LEWIS SILKIN

Insolvency FAQs

Inside

Introduction

In the current economic climate many of our clients are experiencing situations they've never had to deal with. We've put together the following guide to help answer the most frequently asked questions we receive.

What's the difference between a liquidator and an administrator?

Liquidators and administrators are qualified insolvency practitioners who preside over a particular form of insolvent scheme set down by statute.

Typically, an administrator will be running the business (at least temporarily) before selling it as a going concern. Conversely, a liquidator will usually not be trading – he will instead be selling assets and closing the business down before making distributions to the various creditors. It is not unusual for a company to transition from administration to liquidation and for the same insolvency practitioner to change hats and stay in office.

What does ROT stand for?

ROT stands for retention of title. ROT clauses are often found in supply contracts. They aim to allow a supplier to retain title to (or ownership of) goods until they are paid for.

ROT clauses require careful drafting to be effective. Problems may arise if a clause attempts to entitle a seller to the proceeds of onward sales. This is because the clause may be construed as having created a floating charge - which would be void if the contract is not registered at Companies House.

A well drafted clause will ensure that goods will not be part of the buyer's assets until fully paid for. This means that if the buyer goes into insolvency before paying for the goods, it may be possible to recover the goods from the insolvent buyer's premises. However, there remain practical hurdles such as being able to identify the relevant goods and ensuring they are not mixed with other identical goods.

Should I carry on supplying to a company in administration – will I still get paid?

An administrator will not be responsible for the debts incurred by the insolvent company prior to his appointment. These are debts you will need to claim for as an unsecured creditor during the administration process. A refusal to pay debt may allow you to terminate your contract and refuse further supply. There may be options to terminate either for insolvency (contractual provision) or for fundamental breach (or renunciation). There can be a significant difference in the damages available depending on the basis chosen.

If you choose to supply goods or services to an administrator who continues to trade the business whilst in administration, the cost of those goods or services will be classed as an expense of the administration. This is significant as you will be paid from the company's assets first, in priority to pre-existing debts (and the administrator's own fees).

For this reason it is quite common to continue supplying/dealing with a company after it has gone into administration. Nonetheless, it is always wise to seek payment from the administrator on or before delivery.

If you have been paid for services or goods (i.e. the customer has fulfilled their side of the contract), a refusal to abide with your part of the agreement usually amounts to a breach of contract, depending on its terms. In these circumstances it is quite likely that the administrator will, on behalf of the company, seek to enforce the agreement. This may result in proceedings being issued against you.

When should I stop trading if I think that my company's finances or cashflow have deteriorated?

This is often a finely balanced call.

If a director of a company continues to trade a company and incur debt/liability in the company's name when he knows or ought to have concluded that there is no reasonable prospect of the company avoiding insolvent liquidation, this may amount to wrongful trading. This brings a risk of personal liability for creditor losses.

Historically, only liquidators had the power to bring proceedings for wrongful trading but administrators now also have the same power where the relevant dealings arose on or after 1 October 2015.

The way to minimise the risk of a wrongful trading claim is to show you have taken every step with

a view to minimising loss to creditors. Depending on the circumstances, this may involve ceasing to trade. You should be aware that simply resigning as a director will not, by itself, get you off the hook.

I'm a director – do I have personal liability for company debts?

As a general principle, directors of a company are not personally liable for a company's debts. However, if a director has given a guarantee in respect of company liabilities, he or she may have to make a payment under the guarantee in the event of the company's insolvency.

A director may also be liable for "wrongful trading" (see above). If this is the case, a court may order them to make a payment to the company, quantified by reference to the additional losses suffered by creditors over the period of the wrongful trading. Court action may be followed by separate proceedings seeking to disqualify the director from acting as a company director for a period of between 2 and 15 years.

In extreme circumstances, a director may be liable for the criminal offence of "fraudulent trading" if he or she carries on business with the intention of defrauding the company's creditors. This has the same penalties as wrongful trading and may also result in an unlimited fine and/or imprisonment for up to 7 years.

In recent years there has been a notable development in this area. Wrongful trading claims and fraudulent trading claims (or the proceeds of those claims) can now be assigned by a liquidator or administrator. This may be significant because the particular assignees (who may be creditors or shareholders for example) may be better resourced and/or have a greater appetite to pursue claims in satisfaction of sums they have lost.

