CHALLENGES ENCOUNTERED BY COMPANY LIQUIDATORS IN NIGERIA BRITAIN AND BANKRUPTCY PRACTITIONERS IN AMERICA

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Introduction

Problems faced during the liquidation process may depend on the reasons as to why the company has decided to liquidate. Companies with insolvency issues may face problems with creditors, though these problems may be rectified if a company appoints the right liquidator. Companies that are solvent and have decided to liquidate the company for reasons such as a company director wishing to end the business will find the procedure much easier to deal with.[1]

It is important that company directors are aware of how the liquidation process works before deciding to liquidate a company. If a director fails to follow the liquidator's rules then there could be problems during the process. Liquidators take control of a company during the liquidation process and will carry out a thorough investigation of the company, which some

[1] *Re Farmat Produce and Shipping Line Ltd V Establishment de Commerce General* (1971) 1 All. N.L.R. 27 (WAIFEM) September 17 – 19, 2004, Abuja, Nigeria, available online at www.wkikipedia.org 5-1-2014 at 6.00pm

company directors may disapprove of. Creditors will also question the directors as to why the business has failed, which may prove to be a difficult process for some.[2]

Challenges Faced by Company Liquidators in Nigeria

Company directors also need to be aware of employee rights during the process of liquidation. If a company director has failed to maintain a good relationship with employees then this could cause problems during the liquidation process. Failure to abide with employee rights may result in the employee taking action. With the right liquidator, companies can be sure that all those who are owed money will receive what is rightfully theirs. Once these problems have been solved, the directors will be free to move on. However, there seems to be a bit of a problem with the concept of the law and practice of insolvency in Nigeria. In contrast to the reactions to these other areas of the law, the mere mention of insolvency law to the average Nigerian, including legal practitioners, evokes the impression of a company being wound up for inability to pay its debt or of an individual who is tagged bankrupt.

Many people believe that they know as much about insolvency law and practice as they need to, simply because they know the meaning of the word "insolvency" which has the feeling of failure about it. The truth is that there is a lot that people do not know about the practice of insolvency law and indeed about insolvency practitioners much of whose work; contrary to the popular belief is very positive. Now in Nigeria, because of the relative dearth of relevant

[2] Okonkwo, CO – Legal framework for mergers and acquisitions at the retreat in merger and acquisitions in the bankruptcy industry organized by Central Bank of Nigeria and West African Institute for Financial and Economic Management (WAIFEM) September 17-19, 2014 Abuja Nigeria, Available at www.wikipedia.org 5-1-2014 at 6:00pm.

statistics, we cannot put figures to facts, but we know that in the U.K for instance, out of the 230,000 (two hundred and thirty thousand) jobs put at risk through insolvency in a typical year, 70,000 (seventy thousand) are rescued.[3]

Although, the nomenclature; Insolvency Practice with all its attendant technicalities may not have been in wide spread use in Nigeria, in reality the practice of insolvency is not entirely new in Nigeria. Even before the independence of the country, liquidators had been appointed over many indigenous banks and since then, particularly since the mid 1980's there have been several liquidations of limited liability companies. More recently there were a large number of liquidations of banks and insurance companies by a statutory corporation known as the Nigeria Deposit Insurance Corporation (NDIC) established to act as liquidators to such distressed banks. However the practice is still in its youth, consequently there are only a few persons who have had significant experience in insolvency matters. The expertise is limited to a handful of law firms and a few accounting firms who either have partners with a bias for insolvency or are large enough to have insolvency departments.[4]

The practice of insolvency with particular emphasis on the appointment of receivers however became more popular as a result of the economic depression prevalent in Nigeria in the past 15 (fifteen) years. The downturn of the Nigerian economy in recent years as well as the devaluation, of the Nigerian currency (the Naira) as compared to the various convertible

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[3] Okara, K. and A.I. Ologbosere – *Procedural issues on company liquidation and receivership*. Being a paper presented at the 24th Advanced counsel in practice and procedure organized by the Nigerian Institute of Advanced Legal Studies, Lagos, Nigeria =, on the 25th of October, 2004, available at www.wikipedia.org 06-1-2014 at 6.30pm

[4] European Commission a Best Project on Restructuring, Bankruptcy and a Fresh start final report of the Expert Group; September 2003, available from European Commission website on March 3 2014 (EC 2014).

currencies, specially the US$ (US Dollar) since the late 1980's have taken their toll, on all business sectors of the economy. Probably mostly affected is the manufacturing sector comprising of the large manufacturing industries that have had to import raw materials as well as machinery and spare parts at increasingly exorbitant rates. In order to finance this importation, these companies have had to borrow very heavily from the various lending institutions in the country, in some cases the lending institutions have had to form consortiums in order to meet the huge demand for funding.[5] Most lending institutions and indeed the various consortia that were created to give out loans have, in a bid to protect their interest, insisted on the execution of a mortgage by the borrower. Where the mortgage included floating assets, the security was documented by way of debentures, which usually provided for the appointment of a receiver in the event of default by the borrower.[6]

However, in the event of the harsh economic climate of the time, the inconsistent economic policies of the erstwhile military regimes, mismanagement and fraudulent practices in companies, there was a high rate of default in the repayment off those loans. The debenture holders have in a lot of cases taken the option of appointing a liquidator to sell of the assets of the debtor company to repay the loans. The foregoing scenario has been the major problem for the practice of corporate insolvency in Nigeria; therefore the general belief is that the practice of corporate insolvency consists solely of liquidatorships and that the practice becomes relevant only when a company is insolvent.

Nothing could be further from the truth, the fact is that the law and practice of insolvency is relevant not only when the existence of a company is threatened but also when the company

[5] *Re Stevedonng (Nig) CO Ltd* (1962) 4 R. 164
[6] *Ebrahimi V West Burn Gallaries Ltd* (1972) 2 WLR 1289 at 1303

is expanding or restructuring. It is relevant not only to companies faced with insolvency but also to creditors, shareholders and employees of such companies. The meaning of this is that the insolvency practitioners should provide solutions to an entity faced with insolvency and also give advice regarding options available to an entity that seeks to avoid the threat of insolvency.[7]

Having given a brief overview of the concept of insolvency practice from the Nigerian perspective compared to what it ought to be, this study shall now seek to address some of the salient issues necessary in understanding the Nigerian experience. In Nigeria the term "bankruptcy" is limited to personal insolvency while the term "insolvency" is associated with corporate insolvency. Bankruptcy is however rather rare in Nigeria.[8] This is not an indication that Nigerians are more prudent than their counterparts in other countries but as a result of their custom. We shall consider the legislation governing the insolvency regime with particular emphasis on corporate insolvency, the judicial enforcement machinery, forms of lending and insolvency options available under the regime.[9]

The core laws relevant to the insolvency of companies in Nigeria are only part of the general Company Law of the country and are embodied in the Companies and Allied Matters Act which is the legislation that deals with corporate matters generally in Nigeria. It contains portions dealing with Receivers and Managers, Arrangements and Compromise, and the winding up of companies. The rules governing the winding up of companies in Nigeria are

[7] Nwokoro O.C. "*An Assessment of the Efficacy of the various Agencies of the Compulsory Liquidation Process, perspectives in law and justice* in Umuzulike A (edited) 1996 p. 260.
[8] Nwokoro C.O. Op Cit pp 10 - 12
[9] Nwokoro C.O. Op Cit pp 10 - 12

contained in the Winding-up Rules which were made pursuant to the Companies and Allied Matters Act.[10]

Other useful laws are:

1. The Land Use Act Chapter 202, Laws of the Federation 2004 which is the major land legislation in Nigeria and which has made a deliberate incursion into the law of mortgages. About the most radical change it did was the vesting of all land in the country in the state or federal government with individuals being entitled to only statutory rights of occupancy for a maximum of 99 (ninety nine) years.
2. Failed Banks (Recovery of Debts) and Financial Malpractices in Banks Act No. 18 of 2004. This was promulgated during the military regime specifically to deal with cases of banks that were designated as distressed.[11] It is however arguable whether the aims of the decree (generally considered laudable on it's promulgation) achieved it's desired objectives as allegations emerged at the inception of the recent democratic dispensation that it was merely promulgated as an instrument of selective vendetta.
3. Mortgage Institutions Act Chapter 231 Laws of the Federation of Nigeria 2004.
4. Nigerian Deposit Insurance Corporation Act Chapter 301 Laws of the Federation of Nigeria 2004.[12]

It is no doubt trite that the existence of efficient judicial enforcement machinery is vital to the success of any legal regime. In Nigeria, corporate insolvency matters are dealt with in the first instance by the Federal High Court which by virtue of Section 251(1) of the Constitution of the Federal Republic of Nigeria 1999 is vested with exclusive jurisdiction to handle insolvency matters. Appeals may be made to the Court of Appeal and then from there to the Supreme Court of Nigeria.[13]

Nonetheless, our courts have not fared any better in terms of judicial experience in this area of practice and this is epitomised by the insufficiency of local case law on liquidatorship in

[10] *Sulaiman & Ors V Muslim Bank (WA) Ltd* (1970) A L. R. Comm. 388 at 382.
[11] Nwokoro C.O. Op Cit pp 10 - 12
[12] *Re Cole V R.C. Irving & Co Ltd* (1971) 1 U. I. L. R. 314
[13] Okara, K. and A.I. Ologbosere op cit pp 10 - 11

Nigeria decided upon by the Supreme Court. Since most insolvency cases arise from the issue of unpaid debts, both our legal practitioners and our courts treat them as being akin to debt recovery cases. This is no doubt consequent upon a paucity of knowledge on the part of our practitioners and judicial officers on technical issues relating to insolvency, as they do not have access to regular international insolvency publications (there are quite a few of them) and sources of information such as the "J-Base' which is an electronic database of international insolvency material.[14] For example, a liquidator/receiver may be appointed over the assets of a company, which assets may be subject to adverse trust claims, intellectual property right claims or third party claims of set-off, yet not many courts or legal practitioners in Nigeria have had experience of dealing with issues such as the effect of insolvency on intellectual property rights, trust assets in insolvency proceedings or the rights of set off and deposits as security in cases of insolvency. The effect of this is that the insolvency matters in general and receivership matters in particular are dealt with in Nigeria only on the periphery based on general company law principles and laws relating to pre-emptive remedies, without adequate appreciation of the technicalities of insolvency.[15]

It is however essential to note that our courts do have considerable experience in other forms of insolvency proceedings such as winding up procedures available under voluntary and involuntary liquidation.Another challenge of liquidation is that the entire process is excessively dilatory and expensive. There is much concentration of responsibilities on the courts with a view of protecting the credibility of the liquidation process. Thus making the entire process circuitous as all the persons want the court to exercise its powers bothering on

[14] Okara, K. and A.I. Ologbosere op cit pp 10 - 11
[15] Ibid 613

application to it, in their favour. It is clear that the creditors, committee of inspectors, contributors may work at cross-roads when the C.A.C changes its work attitude and court slow down the process.

