PART B: PRINCIPLES OF INSOLVENCY – GENERAL ISSUES

Corporate Insolvency - Definition

To determine whether a company is "insolvent" one of 2 tests needs to be satisfied:

1. The balance sheet test; or
2. The cash flow test.

The balance sheet test provides that if a company's liabilities, including its contingent liabilities, exceed its assets, it is insolvent.

The cash flow test provides that if a company is unable to pay its debts as when they fall due, it is insolvent.

Corporate Insolvency Procedures

The 5 formal corporate Insolvency Procedures are set out below along with the stated purposes of each:

Procedure	Purpose
Company Voluntary Arrangement ("CVA")	To avoid insolvent Liquidation by reaching a binding agreement / compromise with creditors with the minimal involvement of the Courts.
Administration	To achieve at least one of the following objectives: (i) rescuing the company as a going concern; (ii) achieving a better result for the company's creditors as a whole than if the company were wound up; (iii) realising property to make a distribution to one or more of the secured or preferential creditors of the company
Administrative Receivership	To realise the company's assets subject to floating charge to repay the indebtedness owed to the floating charge holder
LPA Receivership	To exercise the powers conferred on the Receiver under a legal charge to include managing and selling the mortgaged property
Liquidation	Compulsory Liquidation (i) To realise assets of a company and distribute them to creditors in the order prescribed in the IA 1986 (ii) To dissolve the company at the end of the realisation and distribution

	Creditors Voluntary Liquidation To wind an **insolvent** company up without any significant involvement of the Court Members Voluntary Liquidation To wind a **solvent** company up without any significant Court involvement

Appointment Procedures

Procedure	Who may commence	How the procedure takes effect
CVA	(i) the director(s) of the company (other than when a company in Administration or Liquidation) (ii) the Administrator(s) of the company (iii) the Liquidator(s) of the company	(i) Directors draft proposals and appoint a Nominee (alternatively, Administrator(s) or Liquidator(s) draft proposals and, usually, appoints him / herself / themselves as the Nominee(s)) (ii) Directors submit a report on proposals and company's affairs to Nominee(s) (iii) Nominee considers report and, within 28 days, must report to Court on whether to call a meeting of company and creditors (Nominee(s) who are / is an Administrator(s) or Liquidator(s) may call a meeting without reporting to Court) (iv) Nominee gives 14 days' notice of meeting to creditors where proposals will be approved if the following vote in favour: - a simple majority of members; and - 75% in value of creditors (excluding secured creditors) (v) Nominee reports to Court on approval (which may be challenged on grounds of unfair prejudice or material irregularity) (vi) Nominee becomes Supervisor and implements proposals

Administration – Court Route	(i) the Company (ii) the directors (iii) one or more creditors (iv) a CVA Supervisor (v) the designated officer of a Magistrates Court	(i) Apply to Court at which point interim moratorium takes effect (ii) Notify anyone who has appointed, or who is entitled to appoint, an Administrative Receiver and other holders of qualifying floating charges (iii) Court hears application (iv) Court makes Administration Order if: - company is unable to pay its debts; and - Administration likely to achieve one of the stated objectives (v) Court must dismiss the application where Administrative Receiver is in place (except where the charge holder consents, or where security may be set aside, for example, as a transaction at undervalue or preference (vi) Administrative Receiver must vacate office and a Receiver may be requested to vacate office. (vii) Administrator appointed
Administration – Out of Court Route by Qualifying Floating Charge Holder	A Qualifying Floating Charge Holder	(i) Gives two days' notice of intention to appoint an Administrator to any prior qualifying floating charge holder in prescribed form (or obtain consent of prior qualifying charge holder) and file at Court. (ii) Interim moratorium takes effect (iii) Files notice of appointment and other prescribed documents at Court (iv) Administrator(s) appointed (but not if a provisional Liquidator has been appointed as part of a compulsory Liquidation). (v) Moratorium continues
Administration – Out of Court Route by company or its directors	Directors – however, this procedure is only available if: (i) in the last 12 months, the directors have not appointed an Administrator or had the benefit of a moratorium or CVA (ii) no winding up petition or Administration application (as per Court Route above) is pending (iii) no Administrative Receiver has been appointed	(i) Give five days' notice of intention to appoint an Administrator to any qualifying floating charge holder entitled to appoint either an Administrative Receiver or an Administrator out-of-Court and file the same at Court (ii) Interim moratorium takes effect (iii) File notice of appointment and further prescribed documents at Court (including consents from any floating

