A short guide to English corporate insolvency procedures

Administration

Overview

- Administration is a process typically used further down the decline curve from schemes of arrangement, restructuring plans and company voluntary arrangements but up from liquidations.

- Upon a company entering administration, the directors' powers effectively cease and the company comes under the control of a licensed insolvency practitioner who acts as administrator.

- It is designed to be a short lived procedure to ring-fence the company from enforcement action whether by secured or unsecured creditors while the administrator implements proposals to either (i) rescue the company as a going concern; or (ii) achieve a better realisation of the company's assets than if there were an immediate winding-up (as to which procedure see below); or (iii) realise the company's assets for the benefit of its preferential and secured creditors. This is a waterfall of purposes with the administrator required to consider whether the first can be achieved before moving on to the next. The first purpose of a rescue of the company as a going concern is in practice rarely achieved but the company's business can often be saved by means of a sale of the business and assets of the company to a purchaser.

Entry routes to administration

- An administrator can be appointed to a company either by the out of court route of filing of notices at court or by application to court for a court order.

- The out of court route can be used by the company, its directors or a holder of a qualifying floating charge ("**QFC**") which is - simplifying somewhat for ease of exposition - a floating charge that extends over the whole or substantially the whole of the company's property. The court route can be used by an unsecured creditor of the company as well as all the persons who can use the out of court route.

- The two main conditions for any administration instigated by the company or a non QFC creditor are that:

    (a) the company is or is likely to become unable to pay its debts; and

    (b) the proposed administrator is of the opinion that the purpose of the administration is reasonably likely to be achieved.

- For an administration instigated by a QFC holder, the condition in (b) above must be satisfied but the insolvency requirement in (a) above does not need to be satisfied. Instead it is sufficient for a QFC appointment that the QFC has become enforceable even if the debtor company is solvent.

The course of the administration

- Administration is a collective insolvency process and the administrator is under a duty to act in the best interests of the creditors as a whole. Historically, QFC holders appointed administrative receivers rather than administrators. Administrative receivers differed from administrators in that their duties were primarily owed to the QFC holder and not the creditors as a whole. This was considered to be unfair on the other creditors whose outcomes were typically very poor in administrative receivership and so the Enterprise Act 2002 effectively replaced administrative receivership with administration for QFC holders. It is still however possible for a charge holder with a fixed charge or a floating charge that does not extend to the whole or substantially the whole of the company's property to appoint a receiver: see receivership below.

- A "pre-pack" is an administration through which the business and assets are sold by the administrator immediately on the company's entry into administration to a purchaser on terms that were arranged by the administrator before they were appointed. This helps preserve value as it minimises the erosion of value that occurs by reason of the insolvency being known to the world. It is controversial however in that such sales occur usually without the administrator having fully tested the market (as testing the market fully would notify the world and erode value) and without creditor approval, with the administrator essentially seeking the consent of the creditors only after the deal is done and the horse bolted.

Statutory moratorium

- An administrator has the benefit of a wide moratorium that prevents enforcement action being taken against the company and its property not only by unsecured creditors but also by secured creditors unless the consent of the administrators or the court is obtained. In this way administration differs from compulsory liquidation in that in compulsory liquidation the moratorium does not prevent enforcement action by secured creditors.

- The moratorium does not alter a counterparty's substantive rights; it merely means that the enforcement of those rights is suspended.

Company Voluntary Arrangement ("CVA")

Overview

- The CVA is a rescue procedure commenced by the directors of the company by making a proposal to be voted on at meetings of the company's shareholders and creditors. The CVA can also be commenced in an administration or liquidation at the instigation of the administrator or liquidator but this is rare. Typically CVAs are proposed further down the decline curve from schemes of arrangement and further up the decline curve from administration and liquidation.

- There is little in the Insolvency Act 1986 as to the form the CVA must take. It is possible for a CVA to deal with unsecured creditors in different ways. However, the CVA must not unfairly prejudice the interests of any creditor and cannot affect the rights of secured creditors to enforce on their security nor affect the priority of payment of preferential creditors without their consent.

- The CVA procedure is largely an out-of-court process limited to filing various documents. This means that a CVA is often a simpler, lower cost form of restructuring. There is no requirement that the company be insolvent.

What constitutes approval at the meetings?

- Approval by the shareholders requires a simple majority in value of those present and voting.

- Approval by the creditors requires (a) at least 75% (by value) of the company's unsecured creditors who vote, provided that (b) not more than 50% (by value) of the unconnected creditors vote against it.

- All unsecured creditors have a vote, including those whose debt is not being compromised. Contrast this with a Scheme under which only affected creditors vote and in 'classes' of creditors with not dissimilar rights; a CVA is a much blunter instrument.

- In recent years CVAs have been widely used by retailers seeking to compromise their landlord liabilities usually on terms that other creditors are paid in full. This has caused some controversy given that, unlike with Schemes, creditors are not divided into classes and a CVA compromising landlord liabilities can pass on the votes of non landlord creditors subject to the requirement that the CVA is not unfairly prejudicial to landlord creditors, which requirement is detailed further below.

