administration has terminated.

Creditor Claims

An administrator is entitled in certain circumstances to distribute the proceeds of realisation of the company's estate to unsecured creditors. This can only be done where the court has granted permission. The central question will be whether it is in the best interests of all of the creditors. The claims of the unsecured creditors are determined under procedures laid down in the Rules. The administrator must set aside for distribution to the unsecured creditors a fund from the net proceeds of assets otherwise available to a floating-charge-holder (calculated on a sliding scale but subject to a maximum of GBP600,000 per company), unless the sums involved make it commercially impracticable to do so. If a distribution to creditors is to be made by an administrator, mandatory set-off rules apply under the Rules. These are similar to the set-off rules that apply in a liquidation. Alternatively, distribution may be through a CVA, a scheme of arrangement or a subsequent liquidation.

Expenses

The statutory order of priority of claims in an administration where a distribution to creditors is to be made is fundamentally similar to that in a liquidation (see below). Where an administration involves continued trading (unlike most liquidations) or incurs significant tax liabilities, it is possible that the amounts required to be paid to the administrator during the trading period (administration expenses) and which rank in priority to all claims except those of secured creditors with fixed charges will have a more material impact upon returns to other creditors.

Pre-Pack Administrations

Pre-pack administrations are a popular means of implementing a restructuring that involves the transfer of a business. Pre-packs are often used in cases involving a business with a large number of elements, only some of which are profitable. A pre-pack administration of the company enables a transfer of the profitable elements to a new company (with new funding arrangements) leaving the unprofitable parts of the business in the company in administration. Typically, the details of the transfer of the profitable elements of the business are negotiated immediately prior to the commencement of the administration with the prospective administrator's involvement. Immediately upon the making of the administration order – in most cases, pursuant to a court order – the administrator effects the transfer, allowing the business to continue in the hands of the purchaser with minimum dislocation. The administrator ordinarily obtains a court order before completing the sale to protect himself from claims that he improperly sold the assets of the company. The rationale for pre-packaged sales is that they allow viable businesses to continue, minimise dislocation to the business because the relevant asset transfers can be effected immediately and preserve value by facilitating a transfer without the associated stigma of insolvency, thereby resulting in greater returns to creditors in the long term.

Restructurings that require the transfer of business assets may use pre-packaged administrations, for example, to allow senior secured creditors to appoint an administrator to effect a transfer that will override the dissent of more junior creditors whose consent would otherwise be required. Directors of the company would be reluctant to effect a sale in such circumstances for fear of later claims for breach of duty.

In such cases the administrator and those planning the pre-pack will want to ensure they are able to justify any sale by having sound valuation evidence in hand, in case a claim by affected parties is made later. Administrators in such cases have to ensure that full disclosure of the circumstances surrounding the pre-pack sale is made at any creditors' meeting held later.

In the summer of 2012 the British government announced a review of the existing pre-pack regime. The Insolvency Service commenced a review in July 2013 and their report is expected to be published in Spring 2014.

Administrative Receivership

The ability to appoint a receiver is a remedy available to a secured creditor which becomes exercisable (subject to the statutory moratoria in administrations and small company CVAs) when the security becomes enforceable in accordance with its terms. It consequently differs from the other procedures discussed in this Guide in one fundamental aspect. Receivership is not a collective process involving all creditors, but one principally concerned with ensuring the greatest return to the secured creditor.

Types of Receivership

The two most common forms of receivership are administrative receivership and fixed-charge receivership (sometimes also called Law of Property Act or LPA receivership). A fixed-charge receiver is one appointed over a specific asset rather than the entirety of the assets of a company, for example, a specific freehold or leasehold property. Nothing more need be said about such receivers, who are most commonly encountered in property finance transactions and whose job is generally to sell the property.

Subject to the conditions set out below, a holder of a floating charge over substantially all of the assets of a company may, on invitation by the directors or default on the loan, be entitled to appoint an administrative receiver to that company. Like an administrator, an administrative receiver has very wide powers to manage a business, deal with employees and dispose of assets. He is usually able to keep the business intact for a period of trading during which he will try to find a buyer for the business as a going concern. Unlike an administrator (who acts in the interests of the creditors generally), an administrative receiver owes his primary duties to the secured creditor who has appointed him. An administrative receiver also owes duties to the preferential creditors insofar as any floating charge asset realisations are concerned, as such creditors have a claim on those assets.

