

Chapter 21

Corporate Rescue and Receivership

Here, basic guidance to the end-of-chapter questions will be provided.

1. Define the following terms:

- rescue culture;
- moratorium;
- pre-pack administration;
- company voluntary arrangement;
- receivership.

Term	Definition
rescue culture	Where a legal system puts in place mechanisms designed to help financially struggling companies survive and become profitable
moratorium	The temporary prohibition of a specified act (e.g. where a company is in administration, the creditors will be prevented from enforcing their security)
pre-pack administration	An arrangement under which the sale of all or part of the company's assets or business is negotiated with a purchaser prior to an administrator being appointed, and the administrator effects the sale immediately on, or shortly after, being appointed
company voluntary arrangement	An insolvency procedure under which a company enters into a binding agreement with its creditors

2. State whether each of the following statements is true or false and, if false, explain why:

- the principal purpose of administration is to rescue the business of the company as a going concern;
- an administrator can only be appointed by the company or by the court;
- when a company enters administration, the directors will vacate office;
- an administrator's appointment will automatically terminate after one year, unless an extension is obtained;
- a CVA does not come with a moratorium;
- a receiver is a person appointed by a secured creditor to recover payment owed to that creditor.

- **The principal purpose of administration is to rescue the business of the company as a going concern:** This statement is false. The principal purpose of administration is to rescue the company as a going concern, not just the business of the company.
- **An administrator can only be appointed by the company or by the court:** This statement is false. An administrator can also be appointed by a qualifying floating chargeholder.

- **When a company enters administration, the directors will vacate office:** This statement is false. The directors do not automatically vacate office when a company enters administration.
- **An administrator's appointment will automatically terminate after one year, unless an extension is obtained:** This statement is true.
- **A CVA does not come with a moratorium:** This is false. Whilst a normal CVA does not come with a moratorium, there is a form of CVA that does come with a moratorium (although, as noted, the government plans to abolish this).
- **A receiver is a person appointed by a secured creditor to recover payment owed to that creditor:** This statement is true.

3. To what extent has the UK adopted a rescue culture, and should the law seek to rescue financially struggling companies?

Introduction

- Every essay should begin with a succinct introduction that demonstrates that you understand the essay question. Briefly explain what the essay is about and set out what the essay will discuss and how it will be structured.
- This question requires you to discuss the UK's rescue culture.

History

- Prior to the enactment of the IA 1986, UK company law did little to aid ailing companies and companies that struggled with financial difficulties were 'left to die'. Highlight the severe consequences that can result from the liquidation of a company.
- Point out that the law needs to strike a delicate balance between aiding struggling companies and protecting the creditors of such companies. Should a rescue attempt fail and the assets of the company be depleted further, the creditors will receive even less than if the rescue attempt had not been made.
- The 1982 Cork Report favoured the UK adopting a 'rescue culture' whereby mechanisms are put in place to aid struggling companies. The result was the introduction of two notable rescue procedures, namely administration and company voluntary arrangements.

Administration

- Administration was introduced by the IA 1986 and is a clear example of the law's desire to foster a rescue culture and aid ailing companies. In recent years, the value of the administration procedure has been in evidence. Since the financial crisis, a number of prominent high-street companies experienced severe financial difficulties and went into administration in an effort to avoid liquidation. In adverse economic times, the value of the administration procedure is greater than ever.
- The pro-rescue nature of the administration process is evident from the hierarchy of objectives that an administrator is appointed to achieve. Discuss the three hierarchical

objectives of administration, making sure to note that rescuing the company as a going concern is the first objective.

- The pro-rescue nature of the administration process is further evidenced by the statutory moratorium. Discuss the rationale behind the imposition of the moratorium.
- Discuss the advantages that a rescue procedure like administration can have over placing the company in liquidation, including:
 - (a) It may allow a company to trade its way back into profitability.
 - (b) Administration is likely to be less expensive than liquidation.
 - (c) Upon liquidation, the company's assets are usually sold off for whatever price the liquidator can obtain, whereas assets sold by an administrator are likely to fetch a higher price.
 - (d) The company's creditors may have better prospects of being paid than if the company were liquidated, and the employees (or some of them) may be able to retain their jobs.

