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Court voluntary liquidations in Scotland - a creditor's guide

Contents

Appendices

1. Introduction

Insolvency is a complex process whose boundaries are defined by legal requirements and case law. It can be difficult for those unfamiliar with insolvency to understand the reasons why decisions are taken by insolvency practitioners, and what impact a company's insolvency might have on them. The purpose of this document is to provide creditors with some context to help them understand the liquidation process better, what they may expect in terms of information provision, and their rights as creditors of an insolvent company.

2. Why is the company in liquidation?

The most common reasons are where the directors recognise that the company cannot continue to trade and there is no appropriate rescue procedure available; or where the liquidation follows another insolvency process (for example an administration or receivership), and there are funds available for distribution to unsecured creditors.

Where the liquidation is not preceded by another insolvency process, the liquidation is initiated by the shareholders passing a resolution to put the company into liquidation, usually at the directors' request, because it is insolvent. This means that either the value of the debts they owe is more than the value of the assets they own, or that they have insufficient available funds to pay the debts they owe as they become due for payment.

A meeting of creditors must be held within 14 days of the shareholders' meeting (in practice they are usually held on the same day) which will be advertised publicly, in addition the creditors will be given at least 7 days' notice of the meeting. A report (known as a **s98 report**) that will be presented at the meeting may be sent with the notice to creditors, which will include a Statement of Affairs of the company prepared by the directors, summarising the assets and liabilities (including details of creditors' claims), and a summary of events leading up to the liquidation including an explanation of the reasons for the insolvency.

At the meeting, which is chaired by a director of the company, the s98 report is formally presented, and creditors will be invited to question the directors. The creditors then vote to appoint a liquidator (or joint liquidators), voting is based on the values of creditors' claims from those attending the meeting in person or voting by proxy. If the creditors' choice of liquidator differs from that of the shareholders, the creditors' choice prevails. A report of the meeting and its outcome will be sent to all creditors by the Joint Liquidators.

Where the liquidation follows on from an administration, the appointment of the Joint Liquidators will be automatic, following the Joint Administrators filing a notice at Companies House to move the company from administration to liquidation. The Joint Liquidators will have been approved by creditors in the administration, and will confirm their appointment to all creditors.

3. What do the Joint Liquidators do?

The Joint Liquidators' core purpose is to realise the assets of the company, and to distribute the funds to its creditors. Their powers are wide and besides the sale of assets and distribution of funds to creditors, include powers to investigate and take action on the company's behalf where appropriate to attack transactions that have diminished the company's assets. The Joint Liquidators are unlikely to trade on the business in the liquidation, but may continue the company's trade for a brief period while winding it down, for example to complete work in progress in order to enhance its value by selling it as finished goods.

The Joint Liquidators are agents of the company, and are not personally liable for contracts they enter into as liquidator. However, goods and services supplied to a company in liquidation, at the request of the Joint Liquidators will be paid for as an expense of the liquidation.

4. What will happen to my debt?

Debts due to creditors are frozen at the date of the Joint Liquidators' appointment. Secured and preferential creditors are paid before unsecured creditors. Secured creditors are those that have some form of security over a company's property (for instance a bank with a standard security and/or floating charge). Secured creditors are entitled to be repaid their debt out of the proceeds of sale of the secured assets in priority to ordinary unsecured creditors.

Unsecured creditors are those owed money by the company whose debts are not given priority by having registered security – most trade suppliers will be in this category.

Preferential creditors are a special category of unsecured creditor. They consist mainly of certain debts due to employees and the Redundancy Payments Service and are paid in priority to all other unsecured creditors.

