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Quickguides

# A Brief Guide to Corporate Restructuring and Insolvency in England and Wales



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## Quickguide overview

This Quickguide provides an overview of the corporate restructuring and insolvency regimes that are available for a company incorporated in England and Wales.

A separate Quickguide exists outlining in more detail the administration process as this is by far the most common insolvency process that an English company is likely to undergo in the current economic climate.

This publication is not intended to be a comprehensive review of all developments in the law and practice, or to cover all aspects of those referred to. Readers should take legal advice before applying the information contained in this publication to specific issues or transactions. For more information please contact us at London Fruit & Wool Exchange, 1 Duval Square, London E1 6PW T: +44 (0)20 7638 1111 F: +44 (0)20 7638 1112 [www.ashurst.com](http://www.ashurst.com).

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# A Brief Guide to Corporate Restructuring and Insolvency in England and Wales<sup>1</sup>

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## 1. Where do I find the law relating to corporate insolvency?

The law relating to corporate insolvency in England and Wales is largely to be found in the Insolvency Act 1986 (as amended) (**Act**) and the Insolvency (England and Wales) Rules 2016 (as amended) (Rules).

## 2. When is a company insolvent?

The Act does not set out a precise test for when a company is insolvent. However, everything hinges on when a company is "unable to pay its debts". There are two main tests set out in section 123 of the Act to determine when a company is unable to pay its debts:

- The "*cash flow test*". This is set out in section 123(1) of the Act which says that a company is deemed to be unable to pay its debts if (among others):
  - it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due; or
  - a creditor, who has served a written demand for more than £750, has not been paid or the amount has not been settled to the reasonable satisfaction of that creditor within three weeks of the creditor's demand; or
  - a court has ordered execution, payment or process in favour of a creditor and this is returned unsatisfied (in full or in part).
- The "*balance sheet test*". This is set out in section 123(2) of the Act and provides that a company is deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of its assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.

The tests are often difficult to determine in practice, particularly in marginal cases where contingent or unquantifiable risks arise, or when considering how far into the future to look or forecast when applying the tests.

In recent years, the boundaries between the cash flow and the balance sheet test have become more fluid.<sup>2</sup> So, as the law currently stands, debts falling due in the reasonably immediate future are considered relevant for the cash flow test (not just debts that are due now) and a company's accounts are only a starting point to determine balance sheet insolvency. The decision of the Supreme Court in the *Eurosail* case provides guidance on how to take account of future and contingent debts, but the test involves a degree of subjectivity.

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<sup>1</sup> The law in this quickguide is stated as December 2018.

<sup>2</sup> See the cases of *In the Matter of Cheyne Finance Plc (in receivership)* [2007] EWHC 2402 (Ch) and *BNY Corporate Trustee Services Ltd -v- Eurosail UK 2007-3BL Plc & Ors* [2013] UKSC 28; [2013] 1 W.L.R. 1408.

## What insolvency processes exist?

The following processes are set out in the Act. Note that for some of them,<sup>3</sup> it is not a condition that the company is in fact insolvent:

- *company voluntary arrangements*;
- *administration*;
- *liquidation*; and
- *administrative receivership*.

In addition, the following processes exist under the Companies Act 2006 (CA 2006):

- *a scheme of arrangement*; and
- *dissolution* (sometimes also referred to as "strike off").

Lastly, there exists an enforcement method which often combines a contractual remedy as well as provisions set out in the Law of Property Act 1925 (LPA) in relation to the appointment of a fixed charge receiver (sometimes, and when appointed over real estate, known as "Law of Property Act" receiver).

The rest of this quickguide contains a brief overview of each of the above processes, starting with the procedures that are designed to be used for rescue (company voluntary arrangements, schemes of arrangements, and administration) and moving on to terminal processes (liquidation and dissolution).

## Company voluntary arrangements

A company voluntary arrangement (CVA) is a procedure which enables an over-indebted company to agree with its creditors how its debts should be dealt with. Section 1 of the Act defines a voluntary arrangement as either a composition in satisfaction of its debts or a scheme of arrangement of the company's affairs. In essence, a CVA gives the company a "second chance" to restructure its business on a voluntary consensual basis (but with certain cram down possibilities) without having to file for a terminal insolvency process. Alternatively, a CVA can be used by a company as a distribution procedure where it is desirable to avoid liquidation proceedings. A company need not be technically insolvent in order to implement a CVA.

