ALLEN & OVERY

Restructuring across borders

England and Wales

Liquidation | March 2024

allenovery.com

Contents

Introduction

Liquidation (or winding-up) is the dissolution procedure for companies under English law. In that sense, it might be thought akin to Chapter 7 in the United States. ("Bankruptcy" is a term applied only to individuals in England, never to companies.) It is a procedure of last resort and involves a liquidator being appointed to take control of the company and to collect, realise and distribute its assets. Shareholders, creditors and the court have different degrees of control depending on the type of liquidation. Once the process has been completed, the company is dissolved.

Liquidation can take one of two forms: voluntary liquidation (either a members' voluntary liquidation or a creditors' voluntary liquidation, both of which are commenced by a resolution of the shareholders) or compulsory liquidation, commenced by the presentation of a winding-up petition in court and a winding-up order subsequently being made.

Voluntary liquidation

Voluntary liquidation is an insolvency procedure whereby a company, acting through its shareholders, instigates its own liquidation to wind up its affairs. The approval or sanction of the court is not required for a voluntary liquidation. Instead, the liquidation commences when a resolution supported by at least 75% of the shareholders present and voting is passed. Before passing a resolution for winding-up, notice must be given to any holder of a "qualifying floating charge" to give the charge holder the opportunity to appoint an administrator or administrative receiver (if permitted).

While a company is subject to the statutory moratorium under Part A1 of the Insolvency Act 1986, no resolution may be passed for voluntary liquidation unless it is recommended by the directors.

A voluntary liquidation can either be a members' voluntary liquidation (**MVL**) or a creditors' voluntary liquidation (**CVL**). An MVL is available only to a company that is solvent and, in this sense, it is not an "insolvency" procedure. After the passing of the shareholders' resolution, a majority of the directors are required to make a statutory declaration as to the company's solvency stating that, in their opinion, formed after having made a full enquiry into the company's affairs, the company will be able to pay its debts in full together with interest within 12 months. If the directors are willing to make the declaration then the liquidation proceeds as an MVL, however, if they are not, then the liquidation proceeds as a CVL.

While in an MVL, the shareholders nominate the liquidator, in a CVL, the directors are required to seek the nomination of a liquidator from the company's creditors. The decision of the creditors must be sought using the deemed consent procedure or by holding a virtual meeting – if the deemed consent procedure is used but the requisite number of creditors object, a physical meeting must be held. The decision must be made within 14 days following the shareholders' resolution to wind up the company. Before the relevant decision date for the creditors' nomination of a liquidator, the directors are required to deliver to the creditors a sworn statement as to the affairs of the company.

If at any time during an MVL, the liquidator is of the opinion that the company will be unable to pay its debts in full, then the MVL converts to a CVL and the creditors may nominate another liquidator. The creditors' choice of liquidator will displace anyone nominated by the members.

Compulsory liquidation

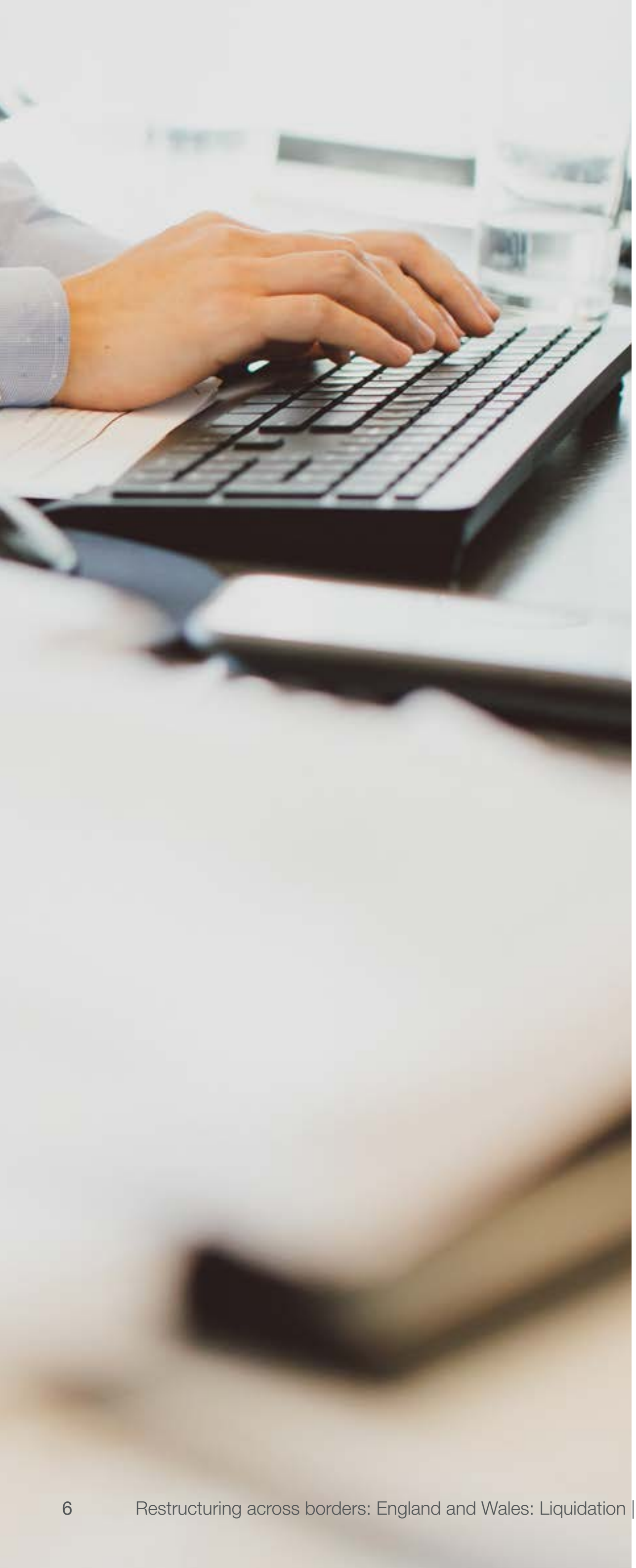
Alternatively, the company, the directors or a creditor (including a prospective or contingent creditor) may present a petition to the court for a compulsory winding-up. The petition to the court has to be based on one or more specified grounds including the inability of the company to pay its debts.[1] If the company is unable to pay its debts then the court will usually make a winding-up order, though the court has discretion on whether to make the order or not.