Another challenge is where liquidators experience challenges during liquidation is in the area of appointment of receiver for the company. There are 2 (two) basic forms of appointment of receivers in Nigeria i.e. the court appointed receiver and the receiver appointed out of court usually under a security document. In the case of a court appointed receiver, an application is made to the court to appoint the receiver on behalf of the debenture holder or other creditors of a company which is being wound up by the court. An application can also be made under section 389 Companies and Allied Matters Act by a person interested and the court has the power to appoint a receiver or a receiver and manager of the property or undertaking of a company if the principal money borrowed by the company or the interest is in arrears or the security or property of the company is in arrears. Such a receiver is known as the "Official Receiver" and he is regarded as an officer of the court and not that of the company and shall act in accordance with the directions and instructions of the court.[16]

The absence of a body to amongst other things, to control and regulate the practice of insolvency is a serious factor militating against its development. The establishment of the Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN), formerly known as the Insolvency Practitioners Association of Nigeria, the name was changed to its current name in order to reflect the growing trends in other jurisdictions with a well developed

[16] European Commission a Best Project on Restructuring, Bankruptcy and a Fresh start final report of the Expert Group; September 2013, available from European Commission website on March 7 2013.

regime of insolvency in which emphasis has shifted to business rescue and turn around management.[17]

At the present time, there is no formal statutory rescue procedure in Nigeria for the financial reorganisation of companies in financial distress as is the case in many jurisdictions, such as the Britain where you have both the informal London Approach and the formal Administration Procedure under the Insolvency Act.

Where the company is in liquidation, the company's activities usually have ceased and its assets will have passed into the hands of the liquidator but since the law does not provide for a moratorium on creditors taking action against the company in a scheme of arrangement until the scheme is sanctioned by the court, schemes of arrangement are seldom used prior to liquidation because the process could be undermined at any stage by the filing of a petition by an aggrieved or unsatisfied creditor. Sometimes a consultant or a sum committee of the lenders is appointed to oversee the activities of the company and report to the creditors on progress. The courts do not have an ongoing supervisory role.[18]

The creditors may take legal action to recover monies from directors if certain conditions apply. A sensible approach could be to allow the bank to recover much of their debt thus reducing the company's liability. There are measures to reduce the financial hardship of employees in the event of liquidation and where the business is not sold as a going concern.[19]

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[17] Ibid 615

[18] *US Department of Commerce "Doing business in Nigeria: A Country Commercial Guide 2008. Available from US at foreign commercial service and US Department of State website, accessed on September 19 2013 (US. Doc 2008)*.

[19] *European Commission a Best Project on Restructuring, Bankruptcy and a Fresh start final report of the Expert Group op cit pp 3 -5*

Where there are big tax losses, the company will lose them in a creditors voluntary liquidation tax loss. Where there is wrongful trading and the officers of the company failed to act correctly when they knew that the company was insolvent, they failed to take the actions of a "reasonable person" to maximise the body of creditor's position and they wilfully continued to take credit that they understood they might not be able to repay. Failure to submit annual returns and accounts is also a big problem faced by company liquidator. Another, problematic area during company liquidation is insufficient information. There is insufficient information publicly available as to the level of Nigeria's compliance with the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems. Nigerian law is based on the principles of British common law, as a result of its historical link with the United Kingdom during the colonial era. Chapter 20 of the Laws of Nigeria comprises the Bankruptcy Law, but this deals with individual bankruptcy and is rarely used. For commercial insolvency issues, provisions in the Nigerian Constitution (1999) and the Companies and Allied Matters Act address related issues.[20]

British common law provides the basis for Nigerian insolvency and bankruptcy legislation. The Bankruptcy Act of 1990, Chapter 30 of the Laws of Nigeria, was amended in 1992. However, the law concerns only individual bankruptcy. Business winding-up is governed by Chapter XV, Sections 407 and 532 of the Companies and Allied Matters Act. According to the 2008 Country Commercial Guide (CCG) published by the U.S. Department of Commerce, statutorily modified common law governs most business transactions, and Nigerian business culture is such that, as a rule, most businessmen do not seek bankruptcy protection. Nigeria appears now to recognize the need to address the issues of insolvency and creditor rights – the

[20] *US Department of Commerce "Doing business in Nigeria: A Country Commercial Guide 2008. Op cit p. 42*

World Bank's website provides access to the text of a seven-point policy agenda of the Nigerian Project, which includes as part of its aims a comprehensive review of the country's bankruptcy and insolvency laws and strengthening of the foreclosure procedure.[21]

Nigeria's insolvency law has been slow in its development, even though the fact of insolvency is a very common occurrence; such laws as do exist are not enforced. In an attempt to address this problem, the Business Recovery and Insolvency Practitioners Association of Nigeria (BRIPAN) was constituted in 1994 under the authority of the Companies and Allied Matters Act. In some detail the BRIPAN mission, seeks to professionalize and regulate Nigeria's insolvency practitioners and keep its members abreast of international developments in the field of insolvency and bankruptcy law. Other challenges faced by company liquidators in Nigeria are inadequate legal regulatory framework, and low literacy level in the nation's corporate sector which is militating against effective and successful company liquidatorship practice in Nigeria.[22]

6 Challenges Faced by Company Liquidators in Britain

Areas where liquidators encounter problems during company liquidation in Britain are underscored below.

(a) Finance/Investment Problems Faced During Voluntary Liquidation

When a company is insolvent, it may enter a Creditors voluntary Liquidation, but in some cases insolvent companies may have no choice but to liquidate as a result of being given a winding up order by a court. Compulsory liquidation can be an extremely difficult process for companies. The voluntary liquidation process means that the company directors can choose,

[21] *Farmart Product and Shippng Line Ltd V Establishment de Commerce General* (1971) 1 All. N.L.R. 247.
[22] Olajide, B. "*BRIPAN to promote insolvency practices*". The Guardian August 5, 2009 p. 10

along with approval from shareholders, to liquidate the company. When a court presents the company with a winding up order, the company has no choice but to liquidate. With a Members Voluntary Liquidation, a company will declare that it is insolvent and a liquidator will value and sell the company's assets in order to pay off creditors. A Creditors Voluntary Liquidation involves the investigation of the company by the liquidator, after which regular meetings will be held with creditors. The company's assets will be sold and the creditors will be paid off, allowing the company directors to move on.[23]

A compulsory liquidation takes place when a creditor petitions to a court in order to wind up the company. Company directors can also petition to courts, though this must be done by a group of directors and not just one director. The company directors will receive the winding up order in court. Companies are able to make an appeal after a winding up order has been presented, but this must be done within a certain time period. Petitioning to the court can prove to be costly for creditors and company directors, so it is always a good idea for companies to consider alternatives.

(b) Insolvency Documents – Importance of Company Numbers on Forms/ Documents and a look at Portrait or landscape Documentation

One of the main problems encountered by the liquidator in dealing with documents received for registration is the omission of the company number. This causes considerable extra work for both Companies House and the presenter of the document since the general Companies House staff has only very limited authority to make amendments of a minor nature received for registration. Often, therefore, their only option is to reject them. It is vital for the correct company number to be quoted on all forms submitted for registration. The consequence of a

[23] *Re Rica Gold Washing Co* (189) 11 CH.D 36. Bankruptcy, 1911 Encyclopedia Britannica

document being placed on the record of another company because of failure to provide the correct number, could, given the nature of the document, have a significant bearing upon that company's perceived standing.

It is also important to look at the quality and format of documents, which are presented to the Registrar for filing. It is easier to read documents which are submitted to Companies House in portrait layout. With that in mind, and due to the introduction of advanced scanning equipment, the Registrar's preference is for the submission of portrait forms. The vast majority of submitted documents already conform to an A4 portrait specification. It must be stressed that no document will be rejected where they satisfy all other filing criteria. Such forms will be registered and a note sent to the presenter explaining the Registrar's preference in this regard for future reference.[24]

(c) Procedures for dealing with court orders to stay winding up proceedings

The court may make an Order staying, winding up proceedings, either altogether or for a limited period of time, pursuant to Section 112 and Section 147 of the Insolvency Act 1986.

The Order is to be forwarded to the registrar of Companies forthwith for entry into the records relating to the company. The Registrar of Companies records the Order into the public records in the following ways:

a. The Order itself is placed on the public record.

[24] *Re Crigglestone Coal CO Ltd* (1906) 2 Ch. 327. Business Law and Practice Review 2003 – 2004 by the business law and practices, school Of Law, University of Leeds, 2000 – 2004. Available online at www.lawleeds.ac.uk/lawleeds/web/docs/lead/uploaded_documenys_04.pdf

b. The Order is listed as a 'Miscellaneous' document on the list of documents received by the Registrar of Companies for the relevant company. (This list is available to the searcher of the public record).

c. The Liquidation status flag is removed from the company's public records.

The searcher would still be able to obtain a copy of the winding up order. In addition the insolvency details would still be available on the insolvency section of electronic search products.[25]

Once the stay order has been recorded, compliance with the company's duty to file annual accounts and annual returns will be pursued just as for any other live and active company. Failure to comply may result in the company being struck off the register pursuant to section 652 of the Companies Act 1985.