		charge holder entitled to appoint either an Administrative Receiver or out-of -Court Administrator) (iv) Administrator appointed
Administrative Receivership	(i) The holder of a floating charge over all (or substantially all) the assets of a company containing a power to appoint an Administrative Receiver and created before 15 September 2003 (ii) The holder of a qualifying floating charge in relation to one or more of the exceptions set out in sections 72B to 72GA of the IA 1986	(i) Company defaults on loan (ii) Floating charge holder appoints an Administrative Receiver (iii) Administrative Receiver must formally accept office N.B. In practice, lenders usually appoint an Administrative Receiver after considering a report from investigative accountants
Compulsory Liquidation	(i) The company (ii) The directors (iii) Any creditor (iv) Any contributory (v) The Administrator of the company (vi) An Administrative Receiver (vii) A CVA Supervisor (iix) A “Voluntarily” Liquidator of the company when the company is in Voluntary Liquidation (ix) The Official Receiver when the company is in Voluntary Liquidation (x) The Secretary of State (xi) The designated officer of the Magistrates Court	(i) Applicant presents a petition to the Chancery Division of the High Court or, for companies with an issued share capital of £120,000 or less, the County Court (ii) The Liquidation is deemed to commence at this point (iii) Copies of petition served on the company, any Liquidator (appointed by CVL), any Administrative Receiver or CVA Supervisor (iv) Applicant advertises the petition in the London Gazette (v) Provisional Liquidator may be appointed in clear cases of insolvency and where the company's property may be at risk (vi) Court hearing – winding-up order will only be made where one or more of eight grounds for winding up is/are satisfied (for example, the company is unable to pay its debts as they fall due) (vii) Copy of Court Order filed at Companies House and sent to the company "forthwith" (iix) Liquidator is appointed (initially, this will be the Official Receiver) (ix) Official receiver decides whether to call a meeting of creditors and contributories (x) Meetings may appoint an insolvency practitioner as Liquidator (in place of the Official Receiver) and a

		Liquidation committee (consisting of creditors of the company)
Creditors' Voluntary Liquidation ("CVL")	Members of the company	(i) Usually, directors call a general meeting at which members will pass a special resolution to wind up the company (ii) Notice of resolution given to Qualifying Floating Charge Holders other than those where the holder may appoint an Administrative Receiver (iii) At least seven days' notice of a creditors' meeting given to creditors (iv) Notice advertising creditors' meeting must also be given in the London Gazette and at least two local newspapers in the locality of the company's principal place of business (v) Directors prepare statement of company's affairs to be presented at creditors' meeting (vi) Creditors' meeting held within 14 days of special resolution, but often on same day as members meeting (vii) Members' and creditors' meetings each nominate a Liquidator (creditors' nominee takes precedence) and appointment takes effect
Members' Voluntary Liquidation ("MVL")	Members of the company	(i) Directors give a statutory declaration of solvency (ii) Notice of resolution given to Qualifying Floating Charge Holders other than those where the holder may appoint an Administrative Receiver (iii) Company passes a special resolution to wind up within five weeks of statutory declaration (iv) Liquidator appointed by members, either by a separate general resolution or (usually) as part of the special resolution

Qualification Requirements

Only persons qualified to act as Insolvency Practitioners under the IA 1986 (or authorised to act in relation to the voluntary arrangement in the case of a CVA) may act in relation to a company, as a Supervisor of a CVA, an Administrator, an Administrative Receiver or a Liquidator.

In order to qualify, an Insolvency Practitioner must be an individual who is authorised to act as an Insolvency Practitioner by a recognised professional body, which has practice rules specifying the matters to be taken into account in deciding whether a person is fit and proper to act as an Insolvency Practitioner. In practice, Insolvency Practitioners are almost always accountants.

General Powers and duties of Appointees

The powers and duties of the Appointees differ depending on the role they will be fulfilling. This is largely as a result of the different objectives which each of the insolvency procedures are to achieve. The table below provides an overview of the powers and duties of the Appointee within each of the specific insolvency procedures.

