Chapter 23
Liquidation, Dissolution and Restoration

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

1. Define the following terms:

- **liquidation;**
- ***pari passu*;**
- **preferential debts;**
- **prescribed part;**
- **deferred debts;**
- **wrongful trading;**
- **Phoenix company;**
- **a preference;**
- **dissolution;**
- **restoration.**

Term	**Definition**
liquidation	The process by which the company's assets are collected and realized, its debts and liabilities paid, and the remainder distributed to persons so entitled
pari passu	'With equal step.' A rule which provides that, if the assets of the company are insufficient to pay off all the company's debt and liabilities, then each creditor will receive an equal percentage of the debt owed to them
preferential debts	Those debts that statute ranks as being prioritized to all other debts, except debts secured by fixed charge and liquidation expenses
prescribed part	The portion of a debt owed to floating chargeholders that must be set aside and used to pay off the company's unsecured debts
deferred debts	Debts which are subordinated to other debts of the company
wrongful trading	A person will be liable for wrongful trading where: • a company has gone into insolvent liquidation or insolvent administration; • at some time before the commencement of the winding up or before the company entered administration, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or insolvent administration, and; • that person was a director of the company at the time
Phoenix company	A company with the same (or very similar) name to a company that has been liquidated, and which as set up by the directors of the liquidated company
preference	Where a company does anything or suffers anything to be done which has the effect of putting a creditor, surety or guarantor of the company into a position which, in the event of the company going

	into insolvent liquidation, will be better than the position he would have been in if that thing had not been done
dissolution	The process by which the existence of a company or LLP is brought to an end
restoration	The process by which a dissolved company is restored back to the register of companies

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

- **the process by which a company's existence is brought to an end is called liquidation;**
- **a voluntary winding up begins by the company passing a special resolution;**
- **the directors will vacate office upon a winding up order being made;**
- ***pari passu* means that all the creditors receive the same amount of money;**
- **the liquidator must first pay off the debts of those creditors whose debts are secured by a fixed charge;**
- **Crown debts are ranked as preferential debts;**
- **a portion of the debt owed to floating chargeholders must be set aside and kept for the unsecured creditors;**
- **wrongful trading occurs where the directors carry on trading even though the company is insolvent;**
- **a liquidator can set aside any charge entered into by the company within a period of twelve months ending on the date of the company's liquidation.**

- **The process by which a company's existence is brought to an end is called liquidation:** This statement is false. The process of bringing a company's existence to an end is called dissolution. Liquidation is the process whereby the company's assets are gathered in and its debts and liabilities are paid. The company is then dissolved.
- **A voluntary winding up begins by the company passing a special resolution:** This statement is true.
- **The directors will vacate office upon a winding up order being made:** This statement is true.
- ***pari passu* means that all the creditors receive the same amount of money:** This statement is false. The *pari passu* principle provides that, if there are not enough assets to pay all the creditors in full, each creditor will receive an equal percentage of the debt owed to them.
- **The liquidator must first pay off the debts of those creditors whose debts are secured by a fixed charge:** This statement is false. The liquidator has no control over any assets secured by fixed charge. Instead, the fixed chargeholder can simply seize the charged assets and sell them to satisfy the debt owed.
- **Crown debts are ranked as preferential debts:** This statement is false. Currently, Crown debts are ranked as unsecured.
- **A portion of the debt owed to floating chargeholders must be set aside and kept for the unsecured creditors:** This statement is true.

- **Wrongful trading occurs where the directors carry on trading even though the company is insolvent:** This statement is false. Simply trading whilst insolvent will not amount to wrongful trading. A person will be liable for wrongful trading if they were a director of a company that entered insolvent liquidation or insolvent administration and at some time before the commencement of the winding up or before the company entered administration, that person knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation or insolvent administration.
- **A liquidator can set aside any charge entered into by the company within a period of twelve months ending on the date of the company's liquidation:** This statement is false. The liquidator only has the power to set aside floating charges, not fixed charges.

3. 'The wrongful trading provisions have proven to be confusing and largely ineffective.' Discuss this statement.

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 wrongful trading provisions in the IA 1986.

The wrongful trading provisions

- Below are a number of issues and criticisms that have been advanced regarding the wrongful trading provisions.
- Remember that s 214 is not the only relevant provision. Section 214 applies to companies in insolvent liquidation, but 246ZB also imposes liability for wrongful trading in relation to companies in insolvent administration. The introduction of s 246ZB is important as it widens notably the scope of the wrongful trading provisions.
- Even if it appears that wrongful trading has taken place, a liquidator/administrator is not obliged to commence a wrongful trading action against a director. The Cork Report recommended that members and creditors should have standing to make a wrongful trading claim, but this was not implemented.
- A difficulty of establishing wrongful trading is proving that if and when the directors knew or ought to have known there was no reasonable prospect of avoiding insolvent liquidation/administration. Section 214 states that this must be established 'at some point' before the winding up, but the Act gives no guidance as to when this point arises. The term 'at some point' is very vague.
- The burden of proof is placed on the liquidator/administrator, and getting access to evidence in claims involving the personal liability of directors can be difficult.
- If a wrongful trading action fails, the liquidator will acquire the costs from the company's assets, thereby further depleting the assets further.
- Wrongful trading claims can only be brought up to six years following the company going into liquidation/administration.

- In a number of cases, the court held that the directors had engaged in wrongful trading, but did not make an order for the directors to make a contribution (see e.g. *Grant v Ralls*). As a result, the creditors gained no benefit from the wrongful trading action (indeed, they would likely have lost out as the company's assets would have been depleted in defending the action).
- There has been a notable lack of wrongful trading actions being brought. This could be down to liquidators being risk-averse (as the costs of failure will be borne by the company).