Who Can Appoint an Administrative Receiver?

The holder of a floating charge which, together with other security, covers the whole or substantially the whole of a company's undertaking and was created *before* 15 September 2003, can appoint an administrative receiver. However, the general rule is that there may not be an administrative receiver appointed under such a floating charge if it was created *on or after* 15 September 2003 unless the circumstances fall within several restricted sets of circumstances laid down by the Insolvency Acts. These exceptions, set out in section 72A *et seq* of the Insolvency Act 1986, mainly relate to finance transactions including capital market transactions (e.g., securitizations), project finance, utility finance and finance transactions for social housing. Additionally, some of the exceptions require the relevant transaction under which the security is created to involve a loan of GBP50 million or more. The operation of the exceptions and the question of whether any transaction falls within them can be complex. These restrictions mean that administrations are more common than administrative receiverships outside of the specialised markets mentioned in the exceptions.

Where permitted, appointments of administrative receivers can be made very quickly either once a demand has been made under the relevant loan agreements or once a director has requested chargeholders to appoint an administrative receiver.

Conduct of a Receivership

An administrative receiver has wide powers of management and disposition, can trade the business if necessary to achieve a going concern sale, and can act very quickly. His primary duty is to his appointer, with whom he will liaise in relation to whether any offer for the relevant business is acceptable. Once the receivership is concluded any surplus proceeds in the hands of the receiver will be handed over to a liquidator. Receiverships and liquidations of the same company may run in parallel. In such cases the receiver has control of all of the assets falling within the scope of the security under which he is appointed.

Administrative receiverships have a very restricted role in restructurings aimed at returning a company to financial health. More often than not receivership leads to liquidation. In large groups, strategic appointments of receivers might be made, for example, to a parent company to enable a sale of shares in subsidiaries as part of a restructuring. For the most part, receivership is seen as an enforcement remedy and is too blunt a tool to be used in restructurings. It signals to the outside world that a company or group of companies has defaulted on a loan obligation and so is most likely insolvent. It also crystallises claims by preferential creditors, which have to be dealt with before the receivership ends.

Liquidation

Liquidation is a procedure which results ultimately in the termination of the existence of the company after distribution of its estate to its creditors and, if they are paid in full, a return of capital to the company’s shareholders. It is by far the most commonly encountered formal insolvency procedure in the UK. There are two types of liquidation in England and Wales: voluntary liquidation and compulsory liquidation. They differ mainly in the way they are initiated.

Procedure − Voluntary Liquidation

Voluntary liquidations can be either members’ voluntary liquidations or creditors’ voluntary liquidations. Members’ voluntary liquidations are possible only where all creditors’ claims will be paid in full within 12 months. Creditors’ voluntary liquidations require the company to be insolvent.

To start a members’ voluntary liquidation the shareholders pass a winding-up resolution and nominate a liquidator, who must be a licensed insolvency practitioner. As the company is solvent the directors swear a statutory declaration of solvency, i.e., a formal statement that its liabilities will be paid in full within 12 months. In a members’ voluntary liquidation the expectation is that all creditors will be paid in full so the directors may retain some ability to deal with the company’s assets if the liquidator agrees. This type of liquidation is generally used to restructure solvent companies in a tax-efficient manner and to terminate the life of companies that are no longer needed. It can be used to distribute assets *in specie* to shareholders under what are termed section 110 agreements.

Where no declaration of solvency can be sworn by the directors of the company because it is insolvent, a creditors' voluntary liquidation will be used. A shareholder resolution is passed that the company be wound up by reason of its inability to pay its debts and a members’ appointee initially takes office as liquidator. Before any creditors’ meeting is held the nominee has only restricted powers to deal with the assets of the company so as to preserve value. The resolution of the shareholders is the point at which the winding up starts. There must be a meeting of creditors (on the same day or within 14 days) at which the creditors will decide whether to ratify the nomination of the liquidator appointed by the shareholders or whether to appoint somebody else as the liquidator.

Procedure − Compulsory Liquidation

The appointment of a liquidator can also occur as a consequence of the directors, shareholders or a creditor filing a winding-up petition with the court. The petition must state that the company is insolvent or that it is just and equitable that it be wound up, and the petition must be verified by a statement of truth. A creditor whose claim is disputed on *bona fide* grounds may find its petition to wind up the company is rejected by the court. The petition is served on the company and certain other parties, including anyone who is entitled to appoint an administrator under a qualifying floating charge. The petition is advertised in the *London Gazette* and heard in court on an appointed date, which may be up to several months after the date it is presented.