(a) Statements to the registrar of Companies in Creditors Voluntary Liquidations (CVLs)

Under section 192 of the Insolvency Act 1986, if liquidation is not completed within one year of its commencement, the liquidator shall at required intervals file a statement in the prescribed form with Companies House until the conclusion of the liquidation. Further, rule 4.223-CVL (4) of the Insolvency Rules 1986, applicable to CVLs only, provided for the required statement, in form 4.68, to be filed in duplicate. Companies House previously sent the second copy to the Insolvency service (insolvency practitioner Unit) to allow for monitoring of the banking in the ISA, to ensure it was being undertaken correctly.

[25] David Kersham: *Company Law in Context*, Oxford University Press 209, pp. 30 – 32.

Further to the Enterprise Act 2002 coming into force, practitioners are no longer required to use the ISA account in CVLs and therefore there is little merit in Companies House continuing to forward those forms they do receive. Practitioners are therefore advised that this aspect of desktop monitoring will no longer take place and therefore the duplicate copy of form 4.68 is no longer required by the Insolvency Service. It is intended to seek an amendment to the Rules to reflect current practice, and in the meantime it has been agreed with Companies House that insolvency practitioners may disregard rule 4.223-CVL (4).

(b) Filing Requirements at Companies House under the Enterprise Act

Companies House always fields enquiries from company liquidators and rejects a significant number of documents sent to the Registrar under the terms of the Enterprise Act. There appear to be some documents, in particular, for which the insolvency practitioners are not clear about the filing requirements as specified by the Enterprise Act. Below is a list of the forms required to be filed.[26]

Form 2.23B – Notice of Result of Creditors Meeting

Companies House receives significant numbers of Forms 2.23B without copies of the proposals attached (see Rule 2.46 Insolvency Rules 1986). In order to register the Form 2.23B a copy of the revised proposals must be attached to the form. This is even as the proposals have not changed since the filing of the Form 2.17B – Statement of Administrator's Proposals.

Form 2.24B – Administrator's Progress Report

[26] Armour J. et al. "*Corporate ownership and he evolution in bankruptcy laws: lesson from the United Kingdom* (202) 55 Vanderbilt law review (2012) 699 at 1704.

Companies House receives a considerable number of Forms 2.15 – Administrators' Abstract of Receipts and Payments, when in fact the insolvency practitioner should file the Form 2.24B (see Rule 2.46 Insolvency Rules 1986).

Form 2.15 is specific to the old style Administration Orders and is not required for filing when the company is 'In Administration' under the enterprise Act.

This also applies to all other old style Administration Order forms. If the company is 'In Administration' then the insolvency practitioner will need to file the relevant Enterprise Act form.[27]

Form 2.34B – Notice of Removal from Administration to Creditors Voluntary Liquidation (CVL)

There is some confusion over this form amongst insolvency practitioners (see Rule 2.118 Insolvency Rules 1986). Insolvency practitioners are filing Forms 2.30B – Notice of Automatic End of Administration, Form 2.32B – Notice of Court Order Ending Administration, together with the Form 2.34B. There is no need for insolvency practitioners to file Notice of End of Administration documents with this form. This form has been designed along with the IT functionality at Companies House to close the Administration and start the CVL, both on the date that the Form 2.34B is registered at Companies House (i.e. the one form provides both functions).

[27] Searly L.S. *Cases and materials on company law*, 4th edition, London, Butterworths & Co Publishers limited 1989, p 137.

Insolvency practitioners should note that this practice could have significant consequences for them if a Form 2.30B is filed with the Form 2.34B and they become separated in the Post Room, during the post-sort stage. It is possible that the Form 2.30B can be registered first, the Administration closed and the Form 2.34B cannot then be registered. This means that the insolvency practitioner would then have to get an order from the court to allow the incorrectly filed document to be removed and the correct Form 2.34B filed. This can be time-consuming and costly for the insolvency practitioner.

Also, there is no need to file a Form 000.420, or Extraordinary Resolution, as the Form 2.34B performs the function of these three documents.[28]

Form 2.35B – Notice of Removal from Administration to Dissolution

There are similar problems with this form as with the Form 2.34B. Insolvency practitioners send the End of Administration forms as well as Form 2.35B. There is no need to send any other form apart from Form 2.35B and any associated attachments, when the company moves from Administration to Dissolution. Companies House IT functionality automatically closes the Administration and sets the system to count down the relevant three months to Dissolution date.

Once again, if the forms are separated for any reason within Companies House and the End of Administration forms are registered first, the insolvency practitioner will need an order from the court to remove the incorrectly filed document. It is important to note that in respect of

[28] International Monetary Fund, "*United Kingdom: Financial system stability assessment including reports on observance of standards and code, on the following country report No 03146, Washington DC*. IMF February 2003 available from IMF website accessed on May 3, 2013 (IMF 2003).

Forms 2.34B and 2.35B. Companies House accepts all the documents in good faith. Therefore, if any other End of Administration documents are filed, correctly completed, they will be registered without exception. Once a document has been correctly filed it can only be removed with an order from the court. It should state that the incorrect form filed is a nullity and the document should be removed from the record.[29]

The breakdown of a company can be extremely disheartening for company directors and employees. Some company directors may struggle to come to terms with the fact that the business will end, whilst others may be relieved that the company's debts will be paid off so that they can move on.

The Problem of Chasing Assets in Insolvency

Nowadays with the emphasis on entrepreneurship, the complexity of commercial arrangements and the speed of high value and cross border transactions the instances of wrongful behaviour in the run up to insolvency seem to arise more frequently.[30] Here, some are of the matters to be considered when making claims against directors and others, particularly in the context of liquidation.

(a) Investigation

[29] *Re s Calmex Limited* (1989) BCLC 299
[30] Hugo Groves "*Changing Assets in Insolvency deals with duty claims against the liquidator*. Retrieved from Wikipedia.org on November 7th 2013 at 2.00am

A liquidator is under a statutory duty to get in assets and this includes the making of claims against directors and others. Normally a liquidator comes to the situation after the event. There are a variety of helpful provisions which enable him: to recover the property of the company in a summary fashion: to discover what has happened to the assets of the company and/or to obtain information upon which a decision may be made to pursue directors and others. The most commonly used provisions in IA 1986 are: s. 2 234 getting in the company's property; s. 235 (duty to co-operate) and s. 236 inquiry into the company's dealings etc. S. 236.

(b) Obligation of Disclosure

The obligation of disclosure by the insolvent to an office holder has a long history and it permeates a number of modern insolvency provisions. There is a similar provision in bankruptcy law (s.366): and the public examination provision in bankruptcy (s.290) dates back to 1705 in the [31]Statute of Anne 4 ch 17. Very early on English insolvency law adopted a *carrot and stick* approach to the obtaining of information from the insolvent. The Statute of Anne stated in its recital:

> Whereas many persons have and do daily become bankruptcy, not so much, by reason of losses and unavoidable misfortune was to the intent to defraud and hinder their creditors of their just debts and duties to them due and owing: for the prevention thereof, be it enacted.

The carrot – the debtor who complied with his duty of disclosure would be entitled to keep 5% of realized assets and obtain a discharge from pre-bankruptcy obligations.

The stick – the bankrupt's submission to examination before the "Bankruptcy Commissioners"

Under s.236 an office holder is given the opportunity not only to attempt to reconstitute the

[31] Hugo Groves op cit P. 10.

knowledge of the company but also to discover the facts surrounding a claim against an officer with as little expense and as much ease as possible.[32]

The order may be against any officer/former officer, any person known or suspected to have in his possession any property of the company or supposed to be indebted to the company, any person whom the court thinks capable of giving information concerning the promotion, formation, business, dealings, affairs or property of the company. A commonly sought order is for the oral examination of the respondent and s.236 is sometimes referred to as the "*private examination*" provision. However the court may make a range of other orders including the production of a witness statement (*IR 1968 r.9.2 (3*) or documentation/information e.g. bank statements, solicitors'/auditors' file.[33]

The making of an order under s.236 involves the exercise of an extraordinary power and it will only be made after a careful balancing of the (usually many) factors involved. Where an application is made for a private examination or the production of documents the court has to be satisfied that the order requested is necessary and not oppressive. However an application is not unreasonable simply because it causes a respondent substantive work or inconvenience though those are factors to be weighed in the balance.[34]

It is easier to obtain an order against officers and former officers of the company. There is no longer any rule that where litigation has been commenced by the liquidator then a s.236 private examination will not be ordered. However it is unwise to issue substantive proceedings before applying for a private examination as it will be attacked as a "*fishing exercise*".[35] A private

[32] *Re Rolls Razor Limited* (1968) 3 All ER 698, 700 per Buckley J.
[33] *Re Brook martin & Co (Nominees) Ltd* (1993) BCLC 328.
[34] *British & Commonwealth plc V Spicer & Oppenheim* (1993) AC 426 at 3.
[35] *Re Cloverbay Ltd* (No 2) [1990] BCC 414

examination under s.236 is in substance an inquisition by the liquidator who may be fuelled by a creditor (*IR 1986 r.9.4(2)*) and the right of the respondents' legal advisers to intervene is limited (*IR 1986 r.9.4(5)*).

Attacks have been made over the years on what is perceived as the draconian reach of s.236 but without notable success. Thus an examinee cannot refuse to answer questions on the basis of self-incrimination[36]*... of criminal proceedings;*[37] material obtained as a result of a s.236 examination does not necessarily involve a breach of the right to a fair[38] and the court has recently used the provision to order HMRC to disclose under a letter of request concerning transactions between a company and a certain bank in the Dutch Antilles[39] S.235.

In practice s.236 is somewhat of a last resort if the object is to obtain a helpful interview with a director. It obviously involves making an application to court and this may be time consuming and expensive. The initial approach should be to remind the director of his duty to co-operate under s.235 and the obligation imposed to supply information and to attend on the liquidator. The obligation is imposed on officers and former officers (which would include an auditor[40]); those involved in the formation of the company within one year prior to the entry into liquidation/appointment of provisional liquidator; employees within that year (employment is extensively defined – includes professionals rendering services); and where a company is wound up by the court any former administrator, administrative receiver or liquidator are also under obligation to supply information to the new liquidator.

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[36] *Bishopsgate Investment Management Ltd v Maxwell* (1992) Ch 1
[37] *Saunders v United Kingdom* (1997) 23 EHRR 313, 433
[38] *Re Westminster Property Management Ltd* (2001) BCC 121.
[39] *In the Matter of ABC Ltd (in liquidation)* (2010) EWHC 1645 (Ch) S.235
[40] *Sasea Finance Ltd v KPMG* (1998) BCC 21.