Appointee	Powers and Duties
Supervisor of a CVA	- A CVA proposal must provide for some person (the Supervisor) to act in relation to the voluntary arrangement either as trustee or otherwise for the purpose of supervising its implementation; - The Supervisor has the power to apply to Court for direction in relation to any matter arising under the CVA; - The Supervisor may also apply to the Court to wind up the company or place it into Administration; - The CVA may require authorise or specifically require the Supervisor to: (i) carry on the business of the company or trade on its behalf or in its name; (ii) realise the assets of the company; or (iii) otherwise administer or dispose of its funds in such circumstances the Supervisor shall keep accounts and records of his acts and dealings and in connection with the CVA, including in particular records of all receipts and payments - The Supervisor must on each period of 12 months ending with the anniversary of the commencement of the CVA, send a report on the progress of the implementation of the CVA to (i) the Registrar of Companies (ii) the company (iii) the company's creditors who are bound by the CVA (iv) the members of the company (unless exempted from doing so) (v) the company's auditors (if any)
Administrator	- Once appointed, an Administrator is an officer of the Court - this imposes upon him a general duty to behave

fairly and honourably whilst in office

- The Administrator must carry out his functions in the interests of creditors as a whole and as quickly and efficiently as possible
- Upon his appointment, the Administrator must take custody and control of all of the property that the company appears to be entitled to
- In the absence of any special relationship, an Administrator owes no duty of care to individual unsecured creditors
- An Administrator may do anything necessary to manage the assets, business and affairs of the company to which he is appointed and has a series of specific powers, including the power to:
  - (i) Take control and possession of the company's property;
  - (ii) Sell or otherwise dispose of the company's property;
  - (iii) Bring (certain) or defend legal proceedings on behalf of the company;
  - (iv) Make any payments necessary to allow him to carry on his functions / carry on the company's business of the company
  - (v) Take or surrender a lease of any property on behalf of the company
- An Administrator can apply to Court for an order requiring:
  - (i) Anyone who holds property belonging to the company to deliver that property to Administrator
  - (ii) The provision to the Administrator of any information or documents relating to the business, dealings or affairs of the company from any of the following parties:
    - (a) anyone who is or was an officer of the company
    - (b) anyone involved in the formation of the company, where that formation was within a year of the company entering Administration
    - (c) Any employee of the company or anyone that the company employed in the year leading up to it going into Administration
    - (d) anyone otherwise capable of providing information about the business, dealings and affairs of the company
- An Administrator has a general power to distribute the assets of a company to its creditors (However, before making a distribution to unsecured creditors, he must obtain a Court Order permitting that distribution.)
- The Administrator can remove any of the directors from office and can appoint directors to the company, irrespective of whether there is a vacancy.
- Administrators are also required, under the Company Directors Disqualification Act 1986, to submit a conduct

	report to the Secretary of State for Trade and Industry on the conduct of each of the directors and/or former directors of the company within six months of the company entering Administration.
Liquidator	A Liquidator has a number of statutory powers to enable him to fulfil his duties. Some of these powers are exercisable with sanction by the Court or the Liquidation committee; others can be exercised without either sanction. Powers exercisable with sanction - Carry on the business of the company, but only to the extent that is necessary for the beneficial winding up of the company - Commence or defend Court proceedings in the name of the company, for example to recover debts owed to it or dispute debts alleged to be owed by the company - Pay debts and compromise claims Powers exercisable without sanction - Sell any of the company's property - Execute deeds and other documents in the name of the company - Raise money on the security of the company's assets - Make or draw a bill of exchange or promissory note in the name of the company - Appoint an agent to do any business that the Liquidator himself is unable to do - Do all other things that may be necessary to wind up the company's affairs and to distribute its assets

Key Documents - Mortgages

Legal Mortgages

A Legal Mortgage is the most secure and comprehensive form of security interest. It transfers legal title to the lender (the mortgagee) and prevents the mortgagor from dealing with the mortgaged asset while it is subject to the mortgage.

The formalities required for creating a legal mortgage depend on the type of property being secured:

1. The creation of a legal mortgage over land must be by deed.
2. Legal mortgages over chattels do not generally require any formalities to make them effective, provided there is a valid agreement and intention to create a legal mortgage.

