STATEMENT OF INSOLVENCY PRACTICE 13 (E&W)

ACQUISITION OF ASSETS OF INSOLVENT COMPANIES BY DIRECTORS

ENGLAND AND WALES

1. INTRODUCTION

1.1 This statement of insolvency practice is one of a series issued by the Council of the Society with view to harmonising the approach of members to questions of insolvency practice. It should be read in conjunction with the Explanatory Foreword to the Statements of Insolvency Practice and Insolvency Technical Reminders issued in June 1996. Members are reminded that SPI Statements of Insolvency Practice are for the purpose of guidance only and may not be relied upon as definitive statements. No liability attaches to the Council or anyone involved in the preparation or publication of Statements of Insolvency Practice. This statement applies to England and Wales only.

1.2 The purpose of this statement of insolvency practice is to:

- ensure that members are familiar with the legal obligations of directors in relation to the acquisition of assets of companies by them or persons connected with the company (as defined by section 249 of the Insolvency Act 1986) (together in this statement referred to as 'directors') and the statutory provisions relating to such acquisitions;
- ensure that members are aware of their legal obligations as insolvency office holders in relation to the disposal of assets to directors and of relevant statutory provisions;
- set out best practice with regard to the disposal of assets to, and their acquisition by, directors;
- set out best practice with regard to the disclosure of such transactions.

This statement has been produced in recognition of the fact that the acquisition of assets of insolvent and prospectively insolvent businesses by directors may give rise to concerns that assets may have been disposed of at less than market value and that those who have been prejudiced by the insolvency of the disposing company may be exposed to further risk through continued trading by those who have or may have had responsibility for the insolvency of the disposing company. It recognises that connected party transactions may be in the best interests of creditors but requires such transactions to be conducted with the greatest degree of propriety and with disclosure to those interested as soon as reasonably practicable.

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2. SCOPE

The statement covers the following:

- legal obligations of directors and related statutory provisions;
- obligations of members acting as:

- professional adviser to the directors as the people responsible for the conduct of the company's affairs;
- insolvency practitioner assisting the directors in the convening of meetings of members and creditors in connection with the winding up of the company as a creditors' voluntary liquidation;

- obligations of members acting as:

- nominee in relation to a proposed company voluntary arrangement;
- office holder -

  as supervisor of such arrangement if approved by members and creditors;

  as administrator;

  as receiver or administrative receiver;

  as provisional liquidator;

  as liquidator in a winding up by the court or in a creditors' voluntary liquidation.

In this statement the word 'director' includes directors by whatever name called and shadow directors, and the word 'assets' includes all tangible and intangible assets including the goodwill and the right to use any trading name of the company.

3. THE LEGAL OBLIGATIONS OF DIRECTORS AND STATUTORY PROVISIONS

The following are the principal legal obligations and some of the statutory provisions of particular relevance to directors of a company which is or is prospectively insolvent.

The overriding obligation of directors of a company is to act in the best interests of the company, its creditors and its members. Failure to do so exposes directors to claims for misfeasance or breach of duty.

At any time when the directors knew or ought to have known that insolvent liquidation is unavoidable they have an obligation to take such action as is appropriate to protect the interests of creditors. Failure to do so renders them liable to claims under section 214 of the Insolvency Act 1986.

Transactions at an undervalue and preferences as defined in the Insolvency Act 1986 may be set aside at the instance of a liquidator or administrator.

The acquisition of assets of a company by directors or parties connected with them may require approval by the members of the company by resolution (Companies Act 1985 section 320). It is the duty of directors to ensure that when it is required such approval is obtained before any relevant transaction is undertaken. Any transaction requiring approval but undertaken without it will be voidable at the instance of the company unless the conditions set out in subsection 322(2) of the Companies Act 1985 apply, and may give rise to claims against directors on any gains made by them.

The use by any person connected with a company which has gone into insolvent liquidation of the name of that company or of a similar name is only permissible if the provisions of section 216 of the Insolvency Act 1986 are complied with or the circumstance specified in rules 4.228 to 4.230 of the Insolvency Rules 1986 apply. Failure to comply renders the persons concerned liable to prosecution and personal liability for the debts of the company under section 217.