(c) Enforcement Concerns

It is important to establish as much as possible the asset position of the intended respondents and this exercise is often fraught with difficulties. If the respondent is a director it may be worth considering whether a claim can be made against any directors' and officers' insurance policy that is in existence.

(d) Funding Concerns

One practical solution to a lack of funding is to enter into a conditional fee agreement ("CFA"). The fundamental requirements for these were set out in s.58 Courts and Legal Services Act 1990 and the rules as to the recoverability of success fee are set out in CPR 44.3A, 44.3B.

Conditional Fee agreements are presently a fact of legal life and the rules must be strictly followed.[41] When the use of CFAs was first extended from personal injury claims the two additional areas were human rights cases and insolvency proceedings. CFAs remain for some people difficult and unpopular with both claimants and defendants. The problem in the usual insolvency case is that there are no assets left which could fund litigation and/or no desire on the part of creditors for funding a claim.

(e) Selling causes of action

It is clear that a cause of action vested in the company can be sold as property of the company as contained in *Sched 4 para 6 IA 1986,* and,[42] but claims by office holders such as wrongful trading/preference[43] may not be assigned. In respect of those claims the officer holder can assign the benefits of the claim.

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[41] *Segal v Pasram* [2008] EWHC 3448 (Ch)
[42] *Grovewood Holdings plc v James Capel & Co Ltd* [1995] BCC 760
[43] *Re Oasis Merchandising Services Ltd* [1998] Ch 170

The underlying claim vested in the company can be sold by the liquidator though there may be some good issues of public policy to consider in assigning to a bidder who is or may be a respondent to the claim as evident.[44]

In recent times there have been a number of cases of respondents taking the point that they are not directors and therefore not liable for breach of directors' duties or for disqualification proceedings.

The statutory definition of a director is not completely illuminating. A director is a director *"by whatever name called*" and even the completion of the relevant return to Companies House is not determinant.[45]

A company must have at least one director who is a natural person - at least 16 years old (s.157 CA 2006*)* – Secretary of State may make regulations reducing age. The *position of de iure or de facto* and shadow directors should be considered. The determination of whether a person is a de facto director involves an evidential exercise which may be difficult to predict.[46]

Shadow has been cast since 1948 *(annual return details)* – but only seen to as "shadow directors" from 1980. The requirement to show the board was accustomed to act on the directions and instructions of the shadow (*director*) – whether any particular communication from an alleged shadow was such direction/instruction should be objectively ascertained in light of all the evidence.[47] "The general duties apply to shadow directors where, and to the

[44] *Whitehouse v Wilson* [2007] BPIR 230.
[45] *Re CEM Connections Ltd* [2000] BCC 91.
[46] *Re Gemma Limited* [2008] BCC 812.
[47] *Secretary of State V Deverell* [2000] BCC 1057.

extent that, the corresponding common law rules or equitable principles so apply" under s.170 (5).[48]

(f)To freeze or not to freeze

One concern in making an application for a Freezing Injunction Order is the giving of a cross undertaking in damages.[49] The liquidator usually demands that the cross undertaking is restricted to the assets of the company in liquidation.[50]

The question of fortification of the cross undertaking was extensively considered.[51] Here, the respondents applied for fortification on the basis that the applicant companies were in administration and clearly insolvent. The court considered that the applicants were in no position themselves to fortify the undertaking but it would not be unreasonable for the administrators to approach the main creditors who were banks to seek an indemnity; albeit for considerably less than the respondents requested. The court balanced the potential harm to the respondents if it transpired that the Freezing Injunction Order had been wrongly granted (which was assessed as significant), with the harm to the applicants if the fortification was ordered unnecessarily. The court concluded that fortification would not stifle the action nor put the administrators to unreasonable risk. The court placed particular emphasis on the identity of the creditors as banks[52] was distinguished as being a case involving a large number of small creditors who were not in a position to offer fortification.

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[48] *Ultraframe (UK) Ltd v Fielding* [2005] UKHC 1638
[49] *Re DPR Futures Ltd* [1989] 1 WLR 778.
[50] *RBG (Resources) plc v Rastogi* [2002] BPIR 1028.
[51] *Re Bloomsbury International Ltd* [2010] EWHC 1150 (Ch).
[52] *Re DPR Futures Ltd*

In deciding the question of fortification the evidence of the applicant should deal with any attempts to approach creditors and/or legal insurance providers which have taken place. Though the absence of immediate assets is an important factor to be taken into consideration it is not necessarily a determinative one. Clearly an applicant must be careful to ensure that he complies with the duty of full and frank disclosure.[53]

A misfeasance application is typically regarded as a "short form" procedure available in liquidation. It is commenced by an application supported by a witness statement. It does not create any new cause of action[54] and the malfeasant director can apply for relief under s.1157 CA 2006 on the basis that he has acted honestly and reasonably. The limitation period is dependent on the underlying cause of action rather than the date of liquidation.[55]

The essence of liability under s.212 is the causing loss to the company and it is not vital to prove insolvency.[56] There are cases of general misfeasance claims being made because there has been a breach of duty by a director or a breach of a statutory provision. But, is not every breach that causes a loss to the company for example, *section 127 void dispositions in the shadow of a winding up petition)*,[57] s.239 bothers on preferences[58] concerning non payment of value added tax.[59]

S.212 covers the whole sphere of directors' duties from the "amiable lunatic" to the fraudulent,[60] and can include the unlawful mixture of group companies' affairs.[61]

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[53] *Franses v Al Assad and others* [2007] BPIR 1233.
[54] *Re Simmon Box (Diamonds) Ltd* [2002] BCC 82)
[55] *In Re Eurocircuit Europe Ltd* [2007] EWHC 1433 (Ch)
[56] *Gamble and Mann v Hoffmann* (1997) 15 A.C.L.C. 1314
[57] *Re Continental Assurance plc* [2001] BPIR 733.
[58] *Re Brian D V Pierson (Contractors) Ltd* [1999] BCC 26
[59] *Re ED Games Ltd* [2009] EWHC 223 Ch.
[60] *Re D'Jan of London Ltd* [1993] BCC 646
[61] *Re Westlowe Storage and Distribution Ltd* [2000] BCC 851

In respect of a breach of directors' duties the liquidator has a choice to use the company's name to sue or make application in his/her own name under s.212. A perceived advantage for the liquidator to issue in his own name is that security for costs cannot be ordered.[62]

It is not clear whether the directors' duties (now in statutory form in CA 2006) will lead to more use of s.212. Such little authority as there is presently suggests that CA 2006 is a codification.[63] The new duties include: *"A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole and in doing so have regard (amongst other matters) to -*

a) *the likely consequences of any decision in the long term;*
b) *the interests of the company's employees;*
c) *the need to foster the company's business relationships with suppliers, customers and others;*
d) *the impact of the company's operations on the community and the environment;*
e) *the desirability of the company maintaining a reputation for high standards of business conduct, and;*
f) *the need to act fairly as between members of the company* S.172(1) CA 2006

The duty imposed by this section has effect subject to any enactment or rule of law requiring directors, in certain circumstances, to consider or at in the interests of creditors of the company. S.172 (3) CA 2006

[62] *Re Strand Wool* [1904] 2 Ch.
[63] *Re West Coast Capital (Lios) Limited* [2008] CSOH 72.

A director's duties to creditors arises not only where the company is insolvent but also where the company is in such financial difficulties that its creditors are at risk[64] and S.214 IA 1986.

This provision was necessitated when it was believed that the fraudulent trading provision (s.213) had failed to prevent directors running up losses at a time when the company was already in dire financial circumstances.[65]

Briefly the conditions for an application under s.214 are that: (a) the company has gone into insolvent liquidation: (b) a person was a director at the time of liquidation or a former director or shadow director; and (c) at some time before commencement of liquidation that person knew or ought to have concluded that there was no reasonable prospect that the Company would avoid going into insolvent liquidation. The limitation period is six years from the date of the winding-up order or resolution.[66]

The court can make an order that the respondent is liable to make such contribution to the company's assets as the court thinks proper. The application can only be made by a company liquidator.[67] The date of the commencement of wrongful trading has been handled;[68] in practice it is advisable to include alternative dates.

Before an order for contribution is considered it must be shown that the net deficiency to creditors has increased.[69] It has to be shown that as a result of the continued trading (after the wrongful trading began) the company was at the date of liquidation in a worse position than it would have been in if trading has ceased at the time it is contended it should have done. The

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[64] *Re MDA Investment Management Ltd* [2004] BPIR 75
[65] Insolvency Law Review Committee, *Insolvency Law and Practice Cmnd* 8558, 1982 paras 1776-1778
[66] *Re Farmizer (Products) Ltd* [1997] 1 BCLC 58
[67] *Re Oasis Merchandising Ltd* [1995] 2 BCLC 493
[68] *Rubin v Gunner* [2004] 2 BCLC 110
[69] *Re Marini Ltd* [2004] BCC 172

correct comparison therefore is between the net deficiency in the assets of the company at the date of the commencement of wrongful trading and the date at which trading actually ceased. If the accounting and financial records are in so bad a state that no such comparison can be made then an alternative basis for contribution may be considered.

[70] There are in fact a range of orders that can be made including orders for subordination (s.215 (4)). The first substantive case on wrongful trading,[71] though the facts of that case may have justified using the fraudulent trading provision. There have been a couple of high profile failures to establish such facts.[72]

Though, directors are jointly and severally liable for breach of duty[73] the starting point in making an order for contribution under s.214 is to consider the liability of the directors severally.[74] There is always room for a novel defence to wrongful trading application.[75]

h) Fraudulent Trading.