Should I request a physical creditors' meeting?

Since 6 April 2017, office holders have no longer been required to summon physical meetings of creditors unless requested by to do so by either 10 per cent of the creditors in value, 10 per cent of the total number of creditors or 10 individual creditors.

Creditors meetings are an opportunity to obtain information from the office-holder and voice objections to the conduct of the insolvency process.

In a liquidation the first creditors' meeting is usually to approve the appointment of the liquidator and to agree his or her terms of remuneration.

Since liquidators have duties to the creditors as a whole and the level of their remuneration is regulated, often there may be little to be gained in requesting a physical meeting. In an administration you may have questions about how long the process will take, whether the administrator is interested in selling all or part of the business to you or whether he has had specific interest from others, or where certain assets have gone. A physical meeting may represent a good chance to meet the office holder personally, and press for information. In that sense it can be a good opportunity to obtain more complete information or to put requests for particular investigations regarding company assets on the record.

I'm owed money by a distressed company – can't I just protect myself by obtaining security?

If you are owed money by a company experiencing financial difficulties, it may be too late to get valid security.

If the company has already granted security to its bank, the bank will need to consent to new security and it may be unwilling to do this. Even if you are granted security by the company, that security is vulnerable to being set aside by the court on a later application from liquidators or administrators if it was granted in exchange for "prior consideration". More particularly, a floating charge on the company's property may be set aside as invalid if it is:

- given in exchange for "prior consideration";
- granted in the 12 months before commencement of the company's liquidation or administration (or two years if it is granted to a connected person); and
- the company is insolvent at the time, or became insolvent as a result, of the transaction. Note that this last requirement is not necessary where the parties are connected.

In addition to this risk, an administrator or a liquidator might also challenge the grant of security as a preference. In outline, a preference may arise where a company acts in a way which benefits a creditor, surety or guarantor by putting it into a better position than it would have been in the event that the company becomes insolvent and, in acting as it did, the company was influenced by a desire to produce that outcome. Where there is a connection between the parties, it will be presumed that there was such a desire. The office holder is able to look back at transactions which took place 6 months before the onset of insolvency (rising to two years where the parties are connected) but he will need to establish that the company was insolvent at the time of the transaction (or became so as a result of it).

Under the terms of my contract, copyright doesn't pass to the client until it has paid me. I haven't been paid so can I stop the client using the work we supplied – if so how?

Yes – you can stop them using the work you supplied.

You can get your legal advisors to write to them, putting them on notice of your rights in the work and of the fact that they have no rights to use the work (and are, in fact, infringing your copyright by using the work), until they have paid all outstanding amounts in full.

You may wish to consider threatening to issue legal proceedings:-

(a) for breach of contract for failure to pay monies owed; and

(b) for copyright infringement if they use your work without permission.

You might also threaten to apply to the court for an interim injunction to prevent them from using the work, until all monies have been paid. This will often be sufficient to get the client to pay. However, if it does not have the desired effect, you may then need to act on your threats and issue proceedings.

Who controls the company when it is insolvent?

The directors will continue to manage the company's affairs until a formal procedure to put the company into administration or liquidation gets underway. Sometimes creditors are concerned by the way in which the company is being managed. In urgent cases it is possible to apply to the court for a provisional liquidator to be appointed, so that assets and value can be preserved and/or protected before a formal process starts.

If the company goes into administration, an administrator will be appointed who will have wide powers to carry on the company's business and realise its assets. The administrator can remove any of the directors from office and can appoint new directors to the company. The directors cannot exercise any management powers without the consent of the administrator. An administrator is an officer of the court who must carry out his functions in the interests of all creditors and not prefer one creditor over another.

In an insolvent liquidation the board are dismissed automatically and control shifts entirely to the liquidator who has a number of statutory powers to enable him to fulfil his duties. A liquidator may pay any class of creditor in full, sell any of the company's property, execute deeds or documents in the name of the company, raise money on the security of the company's assets and do all things necessary to wind up the company's affairs and to distribute its assets.

Where does my debt stand in the creditors' queue?

It depends what sort of debt you have.

If your debt is secured by a fixed charge, you will take priority and will be paid out of the proceeds of disposal of the asset(s) subject to that charge, before the remaining proceeds are passed to the creditors as a whole.