Company voluntary arrangements

- Point out that the CVA is an important, but much underused, rescue procedure. Explain the basic workings of a CVA.
- The pro-rescue nature of the CVA is evidenced in that, if the company is in the process of being wound up when the CVA is approved, then the court can stay the winding up and give such directions as it thinks appropriate for facilitating the implementation of the CVA.
- Initially, the effectiveness of CVAs was adversely affected by creditors who could derail the CVA by appointing a receiver or by petitioning the court for a winding-up order. Accordingly, a new form of CVA was introduced that provides the company with a moratorium similar to that which exists under the administration procedure.
- Point out that whilst a CVA is a useful rescue procedure, there is little doubt that administration is a more effective procedure. Discuss why administration is preferable to a CVA, but also state that, for directors who wish to retain office, a CVA might be a more appropriate procedure.

Conclusion

- Every essay should end with a conclusion. Briefly summarise the main points/arguments and, if possible, come to a conclusion regarding the essay topic (i.e. which of the opposing views has the stronger arguments).

4. Dragon plc borrowed £2 million from Welsh Bank plc to renovate several of its factories and purchase new equipment. This loan was secured by way of a fixed charge over the company's headquarters. The renovations were completed and the equipment purchased, but the company then experienced a significant downturn in performance and it has struggled to pay its debts. Dragon also had an overdraft with Welsh Bank, and the bank agreed to increase Dragon's overdraft limit in return for a floating charge 'over all the assets and business of the company.'

Dragon's financial position continued to decline and it now cannot pay its debts as they fall due. Dragon has fully drawn on its overdraft facility and it owes HM Revenue & Customs £100,000 in unpaid tax. Accordingly, HMRC filed a petition to wind up the company.

Concerned that it will not be repaid in full, a bank manager of Welsh Bank has requested a meeting with the board of Dragon. Prior to the meeting, the bank manager seeks your advice regarding the following:

- **If HMRC's winding up petition is granted, will the bank be repaid in full?**
- **Could the bank recover the debt owed to it by appointing a receiver?**
- **Would the bank stand a better chance of being repaid if Dragon was placed in administration? If so, can the bank appoint an administrator, bearing in mind HMRC's winding up petition? If the bank is able to appoint an administrator, set out the process by which the administrator would be appointed.**

Will Welsh Bank be repaid?

- Based on what we are told, we cannot predict with certainty whether Welsh Bank will be repaid in full.
- Welsh Bank does, however, have considerable security. As it has a fixed charge over Dragon's company headquarters, it could seize the headquarters and sell them. The headquarters were worth more than the debt owed to Welsh Bank, then it would indeed be paid in full.
- It also has a floating charge over all the assets and business of the company. Accordingly, if the sale of the headquarters did not fully pay off the debt owed to Welsh Bank, the floating charge would ensure that the overdraft debt owed to Welsh Bank would rank ahead of the money owed to HMRC.
- However, two points should be noted:
 1. Depending on when the floating charge was granted and when Dragon went into administration, a liquidator could invalidate the floating charge (IA 1986, s 245). This would mean that, in relation to the overdraft, Welsh Bank would be an unsecured creditor.
 2. If the floating charge remained valid, then a portion of the money that would go to floating chargeholders would instead be set aside to pay off the unsecured debts.

The appointment of a receiver

- If a charge instrument held by Welsh Bank empowers it to appoint a receiver, then it will be able to do so. If the instrument does not empower Welsh Bank to appoint a receiver, then it can apply to the court for a receiver to be appointed.
- The receiver's duty will be to realize the charged asset(s) to satisfy the debt of Welsh Bank.

Placing Dragon in administration

- Welsh Bank has two ways to appoint an administrator. First, it could apply to the court for an administrator to be appointed by the court granting an administration order. The court will only grant the order if two conditions are satisfied, namely:
 1. Dragon is, or is likely to become, unable to pay its debts, and;
 2. the administration order is reasonably likely to achieve the purpose of administration.
- Second, Sch B1, para 14 of the IA 1986 provides that a qualifying floating chargeholder can appoint an administrator itself. A floating charge will be qualifying if two conditions are met, namely:
 1. the charge, alone or in combination with other forms of security, covers the whole or substantially the whole of Dragon's property (which is the case), and;
 2. the charge instrument (i) states that para 14 applies to the charge, or; (ii) empowers Welsh Bank to appoint an administrator or administrative receiver.
- If an administrator is appointed by an administration order, then HMRC's winding up petition will be dismissed. If an administrator is appointed by Welsh Bank, HMRC's winding up petition will be suspended.