



Making things clearer

The Jargon Buster: a guide to insolvency

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Chartered Accountants • Licensed Insolvency Practitioners

Administration begins with the appointment of one or more Insolvency Practitioners. This can be done out of court by:

- the holder of a Qualifying Floating Charge (see glossary) – usually a bank;
- the directors; and
- the company, by resolution of the shareholders

Administration can also be initiated by the court, usually on the application of the directors of the company or unsecured creditors. The Administrator will take control under the order but may allow the directors to retain some management functions. Within ten weeks of appointment, the Administrator circulates proposals for the company and holds a creditors' meeting to seek approval of the plan. The proposals may include a Company Voluntary Arrangement (see definition below). The whole process should be completed within twelve months, unless an extension is agreed.

What is a Company Voluntary Arrangement (CVA)?

This is when the directors of a company, or its Administrator, make proposals to the company's creditors for a release from its existing debts, coupled with a plan by which creditors will receive some, or all, of the amounts due to them over a specified period of time. A CVA allows an underperforming business the chance to trade out of its problems. To be effective, the proposals must be approved by more than 75% of those creditors who vote on them. If approved, the proposals bind all creditors.

What is an Administrative Receivership?

The main duty of an Administrative Receiver is to recover assets for the benefit of the lender to whom he is responsible, for example a bank. The Administrative Receiver will not be responsible for making payments to ordinary unsecured creditors.

What is a liquidation?

This is the 'end of the line' for a company. The assets of the company are sold by the Liquidator, and turned into cash to pay creditors.

What is a Creditors Voluntary Liquidation (CVL)?

In a Creditors Voluntary Liquidation (CVL) the shareholders themselves decide to close the business down and appoint a Liquidator. A meeting of creditors is held to confirm the appointment of the Liquidator or to appoint an alternative in his place. An Administrator can also place a company into CVL.

What is a Compulsory Liquidation?

A petition can be presented to the court for an order to wind-up a company. This means that the company will be placed into liquidation but unlike voluntary liquidation, compulsory liquidation involves investigation by the Official Receiver and is usually more time-consuming and expensive. Most petitions are presented by creditors. HM Revenue & Customs frequently takes such action when liabilities for VAT and PAYE are unpaid.

What is a Members Voluntary Liquidation (MVL)?

Normally this applies when the proprietors of a company wish to unlock their capital and retire, or when a subsidiary within a group has outlived its usefulness. In an MVL, the shareholders resolve to appoint a Liquidator and all liabilities of the company (including the expenses of liquidation) should be settled within 12 months. The assets remaining after paying all liabilities are then distributed to the shareholders. MVL is also the normal route in a company re-organisation so as to benefit from tax exemptions, income, capital gains and corporation tax (Section 110, Insolvency Act 1986).

When a company is insolvent, how much return are creditors likely to get?

There is no specific answer to this question. However, creditors tend to get a better deal when the directors of an insolvent company recognise problems early and take the appropriate steps to curtail any further losses to the creditors. The Company Directors' Disqualification Act 1986 deals harshly with directors who ignore the warning signals.

Will shareholders see a return?

Not unless all creditors are paid in full. However, in the case of a CVA, they will retain their interests on completion of the arrangement.

What is the role of the Insolvency Practitioner?

- To advise and establish a strategy
- To act upon that advice professionally and to take appointments
- To look after the interests of the creditors
- To act impartially at all times
- To follow the ethical guidelines as set out by the licensing bodies
- To fulfill the statutory obligations placed on them by the appointment

Who pays the Insolvency Practitioner?

The Insolvency Practitioner is paid out of the individual's or the company's assets in agreement with either the creditors, or occasionally, the court.

What happens to the employees of an insolvent company, and how do they get redundancy pay?

Jobs may be saved if the business, or part of it, is sold as a going-concern. If there are job losses, then employees may claim for redundancy, holiday pay, pay in lieu of notice and unpaid wages, where applicable. They can receive up to 8 weeks unpaid wages, but the Government will only pay up to a limit set annually by law. Claims are paid by the redundancy payments section of the Insolvency Service which in turn becomes a creditor of the company.