The court's discretion when presented with a petition to place a company into compulsory liquidation is wide. The court can make any order it thinks fit, including to stay any petition. For example, the court may take into account whether or not the debt is disputed in good faith, whether the company has a genuine cross-claim against the petitioner, whether the company has the ability to raise additional funding, and whether or not the petition is an abuse of process.

While a company is subject to the statutory moratorium under Part A1 of the Insolvency Act 1986, no petition may be presented for the winding up of the company (nor order made) except on an application by the directors.

Generally, the conduct of a compulsory liquidation is subject to a greater degree of control by the court than a voluntary liquidation. However, in a voluntary as well as a compulsory liquidation, interested parties such as the liquidator, contributory or creditor can apply to the court to determine questions arising in the winding up or to confirm, reverse or modify any act or decision of the liquidator or otherwise exercise any power that the court might exercise in a compulsory winding up.

[1] It is also possible for the courts to order the compulsory liquidation of a company on certain other prescribed grounds, including if the court thinks that it is just and equitable to do so.



Effect of liquidation

In both a creditors' voluntary liquidation and a compulsory liquidation, the powers of the directors cease. The company retains legal title to its assets but loses beneficial ownership.

The effect of a liquidation on claims against the company is broadly as follows:

- security and proprietary rights against the company are unaffected and remain enforceable and entry into liquidation will bring to an end any statutory moratorium under Part A1 of the Insolvency Act 1986, allowing creditors to enforce their security;
- entry into liquidation triggers the ban on the operation of *ipso facto* clauses contained in section 233B of the Insolvency Act 1986. More detail on this can be found in the **"England and Wales – Overview" factsheet available here**;
- in a compulsory winding-up, once the winding-up order has been made, no action or proceedings can be commenced or proceeded with against the company or its property without the leave of the court. Although there is no equivalent automatic statutory provision in the case of a creditors' voluntary liquidation, the liquidator may apply to the court for a stay of such proceedings to ensure an equal distribution of the company's property; and
- claims against the company are crystallised as at the date of liquidation and the proof of debt mechanism referred to below comes into play including the mandatory set-off provision.

Role of the liquidator

Regardless of whether the liquidation takes the form of a compulsory liquidation or a creditors' voluntary liquidation, the liquidator's role is to wind up the affairs of the company; get in and realise the assets of the company; agree creditors' claims; and distribute the asset realisations in the statutory order of priority.

The liquidator's duties are owed to the general body of creditors and shareholders. The liquidator has wide powers to act as agent of the company including power to sell the company's assets. Although they can continue the company's business, borrow money and secure it on assets of the company, they can only do so in so far as it may be required for the company's beneficial winding-up and, in practice, a liquidator does so only rarely and is much less likely to be able to sell a business as a going concern than an administrator or administrative receiver. The liquidator is required to prepare a progress report every 12 months to keep creditors informed of the progress of the liquidation.

The powers of the liquidator are set out in Schedule 4 to the Insolvency Act 1986. These powers include: the power to sell the company's property; the power to pay any class of creditors in full; and the power to make any compromise with creditors. The liquidator also has the power to challenge and have set aside antecedent transactions (eg transactions entered into at an undervalue and preferences given) and must investigate the conduct of the directors in the run-up to insolvency, which could lead to the directors being disqualified and/or being liable to contribute to the assets of the company, thereby increasing the assets available for creditors.

Agreeing creditors' claims

One of the key tasks for a liquidator is to agree creditors' claims for the purpose of making distributions. All creditors who wish to claim in the liquidation are required to submit a 'proof of debt' or claim form.[2] Creditors may submit a claim not just for actual claims that have arisen, but also for future and contingent claims, unascertained as well as ascertained claims. If claims are denominated in a currency other than pounds sterling, these will be converted into pounds sterling for the purposes of the proof of debt. Unsecured creditors rank *pari passu* for dividends in equal proportions to their respective claims (including in respect of any funds ring-fenced from floating charge realisations for unsecured creditors, as discussed further below).

