

## **Winding Up Orders now used as Debt Collecting Tools**

Winding up (or compulsory liquidation) is the closest thing to bankruptcy for a limited company. The process is normally initiated by one or more of a company's creditors who feel that the company should be closed and cease trading. The creditor will present a petition to wind up the company at the court (a Winding Up Petition). The company may then be ordered by the court to be liquidated or wound up.

Once a winding up petition is ordered, a liquidator will be appointed who will be responsible for closing the business. They will make any employees redundant. The liquidator will also try to sell any of the company's assets to generate cash which is used to repay outstanding debts to the company creditors. They will also be responsible for reporting on the company's directors and investigating whether they have been guilty of wrongful trading (allowing the company to continue to trade when they knew that it was insolvent).

Traditionally, winding up was initiated by a creditor because they believed that a company was not in a position to pay its current outstanding debts. As such, they wanted to protect both themselves and other potential creditors from trading with the business in the future which may not be able to afford to pay them. The company itself would be protected from misunderstandings by the court. The court has the opportunity to grant or reject a winding up petition after reviewing the creditor's grievance and any defence put forward by the business as to why the petition is not valid.

Despite the traditional use of winding up, over the past 12 to 18 months I have seen more and more creditors using winding up petitions to force creditors to pay outstanding debt. One of the significant downsides for a company which has a winding up petition issued against it is that any petition must be advertised in the London Gazette. This advertisement will be picked up by all banking institutions whose standard action will be to freeze the bank account of the company in question. This action will prevent payments being made either in or out of the account. If a company is already suffering financial difficulties, a frozen bank account will result in significant operational problems. As such, the directors of the company often have no choice than to pay the outstanding debt (and associated legal costs) in full to insure the petition is lifted by the petitioning creditors.

Whether this practice is legitimate as a method of debt collection is subject to debate. Ultimately if a creditor has used all other reasonable methods to try and collect debts owed to them and payment is still not forthcoming then I believe they should be allowed to pursue a winding up order. However, clearly the purpose of the action is to force the company to pay its debt, rather than actually stop it trading. If the winding up order was actually granted by the court, all of the company's unsecured creditors will be treated equally and be eligible for a fair share of any available cash. However, if, in order to avoid a winding up order, a company is pressured into paying off one creditor in full, I believe that this could be seen as creditors almost making themselves preferred by the back door and thus to the detriment of all others.

***Derek Cooper – June 2009***

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