Debtor in possession but with IP oversight

- Unless the CVA commences in an administration or liquidation, the company will remain in the control of its directors throughout the duration of the CVA. Unlike a Scheme, however, the CVA proposal must nominate a licenced insolvency practitioner to act either as trustee of the CVA or otherwise for the purpose of supervising its implementation.

Moratorium on approval of CVA

- The CVA itself will also usually contain a moratorium on unsecured creditor actions but this cannot prevent secured creditors from taking enforcement action under their security.

Challenge?

- A creditor or shareholder has standing to apply to court to challenge the CVA on the grounds either:

  (a) that the CVA unfairly prejudices the interests of that creditor or shareholder; or

  (b) that there has been a material irregularity at either of the meetings.

- As regards what may constitute unfair prejudice, there is no universal test but the courts have emphasised the importance of the so-called "vertical" and "horizontal" tests:

  (a) A vertical comparison is a comparison between the creditor's entitlement in the CVA and in a hypothetical liquidation. The CVA should not result in a worse outcome for any creditor than in a hypothetical liquidation.

  (b) A horizontal comparison is a comparison between the position of the applicant and other creditors within the CVA. The fact that a CVA involves differential treatment of creditors is a relevant factor, although it will not automatically render a CVA unfairly prejudicial.

- The court has at first instance held that retail CVAs which compromise landlord creditors while other creditors are paid in full is not inherently unfairly prejudicial to landlords provided their rights to forfeiture are not varied by the CVA. This judgment is currently being appealed to the Court of Appeal.

Liquidation (also known as winding up)

Overview

- Liquidation is the process by which a company is wound up prior to its dissolution under the control of a liquidator.

- There are three types of liquidation:

    (a) Members' voluntary liquidation. This is an out of court process instigated by the directors where the company is solvent.

    (b) Creditors' voluntary liquidation. This is an out of court process instigated by the directors where the company is insolvent.

    (c) Compulsory liquidation. This is a court process usually instigated by an unsecured creditor presenting a winding up petition against the company at court.

Entry routes to liquidation

- In both a CVL and an MVL the directors call a meeting of the shareholders to vote on whether the company should go into MVL and to nominate their choice of liquidator. To pass at least 75% of voting rights cast must vote in favour. In a CVL there is then a creditors' meeting which cannot reverse the decision to go into CVL but can replace the liquidator nominated by the members with their own choice of liquidator.

- A compulsory liquidation is usually instigated by an unsecured creditor petitioning the court. The creditor is required to show that the company is unable to pay its debts which can be shown in one of four ways:

    (a) the company has failed to pay a statutory demand (a formal demand in a specified written form) for the debt within 21 days;

    (b) execution or other enforcement process carried out pursuant to a court judgment for the debt has been returned unsatisfied in whole or in part;

    (c) the debtor is unable to pay its debts as they fall due (the so-called cash flow test); or

    (d) the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities (the so-called balance sheet test).

The course of the liquidation

- As with administration, liquidation is a collective insolvency process and the liquidator is under a duty to act in the best interests of the creditors as a whole.

- The liquidator has limited powers to continue trading the business. The administration procedure detailed above is usually more appropriate than liquidation where ongoing trading is contemplated. Instead in all three types of liquidation, trading will ordinarily cease and the liquidator will seek to realise the company's assets to make a distribution to creditors and, in the case of the solvent MVL, to shareholders.

Statutory moratorium

- A compulsory liquidator has the benefit of a moratorium that prevents enforcement action being taken against the company and its property by unsecured creditors. This moratorium is however narrower in scope than the moratorium for administration in that it does not prevent secured creditors from taking enforcement action.

- There is no automatic moratorium in an MVL or CVL but the liquidator may be able to avail themselves of a moratorium of the same scope as in a compulsory liquidation by means of an application to court.

Receivership

- Receivership is a form of security enforcement available to certain secured creditors where the security has become enforceable. As already noted above in the entry on administration, historically, QFC holders (ie the holder of a floating charge that extends over the whole or substantially the whole of the debtor's property) could appoint administrative receivers. For QFC security granted on or after 15 September 2003, administrative receivership has been replaced with administration. The possibility of appointing receivers remains however for fixed charge security, and for floating charge security that does not extend to the whole or substantially the whole of the debtor's property.

- The appointment of a receiver ordinarily does not require the involvement of the court but is a contractual appointment started by demand under the facility and followed by a Notice of Appointment sent by the charge holder to the proposed receiver who must accept the appointment by the close of the following business day for the receivership to take effect.

- While increasing costs, the appointment of a receiver has an advantage over the mortgagee going into possession itself as a receiver acts as an agent of the debtor company not the mortgagee thus reducing liability risk for the mortgagee. Notwithstanding this agency relationship, the principal duty of the receiver is owed not to the chargor or its creditors but to the chargee who appointed them.

Scheme of Arrangement ("Scheme")

- A Scheme is a mechanism contained in Part 26 of the Companies Act 2006 by which a company can agree a compromise or arrangement with its members or creditors or any class of them.

- It can be utilised by both solvent and insolvent companies. Even in an insolvency scenario, the Scheme is usually used further up the decline curve than the Insolvency Act 1986 procedures described above, at the instigation of the company itself with the directors remaining in control of the company throughout.