A proposal may be made by the directors, or if the company is in liquidation or administration, the liquidator or administrator. The proposal must be voted on by both the shareholders of the company and its creditors (although even if the shareholders vote against the proposal, the creditors' decision takes precedence). If the shareholders approve the proposals by a simple majority (in number), and three quarters or more (in value) of those responding vote in favour, then the CVA takes effect and binds all creditors who were entitled to vote (whether or not they received notice)<sup>4</sup>. A CVA cannot alter the rights of preferential and secured creditors unless they agree.

Once approved by the members and the creditors, the CVA becomes effective. However, the CVA can be challenged within 28 days of the filing at court and reports of the members and creditors' votes on the grounds of unfairness, or material irregularity in relation to the voting processes. The CVA therefore normally becomes effective at the end of the 28-day challenge period.

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<sup>3</sup> Company voluntary arrangements, schemes of arrangement and dissolution.

<sup>4</sup> Note that the resolution to approve the CVA will, however, be invalid even if three quarters or more creditors in value have voted in favour of it, if those creditors who voted against the proposal include more than half of those creditors whose claims have been admitted for voting and who are not connected to the company.

The making of a proposal for a voluntary arrangement does not restrain creditor action unless and until it is approved (and may itself cause creditors to take precipitative action against a company). However, if the company is an "eligible" company (i.e. broadly, and subject to exceptions, a company which satisfies two of the requirements for being a "small company" specified in the CA 2006), its directors may take steps to obtain a moratorium for the company as a preliminary step before proposing a voluntary arrangement. Otherwise, it is possible to combine a CVA with an administration to take advantage of the automatic moratorium that takes effect on administration (see later in this note).

### **The role of the nominee/supervisor**

An insolvency practitioner is appointed first as "nominee" to oversee the voting process. Once the CVA is approved the nominee becomes the "supervisor" of the CVA charged with supervising its implementation. The duties and powers of the supervisor will be set out in the voluntary arrangement rather than being specified in the Act and the Rules. It is possible for the company's directors to retain control of the business during a CVA.

### **Ending a CVA**

The voluntary arrangement will terminate upon completion of the arrangement, at which point notice will be given to the members, the creditors, the court and the Registrar of Companies, together with a report by the supervisor summarising the receipts and payments. Alternatively, if the CVA fails, the supervisor will usually take steps to wind the company up or put it into administration.

## **Scheme of arrangement**

A scheme of arrangement is another process by which a distressed company can restructure its debts and/or its organisation and return itself to financial health. It is often used to avoid the need for a formal insolvency process. A scheme is a more sophisticated process than a CVA, it has greater court involvement, and it can bind secured creditors.

A scheme is a compromise or arrangement between a company and its creditors or members (or any class of them) which requires the agreement of over 50 per cent in number and 75 per cent in value of creditors or members (or class of them) attending the meetings in person or by proxy in order to become binding on all of them when sanctioned by the court. Creditors may need to be divided into separate classes for voting purposes if their rights are too dissimilar to vote in one single class. The process is set out in Part 26 of the CA 2006 and is available to both solvent and insolvent companies.

A scheme of arrangement can be initiated by a company, an administrator, a liquidator or a creditor (although in practice it is difficult for a creditor to do so without the involvement of the company). It can even be used by a foreign registered company provided there is a sufficient connection to this jurisdiction, for example English law governed finance documents and an English jurisdiction clause. Once sanctioned by the court and filed with the Registrar of Companies, the scheme becomes binding on all creditors (or members) and the company, whose rights are affected by the scheme.

Like a CVA, the directors will usually retain control of the company's business and affairs throughout the scheme process (unless it is initiated as part of formal insolvency proceedings in which case the insolvency office holder retains control).

