MCTEAR WILLIAMS WOOD

addendum to book title: corporate insolvency

This document forms an addendum to McTear Williams & Wood's book, Corporate Insovency, published in 2004. It reflects the changes in legislation and regulatory areas since that time and should be read in conjunction with the book.

Corporate Insolvency by Andrew McTear, Chris Williams & Frank Brumby. Published by Cavendish Publishing 2004.

To be a small company, at least two of the following conditions must be met:

- Annual turnover must be £6.5 million or less
- The balance sheet total must be £3.26 million or less
- The average number of employees must be 50 or fewer

Page 45: Prepacks

As a consequence of administrations being more accessible to smaller companies, a new term has been coined for when a business goes into administration and then is immediately sold on. This is essentially what a prepack is. The term comes from the pre packaging of the business before the company goes into an administration. A buyer is found and terms agreed before the wider world are aware that the company is about to go into administration. This is both the advantage and disadvantage of a prepack. From the insolvency practitioner's point of view this is often the way to maximise the sale price of the business, minimise the cost of trading the business while finding a buyer and get a better return to creditors. This is possible because much of the value of a business lies in its people, contracts and brand – the value of which all diminish very quickly if the company goes into administration.

However, the creditors see a prepack as a way for unscrupulous directors to ditch the company's debt and restart debt free putting them at an unfair trading advantage to their competitors and using the suppliers' goods, which they have not paid for in the new business.

Done properly and for a premium price the prepack does have its place.

In an attempt to satisfy the creditors' hostility, the insolvency profession has to comply with a new SIP – SIP16 – which sets out the contents of a report, which must be issued to creditors as soon as the transaction completes. This includes demonstrating that it was the best deal for creditors, details of the valuations and marketing exercise that went on and the alternatives that were considered.

TUPE or Transfer of Undertakings Regulations

In recent years the position on whether TUPE applies or does not apply has been somewhat undecided.

Essentially TUPE operates so that when there is a transfer of employment from one business to another of all or most of the workforce the regulations apply so that the employees' rights are protected – for example the number of years of continuous service. Obviously, this has an effect on the new business if it subsequently

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discovers that it needs to made redundancies. If TUPE applies then the new business will pay the redundancy costs as though it has employed the workers for the time they were employed in the old business. This can be quite expensive and, in some cases, acts as a turnoff from acquiring a business.

The good news is that there is an exception for businesses that are in a Bankruptcy or analogous procedure. The bad news is that the Courts are still trying to decide what is analogous to a Bankruptcy. Recent case law suggests that an administration can never be analogous to a bankruptcy as its first objective is to save the company as a legal entity. It is believed by many that a liquidation is analogous to Bankruptcy and that therefore TUPE will not apply in a liquidation. But the law remains in a state of flux. Confused? Other than taking legal advice, if you are considering buying a business from an liquidator or administration then you should calculate the potential redundancy costs and be sure that the risk of having to make someone redundant is worthwhile.

Page 48:

The Inland Revenue has withdrawn the concession and now most businesses will need to go through an MVL to realise the gain as a capital gain rather than rely on the concession.

Page 54:

The DTI levy is now a sliding scale with 15% being a very rough average.

Page 55:

Due to changes in the Companies Act, a special resolution is now required to place the company into liquidation. In order to pass a special resolution 21 days' notice must be given unless the Company was incorporated under the Companies Act 2006 or the Company has adopted the new articles under the 2006 Act, and then the notice period is still 14 days.

Page 61:

A liquidator is no longer compelled to advertise locally unless he thinks there is a need to do so. A liquidator no longer has to file six monthly receipts and payments' accounts. Instead a copy of the liquidator's progress report to creditors is filed at Companies House. This report will include a receipts and payments' account.

Page 75:

The current maximum is £464 per week from 1 April 2014.

Changes in the marketplace since the book was published:

Since the book was published in 2004 the global economic conditions have deteriorated into the worst seen in living memory. Yet despite this the number of corporate failures did not reach the levels seen in the recession of the 1990s. Commentators have been speculating why this might be and point to the following factors:

- Banks all hit the sell button at the same time in the 1990s recession resulting in significant falls in asset value – they are keen not to repeat this.
- This time round the Bank's themselves have had to be bailed out and are therefore under significant political pressure not to force companies out of business.
- Interest rates are at all time lows so the servicing costs of the debts are not too high.
- HMRC reacted quickly with a generous 'time to pay' scheme.

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- The old method of securing bank borrowings was with a debenture and the banks held a fixed charge over book debts. Case law held that Banks could not have a fixed charge over book debts and so Banks found new ways to secure their debt. This has resulted in the emergence of asset based lenders ("ABL"s) which lent specifically against assets such as plant and machinery through hire purchase or leasing arrangements, or debtors through factoring and invoice discounting. This has allowed the bank to enforce their security or recover assets without necessarily forcing the company into receivership.
- The change to the administration process in 2003 has made it easier and cheaper for directors to appoint an administrator. Banks have been unable to appoint Administrative Receivers under the debenture if it was created after 23 September 2003. Although Banks have the power to appoint Administrators they seem reluctant to do so, perhaps under political pressure.
- Removing the preferential status of HMRC for VAT and PAYE has also perhaps been beneficial. Previously banks had to act quickly to prevent the build up of arrears of VAT and PAYE as they would need to be paid before their floating charge. Under the post 2003 regime not only have the assets under the fixed charge diminished, but the assets under the floating charge are subject to the prescribed part which potentially reduces the amount that the Bank could see through a formal insolvency. Better the Bank seek to recover its debts pre formal appointment to avoid this?

Other market changes:

The Companies Act 2006 introduced for the first time statutory duties of directors, in most cases codifing the case law already decided. One important point of which to be aware is the change in emphasis on insolvency. Ordinarily, the directors owe a duty to the shareholders. On insolvency this changes to owing a duty of care to the creditors. This makes it important that directors can identify when the company is insolvent and when their duty should change.

The pre-pack has been born. Partly a result of the easier and cheaper route to appoint administrators but also a realisation that a trading administration is both costly in terms of fees and the reduction in value. The makeup of the asset base is changing as well. Most assets are now financed in one way or another, or the business has reduced its asset base. Often the key assets are the intangibles – the staff and the goodwill for which value can only be obtained through a prepack.

The Company Voluntary Arrangement ("CVA") is being used more now than in 2004. It is a very flexible tool and provides (in theory) a better return to creditors. Unfortunately most CVAs never get to full term. Partly because they are normally five years, which is a long time, and partly because directors too readily agree to over optimistic cashflow forecasts or overly generous payments to creditors.

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