

Company Liquidation – What is Liquidation and when should it be used?

If you do not want to continue running your business or you think it is in difficulty and cannot continue to trade, then you need to get good information about your possible options. One area which you will need to consider is company liquidation. The purpose of this article is to explain in simple language what company liquidation is and when its use might be appropriate.

Liquidation is simply the term used to describe the process of closing a company down. The company's trading is stopped and its assets are sold and turned into cash or "liquidated". There are different types of liquidation depending on whether the company to be closed is solvent or insolvent. There are two simple tests to see whether a business is solvent. The cash flow test and the balance sheet test. The cash flow test asks whether the company is able to pay its creditors as and when the debts fall due. If the answer is no, the company is insolvent. The balance sheet test asks if there are more assets than money owed to creditors. If the answer is no, then the business is insolvent.

If the company to be closed is solvent the liquidation procedure to be used is called Members Voluntary Liquidation or MVL for short. Simply put, the members or shareholders of the business decide to close it. The directors of the company have to make a sworn legal declaration that the company is solvent and if assets need to be sold, to pay debts, this must be possible within 12 months. The business is closed and all outstanding creditors paid. Any remaining assets or cash is then the property of the shareholders of the business to do with what they wish.

You may question why a solvent business would be closed at all. There are a number of reasons why this would happen. Perhaps the owner may simply want to close it because they no longer want to run it. May be the company is a family business where the owners / parents have retired and children or family do not want to run the business. Alternatively, a group of companies may need to be rationalised requiring a solvent business to be closed and its assets transferred into another company within the group.

If a business is insolvent and no further investment can be found or other arrangements with creditors cannot be agreed, then action must be taken to close the company. There are two possible types of liquidation procedure in these circumstances:

The first of these is Creditor's Voluntary Liquidation or CVL for short. A Creditors Voluntary Liquidation will normally be started by the directors and or shareholders of the business. The shareholders appoint an Insolvency Practitioner who will call a meeting of the company's creditors informing them of the company's insolvency and allowing them to appoint a liquidator of their choice. As such, the liquidation is approved by, and works for, the benefit of the creditors. The Liquidator's prime duty is to sell the assets of the company and distribute any proceeds to the company's creditors. The Liquidator will close the company, cancel any outstanding leases make any remaining staff redundant.

The second type of liquidation where a company is insolvent is called Compulsory Liquidation – more commonly known as Winding Up. The act of Compulsory Liquidation is started by an aggrieved creditor who has not been paid. Such action can be started by any

creditor who is owed more than £750 which is not paid after a statutory demand for payment has been issued. The aggrieved creditor will employ a solicitor who asks the High Court to hear the argument why the company should be wound up. This is called a Petition. Notice of the petition must be given to the company. Then if the debt is still not paid, a "hearing" is held in front of a High Court judge who then passes an order to wind up the company compulsorily. An Official Receiver (or Liquidator if appointed) will then close the company and sell any assets which will then be distributed across all of the company's creditors.

It is important to remember that the question of whether company liquidation is the most appropriate course of action can only be answered after a proper review of a company's circumstances. If as a Director, you believe that your business is in trouble, you should get further advice from an expert as soon as possible.

An important additional note for Company Directors in this area is that you must be aware that you must not continue to allow a company to trade which you know to be insolvent. If your company is eventually liquidated because it is insolvent, the Liquidator will have a duty to review the conduct of you as a Director to ensure that you have acted properly to minimise creditor's losses. If the Liquidator decides that you as a director have acted badly, they can accuse you of wrongful trading. If this is upheld, then you can be made personally liable for the company's debts from the time you knew the company was insolvent. As such, getting the appropriate advice about company insolvency is a must.

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Cooper Matthews specialise in Business Recovery Services Advice offering provide straight forward insolvency advice for businesses with financial problems. They have significant experience in working with small to medium sized businesses.