NOTE - Legal Mortgages cannot be created over all types of asset

Equitable Mortgages

In general, an Equitable Mortgage will arise where one of the following applies:

1. The formalities necessary to create a legal mortgage have not been complied with.
2. The parties have merely entered into an agreement to create a legal mortgage in the future over the asset in question.
3. The property to be mortgaged is recognised only in equity.

<u>Key Documents – Charges</u>

For practical reasons, most lenders will not want to take possession of a debtor's assets. Equally, a debtor will not want to lose control of its assets, especially if they are used in the day-to-day running of its business. Accordingly, a lender will want to take security by obtaining rights over, but not necessarily possession of, specific assets of the debtor as security for the loan.

Fixed Charges

Fixed Charges attach immediately to the charged asset (provided that the asset is, or is capable of being, ascertained and definite) and can be granted by anyone, including companies, LLP's, traditional partnerships and individuals.

The key characteristic of a fixed charge is that it gives the lender control over the charged asset. This control is crucial to the nature of a fixed charge. Without sufficient control by the lender over the asset, the charge will be floating and not fixed.

Typically, a document under which a lender takes a fixed charge will give the lender the right to:

1. Prevent the chargor from disposing of the asset without the lender's consent.
2. Sell the asset if the chargor defaults under the loan.
3. Require the chargor to maintain the asset while it remains in the chargor's possession.
4. Claim the proceeds of sale of the charged asset in priority to other creditors and thereby satisfy the purpose of taking security.

Whether a charge is fixed is not a matter of the intention of the parties, but a matter of fact.

Floating Charges

A floating charge is a charge on a class of assets, present and future, belonging to a chargor. That class of assets is one which, in the ordinary course of the chargor's business, changes from time to time so when a floating charge is taken, it is contemplated that until some future step is taken by, or on behalf of, those interested in the charge, the chargor will carry on its business in the ordinary way in relation to that class of assets (including disposing of those assets) without the consent of the chargeholder.

The group of assets subject to a floating charge may fluctuate from time to time, either through the chargor disposing of them in its ordinary course of business, or through the acquisition of assets of that class after the floating charge was created. This is the great advantage of a floating charge, but this freedom to deal with the assets presents the lender with the problem of how to stop the chargor from disposing of all the assets secured by the floating charge, leaving it as a shell.

This is one reason why lenders prefer to take fixed charges over specific assets where possible. However, lenders do have some limited protection under a floating charge since a floating charge, either by operation of law or by agreement of the parties, will become a fixed charge over the charged assets when certain events occur, e.g. crystallisation on the event of insolvency.

In spite of the inherent weaknesses of a floating charge, it is usually important for a lender to take a floating charge where possible, either on its own or in addition to one or more fixed charges. This is because a floating charge acts as a catch-all, sweeping up assets which, for practical purposes, cannot be specifically charged by a fixed charge (for example, stock in trade or goodwill) or of which the lender is unaware. It also enables a lender to take security without unduly restricting or affecting the chargor's ability to carry on its business.

<u>Secured / Unsecured Creditors</u>

A creditor of an insolvent company is a party to which, on the date of the insolvent company's entry into Administration or Liquidation (the insolvency date):

1. is owed money;
2. is under some form of obligation which will in future create a liability on the insolvent company to pay money to the party in question. If the relevant obligation exists at the insolvency date, it makes no difference that the amount of the eventual liability is not known or that there is no certainty as to when the liability will fall due

Secured creditor with a fixed charge

A secured creditor with a fixed charge over a particular asset is entitled to the proceeds of the realisation of that asset in satisfaction of the liability due from the company to that creditor.

Secured creditor with a floating charge

Typically in an insolvency context, a floating charge will automatically crystallise (i.e. become fixed over specific assets) on the insolvency date.

A creditor that holds a floating charge is entitled to receive the proceeds of the realisation of the assets caught by the charge in repayment of the liability due from the company to the creditor.

Unsecured creditors

An unsecured creditor is one who has no security over any of the assets of the insolvent company. An unsecured creditor will only receive a distribution if there are surplus funds after secured and preferential creditors have been paid.

<u>Company Directors Disqualification Act</u>

Under the Directors Disqualification Act a Court may make a disqualification order against a person that he shall not, without leave of the Court, be a director of a company or in any way, whether directly or indirectly, be concerned or take part in the promotion, formation or management of a company for a specified period beginning with the date of the order.

“Director" is widely defined to include any person occupying the position of director, by whatever name called.