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. Alison and Lyndsey incorporated Dragon Consultancy Services Ltd ('DCS') in January 2012. Alison and Lyndsey are the company's only directors and members with each holding 100 £1 shares.

Despite several years of excellent financial performance, the company began to experience financial difficulties. In February 2017, DCS had reached the overdraft limit it had agreed with Welsh Bank plc. In return for increasing the overdraft limit to £100,000, Welsh Bank took a floating charge over all DCS's assets. The business continued to deteriorate and, in January 2018, DCS's accountant told Alison and Lyndsey that it was unlikely that DCS would be able to avoid liquidation. Alison and Lyndsey were of the opinion that DCS could trade its way out of its financial difficulties by having a sale, but this proved ineffective and, in January 2019, DCS was wound up. At this time, DCS's overdraft with Welsh Bank had reached £90,000.

You have been appointed as DCS's liquidator and have discovered the following: (i) in March 2018, Lyndsey had lent £10,000 to DCS and the company had repaid this loan in August 2018; (ii) in addition to the money owed to Welsh Bank, DCS owes £10,000 in unpaid taxes, £20,000 to employees in unpaid wages, and £40,000 to various unsecured creditors. The total assets of DCS amount to around £60,000 and the cost of liquidation DCS will be £3,000.

Carry out the role of liquidator and (i) discuss any ways in which the pool of assets can be augmented, and; (ii) work out the amount that each creditor will be paid.

Augmenting the pool of assets

- Before distributing the assets, the liquidator will see if the assets of the company can be augmented by bringing actions against certain persons or by adjusting transactions entered into prior to liquidation.

Wrongful trading

- In January 2018, DCS's accountant told the directors that it was unlikely that DCS would be able to avoid liquidation. The question is whether this amounts to wrongful trading.
- Discuss the three requirements of wrongful trading (these are set out at 23.3.4), focusing on the second requirement, namely that at some time before DCS's liquidation, the directors knew or ought to have concluded that there was no reasonable prospect that the company would avoid going into insolvent liquidation.
- On the one hand, the accountant's warning might indicate that this second requirement has been satisfied, but the question does state that Alison and Lyndsey were of the opinion that DCS could trade its way out of difficulty by having a sale. We cannot comment on how realistic this belief was as we are not provided with enough information.

Lyndsey's loan to DCS

- In March 2018, Lyndsey lent £10,000 to DCS and this loan was repaid in August 2018. The issue here is whether the repayment of the loan was a preference under s 239 of the IA 1986.
- Go through the requirements of a preference. First, the company must be in liquidation or administration, which is the case here.
- Second, the alleged preference must have been given to a person who was a credit of the company or surety or guarantor of the company's debts. Lyndsey was a creditor of the company, so this requirement is satisfied.
- Third, the effect of the alleged preference is that it put Lyndsey in a position which, in the event of the company going into insolvent liquidation, was better than the position she would have been in if the alleged preference had not been given. By paying Lyndsey's loan off prior to liquidation, Lyndsey did not have to wait to see if she would have been repaid in full by the liquidator. As Lyndsey was an unsecured creditor, there is a chance she would not have been paid in full (or paid at all). So this requirement appears to have been satisfied.
- Fourth, the alleged preference must have been given at the 'relevant time.' As Lyndsey is connected to the company, this is a two-year period ending on the date of insolvency. This condition has been satisfied.
- Fifth, it must be shown that the company had a desire to give a preference to Lyndsey. As the alleged preference was given to a person connected to the company, this desire to prefer will be presumed to exist, unless the contrary is shown.
- If a preference has been given, the liquidator can apply to the court for an order, and the court can make such order as it thinks fit for restoring the company to the position it would have been in had the preference not been given. This would likely involve Lyndsey repaying the £10,000 to the company.

The distribution of the company's assets

- When determining the distribution of assets, you can only base your answer on the information provided. There will be certain issues that you cannot take into account at this stage (e.g. if wrongful trading had occurred, the contribution made by the directors) as they will be too speculative.

- Before looking at how the assets will be distributed by the creditor, look to see if there are any transactions that could be adjusted to alter the distribution.

Welsh Bank's floating charge

- In February 2017, Welsh Bank increased DCS's overdraft in return for a floating charge over all of DCS's assets. Section 245 of the IA 1986 allows a liquidator to avoid certain floating charges made prior to liquidation.
- A floating charge will be invalid if it is made at the 'relevant time.' As Welsh Bank is not connected to the company, this is a twelve-month period ending on the date of insolvency.
- We are not told when DCS became technically insolvent, but one could argue that as the charge was made two years prior to the company being liquidated, the company may not have yet been insolvent at this point.

The distribution of assets

- At the time of its liquidation, DCS had assets of £60,000. The liquidator could recover £10,000 from Lyndsey if the repayment of the loan was a preference. Further sums could have been obtained if the directors had engaged in wrongful trading, but these are too speculative to be included here. Accordingly, the assets of DCS amount of £70,000.

Debt	**Amount owed**	**Amount remaining**
Liquidation expenses	£3,000	£67,000
Preferential debts (employee's unpaid wages)	£20,000	£47,000
Debt secured by floating charge (Welsh Bank's overdraft)	£90,000	The prescribed part is £12,400, so Welsh Bank would receive £34,600
Unsecured debts	• £40,000 to various creditors • £10,000 to HMRC	The £12,400 would be distributed *pari passu* amongst the unsecured creditors