

## **Insolvency: What's changed?**

It is a fact of life that some businesses fail. The continuing credit squeeze and a changing business climate mean that, regrettably, the failure rate may increase this year. Such failure of our clients has been historically rare, but many of them have to deal with the consequences of the insolvency of others, including business partners, suppliers, customers and competitors. Some, equally, have expanded through the low cost acquisition of insolvent businesses and their assets.

Insolvency processes have seen some significant changes in recent years, so it is worth reminding those of you who have not had to deal with insolvency for a while as to what they are.

Since 15 September 2003 Administration has been preferred to administrative receivership. A lender holding a qualifying floating charge (such as those found in most standard bank debentures) executed before that date can still choose to appoint an administrative receiver in the traditional way, but those holding charges created after that date can only do so in very limited circumstances, mostly related to large, complex, structured financings. In practice, the advantages of the reformed administration process are such that the appointment of receivers under any security is in steep decline. In 2007 administrations outnumbered administrative receiverships by over 5 to 1, a reverse of the position in 2002. So banks no longer call in the receivers, they send in the administrators.

This is because it is now much easier to do so. Administrators can still be appointed by petition to the court, but they can also be appointed by notice. The notice procedure is quick and relatively cheap, and can be used when the courts are closed. The long reports that used to accompany administration applications have been replaced by simpler declarations of belief that the purpose of the administration is likely to be achieved. That purpose is now the survival of the company or its business as a going concern. If this is not possible then the achievement of a better realisation of assets for creditors, including any appointing chargeholder, than would be achieved in a liquidation. In practice this usually means trading for a period to obtain a going concern value for the business.

Administration still imposes a comprehensive moratorium on enforcement action against the company by creditors. This is its key advantage over receivership. Creditors can still ask the administrator to allow enforcement action, and he should do so if it would not prejudice the purposes of the administration. In most cases administrators will pay ongoing expenses of trading, such as rent and wages, as expenses of their administration to avoid such requests, but cannot be forced to pay arrears.

Administrators must now send their proposals for the company to creditors within eight weeks of appointment. Their appointment automatically ends after one year, unless extended by the creditors or the court. This is intended to speed up the process, and there is evidence that this has happened.

Before 2003 administration was not an exit procedure; creditors could not be paid a dividend by the administrator, who had to use a second procedure to do this. This is no longer always the case, meaning exits can be cheaper and quicker.

Another major change has been the abolition of the preferential status of Crown claims, for unpaid PAYE, VAT and National Insurance contributions, in all insolvency cases. The only preferential creditors now are employees for limited amounts of unpaid wages. Part of the sum released by this abolition is put into a fund in each case for the payment of the company's unsecured creditors. This fund is limited in various ways, and has not produced very large payments in most cases, but it does give all creditors some interest in the outcome of all corporate insolvencies, which was not previously the case.

Changes have been made to the regime for Company Voluntary Arrangements (CVA), including the abolition of the shareholders veto, but CVAs still lack a moratorium and remain restricted primarily to an exit route from other procedures. Personal bankruptcy procedures also changed, in 2004, most notably by the reduction of the usual restrictive bankruptcy period to one year from three years, although the assets that fall within the bankrupt estate are unchanged (still almost everything of value).

This is just a brief introduction to the changes to a complex area of law, which can have major implications for all those who become involved in it. If you need further information on any aspect of insolvency or help at the early stages when difficulties first emerge, please contact Andrew Roberts.

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