4. THE OBLIGATIONS OF MEMBERS ACTING IN AN ADVISORY CAPACITY

4.1 Members Acting As Professional Advisers To Directors

4.1.1 Members acting in an advisory capacity in relation to the affairs of companies in financial difficulties must at all times have regard to the general professional conduct guidance of the body by which they are authorised to act as an insolvency practitioner. Subject to this overriding obligation, an advising member should:

- agree and record the identity of the instructing client. This is particularly important where advice is given in relation to insolvent companies and members should ensure that it is clear whether the instructing party is the company, its board of directors or one or more of its directors individually;
- act in the interests of his client with objectivity, integrity and independence;
- ensure that his client is made aware of the matters set out in paragraph 3 above;
- keep under consideration whether his client has any conflicts of interest or duty and bring any such conflicts to the attention of his client. Where a client persists in disregarding material conflicts of interest or duty, the member should cease to act unless the client agrees to limit the client's retainer to one such duty or interest and to take advice on the other elsewhere;
- not accept instructions to assist a client in conduct which will undermine public confidence in the proper administration of insolvency procedures.

4.1.2 Members should bear in mind that, when asked to advise in relation to the planning or execution of a transaction, they may incur civil or criminal liability through participation, even in an advisory capacity, and will in any event be acting improperly if they assist directors in any conduct which amounts to misfeasance. A member should cease to act if his advice to an officer that a proposed act or omission would amount to misfeasance is disregarded. However, this does not prejudice any duty of a member to give confidential advice in the interests of a client in relation to events which occurred before the member was instructed.

4.1.3 Members acting in an advisory capacity which may lead to their assisting the directors in relation to the creditors' voluntary liquidation of the company should bear in mind the requirements for disclosure at the section 98 meeting of transactions between the company and its directors (and connected parties) in the period of one year prior to the winding up and the names of those who advised the directors (as such) in relation to such transactions as set out in Statement of Insolvency Practice 8 (E&W).

4.2 Members Acting In Relation To Section 98 Meetings

4.2.1 Where a member is assisting the directors in relation to the convening of meetings of members and creditors for the purposes of a creditors' voluntary liquidation he should ensure that his advice to directors as such in the period prior to the commencement of the winding up is given on the same basis as set out in paragraph 4.1 above. There can be circumstances when it is in the best interest of creditors for a connected party transaction to be undertaken with complete propriety but it is essential that such a transaction is not undertaken without a thorough appraisal of its propriety and the benefits expected to accrue to creditors from it.

4.2.2 In paragraph 4.1.3 reference has been made to the disclosure requirements in Statement of Insolvency Practice 8 (E&W). It is the duty of the advising member to inform the directors of the need for full disclosure of connected party transactions.

4.2.3 Members should consider, if any connected party transactions are undertaken at any time when they are acting as advisers to the directors, whether it is appropriate for them to seek appointment as liquidator bearing in mind the obligations of liquidators to investigate antecedent transactions.

5. MEMBERS ACTING AS OFFICE HOLDERS

5.1 The obligations on both directors and office holders in relation to the maximisation of realisations of assets or the optimisation of the position of members and creditors of the company do not in any way preclude disposals by way of connected party transactions. Members should ensure that such transactions are conducted with due regard to their own and the directors' obligations.

5.2 There are no requirements of English law which require assets to be disposed of by any particular method. There is an overriding duty to obtain the best price for assets whether sales are effected by private treaty sale, by sale by tender or at auction. While it is recognised that circumstances may arise when full exposure to the market of the availability of assets for purchase is not practicable members are reminded that they should normally, unless sale by auction is the chosen means of disposal, take steps to advertise assets for sale or circularise (for example, by use of mailing lists) known prospective interested parties.

