



Insolvency FAQs

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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 insolvency.

Typically, an administrator will be running the business (at least temporarily) before selling it as a going concern. Conversely, a liquidator will not be trading – he will instead be selling assets and closing the business down before making distributions to the various creditors.

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) the goods supplied until the supplier is paid for these goods by the buyer.

ROT clauses are tricky and rely on good drafting to be effective. For instance, problems may arise if a clause attempts to entitle a seller to the proceeds of sales. This is because the clause may be construed as having created a floating charge - which would be void if 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.

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

If you have outstanding invoices ordinarily an administrator will not be responsible for the debts incurred by an insolvent company prior to his

appointment. These are debts you will need to claim for as an unsecured creditor during the administration process. Usually non-payment of debts will allow you to terminate your contract and refuse further supply.

If you chose to supply goods or services to an administrator who has been appointed to trade the business in administration, the cost of those goods or services will be classed as an expense of the administration. You will be paid from the company's assets first – in priority to pre-existing debts.

For this reason it is quite common to continue supplying/dealing with a company after it has gone into administration. But 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 the company's finances or cashflow have deteriorated?

This is a difficult call.

If a director of a company continues to trade a company and incur debt/liability when he knows or ought to know that there is no reasonable prospect of the company avoiding insolvency, this may amount to wrongful trading, a statutory offence.

The way to avoid wrongful trading 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?

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

guarantee in the event of the company's insolvency.

A director may be liable for "wrongful trading". If found guilty, a director will be required by the court to make a payment to the company as compensation to those creditors who have suffered due to the wrongful trading.

A successful prosecution may also lead to action 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.

Should I go to a creditors' meeting?

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 is little to be gained in attending to vote. A form can be completed for a proxy to vote on your behalf. Voting is not obligatory.

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 vanished to. This is a chance to meet the administrator personally in a process designed to require the administrator to provide information to creditors. It can be a good opportunity to obtain fuller information or to put requests for particular investigations regarding company assets on the record.

I'm owed money – can I get security?

If you are owed money by a company experiencing financial difficulties, it may be too late to get any 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, it is vulnerable to being set aside within certain time limits under the Insolvency Act. The power to set aside transactions is vested in both liquidators and administrators, who can review transactions at an undervalue, preferences and the grant of "invalid" floating charges.

If you have already lent or advanced the money or provided services to the company so you are not lending new money at the time of taking the security, any security granted to you will be in exchange for "prior consideration".

A floating charge on the company's property will be invalid if it is given in exchange for "prior consideration", is granted in the 12 months before the commencement of the company's liquidation or administration (or two years if it is granted to a connected person) or in the case of a floating charge granted to an unconnected person, the company is insolvent at the time or became insolvent as a result of the transaction.

An administrator or a liquidator can apply to the court to set aside any transaction (for example a sale of assets) in which the company received either no consideration or consideration worth significantly less than the consideration that the company actually provided. The transaction must have been entered into in the two years before the winding up or administration and must have been made when the company was insolvent or have resulted in the company's insolvency. Where the transaction is with a connected person it is presumed to have resulted in the company's insolvency.

An administrator or a liquidator can also apply to the court to set aside a preference. A preference is a transaction in which a company intentionally benefits a creditor, surety or guarantor by enhancing its position in the event that the company becomes insolvent.

Under the terms of my contract, copyright doesn't go 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.

In the letter, you can 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 letter, in itself, will often be sufficient to get the client to pay. However, if it does not have the desired effect, you may then wish 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.

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 a liquidation, the liquidator has a number of statutory powers to enable him to fulfil his duties. Some of these powers are only exercisable with sanction by the court or the liquidation committee (which is made up of a selection of the creditors). Some powers can be exercised without sanction.

A liquidator may, without sanction, 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 assets 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 on 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 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 is about 5p for every £1 of debt.

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

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 Insolvency Service.

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.

All payments from the Insolvency Service are subject to a weekly pay limit.

If you are still owed some normal pay from your employer at the time it becomes insolvent, you can claim that but a maximum weekly limit applies and there is an additional limit of eight weeks pay in total.

If your normal pay is more than the maximum weekly limit, you will be paid up to the limit and can lodge a claim as a creditor for whatever remains above the limit. This will be treated as one of the debts the company owes and you will rank as an unsecured creditor for this element of the money owed to you.

Will employees lose their jobs?

One of the first things the liquidator or administrator will 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.

Will employees be paid?

It depends. If a business is wound up, any money left after the disposal of the assets is gathered together and distributed in a particular order amongst everyone who is owed money (see 'where does my debt stand in the creditors queue'). Whether employees are paid depends on how much money is left in the pot and where they rank in the order. For some amounts, employees rank above ordinary creditors, but only up to a total of £800 plus any holiday pay. If any further money is owed, employees rank joint bottom of the pile. In practice, the employees' chances of getting all money owed to them are slim.

Can employees get help elsewhere?

Often employees cannot take legal action against the insolvent business 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. For example, the most back pay any employee can get is 12 weeks at £330 per week. It can also take some time to receive it.

What are the employment implications of buying an insolvent business?

You may be tempted to snap up all or part of an insolvent business going cheap but may be concerned about 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 transfer 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 because they have transferred from the insolvent business. This may deter potential buyers.

To deal with this, in insolvency proceedings which are started with a view to carrying on the business as a going concern (typically administration), TUPE can allow changes to the employment contracts to be 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 is worth taking expert advice.

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. 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.

You should also be aware that if you are proposing to buy a business or part of a business, there are particular rules regarding employees which apply whether or not the business is insolvent or solvent (see previous question). It is worth taking expert advice if you are planning on buying assets or a business (or a part of a business) from an administrator.

Landlord and Tenant issues

Insolvency raises particular difficulties in landlord and tenant relationships – see the copy of our separate fact sheet 'Landlord and Tenant FAQs.'

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