S.213 Insolvency Act 1986 applies where in the course of a company's liquidation it appears that ".. *Any business of the company has been carried on with intent to defraud creditors ... or for any fraudulent purpose"*. Where that is established a liquidator may then apply for a declaration that "*.... Any persons who were knowingly parties to the carrying on of the business"* fraudulently "*... are to make such contributions (if any) to the company's assets as the court thinks proper".* A distinct advantage of s.213 over s.214 is that it is not necessary to prove that the respondent was a director although the hurdle of proving fraud is always a high

[70] *Re Purpoint Ltd* [1991] BCC 121
[71] *Re Produce Marketing Consortium Ltd* (1989) 5 BCC 569
[72] *Re Sherborne Associates Ltd* [1995] BCC 40.
[73] *Re Carriage Co-Operative Supply Association* (1884) 27 Ch D 322
[74] *Re Continental Assurance Company of London Plc* [2001] BPIR 733
[75] *Singla v Hedman* [2010] EWHC 902 (Ch).

one. To be liable for fraudulent trading a certain state of mind is needed. The party must be shown to have known at the time that it was participating in a fraud and *"blind eye"* knowledge suffices.[76]

In the context of claims for dishonest assistance in a breach of trust it is not necessary for the claimant to prove the exact nature of the fraud or the identity of the victim:

> It is not necessary that he should have been aware of the precise nature of the fraud or even of the identity of the victim. A man who consciously assists others by making arrangements which he knows are calculated to conceal what is happening from a third party takes the risk that they are part of a fraud practised on that party.[77]

(1) Contribution issues

There appears to be little authority on how to approach orders for contribution in fraudulent trading (and for that matter wrongful trading) cases. In the context of limiting a Freezing Injunction Order it is an even more imprecise exercise.[78]

Where there is a finding of fraud the court is likely to take a robust approach to the question of contribution.[79]

In both liquidations and reorganisations, a distribution will be made when sufficient funds are available to justify it. In the case of a reorganisation, the administrator or the responsible office-holder will decide when and how.

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[76] *Re Bank of Credit and Commerce International SA* [2004] BCC 404, 419.
[77] *Agip (Africa) Ltd v Jackson* [1990] Ch 265, per Millett J. at 720
[78] *Re Industrial Services Group Ltd (No 1)* [2003] BPIR 392.
[79] *Re QEB Metallics Ltd* [2009] EWHC 3348 (Ch)

Provided the rules are observed and the liquidator maximises the interests of creditors then the business assets can be sold to a "connected party". In this event the liquidator must satisfy himself that he/she has

- Obtained the best possible value for the assets having typically had the assets valued by an external valuer.
- Having typically advertised the assets for sale in the media and or on the internet.
- Ensured the creditors interests are not compromised by investigating the conduct of the directors prior to the liquidation.
- The trading name of the new company is not the same or similar to the liquidated company.
- This restriction on re-use of a trade name can be lifted if the court agrees.

Often this phoenix will require new cash in the form of investment to get the company going. This can sometimes be a stumbling block too. As can be seen the fact that the new company may, have to take on the employees employment rights from the old company. Transfer of undertaking protection of employment rights is a very complex issue that must be considered before going down the liquidation path. Typically, when the company is very distressed and the board has already decided to cease trading, the normal liquidation process starts but the directors or shareholders or both buy some of the assets from the company and bank the receipts or pass the money to the proposed liquidator. The new company starts to trade. Often a similar name is used to the old company - this can be a legal minefield. From a directors and shareholders point of view: any tax losses built up in the period prior to the liquidation are lost,

goodwill is lost, the director's conduct will be investigated and it is a costly exercise. In virtually all cases there is no return for the shareholders and the directors.

If wrongful trading can be proven then the director (s) can be made personally liable for the debts of the business. This is usually from the point where they should have known the company had no "reasonable prospect" of surviving.[80]

From a creditors perspective a creditor voluntary liquidation can be a negative step because: assets tend to be sold for very much less than book value, creditors' claims can be much higher (such as claims from employees, landlords and secured creditors), there is often no prospect of continued trade. Coupled with the actual cost of doing the insolvency work, the return to creditors in liquidation is usually nil or very low. Once the company has entered liquidation the liquidator will agree to the creditors' claims. This process is known as adjudication and can take weeks and sometimes years. Every creditor's claim need to be carefully scrutinised, indeed although every creditor in a formal insolvency has a duty to mitigate (or reduce) their claim, many "try it on". In other words they inflate their claim to try and get a higher return.

The liquidator's staff will work out the claims based upon company records, copy of invoices and statements from the creditor. His view of the debt is usually final, unless the creditor takes legal action to dispute his findings. The process of a company dying is not a happy one for the directors or creditors. Directors cannot or will not give information on payments, so the creditors keep chasing because their systems say they have to. This can lead to legal actions, bailiffs, petitions and threats.

[80] *Re Bellador Silk Ltd* (1965) 1 All. E.R. 667

Naturally the bank will be disappointed. It is likely that the bank will have some form of security - typically through a debenture. If the bank's lending to the company is significant and the company is insolvent they will probably have taken steps to learn more about the company's insolvent position and how its security looks already. If the bank debt is not material, they will often wait until the liquidator recovers the assets and receives payment in order of priority. In liquidation the bank must give the liquidator permission to collect his fees.

The debt which built up is important because the creditor - in other words cannot stop the building up of debt unless it takes legal action to wind the company up and because the funds have failed to pay over are employees' tax and deductions. This is an illegal non-payment and can result in the veil of incorporation being lifted (directors protection under limited liability) and the directors being made personally liable for the debt.[81]

Other Complexities of Company Liquidations in Britain

Some of the problems encountered by company liquidations in Britain are, legal actions, bailiffs, petitions, threats, how to collect liquidators fees ,investigating the companies, affairs of the companies, how to recover assets of the company, challenges from banks and creditors, as well as employees tax and pension deduction payment coupled with pay as you earn (PAYE).

The company cannot nominate a liquidator when a creditor has a winding up petition with a hearing granted. A creditor's voluntary liquidation may cut down the costs and possible complexities of the liquidation. In this event, the petitioning creditor must consent to withdraw his petition, but remember he is not compelled to withdraw the petition. Alternatively, if there

[81] *Re Sub urban Hotol Co* (1867) 20h APP 737

is a petition then obtaining an administration order will create an effective moratorium over the winding-up petition .A common problem that faces directors where the assets have all been used to borrow is how to pay the cost of creditors' voluntary liquidation.

Another problem is that cost of liquidation is very high. Only licensed insolvency practitioners can perform the role of liquidator. He or she must be licensed by and regulated by a professional body. This costs money to qualify and re–licence each year.[82]

Secondly, the liquidation process has very strict rules of advertising in the local press and Gazette; this costs money. Thirdly, they must insure their actions and any company assets. Fourthly, they must call and pay for a creditors meeting. If there are lots of creditors they must all be written to and files set up to cope with incoming mail, votes and queries. All of this takes time which they need to recover and be paid for.

Technical Issues

These covers some of the more technical issues in liquidations with particular regard to the company directors, their actions, how those actions may impact upon directors and how they may be attacked or investigated by liquidators. In most of the companies, directors can overdraw director's current account thereby making the companies to be struggling companies. This is also a major problem faced by liquidators during liquidation.[83]

Having an overdrawn director's current account is actually a breach of the Companies Act. All accounts filed at Companies House should refer to any overdrawn Current accounts as loans to the director concerned. The company should try to get these paid back or reversed in

[82] *Re Baku Consolidated Oil Fields Ltd* (1944) 1 All. ER. 24
[83] *Re blenot Manufacturing Aircraft CO Ltd* (1916) 32 TLR. At 253

subsequent periods as the Revenue Office will tax the liquidator. If the company has no distributable reserves, it cannot pay dividends. So if the company's balance sheet starts a year with nil or negative reserves and if it realises no profits, the liquidator must stop taking dividends as soon as he becomes aware of this. Illegal dividends are a complex area at the best of times under the new law. But when a company is insolvent they can lead to serious risk of personal liability for the monies taken. It is much better to pay oneselves through pay as you earn and pay the tax. If the company cannot afford to pay the gross then it is pretty much insolvent.

If the company is simply no longer viable then the board should start the liquidation process regardless of the overdrawn director's account. In liquidation the liquidator can demand that directors repay their overdrawn directors current account to the company for the benefit of the creditors. They can take legal action to make directors pay this or even make them bankrupt. So, directors could lose their properties if the directors' current account is overdrawn and not recovered. Or, more likely the directors could do a deal with a friendly insolvency practitioner or liquidator to pay back a percentage of that debt once the liquidation is under way. If the director can prove that he has very little in the way of assets then the liquidator will probably accept a small repayment as a good recovery for the creditors. If the director has plenty of assets and equity, then, he should be prepared for aggressive recovery action by the liquidator. Another problem is; directors can be guilty of wrongful trading, if the Company is Insolvent. This means because directors have talked to their accountants, advisors, insolvency practitioners etc. The simple explanation is that if the director acted badly when he know the company is insolvent, then he may have some personal liability if the company is liquidated.[84]

[84] *Re Davis and Colliet Ltd* (1935) Ch 693

Now where the company sells the company's assets to another company and then knock the insolvent company over. This is possibly a “transaction at undervalue”. This is actually a very complex one that can lead to trouble for the average director. If the company is no longer viable and the directors believe that the company has no future, it may be tempting to "move" or sell some of the assets across to another trading company or partnership.

If the company has assets that actually belong to say a bank or Hire Purchase company, then these assets must not be sold or transferred without their clear written approval.

But, if the assets are unencumbered and are then sold below their proper value, or moved for no payment (consideration), then there is a possible breach[85] of s238 Insolvency Act 1986 - Transaction at Undervalue.

This section applies in the case of a company if -

(a) The company enters administration or (b) the company goes into liquidation and "the office-holder" means the administrator or the liquidator, as the case may be.

Where the company has at a relevant time (typically 2 years if a connected party and 6 months if an unconnected party) entered into a transaction with any person at an undervalue, the office-holder may apply to the court for an order under this section, the court shall, make such order as it thinks fit for restoring the position to what it would have been if the company had not entered into that transaction. So the court can reverse that sale or movement of assets. If there is a plan to sell any asset, then the safest policy is to get the asset(s) independently valued,

[85] *Re Thomas Brinsmead & Sons* (1897) 1 Ch 406

make sure that the valuation has going concern and forced sale values. The asset is sold or about forcibly sold, care should be taken to maximise the interest of the companies' directors.

Alternatively, the company can be liquidated and the director offer to buy the assets over time from the liquidator.