Funds will become available for distribution to unsecured creditors either because the secured creditors who rank ahead of them have been paid in full, or from the Unsecured Creditors' Fund, which is also referred to as the 'prescribed part'. The Unsecured Creditors' Fund is generated as a proportion (effectively 20%) of net realisations from the floating charge assets of the company (typically stock, plant and machinery and in some cases book debts) up to a maximum of £600,000, which will be shared by the unsecured creditors unless one or more of the following criteria applies:

- the floating charge was created prior to 15 September 2003;
- the net realisations from floating charge assets are less than £10,000, and the Joint Liquidators think the cost of making a distribution to unsecured creditors would be disproportionate to the benefits; and
- the court makes an order following an application by the Joint Liquidators that the cost of making a distribution to unsecured creditors would be disproportionate to the benefits.

Funds that are distributed to unsecured creditors are paid as a proportion of each creditor's debt. The process of realising the assets and verifying what each creditor is owed will take time. As the Company may owe far more than value of their assets, the amount received by unsecured creditors may only receive a fraction of what they are owed, in some cases they will receive nothing. The Joint Liquidators will provide information on the amount they estimate is likely to become available to creditors in their reports (see section five).

The Joint Liquidators will write to all known creditors asking them to submit claims. You must submit your statement of claim to the Joint Liquidators in writing using form 4.7(scot), providing sufficient supporting evidence of your claim, eg copy statements, invoices, correspondence etc. to allow the Joint Liquidators to decide whether or not your claim is valid. Any costs incurred in submitting your claim will not be reimbursed.

You may claim interest on your outstanding debt up to the date of liquidation if it bore interest, if it was payable at a previous date under a written instrument, or if you had previously demanded it in writing with notice that you would claim interest. You will not be paid interest on your claim accruing after liquidation, unless all creditors are paid in full, or unless you have a court decree and have been awarded judicial interest, in which case interest will accrue at the rate set until the date of any dividend payment.

The Joint Liquidators will compare your claim to the company's records and any other available information. The Joint Liquidators may ask you for additional information or evidence if they think you have not sufficiently proved your claim. The Joint Liquidators may agree your claim in full or in part, or may reject your claim if they do not think it is valid.

If you believe the Joint Liquidators have unfairly rejected your claim, it is best to contact them in the first instance to discuss any amounts under dispute. If you cannot reach agreement you can, within a set out advised timescale, appeal to the court. If you do not apply to the court within this timescale, the adjudication is final.

If you believe that you own something in the company’s possession, you should contact the Joint Liquidators without delay with full proof of ownership and be prepared to identify what you are claiming. The Joint Liquidators will examine your claim carefully before deciding whether to release goods in question, pay you for them or otherwise.

5. What information will I receive?

The Joint Liquidators will notify all known creditors of their appointment as soon as reasonably practicable and in any event within 28 days of their appointment.

A meeting of creditors will be convened in each year for which the Joint Liquidators are in office to report on the progress of the liquidation. A final meeting will be held at the conclusion of the liquidation, at which an account of what has happened in the liquidation, and in particular how the assets have been realised and distributed. Copies of the reports presented to these meetings will be circulated to creditors to keep them informed of the progress of the liquidation.

6. What will happen after the liquidation is finished?

As the purpose of the liquidation is to wind up the affairs of the company, and to realise its assets and distribute the proceeds to its creditors, once the liquidation has been completed by the holding of a final meeting, the company has no further purpose, and will usually be dissolved three months after the final meeting.

7. What rights do I have as a creditor?

If the Joint Liquidators were appointed at a meeting of creditors, a liquidation ' committee may be appointed at that meeting which must consist of at least three and not more than five creditors. The liquidation' committee receives reports from the Joint Liquidator and may meet periodically. The committee's function is to approve the Joint Liquidators' remuneration and sanction the exercise of their powers if required. If the liquidation follows on from an administration in which there was a creditors' committee, that committee can continue in the liquidation.

If you are unhappy with the Joint Liquidator's handling of the case, either in respect of your claim or otherwise, you should first contact the Joint Liquidators to try to resolve the problem. A creditor who believes they have been prejudiced by the Joint Liquidators' conduct and is not satisfied by the explanations he receives may be able to make an application to court.