Once the petition is presented, those dealing with the company must be careful. This is not just because the petition, once advertised, may damage the creditworthiness of the company with all the consequences that entails. The technical reason lies in the "doctrine of relation back" which is applicable only in the case of a compulsory liquidation. Even though a court makes an order on the winding-up petition some considerable time after the petition was presented (usually some six weeks later), the date on which the petition was presented is the date of the commencement of the compulsory liquidation. Any disposal of the assets of the company after the commencement of the liquidation is void unless validated by the court. Procedures exist for those who deal with companies in this period of hiatus to obtain court sanction for a transaction where it is desirable.

Ranking of Claims

The function of any liquidator appointed will be to agree the extent and validity of creditors' claims, realise all the assets of the company and distribute dividends to creditors. Where the company is insolvent, claims of creditors rank for dividend *pari passu* in accordance with the order of priority laid down by the Insolvency Acts. Below is a summary of the order of priority for claims in an insolvent liquidation:

- Holders of fixed charges, who receive all the proceeds of the assets subject to the fixed charges less the costs of realization;
- Expenses of the liquidation;
- Preferential creditors, who (subject to statutory maxima) normally comprise arrears of wages and salary payments to employees;
- Holders of floating charges, who receive the proceeds of the assets subject to the floating charge less agreed costs of the liquidation, the prescribed part fund and preferential creditor claims;
- Unsecured creditors, including any holders of security whose claims were not fully met by the net proceeds of the charged assets; and
- Shareholders, in accordance with their rights *inter se*.

The liquidator also has various powers to look into suspect transactions entered into by the company during various time windows prior to the commencement of the liquidation. These are discussed in "Clawback and Recovery" below.

Termination of the Liquidation

Once the claims of creditors have been agreed and a final distribution of dividends made, the liquidator may file his final return with the Registrar of Companies in order to effect the company's dissolution.

Scheme of Arrangement

A scheme of arrangement under the Companies Act is a formal court-sanctioned process that enables a company to implement a compromise or other arrangement between the company and its creditors, one or more classes of creditor, or its shareholders. Schemes of arrangement may be proposed by a company, its shareholders or its creditors outside of any formal insolvency process. If the company is in liquidation or administration the liquidator or administrator must propose any scheme of arrangement. A scheme of arrangement is often used in conjunction with the administration process so that the company enjoys the benefit of the statutory moratorium pending the scheme's implementation.

Procedure

An initial application to the court must be made for permission to convene meetings of shareholders and creditors. For these purposes, the applicant must identify the classes of creditor and shareholder in the company. Further the applicant must bring to the attention of the court any issues which may arise relating to the constitution, or as may affect the conduct of meetings of those classes. Classes are distinguished by the rights of those within them, which must not be so dissimilar as to make it impossible for them to consult together with a view to their common interest. This involves a comparison of their existing rights as if there were no scheme of arrangement, with the rights which they will have under the scheme. Following the court granting permission to convene meetings, details of the scheme and an explanatory statement are circulated amongst the classes.

For approval, the scheme requires votes to be cast in favour by a majority in number and representing 75% in value of those present and voting (in person or by proxy) in each class. Unlike a CVA, a scheme can bind dissenting secured and preferential creditors so long as the requisite majorities for approval are obtained. If the requisite majorities are obtained in the class meetings then the parties proposing the scheme go back to court for a second hearing to obtain the court's sanction for the scheme. At the sanction hearing, creditors who object to the scheme have a right to be heard on whether the scheme should be sanctioned. The court will sanction the scheme unless it is established by a party that there has been some procedural irregularity or the scheme is unfair in its treatment of a creditor or class of creditor. The procedure involving court hearings is time-consuming and can be expensive, taking several months to play out.