What happens to the directors?

In liquidation, the directors' role is limited to certain statutory duties. In administration, they could continue in a management role.

Directors are likely to lose their jobs unless there is a chance of saving the company, for example, in a Company Voluntary Arrangement.

Can the Insolvency Practitioner disqualify a director?

No. It is up to the Court to decide, based on the report of the Insolvency Practitioner submitted to the Secretary of State for Trade & Industry.

What is fraudulent trading?

When a director continues to trade whilst knowingly and intentionally causing losses to the creditors.

If fraudulent trading is proven, the directors may face prison sentences and be called upon to contribute personally to the assets of the company.

What is wrongful trading?

Wrongful trading occurs when a director causes a company to continue to trade when it is apparent that the company is insolvent. The current legislation deems that directors should be aware of the company's insolvency and should take steps to protect the interests of the company's creditors.

If wrongful trading is proven, then the directors may be called upon to contribute personally to the assets of the company.

What happens to the assets of insolvent individuals and companies?

The Insolvency Practitioner must obtain the best price for the assets in his control and will often appoint specialist auctioneers and valuers for this purpose. He will also examine sales and asset disposals prior to his appointment, looking for transactions which are detrimental to the creditors generally. The court gives extensive powers to recover assets and to make directors personally liable for irregular transactions.

Questions and answers

An individual's insolvency

What is bankruptcy?

This relates purely to individuals. If an individual cannot pay his debts then either a creditor or the individual may petition for bankruptcy. A Bankruptcy Order renders that individual bankrupt for up to one year.

Who decides if an individual is bankrupt?

The court, in response to a petition presented by either a creditor or the individual.

What happens when an individual is made bankrupt?

The individual's assets are controlled by a Trustee, who is either the Official Receiver or an Insolvency Practitioner. The Trustee realises the assets, discharges the costs and meets the claims of the creditors from the funds in hand.

Does a bankrupt's home have to be sold?

If the bankrupt owns a home, whether freehold or leasehold, solely or jointly, mortgaged or otherwise, the home may have to be sold to go towards paying debts. The Trustee may sell it within three years from the date of bankruptcy, failing which it reverts to the bankrupt. In some cases, a sale can be avoided. The law allows a 12 month 'respite' period before granting possession, but the house must be jointly owned or the spouse must have an equitable interest for this respite to be granted.

What are the effects of bankruptcy on an individual?

Bankrupts are not allowed to act as directors of companies without permission of the court. They may be excluded from professional bodies and public office, and they face restrictions in obtaining credit for more than £500. Where there has been misconduct prior to bankruptcy, the bankrupt may be asked to accept a Bankruptcy Restrictions Order by the court. Bankruptcy restrictions will then apply for two to a maximum of fifteen years.

What other obligations may a bankrupt have?

A Trustee may review the bankrupt's income and outgoings to obtain regular contributions either by agreement or by an Income Payments Order in the court for a period up to three years.

What about pension rights?

Both personal and occupational approved pension arrangements are now protected. However, a Trustee is able to apply for an Income Payments Order in respect of any pension payments made to the bankrupt. In addition, the Trustee has powers to recover excessive contributions made into a pension before bankruptcy.

If someone is bankrupt, are they so for life?

Most bankrupts are discharged within one year from the commencement of bankruptcy. Unpaid debts are effectively written off. However, credit reference agencies keep records of Bankruptcy Orders for fifteen years. The problem can be overcome by obtaining an annulment of the Bankruptcy Order, which can be achieved by way of an Individual Voluntary Arrangement or by discharging the liabilities and costs in full.

Glossary of terms

What is an Individual Voluntary Arrangement (IVA)?

This is a popular route which avoids or ends bankruptcy and means agreeing a proposal for debt repayment in full or in part with the creditors.

What is the role of the Insolvency Practitioner in an IVA?

