

Administration and Company Voluntary Arrangements

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Business

Introduction

If a company gets into financial difficulties, it can quickly be unable to pay its debts and maybe wound up by the people or businesses to whom it owes money. However, if the underlying business is sound, it may be possible to rescue the company and allow it to continue trading.

Administration and company voluntary arrangements (CVAs) are formal procedures that a company can pursue as alternatives to being wound up or liquidation.

This factsheet provides an introduction to administration and CVAs. It explains when each procedure can be used and describes some of the main processes involved.

This factsheet should be used in conjunction with BIF199 Company Insolvency and Liquidation.

Legislation

The main legislation covering these procedures was originally set out in the Insolvency Act 1986 and the Insolvency Rules 1986. Changes were introduced through the Insolvency (England and Wales) Rules 2016. Similar changes were reflected in Scotland in the Bankruptcy (Scotland) Act 2016, together with the Insolvency (Regulation (EU) 2015/848) (Miscellaneous Amendments) (Scotland) Regulations 2017; and in Northern Ireland in the Insolvency (Amendment) Act (Northern Ireland) 2016 and the Insolvency (Amendment) (2016 Act) (Commencement No. 1 and Transitional Provisions) Order (Northern Ireland) 2016.

Further changes were introduced through the Corporate Insolvency and Governance Act 2020 which gives insolvent companies a breathing space of 20 days, though it is extendable, to seek professional advice on the scope for restructuring a company so as to avoid liquidation.

What is administration?

Administration is a formal procedure that gives a company protection from its creditors while a business recovery or restructuring plan is put in place. An administrator, who must be a licensed insolvency practitioner, is appointed to manage the company's affairs while protecting all the company's creditors' interests.

The administrator is an officer of the court (usually the local county court, or equivalent) and is responsible for achieving one or more of the following objectives:

- To rescue the company so that it may continue as a going concern.
- To provide better value for the creditors from the sale of the business or its assets than might be available through an immediate winding-up of the company.
- In some circumstances, to sell some of the company's assets to pay one or more of the preferential creditors so that the company can continue operating.

Who can appoint an administrator?

An administrator is usually appointed without a court order by:

- The company or its directors.
- A creditor who has a floating charge over the company's assets (this is normally the company's bank). A floating charge is security over a liability, such as a mortgage, whose total value may fluctuate. If a business goes into administration, creditors with charges must be paid before the other creditors.
- The company's liquidator.
- The supervisor of a CVA.

This process is quick and does not need a court application or hearing. However, if a company does apply for a court order to go into administration, all floating charge holders must be given five days' notice before the order will be granted.

Alternatively, any of the company's creditors (or most of the parties listed above) can apply to the court, asking for a hearing to determine whether administration is appropriate.

What happens during administration?

A company formally enters administration when the administrator is appointed. The administrator takes over control of running the company from the directors and must send a notice of their appointment to the company and each of its creditors and publish notice of the appointment.

The company's directors have to provide a statement of the company's affairs for the administrator. As soon as practicable, and at most within eight weeks, the administrator submits this statement and their proposals for the administration to the creditors, the members and shareholders and the registrar of companies. The creditors are asked to approve the proposals, either in their original form or modified. The administrator has to notify all creditors of any revisions to the proposals and must inform the registrar of any decisions taken by the creditors.

Provided the administrator does not receive objections from 10% or more of the creditors, the proposals are deemed to be approved. If 10% or more of the creditors object, the administrator must use an alternative decision-making process, such as a virtual meeting, correspondence or electronic voting, to get agreement.

Once the proposals are accepted, the administrator manages the company's affairs for the duration of the administration process.

How does administration end?

Administration can end in several ways:

- Administration can end automatically after one year, although the term can be extended if the creditors or the court agree.
- The administrator can apply to the court to end administration once its aims have been achieved.
- A court-appointed administrator can apply to the court to end the administration if they think the purpose cannot be achieved, the company should not have entered administration, or because of a creditor's decision.
- A creditor can apply to the court to terminate administration.
- The company may go into liquidation.

In practice, many administrations now take place as pre-packaged or 'pre-pack' insolvencies. Here, the proposed administrator markets the business for sale before accepting a formal offer from a buyer who is ready to complete a purchase and who has all relevant finance in place. An advantage of this approach is that the business moves immediately into the hands of its new owners, minimising disruption and maximising the chances of survival.

Frequently, the existing owners or management buy the company since they are best placed to assess the business and arrange finance. However, this can cause a problem with creditors who stand to lose money and fear that the process has been unfair or that directors have benefited from it by buying the now debt-free business and its assets at a reduced price.

Advantages of administration

Administration is a robust procedure that can increase a company's chances of survival because:

- It stops the company's financial position from worsening and the directors from being exposed to claims for wrongful trading.
- It provides immediate protection from creditors, which can prevent the company being liquidated.
- It provides representation and protection for all creditors. Also, they could receive a better return than if the company was liquidated.
- It can potentially lead to all unsecured debts being greatly reduced or even written off.

Disadvantages of administration

- Administration is a public event. All suppliers, many customers and members of the general public will become aware that an administrator has been appointed.
- Directors are not in control of the company and may have to resign, depending on the administrator's proposals.

- The costs involved in administration can be high, making it more difficult for smaller companies to use the procedure.
- Some contracts with suppliers and customers may automatically end if an administrator is appointed.
- The administrator has a duty to file a report regarding directors' conduct with the Secretary of State. This may lead to disqualification proceedings being brought against the directors.
- Where directors have provided personal guarantees to suppliers or finance companies, they may still be personally liable for these losses.