The Joint Liquidators are insolvency practitioners licensed in the UK, should your complaint be unresolved after you have raised it with them and you think that the Joint Liquidators are guilty of professional misconduct, you have the right to refer the matter to the Insolvency Service via their online Complaints Gateway. AlexPartners is regulated by The Insolvency Practitioners Association (IPA), The Institute of Chartered Accountants in Scotland (ICAS) and The Institute of Chartered Accountants in England and Wales (ICAEW).

8. A guide to the remuneration of the Joint Liquidators

The Joint Liquidators' remuneration will be paid out of the funds which are realised from the sale of company business and assets. The basis on which they may be charged can be on the basis of their time costs, as a percentage of the value of funds realised, or as a fixed fee. A combination of these bases may also be used.

If a Liquidation' committee is formed, it will be responsible for agreeing the Joint Liquidators' remuneration. If no committee is formed, or the committee does not make the requisite determination, the Joint Liquidators' remuneration will be fixed by an order of the court A resolution specifying the terms on which the liquidator is to seek to be remunerated may be taken at the meeting which appoints the joint liquidators.

If either the Joint Liquidators or the creditors are dissatisfied with the basis or level of remuneration approved or charged, or cannot agree on an appropriate basis, they may apply to the court to set the remuneration.

Further guidance for creditors on the Joint Liquidators' remuneration is attached as an appendix to this guide.

Appendix A. A creditor's guide to liquidators' remuneration – Scotland

1. Introduction

1.1. When a company goes into liquidation the costs of the proceedings are paid out of its assets in priority to creditors' claims. The creditors, who hope to recover some of their debts out of the assets, therefore have a direct interest in the level of costs, and in particular the remuneration of the insolvency practitioner appointed to act as liquidator. The insolvency legislation recognises this interest by providing mechanisms for creditors to fix the basis of the liquidator's remuneration. This guide is intended to help creditors be aware of their rights to approve and monitor remuneration and disbursements, and explains the basis on which remuneration and disbursements are fixed.

2. Liquidation Procedure

2.1. Liquidation (or 'winding up') is the most common type of corporate insolvency procedure. Liquidation is the formal winding up of a company's affairs entailing the realisation of its assets and the distribution of the proceeds in a prescribed order of priority. Liquidation may be either voluntary, when it is instituted by resolution of the shareholders, or court, when it is instituted by order of the court.

2.2. Voluntary and court liquidation are equally common. An insolvent voluntary liquidation is called a creditors' voluntary liquidation (often abbreviated to 'CVL'). In this type of liquidation an insolvency practitioner acts as liquidator throughout and the creditors can vote on the appointment of the liquidator at the first meeting of creditors.

2.3. In a court liquidation an insolvency practitioner may be appointed to act as provisional liquidator until the making of the winding up order. In all court liquidations, an insolvency practitioner is appointed to act as interim liquidator from the making of the winding up order until the first meeting in the liquidation, and the creditors can vote on the appointment of the liquidator at the first meeting of creditors.

2.4. Where a court liquidation follows immediately on an administration the court may appoint the former administrator to act as liquidator.

3. The Liquidation Committee

3.1. In a liquidation (whether voluntary or court) the creditors have the right to appoint a committee called the liquidation committee, with a minimum of 3 and a maximum of 5 members, to monitor the conduct of the liquidation and approve the liquidator's remuneration and disbursements. The committee is usually established at the creditors' meeting which appoints the liquidator, but in cases where a liquidation follows immediately on from an administration any committee established for the purposes of the administration will continue in being as the liquidation committee.

3.2. The liquidator must call the first meeting of the committee within 3 months of its establishment (or his appointment if that is later), and subsequent meetings must be held either at specified dates agreed by the committee, or when requested by a member of the committee, or when the liquidator decides he needs to hold one. The liquidator is required to report to the committee at least every 6 months on the progress of the liquidation. This provides the opportunity for the committee to monitor and discuss the progress of the insolvency and the level of the liquidator's remuneration.