The Insolvency Practitioner will advise the individual on his proposal to the creditors and will act as Nominee. The Insolvency Practitioner may also obtain an Interim Order that is the ‘ring-fence’ designed to protect the debtor from his creditors. If the proposal is accepted by the creditors, the Insolvency Practitioners will act as Supervisor of the Arrangement throughout its term.

What are the benefits of an IVA?

The IVA offers the creditors substantially more than they might otherwise receive in a bankruptcy. It also allows the debtor to avoid the stigma of bankruptcy by reaching an honourable settlement with his creditors.

Association of Business Recovery Professionals

The trade association of Insolvency Practitioners and Turnaround specialists. Its aims are embodied in the three words, Rescue, Recovery and Renewal, which provide the initials by which the association is commonly known – R3. R3's address is 8th Floor, 120 Aldersgate Street, London EC1A 4QJ, telephone 020 7566 4200, and website: www.r3.org.uk.

Administrator

Insolvency Practitioner appointed to manage a company's affairs, business and property when it goes into administration.

Administration

Procedure where one or more Administrators are appointed. They should achieve the purpose of the administration within a maximum of twelve months, unless an extension is agreed.

Administration Order

Order of Court initiated by the directors, company or creditors to appoint an Administrator.

Administrative Receiver

Insolvency Practitioner appointed in an Administrative Receivership. He can carry on the company's business and sell assets. Usually known simply as 'Receiver'.

Administrative Receivership

Insolvency Practitioner appointed under a floating charge securing the whole (or substantially the whole) of a company's property. Such a charge is a Qualifying Floating Charge, and only where the charge was created before 15 September 2003 can the holder appoint an Administrative Receiver.

Ambulance Chaser

Winding-up petitions are advertised in the London Gazette and county Court judgments in specialist trade publications such as Stubbs Gazette. From these, it is easy to identify a company or individual in financial difficulty. These publications are scrutinised by 'ambulance chasers', who are often unqualified professionals. They offer various escape routes before the client is aware of the Court action, at a time when they may be particularly vulnerable. Such practice is frowned upon by the insolvency and turnaround profession. At such times, it is imperative that proper advice is obtained from suitably qualified, regulated and insured individuals.

Associates

Associates of individuals include family members, relatives, partners and their relatives, employees, employers and companies which the individuals control or direct.

Bankrupt

An individual against whom a bankruptcy order has been made by the Court. The order signifies that the individual is unable to pay his debts and deprives him of his property, which is then realised for distribution amongst his creditors.

Bankruptcy (UK excluding Scotland)

Procedure for insolvent individuals.

Bankruptcy Order

Order of Court commencing a bankruptcy.

Bankruptcy Restrictions Order

Where investigations establish misconduct by a bankrupt, an application can be made to the Court for a Bankruptcy Restrictions Order, imposing bankruptcy restrictions on the bankrupt for between 2 and 15 years. A bankrupt can agree to give a Bankruptcy Restrictions Undertaking, having the same effect, to avoid going to Court.

BERR

Department for Business, Enterprise & Regulatory Reform: the Government department regulating insolvency procedure. The Secretary of State for Business, Enterprise & Regulatory Reform is responsible for authorising Insolvency Practitioners to act, either directly or through professional bodies. He controls the Insolvency Service and the Official Receiver.

Bond

Statutory insurance cover required by a person who acts as an Insolvency Practitioner.

Break-up sale

Dismantling of a business, with assets sold piecemeal, often at auction.

Charge

A form of security over the assets of a borrower such as a mortgage or a debenture.

Chapter 11

A procedure used in the United States comparable to administration. Assets are ring-fenced but control remains with the directors, rather than with an Administrator.

Charging Order

Court Order placing restrictions on the disposal of certain assets such as property or securities, given after judgment, which gives priority of payment over other creditors.

Company Directors Disqualification Act 1986 – ‘CDDA 1986’

The law requiring Insolvency Practitioners to report on the conduct of directors in cases of liquidation (apart from Members Voluntary Liquidations), administrations and administrative receivership, which may lead to disqualification.