Administrative receivership

When a company breaches the terms of its loan from a creditor with a floating charge, the creditor (usually a bank) may appoint an administrative receiver (a licensed insolvency practitioner) to recover the money it is owed.

The administrative receiver's role is to act in the best interests of the charge holder by taking control of and selling the assets covered by the charge. The administrative receiver can sell the assets, sell the business as a whole or in part, or allow the company to trade under its supervision.

Within three months of being appointed, the administrative receiver must report to the company's creditors and the registrar, explaining the circumstances of their appointment and the action they are taking. The report must include a statement of affairs, detailing the company's assets, liabilities and creditors.

What is a company voluntary arrangement (CVA)?

A CVA is a recognised legal procedure that enables a company to enter into a binding agreement with its creditors - specifically, with unsecured creditors who have lent money to the company without securing the loan against a particular asset. The CVA gives details of how the company's debts will be managed and repaid, either in part or in full. It can be used as an alternative to administration or may be used to end administration.

CVAs are designed to help ease the pressure on viable businesses that are in financial distress. The debt prepayment plan can ensure that creditors see the return of some of their money over a period of years (there is often little debt recovery with an administration or liquidation).

A key difference between a CVA and administration is that the CVA allows the directors of the company to retain control. There is no requirement for a report on the directors' conduct to be filed with the Secretary of State, removing the risk of disqualification proceedings. For a CVA to be successful, the company must be able to show that:

- Its turnaround proposal is fit, fair and feasible, and includes financial forecasts.
- The CVA will enable creditors' interests to be maximised.
- The management team accepts that it needs to change the way the business operates.

How does a CVA work?

If the company is insolvent or likely to become insolvent, the company can apply for a CVA if all its directors or members agree. Alternatively, if a company is in administration or liquidation, the administrator or liquidator can propose a CVA.

An insolvency practitioner must apply for and administer the CVA. They must report to the court within 28 days of being appointed with a draft proposal for a payment schedule, including detailed financial forecasts for up to five years to support the plans.

The insolvency practitioner forwards the proposal to all the company's creditors, inviting them to vote on it. For the proposal to be accepted, at least 75% of creditors (by value) need to be in favour. This includes secured creditors.

Once approved, the CVA is binding on the company and all the creditors who have been notified of the proposal, so it is crucial to ensure that all the company's creditors are included in the mailing. No further legal action can be taken against the company in respect of these liabilities as long as it pays the agreed contributions to a trust bank account administered by the insolvency practitioner. These payments continue for the period of the CVA, typically two to five years.

Once the CVA is satisfactorily concluded, the insolvency practitioner issues a completion certificate, releasing the company from its obligations, and any remaining debts that were included in the agreement are written off.

If the company is unable to make the agreed contributions, it is in default and the CVA will fail. Any of the creditors can then apply to wind up the company.

Hints and tips

- First, assess whether the company is solvent or insolvent. The available options will depend on which situation applies.
- When a company is likely to become insolvent, it is essential to seek professional advice immediately from an accountant or solicitor. It is also possible to consult an accredited turnaround professional or licensed insolvency practitioner. Continuing to trade while knowingly insolvent carries potentially serious legal consequences: these can include being held personally liable for some of the company's debts and being disqualified from acting as a director.
- Always try to work with creditors before matters become serious. It may be possible to agree an informal arrangement rather than setting up a CVA.

Further information

BIF150 Selling Your Business
BIF171 Bankruptcy Procedures in the UK
BIF199 Company Insolvency and Liquidation
BIF279 Common Reasons Why Small Businesses Fail

Useful publications

'Liquidation and Insolvency'

Companies House

Website: www.gov.uk/government/publications/liquidation-and-insolvency/liquidation-and-insolvency

Useful contacts

The Insolvency Service is a statutory body that provides information on insolvency, redundancy and related matters in England and Wales.

Website: www.gov.uk/government/organisations/insolvency-service

Accountant in Bankruptcy (AiB) administers bankruptcy and insolvency processes in Scotland. It publishes information on corporate insolvency.

Website: www.aib.gov.uk

The Insolvency Service for Northern Ireland is part of the Department for the Economy. It is responsible for administering bankruptcy and corporate insolvency in Northern Ireland and provides information on bankruptcy and liquidation.

Website: www.economy-ni.gov.uk/topics/insolvency-service

Companies House is the government department responsible for the registration, filing and winding up of companies in the UK.

Tel: 0303 123 4500

Website: www.gov.uk/government/organisations/companies-house

The Insolvency Practitioners Association (IPA) is a membership body for practitioners of insolvency-related work in the UK. It has an online directory of insolvency practitioners.

Tel: 0330 122 5237

Website: <https://insolvency-practitioners.org.uk>

The Association of Business Recovery Professionals (R3) is a professional association for turnaround specialists in the UK. It has an online 'Find a Practitioner' search facility.

Website: www.r3.org.uk

Business Debtline provides free advice and information about debt problems. It covers England, Wales and Scotland.

Tel: 0800 197 6026

Website: www.businessdebtline.org

Advice NI is a network of independent advice services in Northern Ireland. It provides a free helpline for small businesses that are struggling with debt.

Tel: 0800 915 4604

Website: www.adviceni.net/business-debtservice

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