

Corporate Insolvency for businesses: 6 things you need to know first

In challenging economic times, it is not uncommon for businesses of all sizes to find themselves in dire financial straits, which can lead to a company becoming insolvent. While insolvency is not a desirable scenario, some insolvency procedures can be the life raft a drowning company needs to get back on its feet. With this in mind, here are six key things every business owner should know when it comes to corporate insolvency in the UK.

1. How to know if you're insolvent

To determine whether your company is insolvent, you must prove that it is unable to pay its debts. This may be done using the cash flow test, which stipulates certain conditions to prove that your company is unable to pay existing or future debts when they fall due. Alternatively, the balance sheet test can be used to show insolvency by proving that a company's liabilities exceed the value of its assets.

2. The repercussions of being insolvent

The consequences of insolvency vary according to the details of each case, but these are some of the potential repercussions:

- Continuing to trade until insolvency liquidation becomes inevitable could expose directors to disqualification or to personal claims being brought against them by creditors.
- A creditor may serve a statutory demand for payment, resulting in the issuance of a winding-up petition. This petition prevents the company disposing of its assets without court authorisation, and could

lead to compulsory liquidation.

- Instigating insolvency procedures will likely constitute an event of default according to banking facilities, entitling the bank to enforce any security it holds as the lender.
- Suppliers and customers may terminate their contracts with the company as a protective measure.
- Transactions for two years prior to the insolvency proceedings may be reviewed and reversed on application by the insolvency practitioner.

3. The long-term impact of insolvency on your company

Corporate insolvency does not necessarily mean your company will have to close permanently. There are certain insolvency procedures that can rescue your company if properly executed.

4. Insolvency procedures that could save your company

- Company Voluntary Arrangement (CVA)
In this binding, but highly regulated voluntary agreement, creditors decide the best way for a company to handle its debts. Typically, a reduced or rescheduled debt arrangement will be established, allowing the company to survive.
- Administration
This is a collective corporate rescue procedure in which the company's assets are protected by a statutory moratorium on any creditor action. Acting in the creditors' interests, administrators can trade on the insolvent business or seek a buyer for it.
- Scheme of arrangement
Similar to a CVA, a scheme of arrangement is a court-approved agreement between a company and its creditors or members under which the latter decides how best to handle the company's debt. Note, however, that this is more complicated than a CVA and is typically only used by larger companies with many classes of creditors or shareholders.

- Administrative receivership

In this rarely used option, the holder of a floating charge over the company (usually a bank) appoints a receiver to act in its interests. The receiver then sells off the company's assets to pay off the appointer's secured debt. Note that the receiver cannot pay unsecured creditors without court approval.

5. Terminal insolvency procedures

- Liquidation

In this collective process, all of an insolvent company's assets are converted into their cash value and distributed to creditors in a fixed order of priority. This effectively ends the company.

- Dissolution

A company may be dissolved voluntarily, subject to a solvency statement being completed to confirm that there are no outstanding liabilities that need to be paid on dissolution. Dissolution means a company ceases to exist; no one can act on its behalf, nor can it instigate any legal proceedings.

6. Determining the best insolvency procedure for your company

In some cases, business owners will decide to take action to rescue their over-indebted company before the court imposes compulsory insolvency procedures.

However, deciding on the best insolvency procedure requires the expertise and advice of a qualified solicitor and financial advisor. It is therefore strongly recommended that no action be taken without proper legal counsel.

Our team of experienced solicitors can help you determine the most suitable steps to take if your company is in financial difficulty.

For more information, or for expert advice on business or personal legal issues, call us on 020 3475 6751 or via email at info@carterbond.co.uk

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