Court-appointed Receiver

A person, not necessarily a licensed Insolvency Practitioner, appointed to take charge of assets usually where they are subject to some legal dispute. Not strictly an insolvency process, the procedure may be used other than for a limited company, e.g. to settle an ownership dispute.

Creditor

Anybody owed money by a company or individual.

Creditors Committee

Committee of creditors appointed in an administration, administrative receivership or bankruptcy to assist the Insolvency Practitioner in his duties.

Creditors Meetings

Meetings of creditors called to appoint an Insolvency Practitioner to handle insolvency cases and to provide creditors with information. The first meeting of creditors will usually approve the appointment of the Liquidator, Trustee, Supervisor etc. In administration, a creditors meeting will consider and approve, modify or reject the Administrator's proposals.

Debenture

A document which establishes security over the property of a borrower, usually required for bank overdrafts and loans.

Debtor

Someone who owes money to his creditors.

De Facto Director

Someone who acts as if he was a director of a company even though he has not been formally appointed. He is equally liable to face disqualification and other proceedings.

Director

Officer responsible for the actions of a company. Usually a director is appointed in accordance with the Companies Act requirements, but anybody having effective control may be called to account as a 'Shadow' or 'De Facto' director, even if their name does not appear on company letterheads or annual returns and accounts. Disqualification and other Court penalties may then be applied.

Discharge

The release of a debtor from his obligations under a bankruptcy order. This applies automatically within one year, in the case of a first bankruptcy, but can be suspended if the Trustee or the Official Receiver is not satisfied with the debtor's conduct and co-operation.

Disqualification Order

An order made under the Company Directors Disqualification Act 1986 on the application of the Secretary of State prohibiting an individual from being a director of a company or in any way being involved in the promotion, formation or management of a company. Orders are made for up to 15 years. In some circumstances a Disqualification Undertaking, having the same effect, may be accepted, to avoid going to Court. A Register of disqualified directors is kept at Companies House.

Distrain or Distress

Certain creditors may seize the goods of a debtor by this process. An Enforcement Officer will visit business premises and identify items for seizure if the debt is not paid. This is called 'walking possession'. When removed, the goods will be auctioned with the proceeds going to the creditor to the limit of its claim and costs. Distraint is commonly used by HMRC to recover PAYE and VAT, and is also available to local authorities for the arrears of rates. Landlords may also use this remedy.

Dividend

A payment made to a creditor in part or full satisfaction of its claim. Normally expressed as a number of pence in the pound.

Enterprise Act 2002

Provisions which amend the Insolvency Act 1986. These include the new administration procedure, abolition of preferential status of Crown debts and a new bankruptcy regime.

ERA

The Employment Rights Act 1996, which provides financial assistance for employees who are owed money by insolvent employers.

Ethical Guide

Advice and guidelines in governing the professional conduct of Insolvency Practitioners.

The EC Regulation

Council Regulation (EC) No 1346/2000 gives recognition to insolvency proceedings among the Member States of the European Union, and came into force on 31 May 2002.

It applies to most types of insolvency, apart from receivership and administrative receivership, and gives Insolvency Practitioners the opportunity to use their powers throughout the EU (except Denmark, which opted out). It also allows insolvency proceedings to be brought against overseas establishments, where their 'Centre of Main Interests' (COMI) is in the UK.

Execution

On obtaining judgment, a creditor may seek to recover a debt by this process, which relies on the Court Enforcement Officer seizing the debtor's goods for auction. The mechanism is similar to that used in distraint proceedings.

Exit Route

A means of turning a formal insolvency into a different form of proceedings to achieve a business rescue. For example, the exit route for an administration could be a CVA; for a bankruptcy it could be an IVA.

Extortionate Credit Transaction

A transaction by which credit is provided on terms that are exorbitant or grossly unfair compared with the risk accepted by the creditor. Such a transaction may be challenged by an Administrator, a Liquidator or a Trustee in bankruptcy.

Fixed Charge

Security such as a mortgage taken over certain assets; e.g. property and goodwill.