Upon the initiation of the Secretary of State, a disqualification order may be made by the Court against a director or shadow director of a company which becomes insolvent if his conduct as a director makes him unfit to be concerned in the management of a company.

When assessing conduct, the Court is entitled to judge a director unfit on the strength of his conduct in respect of the insolvent company in question alone or his conduct in respect of that company and as director of any other company or companies.

The minimum period of a disqualification order is two years and the maximum is 15 years. It is open to a disqualified director to apply to the Court for leave to act as a director or manager of a company.

Liquidators, Administrative Receivers and Administrators are required to submit reports about directors (including shadow directors) to the Secretary of State if it appears to them that the conditions for disqualification are satisfied in relation to a person who is or has been a director of the company in respect of which they have been appointed.

Insolvency practitioners take the statutory duty to report seriously to avoid criticism if they fail to report and it later comes to light that the directors involved did breach their statutory duties. They need to make difficult judgments, involving both commercial and legal considerations, as to whether directors are unfit to be concerned in the management of a company and, in the case of shadow directors, whether they fall within that category or not.

In determining the question of unfitness, the Court shall have regard in particular to the matters set out in Schedule 1 of the Directors Disqualification Act. These matters include:

1. Any misfeasance or breach of any fiduciary duty by the director in relation to the company.
2. Misapplication or retention of any money or other property of the company.
3. Failure to comply with the provisions in the Companies Act relating to the keeping of accounting records, registers of directors and secretaries, duty to make annual returns and to register any charges created.
4. The extent of the director's responsibility for the insolvency.
5. Any failure to supply goods or services paid for in advance.
6. The giving of preferences or transactions at an undervalue.

It is a criminal offence if a person acts in contravention of a disqualification order and that person is personally liable for all the relevant debts of the company he is managing.

The Secretary of State, in lieu of initiating disqualification proceedings, may accept a voluntary disqualification undertaking from a director to speed up the disqualification process. The advantage for directors giving a voluntary disqualification is that they will not need to pay the costs of going to Court and may also be given a discount on the length of any disqualification period.

If a director agrees to give a voluntary undertaking, the Secretary of State has a discretion as to whether to accept the undertaking or apply to Court for a disqualification order.

A breach of the terms of the undertaking has the same criminal and civil consequences as a breach of a disqualification order.

Retention of Title (“ROT”)

ROT is a contractual provision by which, in its simplest form, the passing of title to goods supplied under a contract is made conditional on payment of the full purchase price by the buyer.

The object of an ROT clause is to give the seller of goods priority over secured and unsecured creditors of the buyer if the buyer fails to pay for the goods because it is insolvent, or for some other reason which may be specified in the clause. The clause may be used in its basic form (supplemented by certain other standard clauses) or with one or more additional clauses, such as an all monies clause, proceeds of sale clause or mixed goods clause.

Basic Clause

The basic clause provides that title to the goods is retained by the seller until it has received full payment for the goods. The basic clause should be supplemented by standard clauses containing:

1. A right for the seller to enter the buyer's premises in order to repossess the goods (so that the seller will not commit a trespass when doing so).
2. An obligation on the part of the buyer to:

   (i) store the seller's goods separately from goods belonging to third parties;

   (ii) to mark them as the seller's property; and

   (iii) to allow the seller access to the buyer's premises to verify that this has been done.

   This will enable the seller more easily to identify its own goods if a repossession of the goods becomes necessary.
3. A list of insolvency related events which will trigger the seller's right to demand payment for the goods (if not already due) and to repossess them.

All Monies Clause

Under an all monies clause, the seller reserves ownership of the goods supplied until the buyer has paid not only for those particular goods, but also for any other goods supplied by the seller to the buyer, and has repaid all other moneys owed to the seller, regardless of how such indebtedness arose. An all monies clause is a way around the obvious limitation of the basic clause, which is that the seller retains title to goods only until <u>those specific goods</u> have been paid for. The effect of the all monies clause is that all of the goods supplied, whether paid for or not, belong to the seller until the buyer has settled all invoices.

Proceeds of Sale Clause

Where the goods supplied are to be sold on by the buyer, the object of a proceeds of sale clause is to enable the seller to assert rights in the proceeds of sale in order to satisfy the purchase price of the goods.