- It can however be instigated by a member or creditor and can even be instigated within administration or liquidation by the administrator or liquidator.

- The persons affected by the Scheme are divided into classes and to be approved the Scheme must receive the approval of each affected class, in each case 75% by value of the members of that class and majority by number of that class. A class must be "confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest". There has been a large amount of caselaw around how affected persons should be divided into classes and it can be a contentious issue in practice.

- The Scheme must also be sanctioned by the court. If the Scheme is approved by each of the affected classes and is sanctioned by the court, the Scheme will bind any class members who dissented notwithstanding their dissent.

- By contrast with the company voluntary arrangement detailed above, the Scheme has the advantage that it can bind both secured and preferential creditors albeit the requirement for voting by separate class will usually mean that such creditors cannot be "crammed down" without their consent (ie their position in the waterfall of creditor payments in a formal insolvency cannot be altered without their consent).

Restructuring Plan

- The Corporate Insolvency and Governance Act 2020, which came into effect on 25 June 2020, introduced two new insolvency procedures: a new scheme of arrangement procedure under new Part 26A of the Companies Act 2006 (the "**Restructuring Plan**") and a new moratorium procedure under the Insolvency Act.

- The Restructuring Plan procedure was expressed to be based on the US Chapter 11 procedure and introduced to be additional to rather than as a replacement for the other cram down procedures, the Part 26 Scheme of Arrangement procedure (see above) and the company voluntary arrangement procedure (also see above) and to address perceived defects in those procedures, ie:

  (a) the inability under the Scheme procedure to cram down an entire class with the concomitant risk to corporate rescue of creditor holds outs; and

  (b) the inability of the company voluntary arrangement procedure to cram down preferential or secured creditors.

- The Restructuring Plan procedure closely resembles the Scheme of Arrangement procedure. In particular, (1) it can be used as a debtor in possession tool with the directors remaining in control of the company; (2) the persons proposed to be affected by the procedure are broken down into classes for voting purposes; and (3) there are two court hearings, the first to examine the class break down and the second to determine whether the relevant requirements for the proposal to take effect have been met.

- The main differences from the Scheme procedure are that:

  (a) under the Restructuring Plan procedure, the company must have encountered or be likely to encounter financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern, ie there is a distress criterion. In contrast, the Scheme procedure can be used by solvent companies as well as distressed companies;

  (b) the court has a statutory right to exclude from voting those creditors or members who have no genuine economic interest in the company (albeit caselaw has confirmed that an equivalent effect can be achieved even under the Scheme procedure); and

  (c) most critically, the court may still sanction a Restructuring Plan even if one or more classes have rejected it provided:

    a. the court is satisfied that none of the dissenting classes are any worse off under the plan than they would be in the event of the "relevant alternative"; and

    b. the plan has been agreed by another class of voters who would receive a payment, or have a genuine economic interest in the company, in the event of the relevant alternative. The relevant alternative is defined as whatever the court considers would be most likely to occur in relation to the company if the plan were not sanctioned by the court.

- Thus, unlike the Scheme procedure, the Restructuring Plan procedure enables entire or cross class cram down subject always to the court's absolute discretion to refuse to sanction on the basis that it is not just and equitable.

Moratorium

- The second new procedure introduced by the Corporate Insolvency and Governance Act 2020 is the moratorium procedure.

- This new procedure enables a company to avail itself of a moratorium similar in scope to an administration moratorium including preventing secured creditor enforcement and forfeiture by landlords. However, it has the potential advantage over an administration procedure that the management of the company remain in control of the company subject to oversight by a licenced insolvency practitioner named a monitor, ie, unlike administration, it is effectively a debtor in possession procedure.

- A company can avail itself of this procedure simply by filing notices at court save where there is an outstanding winding up petition against the company or it is an overseas company, in which cases a court application is required.

- The following requirements must be met:

  (a) the directors must confirm that in their view, the company is, or is likely to become, unable to pay its debts;

  (b) the proposed monitor must confirm inter alia that, in their view, it is likely that a moratorium for the company would result in the rescue of the company as a going concern; and

  (c) the company must not have been in an insolvency procedure in the previous 12 months although this requirement can be lifted by the court.

- Notwithstanding the moratorium, the company will still be required to pay liabilities under new contracts entered into by the company during the moratorium and to pay certain pre moratorium liabilities, known as “pre moratorium liabilities without a payment holiday”, including:

  (a) goods and services supplied during the moratorium under pre-moratorium supply contracts;

  (b) rent during the moratorium;

  (c) employees’ wages and salary whether arising pre or post moratorium;

  (d) redundancy payments whether arising pre or post moratorium; and

  (e) liabilities arising under a contract involving financial services, whether arising pre or post moratorium.

- If the company does not pay these liabilities, the creditor is not entitled to bring enforcement action against the company but instead the monitor is required to bring the moratorium to an end.

- This procedure has been introduced to address the concern that the English system has no simple debtor in possession procedure where the management remains in control of the company rather than coming under the control of an independent insolvency practitioner.

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