5.3 Except in the case of a nominee or in most cases (depending upon the nature of the arrangement) as supervisor of a voluntary arrangement, the member will have the assets of the company under his legal control. It is his duty to ensure that all transactions between the company of which he is acting as office holder and directors and connected parties are conducted on a fully arms length basis and, as regards the value of any assets which are the subject of any such transaction, on the basis of a professional appraisal of the value of those assets. When such appraisal is not conducted by an independent valuer the office holder should ensure that he has conducted all due enquiries as to the value of the assets and retains appropriate documentation in his papers. Where assets are sold without professional valuation the office holder should consider seeking the views of the committee, if there is one. It is his duty to ensure that the value of the assets is maximised but this does not require him to obtain the maximum value for each individual asset if disposal of a parcel of assets or the assets as a whole will, in aggregate, maximise total realisations. Since the allocation of the consideration between the constituent assets affects interests of creditors it should be made on a basis which can be justified objectively.

5.4 Where a member is acting as provisional liquidator and it is proposed that assets of the company should be acquired by directors the sanction of the court should be obtained.

5.5 Where a member is acting as nominee or supervisor in relation to a voluntary arrangement he should ensure that any connected party transactions are in the best interests of the company, its members and creditors, and are only undertaken in accordance with the terms of the arrangement as approved by the members and creditors. When a connected party transaction is proposed as part of an arrangement or has taken place in the year prior to the date of his appointment as nominee he should ensure that it is included in the proposals on a full disclosure basis.

6. DISCLOSURE OF CONNECTED PARTY TRANSACTIONS

6.1 The requirement for disclosure of connected party transactions in the reports to meetings of members and creditors in creditors' voluntary winding up proceedings has been referred to above.

6.2 Where, prior to the section 98 meeting, directors have indicated that they may wish to make an offer to the liquidator (when appointed) for assets of the company this should normally be disclosed at the meeting and the advising member should advise the creditors that if they form a liquidation committee the liquidator will, unless there are overriding commercial reasons why this should not be done, advise the committee of any offers for assets made by the directors and they will have the opportunity to comment on such offers. While the sanction of the committee is not required for a connected party transaction and full responsibility for it will rest with the liquidator, discussion of the proposed transaction with the committee should assist the liquidator in dispelling any concerns which creditors may have about it. In both voluntary and compulsory liquidations, the liquidator has a statutory obligation to give notice to the committee where he disposes of any property of the company to a person who is connected with the company. If it is not appropriate for there to be prior discussion with the committee the liquidator should report to the committee that he has contracted a disposal by way of connected party transaction as soon as reasonably practicable.

6.3 The liquidator should report any connected party transaction to members and creditors when he first reports to them after the transaction has taken place.

6.4 In administration order proceedings a member who is preparing an independent report (as provided for in Rule 2.2 of the Insolvency Rules 1986) should consider whether that report should contain details of any transactions between the company and its directors or other connected parties: any which might bear upon the court's consideration as to whether it is appropriate that an administration order be made should be included. In administration the administrator should include in his proposals under section 23 et seq. of the Insolvency Act 1986 reference to any connected party transaction undertaken in the period of two years prior to the making of the administration order and in the period since the making of that order, or proposed to be undertaken. If a creditors committee is appointed, the members of the committee should be advised of any such transaction undertaken after the meeting of creditors to consider the proposals.

6.5 In administrative receivership the administrative receiver should include in his report to creditors at the section 48 meeting information regarding any connected party transaction if this has taken place prior to the meeting and, if it takes place after that meeting, report it to any creditors committee appointed at that meeting.

6.6 Any disclosure made in accordance with the requirements set out in paragraphs 6.1 to 6.5 above should provide creditors with sufficient information to have a full appreciation of the nature of the transaction, and should normally include the following information:

- The date of the transaction
- Details of the assets involved and the nature of the transaction
- The consideration for the transaction and when it was paid
- The name of the counterparty
- The nature of the counterparty's connected party relationship with the vendor
- If the transaction took place before the appointment of the member as office holder, the name of any adviser to the vendor
- Whether the purchaser and (if the transaction took place before the appointment of the member as office holder) the vendor were independently advised
- Where the transaction took place before the commencement of liquidation or administration, the scope of the office holder's investigation and the conclusion reached
- Where the disclosure is to a liquidation committee and the committee has not been consulted prior to contract, the reason why such consultation did not take place
- Where, in a liquidation, the disclosure is to creditors, whether the liquidation committee (if there is one) has been consulted and the outcome of such consultation.

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