Unfortunately, it is now extremely difficult, if not impossible, to draft a proceeds of sale clause without its being construed as a charge over the goods (and therefore unenforceable unless registered as such).

Mixed Goods Clause

Where the seller is selling goods for use in a manufacturing process (if, for example, it is a seller of components rather than finished products), and the goods supplied may be mixed or combined with other goods owned by the buyer or by third parties, the object of a mixed goods clause is to enable the seller to assert rights of ownership in any new product resulting from the manufacturing process. The case law distinguishes between:

1. Goods which maintain their identity (and which, if attached to other goods, can be separated without causing damage). Such goods will continue to belong to the seller where there is a basic form of retention of title clause as described above, so no additional provisions are necessary.

2. Goods which lose their identity in the manufacturing process. The resulting new product will belong to the buyer and the Courts have held that if a retention of title clause purports to reserve rights in the new goods to the seller, the clause will create a charge which will be ineffective if not registered.

It is clear from the case law, therefore, that the use of a mixed goods clause will achieve nothing for the seller. On the contrary, it may do harm if (following the same argument as described above in the case of a proceeds of sale clause), its invalidity also rendered the basic and all monies clauses invalid for non-registration as charges. Sellers of products which are quickly consumed within a manufacturing process should therefore consider alternative means of securing their purchase price, such as credit insurance.

Limitations of the effectiveness of ROT clauses

The following actual or potential limitations upon the effectiveness of retention of title clauses should be borne in mind:

1. If the buyer is a company in Administration, no steps can be taken without the consent of the Administrator or the permission of the Court to repossess goods supplied pursuant to a retention of title clause. This prohibition also applies during any interim moratorium in an Administration.
2. The retention of title clause must be properly incorporated in the contract between the seller and the buyer in order to be enforceable as a contract term.
3. A retention of title clause may be ineffective if its operation is inconsistent with the overall trading relationship between the parties.
4. Retention of title will be of little or no practical benefit where the goods supplied are perishable or have a low scrap value.
5. Retention of title is an area which generates a rapidly changing body of case law. Particular clauses are liable to be rendered ineffective by a Court decision at any time, so a review of retention of title clauses is a particularly important aspect of the overall review of standard terms which sellers should be carrying out on a regular basis

<u>Employees' Rights</u>

An insolvency situation gives rise to significant concerns for all parties involved. This is particularly true for the employees of the business, who may find themselves at risk of redundancy and/or unable to recover all sums due to them from their employer under their contracts of employment or statute.

Whether the onset of an employer's insolvency automatically terminates employment contracts will depend on the particular insolvency procedure involved.

PROCEDURE	EFFECT
CVA	CVA's do not immediately affect contracts of employment because the aim of the procedure is to enable the company to continue as a going concern . However, a CVA can occur in conjunction with an Administration or (rarely) a Liquidation to facilitate the distribution of the assets to unsecured creditors. Where that happens, whether employment contracts terminate or not depends on the type of process that the company subsequently enters into (see below).

Administration	An Administrator is appointed to promote (if possible) the rescue of the company as a going concern. Because the Administrator is the agent of the company, their appointment does not amount to a change of employer and so employment contracts do not automatically terminate on the appointment of an Administrator. An Administrator will have adopted contracts of employment if, in substance, they continue to employ staff and pay them in accordance with their previous contracts, after the first 14 days of his appointment.
Administrative Receivership	Subject to the three exceptions mentioned below, as a general rule, employees are not immediately affected by the appointment of an Administrative Receiver and there is no automatic termination of contracts: 1. Where the appointment is accompanied by an immediate sale of the business 2. Where simultaneously or soon after the appointment, the Administrative Receiver and employees enter into a new contract which is inconsistent with the old contract 3. Where the continuation of the employment of a particular employee would be inconsistent with the role and functions of the Administrative Receiver (for example, the appointment of an Administrative Receiver may, depending on the facts, render the role of a managing director inappropriate, as the receiver will be in control of managing the business). An Administrative Receiver will have adopted contracts of employment if, in substance, they continue to employ staff and pay them in accordance with their previous contracts, after the first 14 days of his appointment.
LPA Receiver	The appointment of an LPA Receiver does not automatically terminate employment contracts. If an LPA Receiver causes the company to retain an employee (usually unlikely given the narrow parameters of their role), the he / she becomes personally liable for all liabilities that the company owes to that employee (including redundancy payments and payments for unfair or wrongful dismissal). An LPA Receiver will have adopted contracts of employment if, in substance, they continue to employ staff and pay them in accordance with their previous contracts, after the first 14 days of his appointment.
Compulsory Liquidation	The effect of compulsory Liquidation is to automatically terminate all employment contracts with immediate effect on the date the Order is made. The employee will usually have a claim for damages for wrongful dismissal (unless termination has been in accordance with their contract of employment). In principle, there will be no claim for unfair dismissal in these circumstances as the dismissal is by operation of law