## Administration<sup>5</sup>

The administration regime is set out in Schedule B1 to the Act and is a hybrid process. It can be used to rescue a company. In practice, however, a rescue of the company is rarely achieved and most administrations result in sales of the company's business and assets and the dissolution of the company. Administrations are used for both the biggest and the smallest companies imaginable – some of the high-profile administrations of recent years are Lehman Brothers International Europe, MF Global, Woolworths, HMV, Blacks, City Link and BHS.

### The purpose of administration

An administrator is appointed as a temporary measure (initially for no longer than a year – although this can be extended). An administration must have one of three statutory purposes (set out in paragraph 3 of Schedule B1 to the Act):

- to rescue the company as a going concern, or where this is not possible;
- to achieve a better return for creditors as a whole than would be likely if the company were wound up without having been in administration first, or, where this is not possible;
- to realise property in order to make a distribution to one or more secured or preferential creditors.

### How to place a company into administration

There are two methods of placing a company into administration: in-court and out-of-court.

Placing a company into administration using the "in-court" route simply means that an application is filed with the court requesting the court to make an administration order (much like the process for a winding-up order following the presentation of a winding-up petition).

Placing a company into administration using the "out-of-court" route means that no court hearing is necessary. This process is achieved by simply filing certain prescribed documents with the court.

The holder of a qualifying floating charge (which, in essence, is a holder of a floating charge over all or substantially all of a company's property), the shareholders or the directors themselves can place the company into administration using the out-of-court route. A creditor (among others) cannot do so but he/she can apply to the court to place a company into administration using the in-court route of appointment. A qualifying floating charge holder must be given five business days' notice of any out-of-court appointment (and the proposed choice of administrator) and may "trump" the appointment by appointing his own choice of administrator during this period.

In practice, most administrations we tend to deal with involve "out-of-court" filings by the directors with the qualified floating charge holder's consent and the filings are all achieved on the same day.

### Effects of administration

Once a qualifying floating charge holder, the shareholders or the directors file a notice of intention to place the company into administration with the court, or an application for an administration order has been made, an interim moratorium comes into effect. The interim moratorium lasts until the appointment of the administrator takes effect (at which point the moratorium becomes final) or a certain time period from the filing of the notice of intention to appoint administrators lapses.<sup>6</sup> The

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<sup>5</sup> This Quickguide provides only a whistle-stop tour of administration. For a more detailed analysis, see Ashurst's Quickguide "An Overview of Administration".

<sup>6</sup> Five business days from the filing of the intention to appoint in the case of a holder of a qualifying floating charge and ten business days from such filing for the company or its directors.

moratorium grants the company some "breathing space" and prevents, among other things, the commencement or continuation of any legal proceedings against the company, the forfeiture of leasehold property, or the enforcement of security without the consent of the administrator or the permission of the court.

### **The administrator**

The administrator of a company must perform his functions in the interests of the creditors of the company as a whole. He must perform his functions as quickly and as efficiently as reasonably practicable. An administrator is an officer of the court and in exercising his/her functions, the administrator of a company acts as its agent.

An administrator takes control of the company's assets and affairs and has the power to carry on the business of the company. Once appointed, the administrator displaces the board of directors, whose management powers cease. The administrator has the power to pay creditors who supply goods to the company after the administration has begun in priority to ordinary unsecured creditors. An administrator also has power to make distributions to secured or preferential creditors of the company and to distribute a ring-fenced fund of floating charge realisations known as the "prescribed part" to unsecured creditors. The court's permission is needed to make other distributions to unsecured creditors. Unlike a liquidator, an administrator does not have a statutory power to walk away from a contract (although in practice he/she may choose not to honour the terms of a contract and incur an unsecured claim for breach of contract instead), but he/she does have powers to challenge certain pre-administration transactions on the basis of undervalue or preference and to bring wrongful trading proceedings against the directors if warranted.

### **Ending an administration**

As an administration is not intended to be a terminal procedure, it automatically ends after the expiry of one year from the commencement of the administration. This period can be extended either with the consent of the creditors (in certain circumstances) or the consent of the court. If it is not possible to restore the company to life (as is usually the case), an administration can be converted into a creditors' voluntary liquidation (see below) or the administrator can dissolve the company directly from the administration (see below) – without a prior liquidation.