If you are an employee and are on a salary, you will have preferential status for part of the sums owed to you up to a set maximum (further information appears later in this guide). This means you will be paid (at least for that element of your claim) in advance of the general body of creditors, but after creditors with debts secured by a fixed charge.

If you have a floating charge over various assets broadly speaking this will mean you are next in the queue after the preferential creditors (such as employees) and will be paid from the proceeds of disposal of the assets subject to the floating charge.

If you are an ordinary unsecured creditor you will rank alongside all other unsecured creditors at the bottom of the pile, just above the company's shareholders. Each of you will be paid a proportion of what is owed to you by reference to the sums available to the liquidator or administrator. Statistically the average recovery for unsecured debt is very poor.

Will I get paid if my employer goes bust before pay day?

It depends how much money is available in the insolvency. For some amounts, employees rank above ordinary creditors, but only up to a total of £800 plus any accrued holiday pay. If any further money is owed employees rank as unsecured creditors, towards the bottom of the pile. In practice, the employees' chances of getting all money owed to them are slim.

If your employer goes into administration then you may be kept on as an employee by the administrator who will continue to pay you until the business is sold or you are made redundant.

You may find yourself redundant immediately in which case you have some protections even if your employer is no longer in a position to pay you. The government steps in to offer a degree of support through the National Insurance Fund:

- All payments from the National Insurance Fund are subject to a weekly pay limit and an overall cap of £4,304 from 5 April 2020.
- You can claim the redundancy payment you would normally have been entitled to from your employer. However, if your contract of employment entitled you to more than the statutory minimum, you will not get that extra amount from the National Insurance Fund.
- If you are owed arrears of normal pay from your employer at the time it becomes insolvent, you can claim that. In addition to the caps mentioned above, your entitlement is limited to eight weeks pay in total.

If your entitlement exceeds the limits imposed by the National Insurance Fund, you will need to lodge a claim as a creditor for the shortfall. This will be treated as one of the debts the company owes and you will rank as an unsecured creditor.

Will employees lose their jobs?

One of the first things the liquidator or administrator will have to decide is whether or not to keep on some or all of the workforce. They may, for example, retain key staff necessary to continue the business in the short term before it is wound up. Alternatively, they may retain staff working in a healthy part of the business if they think that part could be sold on as a going concern. In many cases though, employees do lose their jobs if insolvency proceedings are commenced.

Can employees get help elsewhere?

Often employees cannot take legal action against the insolvent employer to recover their losses or if they are dismissed. Once a company is put into administration from that point on a legal stay is imposed, preventing employees (or indeed any creditors) from bringing or continuing claims.

But in most insolvency situations, the state guarantees certain employee payments, such as notice pay and statutory redundancy pay, out of the National Insurance Fund. Employees should apply on Form RP1 to the Redundancy Payments Office. Again this is not as good as it sounds, but is often the best hope. Payments are capped (see above) and any payments received are subject to tax and National Insurance Contributions.

Can I buy an insolvent business from an administrator or liquidator?

Yes. But care is needed.

Usually when you are buying a business you can be certain that the person selling it to you

actually owns it and you will get the benefit of warranties from the seller. However, you will not get the same assurances as to title and nor will you get any warranties when buying assets from an administrator or liquidator.

Also, there are potentially complex issues around the workforce so, whilst you may be tempted to snap up all or part of an insolvent business, you need to consider the risk of inheriting unwanted employees.

Special rules known as TUPE govern what happens to employees in businesses which are acquired by other businesses or where a particular part of a business is taken over by another business.

If TUPE applies, employees of the business (or part of the business) being sold automatically transfer across to the buyer on their existing terms and conditions of employment. The buyer is obliged to honour these terms and cannot simply alter them to harmonise with its existing business.

It will be an unfair dismissal if the buyer seeks to dismiss an employee or not to take employees on merely because they have transferred from the insolvent business. This may deter potential buyers.

To reduce the impact of TUPE in "non-terminal" insolvency proceedings which are started with a view to carrying on the business as a going concern (typically administration), changes are allowed to the employment contracts where agreed with employee representatives, provided the changes are designed to safeguard jobs by ensuring the business survives. The buyer in this situation also benefits from not assuming liability for those employment debts of the insolvent business which are guaranteed by the state. This is a tricky area and it requires expert advice.

For further information on this subject please contact:

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