Effect of Sanction

Once the sanction order of the court is filed with the Companies Registrar the scheme is effective in accordance with its terms. Any dissenting creditors are bound by it. Additionally, any creditor who falls within the scope of the scheme will be bound by it even if he did not receive notice of the scheme and the meetings, provided this was not deliberate on the part of those proposing the scheme. For large, complex debt restructurings the scheme of arrangement has proven itself to be an extremely useful tool over the last several years. The reasons for this are numerous, but include the following:

- A scheme does not necessarily involve a formal declaration of insolvency with the potential to damage the business that entails;
- A scheme is very flexible and can be used in relation to all creditors or just one class of creditor enabling, for example, senior secured creditors to override obstructive junior secured creditors;
- A scheme can provide a tailor-made way to quantify claims that would otherwise prove difficult to value;
- Where there are large numbers of creditors, some of whose identities are not capable of being ascertained, the procedure is flexible enough to bind such creditors and so bring certainty to an otherwise uncertain situation; and
- Schemes can provide not just for the compromise of liabilities but also for the transfer of assets or assumption of liabilities, and this makes it possible to move assets or liabilities into newcos or SPVs as part of an overall scheme to restructure debt.

Careful thought needs to be given to how a restructuring will be implemented where it is necessary to enforce the terms of a scheme of arrangement outside of England and Wales. Some jurisdictions recognise schemes of arrangement under domestic recognition regimes. However, in many jurisdictions, including other EU member states, there is doubt as to whether schemes of arrangement can be recognised in the same way that a judgment of the English court can be recognised.

Overseas Companies

A growing body of case law has established that non-UK-registered companies can take advantage of the scheme of arrangement mechanism to restructure their affairs, provided there is some connection with England and Wales which allows the court to assume jurisdiction. Having assets within the jurisdiction or creditors whose debt is governed by English law will help satisfy the criteria for the court taking jurisdiction over a scheme proposed by a non-UK company.

Clawback and Recovery

The Insolvency Act provide liquidators and administrators with a number of powers to review transactions which have been entered into before the inception of the insolvency with a view to clawing back assets into the estate of the debtor for the benefit of creditors generally. Any party dealing with a company in the run-up to its insolvency or potential insolvency needs to consider the possibility that any transaction may be scrutinised by any appointed insolvency office-holder.

Transactions at Undervalue

In order for a successful challenge to be made, the administrator or liquidator, under section 238 of the Insolvency Act 1986, needs to satisfy the court that the insolvent entity:

- Was either insolvent at the time of the transaction or rendered insolvent by it;
- Made a gift to a person or otherwise entered into a transaction with a person on terms that provide for it to receive *no consideration or entered into a transaction for a consideration the value of which, in money or money's worth, is significantly less* than the value, in money or money's worth, of the consideration provided by the company; and
- The transaction was entered into within a period of two years prior to the commencement of insolvency proceedings.

If successful, the court can make an order to restore the position to what it would have been if the transaction had not been entered into.

A court cannot make an order if the transaction was entered into in good faith by the company for the purpose of carrying on its business and at the time there were reasonable grounds for believing the transaction would benefit the company.

Preferences

Under section 239 of the Insolvency Act 1986, a company gives a preference to a person if it enters into a transaction with a person (at a time when it is insolvent or becomes insolvent as a result of the transaction) and:

- That person is one of the company’s creditors or a surety or guarantor for any of the company’s debts; and
- The company does or suffers to be done anything which has the effect of putting that person in a better position, in the event of the company going into insolvent liquidation, than it would otherwise have been in.

A transaction is not a preference unless the company making the preference is motivated by a desire to prefer the recipient. This can give rise to difficult evidential problems for those involved in litigation relating to preferences.

Under the preference regime a liquidator may look back at transactions which took place within a period of six months prior to the appointment of an insolvency office-holder if entered into with an unconnected party, and two years if entered into with a connected party (other than an employee). “Connected party” is widely defined to capture most types of associates.

If the challenge is successful, the court may make such order as it deems fit in order to restore the position to what it would have been if the preference had not been given.

Floating charges

Under section 245 of the Insolvency Act 1986, a floating charge which is created in the year prior to the onset of insolvency (or the two years prior to the onset of insolvency where connected persons are involved) may be vulnerable to attack save to the extent new money or value was provided at the time or after the floating charge was created.

There are a number of other provisions under English law that deal with attempts by companies to defraud creditors and which provide remedies to victims.

Personal Liability of Directors

There are a number of provisions under the Insolvency Acts which provide for directors and shadow directors (i.e., those not formally appointed but pursuant to whose instructions the board acts) to be personally liable to contribute to the estate of the insolvent company where they are deemed not to have taken steps to minimise the damage done to creditors.