## **Liquidation**

Unlike some of the other insolvency processes, liquidation is a terminal process – the company will not be resurrected and will ultimately be dissolved. Liquidation is a process whereby an insolvency practitioner (the liquidator) is appointed for the purposes of collecting-in and realising the assets of a company and distributing the realisations in a prescribed statutory order to (partially) satisfy the company's liabilities.

There are two different types of liquidation: compulsory liquidation; and voluntary liquidation.

### **Compulsory liquidation**

This occurs when the court makes an order that a company be wound up on the presentation of a petition, usually brought by a creditor on several grounds (set out in section 122 of the Act). The most commonly used ground is that the company is unable to pay its debts (see above). A company may also be wound up if the court is of the opinion that it is just and equitable to do so.

On the making of the winding-up order, the "Official Receiver" (a civil servant) acts as liquidator but, where there are sufficient assets to meet the expense, the creditors and shareholders may appoint a private liquidator. In the event that the creditors and shareholders nominate different liquidators, the creditors' choice prevails.

### **Voluntary liquidation**

There are two types of voluntary liquidation which are governed by sections 84 to 116 of the Act, namely: members' voluntary liquidations; and creditors' voluntary liquidations.

Both types of voluntary liquidation are commenced by a resolution of the shareholders that the company be wound up. If the company is solvent and the directors swear a statutory declaration of solvency, then the liquidation will proceed as a members' voluntary liquidation. The directors will have to swear such statutory declaration not more than five weeks before the shareholders' meeting to resolve to wind up the company. If the liquidator finds that the company is in fact not able to pay its debts within the timeframe specified in the statutory declaration, there is a (rebuttable) presumption that the directors made the declaration without reasonable grounds. The penalty for doing so is up to two years' imprisonment and an unlimited fine. Directors therefore have to consider very carefully whether they are able to make a statutory declaration of solvency.

If the directors do not swear a statutory declaration of solvency, the liquidation will proceed as a creditors' voluntary liquidation and a decision of creditors on the nomination of a liquidator must be sought within 14 days of the shareholders' resolution. If the creditors nominate a person other than the liquidator nominated by the members, the creditors' choice prevails.

### **Effects of liquidation**

In a compulsory liquidation, upon the making of a winding-up order, no action may proceed or be commenced against the company except with the permission of the court. There is no automatic moratorium in any type of voluntary liquidation, but it is possible to ask the court to issue a stay of proceedings where this would assist the liquidation.

In both types of liquidation, the company must cease to carry on its business except in so far as it is necessary for its beneficial winding-up. Also, in both types of liquidation, the powers of the directors effectively cease, but the company retains its corporate existence until dissolution and remains liable for its existing contracts. However, a liquidator has a statutory power to disclaim an onerous contract.

In a compulsory liquidation, disposals of the company's property made after the commencement of the winding-up (which, on a compulsory winding-up, dates back to the date when a winding-up petition was presented) are void unless validated by the court.

### **The liquidator**

The liquidator is deemed to be the agent of the company. He occupies a fiduciary position and must exercise his powers in the interests of the company and its creditors collectively. The liquidator has the power to bind the company to contracts but is not personally liable for contracts entered into by him in carrying out his functions unless he acts beyond his authority.

The main powers of a liquidator are set out in sections 165 to 168 and Schedule 4 of the Act and are exercised solely for the purpose of the beneficial realisation of the company's assets and distribution of the proceeds. The powers are wide-ranging.

The liquidator also has powers of an administrative nature allowing him/her to administer the process of proofs of debt and to distribute dividends to creditors after covering the costs of the liquidation.

In carrying out his/her functions, the liquidator has power to increase the company's assets by taking action to avoid certain transactions such as transactions at an undervalue or preferences given by the company during the relevant period prior to the commencement of the liquidation. The liquidator can also pursue directors for wrongful trading liabilities and he/she can assign all of these actions to a third party for value. The liquidator also has certain duties and inquisitorial powers (for instance, examining persons capable of giving information relating to property belonging to the company).

### **Fixed charge receiver**

Unlike the processes described above, which are collective, in the sense that the office holder has duties to the company's creditors as a whole, receiverships are an enforcement procedure and exist for the primary benefit of the secured creditors only.