Preference

Another problem during liquidation is how to manage preferences under the Insolvency Act. A potential preference occurs when a company pays a creditor(s) and by doing so makes that creditor "better off" than the majority of other creditors, before going into a formal insolvency like Administration or liquidation. The "desire to create a preference" test is much more difficult to prove in other cases, often the threat of the liquidator taking action sees a deal being done where some of the debt is repaid, to the liquidator, for the benefit of other creditors. This is a difficult subject matter but a vitally important one for every director to consider when reviewing the company's insolvency and how they have acted. Clearly, paying friends and family is risky. Paying back directors' loans is a definite preference if the company subsequently enters liquidation.[86]

Finally, though preferences are only crystallised by a formal insolvency like administration and liquidation, common sense dictates that if the decision to pay someone seems "off" it usually is! The safest route is to ensure that all creditors are treated "equally". If that is not possible then ensure that if one creditor is being paid faster than others that there is a strong commercial reason for doing so. This is a path that requires professional advice, common

[86] *Re London and County Coal CO* (1866) 3 Eq 355

sense and full discussion by the board and proper documentation of decisions to continue trading and to pay suppliers taken at board and management levels.

Using the Company's Name

Another problem is using the same company name again, even when it is liquidated. There are certain very strict restrictions on re-use of trade names. It is possible, provided the liquidator or the court agrees, but the rules are tight and are aimed at "passing off".

S216 Insolvency Act sets out strict rules for this and one should always take great care to get professional advice. As it is a criminal offence to "pass off" as the old company. . It is easy to breach this rule and cause many problems. But it is also not that difficult to avoid.

Insolvency Act and the Penalties

Again, another problem is related to the Insolvency Act and the Penalties:

This aspect applies to a person where a company ("the liquidating company") has gone into insolvent liquidation on or after the appointed day and he was a director or shadow director of the company at any time in the period of 12 months ending with the day before it went into liquidation.

If a person acts in contravention of this law, he is liable to imprisonment or a fine, or both. So, Liquidation and other insolvency procedures can be lengthy and complex, as seen as from the foregoing.[87]

Appointing a Provisional Liquidator

[87] *Thomas V DryJoale* (1961) 1 WLR 1396

Other problem relates to appointing a provisional liquidator to the corporate affairs body. In order to notify the registrar of an appointment of provisional liquidator the court order must be sent to the registrar of companies. Unless the termination is on the making of a wind up order or as the court otherwise directs, notification of the termination of the provisional liquidator must be sent to the registrar as soon as reasonably practicable.

When the Registrar receives the liquidator's final documentation under the Insolvency Act, it must be registered straightaway. After a period of approximately three months, the company is dissolved. However, it may be possible to defer the date at which the dissolution is to take effect.

In order to do so, the Registrar must receive either a direction to defer from the Secretary of State in compulsory liquidation cases or an order of court to defer.[88]

Problems of Annual returns

Once a company goes into liquidation and the statutory liquidation documents are registered at Companies House, there is no need to file annual accounts and annual returns. However, until Companies House receives notification that the liquidation has commenced the annual accounts and annual returns will still be deemed to be due.

If the company comes out of Liquidation, via a court order and is returned to the live companies register then annual accounts and annual returns should then be filed up to date. Failure to comply could result in the company being struck off the register. Companies House will accept correctly completed forms relating to the resignation of directors even if the company has gone

[88] *Baird V Lees* (1924) SC. 83

into liquidation. The Court may make an Order staying, or stopping winding up proceedings, either altogether or for a limited period of time. The Order is to be sent to the Registrar for entry into the records relating to the company.

In 2003, the European Commission's (EC) "Best Project on Restructuring, Bankruptcy and a Fresh Start: Final Report of the Expert Group" summarized the United Kingdom's (UK) compliance with the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems. The UK has fully adopted 9 of these principles and guidelines, almost fully adopted 27 of them, and partially adopted 5. The International Monetary Fund (IMF) in its 2003 Financial System Stability Assessment noted that the UK has a highly "creditor friendly" insolvency regime. There was a period in the late 1990s when, according to the Philippe & Partners and Deloitte & Touché 2002 report, the perception was that the UK regime had tilted a little too far away from creditors rights, and legislative reforms beginning in 2000 were designed to address this problem, while still striving to support the prospects for business rescue or rehabilitation.

In 2003, the European Commission (EC) published its[89] "Best Project on Restructuring, Bankruptcy and a Fresh Start: Final Report of the Expert Group," in which is summarized the United Kingdom's (UK) compliance with the Principles and Guidelines for Effective Insolvency and Creditor Rights Systems developed by the World Bank and partner organizations. However, the report confines itself to enumerating the principles covered in UK legislation, and does not offer a direct assessment as to the practical application of the laws.

[89] European Commissions "*Best project on Restructuring, Bankruptcy and a Fresh Start: Final report of the Expert Group September 2003*. Available from European Commission website, accessed on March 7, 2013 (EC 2013)

According to the EC 2003 report, the UK's insolvency regime is based on two key pieces of legislation: the Insolvency Act of 2000 and the Enterprise Act of 2002. According to the Philippe & Partners and Deloitte & Touché (PP&DT) 2002 report, the Insolvency Act of 2000 was designed to maximize the prospect of a troubled firm to remain in business while still attempting to satisfy creditors, and to create an efficient, effective regime by which to eliminate unfit company directors.

It also establishes the hierarchy according to which payments are to be made, as follows: "(1) secured creditors holding fixed charges such as a bank lending money backed by a mortgage on land and buildings; (2) preferential creditors, who can include... government/crown departments who are statutorily preferred in the order of payment; (3) floating charge holders; and (4) general creditors, such as suppliers of goods and services, and other lenders who have a higher priority for recovering their losses than shareholders" the report added. The PP&DT report further noted that the Enterprise Act of 2002 contains provisions that seek to reduce the risk of unnecessary liquidation of viable firms, abolish the Crown's preferential creditor status, increase the likelihood that unsecured creditors might participate in recovery, and modernize the Insolvency Service. Subsequent amendments to the Insolvency Act passed in 2006 and 2007 have served to tighten up definitions of indebtedness and to clarify certain restrictions on the activities of directors of firms undergoing insolvency proceedings.[90]

According to the EC's 2003 report, there are several available procedures under the UK insolvency regime. First is administration, which creates a moratorium on creditor collection

[90] Philippe & Partners and Deloitte and Touche, "*Bankruptcy and a fresh start: Stigma on failure and legal consequences of Bankruptcy: United Kingdom*" 2002, available from European Union website. Accessed on May 3, 2013 (PP & DT 2002)

activities in order to enable the troubled firm to restructure. This must be approved by the courts. The Corporate Voluntary Arrangement (CVA) is an agreement entered into by the company and its creditors, in which the amount of debt may be negotiated downward in return for an increased prospect of at least partial recovery. Courts are usually involved only minimally, if at all, in this option. In formal receivership, a creditor (usually a bank) sets an administrator in charge of the troubled company's assets, in order to effect collection through the sale of such assets. Liquidation, either voluntarily or through the courts, is another option, as is the Deed of Arrangement.

This latter action is relatively uncommon, having been largely supplanted by the CVA. Finally, the Scheme of Arrangement permits the debtor firm to arrange to deal with its creditors as a class, rather than individually. This requires that a majority of creditors agree to the arrangement and must be approved by the courts. The EC report also noted that the Enterprise Act emphasizes restructuring of troubled firms in order to keep them operating, thus avoiding the loss of jobs and improving returns for creditors and other stakeholders. Access to rescue procedures is subject to no particular conditions, whether the procedure sought is receivership or the CVA. For receivership, a business must be found unable to repay its debts, or to anticipate this inability in the future. Its survival (in some form) under a receivership regime must be likely or, at least, there must be the prospect for a better outcome than would be likely under liquidation. The EC report added that, by law, the UK provides restrictions against a manager or director found culpable of wrongdoing from serving as a director, incorporating, or acting as a liquidator. Directors can be held liable for their company's outstanding debts if

they can be shown to have committed malfeasance, fraud, or wrongful trading, but for non-fraudulent insolvencies, such debts may be discharged.[91]

The 2002 PP & DT report offered a historical perspective on the way in which the UK insolvency regime has evolved. It noted that UK insolvency law has always grappled with the conflicting goals of promoting entrepreneurial spirit while deterring recklessness in the business community and discouraging those who would abuse the assets of their creditors through fraud. The report noted that, over time, UK law developed a pronounced preference toward the interests of the financially troubled firm, to the detriment of creditors. In 1986, 2000, and 2002, reforms were instituted to redress this imbalance. According to the report, under the new regulations laid in Parliament, bringing most of the provisions of the Insolvency Act 2000 into force from April, additional fast track powers have been introduced to disqualify directors of insolvent companies whose conduct makes them unfit to be involved in the management of a company.

The UK's Insolvency Service, created in 1998, receives its statutory authority from the various Insolvency Acts as well as related legislation. It is charged with "administering and investigating the affairs of bankrupts, of companies and partnerships wound up by the court, and establish why they became insolvent." It has statutory authority to involve itself at a variety of points in insolvency actions, both those that are resolved in court and those that are handled without court action. Many of its services and publications are aimed at precluding the need for insolvency actions through counselling and consultation designed to help troubled companies manage their debt.

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[91] Ibid

The Insolvency Service is also responsible for overseeing the professional conduct of insolvency practitioners in the UK, and to that end has established a Guide to Professional Conduct and Ethics, which is available on the Insolvency Service website. The principles of this code focus on five themes: integrity, objectivity, competence, due skill, and courtesy. To enhance integrity, a practitioner must avoid even the semblance of conflicts of interest, including prior relationships of either a personal or financial nature with the parties involved in the insolvency action.[92]

The International Monetary Fund (IMF) provided a brief description of the UK's insolvency regime as part of its 2003 Financial System Stability Assessment (FSSA). According to this report, troubled firms may employ what is known as the "London Approach," defined as "a non statutory and informal framework introduced with the support of the Bank of England for dealing with temporary support operations mounted by banks and other lenders to a company or group in financial difficulties, pending a possible restructuring." Alternatively, firms may follow the principles developed by INSOL International, a global organization that, according to its website mission statement, is "devoted to taking the leadership role in international turnaround, insolvency, and related credit issues; facilitate the exchange of information and ideas, encourage greater international co-operation and communication among insolvency professionals, the credit community, and related constituencies. The IMF 2003 report found that the UK's Enterprise Act of 2002 is noteworthy for having [shifted] the balance away from individual administrative receiverships in favour of collective creditor proceedings in addition to making it easier to bypass the court system in order to negotiate an administrated settlement. The Enterprise Act of 2002 also eliminated the Crown as a preferred creditor, which improved

[92] Ibid

the chances of unsecured creditors to receive some measure of compensation. The IMF also noted that the Financial Services Authority (FSA), established in 2000 with the passage of the Financial Services and Markets Act, has various important rights in insolvency proceedings. At the time of the 2003 IMF report, the majority of UK insolvency proceedings involved receiverships and liquidations.