	However, in the case of compulsory Liquidation, the moratorium on legal proceedings will need to be lifted before employees can bring legal proceedings against the company. Also, an employee's right to damages ranks as an unsecured claim and will be difficult to recover in full. A Liquidator wishing to retain some staff will have to enter into new employment contracts. The advantage of re-engagement is that it will reduce the amount of damages payable for any wrongful dismissal claims arising out of the initial termination.
CVL	Creditors' Voluntary Liquidation may not immediately affect the employment contracts, as the business of the company does not automatically cease. However, Liquidators have only limited power to carry on the business of the company so far as may be necessary for its beneficial winding up. In practice, therefore, it is likely that the business of the company will cease shortly after the commencement of the winding up (if not before) and that, in those circumstances, the Liquidator will terminate contracts of employment.

Ranking Employee Debts

The majority of debts owed to employees are unsecured. As such they rank second to last in the order of priority on a realisation of assets. Although unsecured creditors share equally any available assets of the company in proportion to the debts due to them, in practice, this is likely to be, at best, a few pence of every pound that the company owes them.

However, employee creditors are owed their "remuneration" (up to a capped amount) as a preferential debt. Preferential debts rank third in priority and are paid in full (after secured creditors and the expenses of the insolvent estate).

National Insurance Fund

As a result of EC Law, member states are required to set up and finance “guarantee institutions” to ensure a degree of state guaranteed financial protection is provided to employees when their employer becomes insolvent. In the UK, this “institution” is the National Insurance Fund. (“NIF”)

Where the employer is insolvent, the NIF guarantees a basic minimum payment of specific debts owed to employees by their employers, provided certain conditions are met. This guarantee applies regardless of the type of insolvency procedure or whether the debt is unsecured or preferential.

The guaranteed debts include:

1. Employee debts, such as capped arrears of pay and statutory notice pay.
2. An "employer's payment" (broadly, a statutory redundancy payment or equivalent payment).

In order to qualify for payment of employee debts:

1. The employee's employer must have become insolvent.
2. The employee's employment must have been terminated.
3. On the "appropriate date" the employee must have been entitled to be paid the whole of part of a debt listed in section 184 of The Employment Rights Act 1996.

<u>Asset Distribution</u>

An insolvent company does not of course have sufficient assets to pay, in full, all the liabilities that it owes to its creditors. As such, one of the primary functions of Administration and Liquidation is, to realise the assets of the insolvent company and to distribute the cash realisations made from such assets amongst the insolvent company's creditors.

The IA 1986 and the IR 1986 create a scheme which sets out how Administrators and Liquidators must apply asset realisations to meet creditor claims.

The effect of this scheme is to place creditors into different classes. The insolvency practitioner uses asset realisations to satisfy the claims of each class in turn, in a descending order of priority. With the limited exception of the prescribed part, the insolvency practitioner cannot distribute asset realisations to a class of creditors until he has repaid in full the claims of all creditors in the prior ranking classes.

Order of Priority

1. Realisation for assets subject to fixed charges are paid to fixed charge holders (after deducting the cost of realisation – as agreed between the Administrator / Liquidator and the fixed charge holder.
2. Remuneration and expense of the Administrator / Liquidator.
3. Preferential creditors – e.g. contributions to occupational and state pension schemes, wages / salary of employees for the four months prior to insolvency up to a maximum of £800 and holiday pay due to an employee whose employment contract has been terminated.
4. Payment made from realisations made under the floating charge to unsecured creditors in respect of the “prescribed part”.

5. Remaining realisations from assets subject to a floating charge paid to floating charge holder.
6. Remaining assets distributed amongst unsecured creditors.
7. Any remaining realisations are distributed to shareholders.