Floating Charge

Security for a loan not attached to specific assets of a company. Often included in a debenture. Costs of administration, where applicable, and preferential creditors' claims rank ahead of the floating charge holder, and assets caught by a Floating Charge are subject to the Prescribed Part, which is retained for other unsecured creditors.

Going Concern

The business carries on trading.

Guarantee

A legal commitment to repay a debt if the original borrower fails to do so. Directors may give guarantees to banks in return for the bank giving finance to their companies.

Hive Down

Transfer of a company's business to a wholly owned subsidiary to facilitate its sale as a going concern.

HMRC

In 2005 HM Customs and Excise, the government department responsible for collection of Value Added Tax (VAT), was merged with the Inland Revenue, which collected Income tax including PAYE, to form HM Revenue and Customs, or HMRC.

Insolvency Act 1986

Legislation introduced to consolidate insolvency law and procedure and requiring all Insolvency Practitioners to hold an insolvency licence. It has been substantially amended by the Insolvency Act 2000 and the Enterprise Act 2002.

Insolvency Practitioner

Person licensed to act as an office holder in insolvency proceedings.

Insolvency Proceedings

Bankruptcy, administration, administrative receivership, liquidation and voluntary arrangements etc.

Interim Order

First part of an Individual Voluntary Arrangement (IVA) ordered by the Court. Similar to administration in company law, the Interim Order protects the debtor and ring-fences his assets.

Judgment Debt

Recognition of a debt by a Court. Judgments in the County Courts are published in a register and credit reference agencies take details. When a creditor has obtained judgment, it may seek to recover the debt through the Court Enforcement Officer by way of execution or by seeking attachment orders over the debtor's property.

Lien

Right to retain possession of assets or documents until an outstanding debt is settled.

Liquidation

Process which brings a company to the end of its life, enabling its assets to be realised.

Liquidation Committee

Committee formed to receive information through the Liquidator and able therefore to sanction certain actions. Comparable to a creditors' committee (see above).

Liquidator

Insolvency Practitioner appointed in liquidations.

LPA Receiver

The Law of Property Act 1925 Receiver is a person, not necessarily an Insolvency Practitioner, appointed to take charge of a mortgaged property by a lender whose loan is in default, usually with a view to sale or to collect rental income for the lender. Common in the case of the failure of a property developer, whose borrowings will largely be secured on specific properties.

Members Voluntary Liquidation

Winding-up of a solvent company which must pay its debts in full within a period of 12 months.

Misfeasance

Breach of duty in relation to the funds or property of a company by its directors, managers or owners.

Moratorium

Protection prior to the approval of a Company Voluntary Arrangement, similar to that given by an interim order in an IVA. It is rarely used, as it is only available to small companies and administration is generally a more suitable alternative.

Mortgage

A transfer of an interest in land or other property by way of a security.

Nominee

Insolvency Practitioner instructed in setting up a Voluntary Arrangement, and reporting to the Court as to its submission to creditors for approval or rejection.

Official Receiver

Officer of the Court employed by the Department for Business, Enterprise & Regulatory Reform to deal with bankruptcy and compulsory liquidation.

Partnership Voluntary Arrangement

The Company Voluntary Arrangement procedure which is adapted for partnerships under the Insolvent Partnerships Order 1994.

Petition

The formal document, presented to the Court, by which an individual proceeds into bankruptcy, and companies become subject to administration orders or compulsory liquidation.

Phoenix

A new company taking on the business and assets of one that is insolvent, usually with the same directors, leaving the creditors unpaid and unhappy. Anybody wanting to take on the profitable parts of an insolvent company's business should seek proper advice to avoid the various penalties which might apply in such circumstances.

Preference

A transaction with the intention of placing a creditor in a better position than he would otherwise have been. The Court may make an order to reverse this.

Preferential Creditors

Certain creditors, now mainly employees, have preferential status and their claim must be paid in full before any distribution can be made to other unsecured creditors or those with floating charge security. It should be noted that PAYE and VAT are no longer preferential claims.