4. Fixing the Liquidator's Fees

4.1. The basis for fixing the liquidator's (which includes an interim liquidator's) remuneration is set out in Rule 4.32 of the Insolvency (Scotland) Rules 1986 (as amended) ('the Rules'), and in Section 53 of the Bankruptcy (Scotland) Act 1985 (as amended) ('the Bankruptcy Act') which is applied to liquidations by Rule 4.68. These Rules state that the remuneration may be a commission calculated by reference to the value of the assets which are realised but there shall in any event be taken into account the work which, having regard to that value, was reasonably undertaken, and the extent of the responsibilities in administering the estate.

4.2. It is for the liquidation committee (if there is one) to fix the remuneration and approve disbursements. If there is no liquidation committee, or the committee does not make the requisite determination, the liquidator's remuneration is fixed by the court.

4.3. Rule 4.5 states that the remuneration of a provisional liquidator can only be fixed by the court.

5. What Information should be Provided by the Liquidator?

5.1. When seeking agreement to his remuneration and disbursements, the liquidator should provide sufficient supporting information to enable the committee or the court to form a judgement as to whether the proposed remuneration and disbursements are reasonable having regard to all the circumstances of the case. The nature and extent of the supporting information which should be provided will depend on:

- The nature of the approval being sought;
- The stage during the administration of the case at which it is being sought; and
- The size and complexity of the case.

Where, at any creditors' meeting, the liquidator seeks agreement to the terms on which he is to be remunerated, he should provide the meeting with details of the charge-out rates of all grades of staff, including principals, which are likely to be involved on the case.

Where the liquidator seeks agreement to his remuneration during the course of the liquidation, he should always provide an up to date receipts and payments account. Where the proposed remuneration is based on time costs the liquidator should disclose to the committee or the creditors the time spent and the charge-out value in the particular case, together with, where appropriate, such additional information as may reasonably be required having regard to the size and complexity of the case.

The additional information should comprise a sufficient explanation of what the liquidator has achieved and how it was achieved to enable the value of the exercise to be assessed (whilst recognising that the liquidator must fulfil certain statutory obligations that might be seen to bring no added value for creditors) and to establish that the time has been properly spent on the case. That assessment will need to be made having regard to the time spent and the rates at which that time was charged, bearing in mind the factors set out in paragraph 4.1 above. To enable this assessment to be carried out it may be necessary for the liquidator to provide an analysis of the time spent on the case by type of activity and grade of staff. The degree of detail will depend on the circumstances of the case, but it will be helpful to be aware of the professional guidance which has been given to insolvency practitioners on this subject.

The guidance suggests the following areas of activity as a basis for the analysis of time spent:

- Administration and planning
- Investigations
- Realisation of assets
- Trading
- Creditors
- Any other case specific matters

The following categories are suggested as a basis for analysis by grade of staff:

- Partner
- Manager
- Other senior professionals
- Assistants and support staff

The explanation of what has been done can be expected to include an outline of the nature of the assignment and the liquidator's own initial assessment, including the anticipated return to creditors.

5.2. To the extent applicable it should also explain:

- Any significant aspects of the case, particularly those that affect the amount of time spent.
- The reasons for subsequent changes in strategy.
- Any comments on any figures in the summary of time spent accompanying the request the liquidator wishes to make.

- The steps taken to establish the views of creditors, particularly in relation to agreeing the strategy for the assignment, budgeting, time recording, or the drawing or agreement of remuneration.
- Any existing agreement about remuneration.
- Details of how other professionals, including subcontractors, were chosen, how they were contracted to be paid, and what steps have been taken to review their fees.

It should be borne in mind that the degree of analysis and form of presentation should be proportionate to the size and complexity of the case. In smaller cases not all categories of activity will always be relevant, whilst further analysis may be necessary in larger cases.

The liquidator should always make available an up to date receipts and payments account. Where the remuneration is to be charged on a time basis the liquidator should be prepared to disclose the amount of time spent on the case and the charge-out value of the time spent, together with such additional information as may reasonably be required having regard to the size and complexity of the case. Where the remuneration is charged on a percentage basis, the liquidator should provide details of any work which has been or is intended to be contracted out which would normally be undertaken directly by a liquidator or his staff.