## **Law of Property Act receiver**

A receiver may be appointed under the statutory power given in section 109 of LPA to receive the income of charged property. The powers granted by the LPA are limited but include the power to take all necessary steps to collect the income and to give effective receipts for such income.

Where a receiver is appointed over fixed assets such as land, it is common that the powers set out in the LPA are supplemented by powers set out in the charge document. These powers will be broad, designed to allow the receiver to collect in and realise the assets, and will normally also include the power to take possession of and sell the charged property, to repair, maintain and insure the property and to exercise all other powers incidental or conducive thereto.

## **Fixed charge receiver**

A fixed charge receiver can be appointed by the holder of a debenture which specifically provides for the appointment of a receiver. The charge document will set out the receivers' powers. Often the language "fixed charge receiver" is used to describe a receiver that is appointed over assets that are not real estate, such as shares. Given the fact that most LPA receivers will not only derive their powers from the LPA but from the contract, there is not much difference in practice between an LPA receiver and a fixed charge receiver and the terms are often used interchangeably.

## **The receiver**

The receiver owes duties primarily to his/her appointor. The receiver also owes certain rather limited duties to the company over whose assets he/she is appointed, such that if he acts improperly or to the detriment of the company, it may sue the receiver. The receiver also has a duty of care in equity to any other security holders. The general duty of the receiver is to use his/her powers only for proper purposes and to act in good faith. If a receiver is appointed to exercise a power of sale then he/she must take reasonable care to obtain the best price reasonably possible in the circumstances.

A receiver acts as agent of the company. The agency of a receiver terminates upon the liquidation of the company. The appointment of a receiver does not affect the corporate existence of the company, although the directors are divested of their authority in respect of the property covered by the appointment, and the company remains liable for its existing contracts.

LPA/fixed charge receiverships are an important process that can be used very effectively for secured creditors taking control of and selling shares in a company or a group of companies and/or real estate assets.

## **Administrative receivership**

A holder of a floating charge over all or substantially all of a company's assets may be able to appoint an administrative receiver over the company under section 29 of the Act.

An administrative receiver is accorded a status similar to an office holder in a collective insolvency regime (such as administration) and is generally the agent of the company. The main distinction is that an administrative receiver owes his/her duties not to the creditors as a whole but generally acts for the benefit of his/her appointor only.

Following a change in legislation in 2002, the right of a floating charge holder to appoint an administrative receiver was severely restricted. It is still possible to appoint an administrative receiver in relation to a charge document that was entered into prior to 15 September 2003 or in relation to certain limited exceptions, such as a capital markets exemption. Administrative receivership is, however, now very unusual and in most circumstances the holder of a floating charge will need to appoint an administrator instead of an administrative receiver.

An administrative receiver has, in addition to the powers set out in the charge document, all the powers set out in Schedule 1 of the Act, which are deemed to be included in the charge document unless they are inconsistent with its provisions.

### **Duties of an administrative receiver**

As set out above, an administrative receiver's principal duty is to his/her appointor, subject to a duty not to prejudice unduly the interests of the company or its other creditors. He/she has no authority or duty to deal with unsecured claims.

An administrative receiver's residual duties owed to the company and other security holders are similar to those owed by a non-administrative receiver (see above). As is his/her status as agent of the company, unless and until the company goes into liquidation.

### **Dissolution**

A company can be dissolved after liquidation or administration. Dissolution occurs automatically at the end of a three-month period, following receipt by the Registrar of Companies of a return from either a private liquidator, the official receiver or the administrator, setting out that the winding-up or administration (respectively) is completed.

A company can also voluntarily request that it is struck off the register, for example, if it has reached the end of its useful life and is no longer engaged in any trading activities. Finally, a company can be dissolved by the Registrar of Companies if it has consistently failed to comply with its company obligations, such as the filing of annual accounts and returns.

After dissolution the corporate existence of the company ends, no one can act on behalf of the company and the company is unable to commence legal proceedings. The debts and obligations of the company are extinguished, except to the extent that the company is restored to the register (see below). Any estate or interest in real property that still remains in the company goes to the Crown.

It is possible to restore a company to the register within six years of its dissolution (or at any time if the purpose of the restoration is to bring proceedings for damages resulting from a personal injury).

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