Prescribed Part

In administrations, liquidations and receiverships, where the cost would not be disproportionate, a proportion of the floating charge assets ('net property') will be made available for unsecured creditors, based on 50% of the first £10,000 and 20% thereafter, not exceeding £600,000. This reform was introduced under the Enterprise Act 2002, at the same time as the Crown departments lost their preferential creditor status, and only applies where the charge has been created since 15 September 2003.

Proof of Debt

Document submitted by a creditor to the Insolvency Practitioner giving evidence of the amount of the debt.

Provisional Liquidator

The Court may appoint an Insolvency Practitioner before a Winding-Up petition has been heard to control the affairs of the company and preserve its assets.

Proxy

Document in which a person is delegated to attend and vote at a meeting on behalf of someone else.

Qualifying Floating Charge

A charge held by a secured creditor such as a bank and will cover the whole (or substantially the whole) of a company's property. The holder may appoint an Administrator by the out of Court route, and may nominate an Administrator of its choice in preference to the nomination of the directors or the company. Where the charge was created before 15 September 2003, the holder may also be able to appoint an Administrative Receiver.

R3

Name by which the Association of Business Recovery Professionals is commonly known, standing for Rescue, Recovery and Renewal.

Receiver

See 'Administrative Receiver' and 'LPA Receiver'. This could also be a person appointed by the Court to take charge of assets in the case of a legal dispute (Court Appointed Receiver).

Receivership

The general term applied when a person is appointed as a Receiver or an Administrative Receiver.

Recognised Professional Body

An organisation approved by the Secretary of State as being able to authorise its members to act as Insolvency Practitioners.

The Insolvency Practitioners Association

The Institute of Chartered Accountants in England and Wales

The Institute of Chartered Accountants of Scotland

The Institute of Chartered Accountants in Ireland

The Chartered Association of Certified Accountants

The Law Society of England and Wales

The Law Society of Scotland

The Law Society of Ireland

The Secretary of State

Retention / Reservation of Title

Contract term in which the supplier of goods retains ownership until they are paid for by the purchaser.

Secured Creditor

A creditor holding a charge over a company's assets.

Shadow Director

Someone who is not officially a director of a company but who gives the directors instructions, which they regularly act upon. He is equally liable to face disqualification and other proceedings.

Shareholders

Register of members of a company as the holders of one or more shares in the company.

Society of Turnaround Professionals (STP)

An association whose members are dedicated and regulated Turnaround Practitioners. STP is a member organisation of R3.

Special Manager

A person appointed by the Court in a compulsory liquidation or bankruptcy to assist the Official Receiver in dealing with the business.

Statement of Insolvency Practice (SIP)

Guidelines issued by R3 and approved by the Recognised Professional Bodies (see above) to assist Insolvency Practitioners with their duties.

Statutory Demand

Formal document demanding payment of an outstanding debt within 21 days. May form the basis of a petition and result in liquidation or bankruptcy if uncontested and unpaid.

Supervisor

Insolvency Practitioner appointed to oversee the performance of a voluntary arrangement.

Trustee

The Official Receiver or an Insolvency Practitioner appointed to administer the estate of a bankrupt.

Turnaround

Any process, not necessarily involving formal insolvency, that results in the rescue of underperforming businesses. Normally carried out by turnaround professionals, often members of STP (see above), all of whom are members of R3.

Turnaround Finance

Finance provided by third parties to facilitate both formal and informal turnaround procedures.

Unsecured Creditor

Ordinary creditor who is paid after preferential creditors, ahead of shareholders.

VAT Bad Debt Relief

Available on any debt unpaid for more than six months.

Winding-up Order

Court order for the winding-up of a company, also known as compulsory liquidation. The first stage of the process is the presentation of a petition which sets the date for the hearing, and this is advertised in the London Gazette. As soon as the advertisement appears, bank accounts in the company name will be frozen and trade will probably have to cease.

Wrongful Trading

Continuing to trade when the directors ought to have known that the company is insolvent. Directors may be made personally liable for losses incurred as a result.

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