The UK is deemed to be creditor friendly, but legislation since 2000 has added a predisposition to the rehabilitation of financially troubled firms while still upholding creditor rights. The IMF report noted that the UK's court system is admirably expeditious when court proceedings are called for, and further stated that the UK insolvency regime is largely consistent with the "Orderly and Effective Insolvency Procedures" championed by the IMF's legal department.[93]

According to the "Doing Business 2009" snapshot offered by the International Bank for Reconstruction and Development and the World Bank, the UK ranks 9th out of the 181 economies surveyed, worldwide. The report tracks three aspects of the business-closing process to identify problem areas in insolvency regimes. These include the time it takes, on average, to complete the process, expressed in years; the average cost of the procedure, expressed as a percentage of the debtor estate; and the average recovery rate, expressed in cents on the dollar. The report also offers comparable figures for member states of the Organization for Economic Co-operation and Development (OECD). In the UK it takes an average of 1.0 years to complete a liquidatorship proceeding, whereas the average time required in OECD states averages 1.7 years. It costs an average of 6% of the estate in the UK,

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[93] International Monetary Fund "*United Kingdom: Financial System Stability Assessments, including Reports on observance of standards and codes on the following topics: Banking Supervision, Insurance Supervision, Security Regulation, Payment Systems, Monetary and Fiscal Transparency, Securities Settlement Systems and Anti-Money Laundering and Counter Terrorist Financing*" County Report No 03/46 Washington DC, IMF February 2003. Available from international Monetary fund website. Accessed on May 3, 2012 (IMF 2003).

compared to an OECD average of 8.4%. The average recovery rate is 84.2 cents on the dollar in the UK, compared to an average of 68.6 cents on the dollar in the OECD countries.[94]

Challenges Encountered by Bankruptcy Practitioners in America

One area of challenge is recovering the company assets or dealing with liabilities. The possibility exists that the company may have assets or liabilities other than those disclosed in the balance sheet. If there are any hidden or potential assets such as intellectual property, patents, or trademarks registered in the name of the company, whether beneficially owned or not, the company's representatives need to be told that those assets must be conveyed or assigned before the company is fully wound up. If not, title may pass to the government. Similarly, another challenge is contracts or obligations such as pension funds, hire arrangements and service contracts, to be settled, preferably before the bankruptcy proceedings commences, but certainly before the winding up is completed.[95]

Dormant subsidiary companies can be vulnerable in this respect particularly where, in the process of an earlier reorganisation, the company's business (including its assets and liabilities) has been transferred to another group company, and that company has incorporated those assets and liabilities into its balance sheet either without having obtained title or without having assumed legal responsibility for its contracts or obligations with the consent of the creditors concerned. Dealing with the above is problematic to bankruptcy practitioners.

Other challenges faced by bankruptcy practitioners in America are in the following areas:

(a)Taxation

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[94] International Bank for Reconstruction and development and World Bank, "*Doing business 2010: United States*", 2009. Available from doing business website, accessed on March 7, 2013 (IBRD & WB 2009).
[95] The Library of Congress – *US Congress and Bill Status and text of the bankruptcy About prevention and consumer protection Act of 2005*

As noted above, this is a problem, because it is difficult to:

Fact finding

- Establish contact either with the person at the company or with the accountant who deals with the tax affairs.
- Obtain copies of the latest accounts and tax computation.
- Obtain the address of the inspector of taxes concerned and the company reference number.[96]

(b)Pre-liquidation distributions

It is not possible to anticipate all the challenges that may be encountered under pre-liquidation distributions, but two that occur regularly are:

- Where a company's balance sheet shows capital or revenue reserves, consideration should be given to paying a pre-liquidation distribution of all, or part, of them in order to minimise the effect of capital gains tax when the bankruptcy practitioner distributes the surplus assets.
- In a close company, consideration should be given to the pre-liquidation distribution of all distributable income, in order to avoid a shortfall assessment.

(b) **General tax matters**

Handling or dealing with general tax matters is usually a challenging task for the bankruptcy practitioner. It involves

- Preparing a declaration of insolvency.

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[96] Balleisen, Edward (2001), *Navigating failure: Bankruptcy and commercial law society in Antebellum of North California* Press p. 320 (Finding the people is a challenging task for the bankruptcy practitioner, as they are really evasive)

- Passing a resolution to take steps to place the company into liquidation.
- Instructing the company secretary to summon an extraordinary meeting of members and determining the text of the resolutions to be proposed at that meeting.

Care must be taken to ensure that this meeting is properly convened, and that resolutions are passed and minuted in the prescribed manner: in particular with regard to notice, quorum, voting, the number of directors in office, and any other procedures prescribed by the company's memorandum and articles of association. Minutes of the meeting should be prepared, and signed by the chairman. Whenever possible, all the directors should be encouraged to attend the meeting, and a majority must attend in order that the declaration of bankruptcy may be made.[97]

If there is any difficulty in obtaining the presence of a majority of the directors such as where if some are resident overseas, the problem may be overcome by arranging sufficiently for those who are unable to attend to resign before the declaration is sworn.

Where all the directors are overseas it is possible for the directors' meeting to be held outside, the US provided that the same procedures are observed and that arrangements are made to have the documents filed with the registrar of companies within the specified time limits. So where the above are not diligently done, they become problematic to the bankruptcy practitioners.

The declaration of bankruptcy is expected to be sworn before a solicitor/notary public. Except where short notice is agreed by the members, the company must give 21 days' notice, or any

[97] Cousin S and et al.: *The bases of bankruptcy protection* "The CPA Journal, April 2002. Available from New York State Society of Certified Public Accountants website, accessed on March 7, 2014 at 5.00pm.

greater period that the articles of association require, of a meeting at which a special resolution is proposed.[98] Where it is impracticable, for whatever good reason, to hold a members' meeting in the prescribed manner, any director or member who is entitled to vote may apply for a meeting to be held under the direction of the court.

Alternatively, a resolution or an agreement to wind up signed by all the shareholders is likely to be effective, even if a meeting has not taken place. So, where the above steps are not followed strictly, certain problems will definitely arise for the bankruptcy practitioner.

Annual Meeting and Finalisation

If the liquidation continues for more than 12 months an Annual Meeting of Members must be held. Failure to hold such meeting can lead to certain challenges for the bankruptcy practitioner.

When the affairs of the company are fully wound up the bankruptcy practitioner will call a Final Meeting of Members giving at least one month notice. That meeting should be advertised in the Gazette. The liquidator will lodge a Final Return within seven days and a Final Bankruptcy Practitioner's Account of Receipts and Payments within 30 days.[99]

(a) **Deregistration**

Deregistration is another area where bankruptcy practitioner experience challenges.

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[98] Depamohilis, Donald M.. *Mergers, Acuisition and other restructuring*, 5th Edition, Elsevier academic press, 2009, p 171.

[99] Senate Hearing before the Judiciary Committee on bankruptcy reform 109th congress, February 10, 2005.

Placing a company into liquidation has far-reaching effects on the company and on what it can and cannot do. Those effects will be set out in the company's constitution and also in the Corporations Act.

Most importantly, upon the appointment of a bankruptcy practitioner, all of the powers of the directors cease. In practice, the bankruptcy practitioner will consult with the directors and shareholders and seek their views on issues that arise. The corporate structure and corporate powers of the company continue until it is dissolved. To do otherwise will result in dire consequences for the bankruptcy practitioner. Some members of the company may disagree on the proposed deregistration of the company.

(b) **Liabilities**

Another problem is handling liabilities. The company may also be operating in a high risk industry, for instance where public liability claims sometime arises. Another problem associated with liquidation is that of tax free dividends or franking credits by the deregulation of the company.[100]

The bankruptcy practitioner must provide the timeline for company liquidation/ deregistration.[101] He liquidator should conduct a comprehensive review of matters to be attended to in order to position a company or group of companies for deregistration. He will advise when the application is approved and publish a notice of the proposed deregistration. Failure to do the above things are challenges to the bankruptcy practitioner.

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[100] Armour J. "*Private enforcement of corporate law: An Empirical Comparison of the USA and UK*. Oxford, University, Faculty of Law. 2002, p 170.

[101] Mecham L.R: "*Bankruptcy basic: Applicable to cases filed on or after October 17 2005*". Revised third edition, April 2013, Available from US Courts website. Accessed on March 7, 2013

The main consequences of deregistration are that the company ceases to exist as a separate legal entity and any undistributed property of the company "vests" in the bankruptcy practitioner. That is, after deregistration, he will be the party who deals with any assets of the company. For this reason, all assets of the company should be transferred prior to the deregistration application being lodged.

Another challenge is complying with a lot of statutes. The practicalities and problems are that an applicant needs to be concerned about a number of statutes such as the Income Tax Assessment Act, Fringe Benefits Tax Assessment Act and the Stamp Duties Act. Therefore, in practice, in many cases the process is handed over to a bankruptcy practitioner with the relevant experience,[102] otherwise problems will erupt.

Costs of company deregistration poses serious challenges to the bankruptcy practitioner. The cost of a company deregistration varies according to a number of factors, particularly the size and complexity of the tax issues, the programme of asset realisation and the nature of the assets.[103] The professional fee for the actual deregistration process is very low – the professional attention is needed in getting a company to the stage where it qualifies for a deregistration. By focusing on a single, highly specialised service area, a bankruptcy practitioner is able to bring to bear his experience and professional judgement in a systematised way and provide a streamlined and timely service, to be able to overcome the problems inherent during liquidation.