Secured creditors can only claim if they surrender their security or claim in respect of any unsecured element of their claim. Because secured creditors can seek their own remedy in the liquidation (including by appointing a receiver), the secured creditor has no vote in a liquidation for their secured debt except to the extent of any shortfall.

A creditor who is also a debtor of the company in liquidation may have the benefit of a right of set-off so that they pay to, or claim from, the insolvent company only the net sum.

[2] Except those creditors with small debts which do not exceed GBP1,000. In an MVL, proof of debt is required only if requested by the liquidator.

Distribution

The liquidator is entitled to deduct their remuneration and expenses from the proceeds of the liquidation and is then required to distribute the balance in the following statutory order of priority:

– if the company entered liquidation within 12 weeks of the end of a Part A1 moratorium, any moratorium debts and priority pre-moratorium debts;

– preferential debts, including, occupational pension scheme contributions and four months' wages to employees, as well as certain unpaid taxes owed to HMRC;[3]

– funds ring-fenced from floating charge realisations for unsecured creditors on a *pro rata* and *pari passu* basis;[4]

– floating charge creditors (fixed charge creditors will be able to enforce their security, and receive payment, outside the liquidation process and so do not appear in this list of priority);

– unsecured creditors on a pro rata and pari passu basis;

– subordinated creditors pursuant to subordination agreements (although there are no classes of creditors who are subordinated as a matter of law, unlike in the United States). The degree of subordination and, therefore, where subordinated creditors rank in the order of priorities depends upon whether the contractual subordination in question is effective and also the terms of such subordination agreement.[5]; and

– shareholders, according to their rights and interests in the company although shareholders will receive nothing in an insolvent liquidation.

[3] In respect of insolvency proceedings commenced on or after 1 December 2020, HMRC are a secondary preferential creditor after ordinary preferential claims (which include certain employee claims) with respect to taxes collected by the company on HMRC's behalf. This includes VAT, PAYE income tax, employee's NIC's and construction industry scheme deductions.

[4] A fund of an amount up to GBP800,000 can be ring-fenced. For some charges created prior to 6 April 2020, the maximum amount that may be ring-fenced is GBP600,000.

[5] For example, it is possible for a subordinated creditor to have a floating charge but to agree to be subordinated to other floating charge holders only. Such a floating charge-holder would rank above unsecured creditors

Completion of the liquidation

Once a company's affairs have been wound up (ie all the assets realised and claims dealt with), the liquidator, among other things, makes the relevant reports to the shareholders and creditors, files a return with the Registrar of Companies and vacates office. Unless deferred under certain prescribed circumstances, the company is automatically struck off the register three months after the filing of the return.

Key contacts

If you require advice on any of the matters raised in this document, please contact any of our partners or your usual contact at Allen & Overy, or email **rab@allenovery.com**

Katrina Buckley
Partner
Tel +44 20 3088 2704
katrina.buckley@allenovery.com

David Campbell
Partner
Tel +44 20 3088 4758
david.campbell@allenovery.com

Nick Charlwood
Partner
Tel +44 20 3088 4106
nick.charlwood@allenovery.com

Joel Ferguson
Partner
Tel +44 20 3088 2414
joel.ferguson@allenovery.com

Nick Lister
Partner
Tel +44 20 3088 2469
nick.lister@allenovery.com

Jennifer Marshall
Partner
Tel +44 20 3088 4743
jennifer.marshall@allenovery.com

Hannah Valintine
Partner
Tel +44 20 3088 2238
hannah.valintine@allenovery.com

Tim Watson
Partner
Tel +44 20 3088 3984
tim.watson@allenovery.com

Randal Weeks
Partner
Tel +44 20 3088 2661
randal.weeks@allenovery.com

Kathleen Wong
Partner
Tel +44 20 3088 4281
kathleen.wong@allenovery.com

Lucy Aconley
Counsel
Tel +44 20 3088 4442
lucy.aconley@allenovery.com

Ellie Aspinall
Associate
Tel +44 20 3088 1124
ellie.aspinall@allenovery.com

Further information

Developed by Allen & Overy's market-leading Global Restructuring Group, "**Restructuring Across Borders**" is a free and easy-to-use website that provides information and guidance on all key practical aspects of restructuring and insolvency in Europe, the Middle East, Asia and the U.S.

To access this resource, please **click here**.

For more information, please contact:

London

Allen & Overy LLP
One Bishops Square
London
E1 6AD
United Kingdom

Tel +44 20 3088 0000
Fax +44 20 3088 0088

Global presence

Allen & Overy is an international legal practice with approximately 5,800 people, including some 590 partners, working in more than 40 offices worldwide. A current list of Allen & Overy offices is available at www.allenovery.com/global_coverage.

GB
CS2203_CDD-67970_ADD-112221_England_Wales_Liquidation