Note, however, that there are no rules relating to time limits within which a director who is aware of impending insolvency must file to initiate formal insolvency proceedings as in some other jurisdictions.

Wrongful Trading

This applies where a company goes into liquidation. The liquidator may apply to court for an order making a director liable to contribute personally to the company's assets if, at some time before the start of winding up the company, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation and that person was a director (actual, *de facto* or shadow) of the company at that time. Any order requiring a director to contribute will be of a contributory as opposed to penal nature and should reflect the degree to which the period of wrongful trading either depleted the assets or increased the liabilities of the company.

There is a defence to wrongful trading proceedings where the director can satisfy the court that he took every possible step to minimise the potential loss to the company's creditors.

For the purposes of the Insolvency Act 1986, the facts which a company director ought to know or ascertain, the conclusions he ought to reach and the steps he ought to take are those which would be known or ascertained, or reached or taken, by a reasonably diligent person having both:

- The general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company; and
- The general knowledge, skill and experience that that director has.

Directors whose companies are in financial difficulties will need to hold regular board meetings to consider the company's financial prospects and their reasons for any decision to continue trading.

Fraudulent Trading

Where the directors carry on a company's business with the intent to defraud creditors of the company or any other person, or for any fraudulent purpose, the court may on the application of the liquidator, declare that any persons who were knowingly party to carrying on the business in such a way will be liable to contribute to the company's assets as the court thinks fit.

The distinction between fraudulent trading and wrongful trading is that fraudulent trading involves dishonest intent. Fraudulent trading is a criminal offence.

Statutory Misfeasance

Where a director is found to have abused his position as trustee of the company's assets and has misapplied them in any way, the provisions of section 212 of the Insolvency Act 1986 allow a liquidator to pursue the director for restoration of the company's property, payment of the money involved or compensation.

Reports on Directors

Insolvency office-holders will write a report on the conduct of directors of insolvent companies. Where the report shows evidence of misconduct or breach of duty, the Secretary of State (not the office-holder) may take proceedings against that director with a view to disqualifying the director from being involved in the management of a company for the future.

Consensual Restructuring Agreements

Frequently, before resorting to formal insolvency proceedings, an insolvent company will try to enter into contractual compromise or standstill arrangements with its creditors, usually involving debt repayment or deferral. The advantages of a reaching a consensual agreement with creditors include avoiding the stigma and asset-value erosion of formal insolvency proceedings and the risk of losing all assets or having an ongoing business shut down. Consensual restructurings may also avoid triggering default provisions in contracts which are crucial to the continued viability of the business of the company.

Such consensual restructuring agreements, both temporary as in the case of standstill agreements, and permanent in the case of rescheduling agreements, are recognised under English law. Restructuring practice in England and Wales has developed numerous flexible responses to large, complex debt rescheduling involving parties in multiple jurisdictions.

Conclusions and Additional Observations

Some general observations can be made about insolvency and restructuring law and practice in England and Wales:

- The support of a company's major creditors is necessary if a company is to attempt a consensual restructuring. Key bank and any trade creditors with material amounts outstanding, whose debt will not be paid on time in full, need to be brought into the group of creditors who participate in any restructuring;

- Standstill arrangements can be put in place on a consensual basis, and such agreements will be recognized and enforced by the English courts. Where this is not possible but remains necessary, the moratorium imposed under the administration process may achieve the necessary breathing space for a company to implement a restructuring, although this involves an admission of insolvency which will be public information and a loss of control of management of the business to the administrator;

- The English courts are receptive to non-UK-based companies who wish to use the processes outlined above to assist in any restructuring. The threshold criteria that must be satisfied to engage jurisdiction are considered relatively easy to meet, particularly where assets or major creditors are present within the jurisdiction or credit agreements are governed by English law as is often the case where Loan Market Association documents are used for loan agreements; and

- The cross-border aspects of English insolvency law relating to recognition of other states' insolvency office-holders are well developed. For EU-based insolvency practitioners (except those in Denmark) appointed in collective proceedings in their home state, recognition is automatic under the EU Insolvency Regulation. For non-EU states the UK has implemented the UNCITRAL Model Law on Cross-Border Insolvency fully pursuant to domestic regulations passed in 2006.

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