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[102] Blumberg, M.R. et al. *Sustaining New York and its global financial leadership* at http"//www.senate.gov/schumenwebsiteRess//specialreports2007//Novreport_112_final.pdf.2007.
[103] White and Case, LLP "*Bankruptcy ad a fresh start*" stigma on failure an legal consequences of bankruptcy: United States, July 2002, available from European Commission website, accessed on March 7, 2013.

The bankruptcy practitioner ought to be well knowledgeable in laws governing bankruptcy practices. U.S. bankruptcy law is enabled by the Constitution and is codified under Title 11 of the U.S. Code. The Bankruptcy Reform Act of 1978, known as the Bankruptcy Code, is a federal statute that applies to all the states and is administered by Federal judges, presiding over the bankruptcy courts. Title 11 of the Code, Chapter 7 addresses liquidation proceedings, whereas Chapters 9, 11, 12, and 13 contain the provisions regarding restructuring. In 2005, the U.S. Congress passed new bankruptcy legislation, the Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA) of 2005.

Although the BAPCPA is primarily concerned with individual bankruptcy proceedings, it includes comprehensive business bankruptcy reforms and strengthens the oversight of small business bankruptcy. The United States had fully adopted 32 of the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems; it almost fully adopted two, and partially adopted one. If the bankruptcy practitioner does not know the above, he will run into serious challenges in the course of his work.

In 2002, the European Commission's Expert Group completed its study for the "Best Project on Restructuring, Bankruptcy and a Fresh Start"[104] and the final report was issued in 2003 Working from the research data that was developed by the Expert Group report that included a compliance assessment of U.S. performance with regard to the World Bank's Principles and Guidelines for Effective Insolvency and Creditor Rights Systems. In a series of comparative charts, the United States was shown to have fully adopted 32 Principles, almost fully adopted two, and partially adopted one principle.

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[104] European Commission "*Best Project on Restructuring, Bankruptcy and a Fresh Start - Final Report of the Expert Group*," September 2003, Available from European Commission website, Accessed on May 3, 2013.

A National Report focusing on the United States' data was drafted in 2002 by White & Case, LLP, in which the authors offered an in-depth explanation of the U.S. insolvency system, with particular reference to Chapter 11 proceedings, described as "the cornerstone of sophisticated bankruptcy practice in the United States" (p. 2). Chapter 11 deals with reorganization, whereas Chapter 7 of the Code deals with liquidation of debtor firms. In addition, Chapters 9, 12, and 13 deals with very specifically defined areas in which bankruptcy law may apply: debt adjustments for municipalities (Chapter 9), debt adjustments for family farms (Chapter 12), and debt adjustments for individuals with regular incomes (Chapter 13).[105] From the above, it is imperative for a bankruptcy practitioner to be sufficiently skilled, knowledgeable and experienced.

Both the White & Case report and the Bankruptcy Law Firms (BLF) online bankruptcy law directory, disclose that bankruptcy in the United States is covered by federal statute. The U.S. Constitution authorizes Congress to "establish uniform laws on the subject of Bankruptcy throughout the United States." This is achieved through Title 11 of the United States Code (called the Bankruptcy Code). Although individual states are permitted to enact legislation that deals with certain aspects of the debtor-creditor relationship, they do not have the authority to regulate bankruptcy per se. Title 11 incorporates state-enacted debtor-creditor laws. Chapter 7 of the Bankruptcy Code addresses the liquidation process. In addition to Chapter 11, Chapters 12 and 13 of the Code also address debtor rehabilitation or restructuring.

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[105] International Monetary Fund, *"United Kingdom: Financial System Stability Assessment, including Reports on Observance of Standards and Codes on the following topics: Banking Supervision, Insurance Supervision, Securities Regulation, Payment Systems, Monetary and Fiscal Transparency, Securities Settlement Systems, and Anti-Money Laundering and Countering Terrorist Financing*," Country Report No. 03/46, Washington, D.C.: IMF, February 2003. Available from International Monetary Fund website, Accessed on May 3, 2013.

The BLF website notes that Chapter 7 is the most commonly utilized bankruptcy proceeding, and entails the court appointment of a trustee who is charged with the task of taking over the debtor's non-exempt assets and selling them off, distributing the proceeds of such sales to the creditors. Trustees are also appointed to oversee debtor assets in Chapter 12 and Chapter 13 proceedings, and may be appointed in some cases of Chapter 11 filings, as well. In the United States, bankruptcy proceedings can be initiated by either debtors (voluntary) or by creditors (involuntary). The BLF website adds that once a bankruptcy has been filed, creditors are precluded from collection activities outside the legal proceedings, and debtors are barred from transferring any assets that have been identified as non-exempt assets. The Bankruptcy Code also establishes the prioritization of creditors.

The White & Case report concludes that, in general, the U.S. Bankruptcy Code "performs remarkably well" (p. 32). It balances the interests of both debtors and creditors, achieving reorganization where possible, and maximizing creditors' returns. By preserving viable companies, benefits accrue to the economy. White & Case noted that Chapter 11 has its critics, but remains "a work in progress" as it undergoes modifications to address new needs as they arise. According to White & Case, pressure from banking and lending institutions was growing in recent years, due to fears that the system was subject to abuse by debtors.[106] Such pressures from banking and lending institutions are immense challenges to the bankruptcy practitioner in America.

[106] Philippe & Partners, and Deloitte & Touché, "*Bankruptcy and a Fresh Start: Stigma on Failure and Legal Consequences of Bankruptcy: United Kingdom*," 2002. Available from European Union website Accessed on May 3, 2013.

“Proof of insolvency is not a prerequisite for filing Chapter 11. However, that such a filing may be challenged as "not in good faith" by creditors. Once a Chapter 11 proceeding has been filed, creditors must refrain from further collection activities unless they obtain a court order to the contrary. One of the fundamental protections afforded to debtors, and is intended to permit the debtor an opportunity to stabilize his or her firm and create a reorganization plan. The business is permitted to continue in operation, and is authorized to "use, sell, or lease its property in the 'ordinary course' of its business without prior approval from the bankruptcy court."

While a trustee may be appointed in some Chapter 11 proceedings, such appointments are not automatic. A creditor may request the court to appoint trustee for cause, however, if there are concerns regarding the possibility of "fraud, dishonesty, incompetence, or gross mismanagement." Although, Chapter 7 is the primary route for business liquidations, some debtors may avail themselves of liquidation under Chapter 11, which offers greater debtor protection, particularly with regard to the exemption of certain assets and the possibility of retaining "debtor-in-possession" status rather than the obligation to submit to oversight by a trustee.[107] However, the above can be problematic for the bankruptcy practitioner.

The U.S. Courts website discloses that bankruptcy and insolvency proceedings are subject to both the Bankruptcy Code and the Federal Rules of Bankruptcy, along with any local bankruptcy rules currently in effect. A specialized bankruptcy court is in place in each of the country's 94 judicial districts. Each district court has a specialized bankruptcy judge and generally has its own clerk's office. However, since bankruptcy proceedings are largely

[107] European Commission, "*Best Project on Restructuring, Bankruptcy and a Fresh start: Final Report of the Expert Group*," September 2013. Available from European Commission website Accessed on March 7, 2013.

administrative in nature, much of the work on a given case is assigned to the court-appointed trustee. In a 2006 article available on the U.S. Courts website, Leonards Ralph Meacham addressed changes in the Bankruptcy Code, particularly the effects of the 2005 Bankruptcy Abuse Prevention and Consumer Protection Act (BAPCPA).

According to the U.S. Trustee Program of the Department of Justice the BAPCPA opens a new phase in the history of bankruptcy law and practice, in which the Trustee Program has been assigned new responsibilities. One such new responsibility is the application of means-testing for eligibility under Chapter 7 versus Chapter 13 (the wage-earner protection plan). Trustees must also oversee both random and targeted audits to ensure the accuracy of a Chapter 7 debtor's documentation, and they are charged with enhanced oversight duties in the case of Chapter 11 filings by small businesses.

According to a 2005 article by CCH Incorporated, an information service provider specializing in business and law, although the BAPCPA focuses primarily on individual bankruptcy proceedings. Sections 401 through 447 comprise important provisions for commercial insolvencies as well. In the words of the report, comprehensive business bankruptcy reforms are included, with heightened oversight of small-business bankruptcy. The BAPCPA addresses investor protections, meetings for creditors and equity holders, venues, fees, trustees, and other such issues. In addition, disclosure statements and standardized disclosure forms, filing deadlines, and coverage of benefits and pension issues for employees

of the troubled firms are addressed.[108] So where the bankruptcy practitioner fails to comply with the above, inherent challenges will arise for him in the bankruptcy practice.

The International Bank for Reconstruction and Development and the World Bank produce annual "Doing Business" guides on the ease of doing business in 183 economies, worldwide. One portion of these report and their contemporaneous summary documents deals with business-closing procedures according to three measures: the average time, in years, it takes to complete such proceedings; the average cost of such proceedings, measured as a percentage of the debtor estate; and the average rate of recovery, expressed as cents on the dollar.

These figures are offered alongside comparable figures derived from the average experience of member states of the Organization for Economic Cooperation and Development (OECD). For the United States, the business closings average 1.5 years to complete, as compared to an OECD average of 1.7 years. The cost in the United States averages 7 percent of the estate, and the recovery rate averages 76.7 cents on the dollar. In the OECD experience, the cost averages 8.4 percent, and the recovery rate averages 68.6 cents on the dollar.[109] Complying with the above are daunting challenges for the bankruptcy practitioners in America. For the bankruptcy practitioners to successfully make the necessary contacts are tasking and problematic.

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[108] Philippe and Partners & Deloitte and Touché, "*Bankruptcy and a Fresh Start: Stigma on Failure and Legal Consequences of Bankruptcy*," Belgium, July 2012. Available from Archi SDok website. Accessed on May 20, 2013.

[109] White & Case, LLP, "*Bankruptcy and a Fresh Start: Stigma on Failure and Legal Consequences of Bankruptcy: United States*," July 2002. Available from European Commission website. Accessed on March 7, 2013.