5.3. A liquidator's disbursements are subject to approval by virtue of Rule 4.32. Where a liquidator makes, or proposes to make, a separate charge by way of disbursements to recover the cost of facilities provided by his own firm (such as room hire, document storage or communication facilities), (category 2 disbursements) he should disclose those charges to the committee or the creditors when seeking approval of his remuneration and disbursements together with an explanation of how those charges are made up. Disbursements must either be directly incurred on the case or be subject to a reasonable method of calculation and allocation and the basis on which they are allocated must be disclosed. Such disbursements must be directly incurred on the case and subject to a reasonable method of calculation and allocation. A charge for disbursements calculated as a percentage of the amount charged for remuneration is not allowed.

5.4. Payments to outside parties in which the office holder or his firm or any associate has an interest should be disclosed to the body approving remuneration and should be treated in the same way as payments to himself. They therefore require specific approval as remuneration prior to being paid.

5.5. In Rule 4.12, a resolution may be passed fixing the basis of remuneration at the first meeting of creditors in a court liquidation. The liquidator should immediately notify the creditors of the details of the resolution, and when subsequently reporting to creditors on the progress of the liquidation, or submitting his final report, he should specify the amount of remuneration he has drawn in accordance with the resolution. Where the remuneration is based on time costs he also should provide details of the time spent and charge-out value to date and any material changes in the rates charged since the resolution was first passed. Where the remuneration is charged on a percentage basis the liquidator should provide the details set out in paragraph 5.1 above regarding work which has been sub-contracted out.

5.6. Paragraph 5.3 above does not however apply to a voluntary liquidation.

6. What if a Creditor is Dissatisfied?

6.1. If a creditor believes that the liquidator's remuneration is too high he may, under Rule 4.35, apply to the court for an order that it be reduced. If the court considers the application to be well-founded, it shall make an order fixing the remuneration at a reduced amount or rate. Unless the court orders otherwise, the expenses of the application shall be paid by the applicant, and are not payable as an expense of the liquidation.

6.2. As noted in paragraph 4.3 above, the remuneration of a provisional liquidator is fixed by the court and there is no specific provision in the insolvency legislation to give creditors the right of appeal against the court's determination. Consequently if a creditor is dissatisfied, any appeal must be made to the appropriate court in accordance with normal court rules.

7. What if the Liquidator is Dissatisfied?

7.1. If the liquidator considers that the remuneration fixed by the committee is insufficient he may request that it be increased by resolution of the creditors. He may also request the court for an order increasing its amount or rate, before or after recourse to the creditors. If he decides to apply to the court he must give at least 14 days' notice to the members of the committee and the committee may nominate one or more of its members to appear or be represented at the court hearing. If there is no committee, the liquidator's notice of his application must be sent to such of the creditors as the court may direct, and they may nominate one or more of their number to appear or be represented. The court may, if it appears to be a proper case, order the costs to be paid out of the assets of the company.

8. Other Matters Relating to Remuneration

8.1. Where the liquidator realises assets on behalf of a secured creditor, he will usually agree the basis of his remuneration for dealing with charged assets with the secured creditor concerned.

8.2. Where two (or more) joint liquidators are appointed it is for them to agree between themselves how the remuneration payable should be apportioned. Any dispute between them may be referred to the court, the committee or a meeting of creditors.

8.3. There may also be occasions when creditors will agree to make funds available themselves to pay for the liquidator to carry out tasks which cannot be paid for out of the assets, either because they are deficient or because it is uncertain whether the work undertaken will result in any benefit to creditors. Arrangements of this kind are sometimes made to fund litigation or investigations into the affairs of the insolvent company. Any arrangements of this nature will be a matter for agreement between the liquidator and the creditors concerned and will not be subject to the statutory rules relating to remuneration.

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