

Newman & Partners

Licensed Insolvency Practitioners

RECOVERY & REVIVAL BULLETIN

Welcome to the latest issue of our Recovery and Revival Bulletin, designed to keep you up-to-date on insolvency matters that may be of interest to you. If you have any feedback on this bulletin, or would like to know more about our services or how we can help you, please contact us on **020 8357 2727** or at insolvency@newmanandpartners.co.uk

A guide to antecedent transactions and avoiding clawback risks

One area that we think requires particular attention from accountants at the moment is antecedent transactions, which can expose businesses to clawback risks. As an insolvency practice, we frequently encounter cases where well-intentioned actions by directors or business owners lead to significant legal and financial repercussions.

For context, antecedent transactions are dealings made by a company before entering insolvency, which may be subject to scrutiny during the insolvency process. These transactions can be overturned or 'clawed back' if the court deems them to have been prejudicial to creditors.

Common types of antecedent transactions include preferences, transactions at an undervalue, and the payment of unlawful dividends.

If you understand each type, it will make it easier for you to identify potential risks.



Preferences

A preference occurs when a company favours one creditor over others shortly before entering insolvency. For example, if a company pays off a significant debt to a creditor who is connected to the directors while leaving other creditors unpaid, this can be seen as giving that creditor a preference.

Under section 239 of the Insolvency Act 1986, a preference can be challenged if:

- The transaction took place within six months before insolvency (or two years if the creditor is a connected party, such as a director).
- The company was insolvent at the time of the transaction or became insolvent as a result of it.
- The transaction placed the creditor in a better position than they would have been in had the company entered liquidation.

To protect your clients from preferential claims, ensure that any payments made during this period are proportionate and in line with the company's standard payment practices.

Transactions at an undervalue

A transaction at an undervalue occurs when a company gives away assets or services for significantly less than their market value. For instance, selling a piece

of valuable machinery for a nominal amount or transferring property to a family member at a low price could be challenged under section 238 of the Insolvency Act 1986.

Such transactions can be challenged if:

- They occurred within two years before the onset of insolvency.
- The company was insolvent at the time or became insolvent as a result of the transaction.

If your client is considering any major asset sales or transfers, ensure they are completed at full market value and supported by proper documentation, including independent valuations if necessary.

Unlawful dividend payments

Section 847 of the Companies Act 2006 covers the payment of unlawful dividends. This occurs when a company distributes dividends to shareholders in breach of the relevant rules, usually because there are insufficient distributable reserves to support the payment.

These transactions can be set aside if they

- Took place when the company did not have ample profits to cover the dividends.
- Not compliant with the Companies Act requirements, such as failing to prepare appropriate accounts to justify the payment.

As an accountant, you should advise your clients to ensure that any dividends paid are in line with the company's available profits and backed by the necessary documentation.

Defending against clawback claims

Once an administrator or liquidator is appointed, their role is to maximise the return to creditors, often by investigating and challenging antecedent transactions.

If a transaction is deemed to be prejudicial to creditors, it can be reversed, leaving the client liable to repay funds or return assets.

Here are key steps you, as an accountant, can take to help your clients avoid clawback risks:

- **Maintain accurate financial records:** Keeping detailed records of decisions, transactions and valuations will help defend against allegations of improper dealings. These records should include justifications for payments, valuations of assets sold, and evidence that the company was solvent at the time of any potentially risky transactions.

- **Avoid preferential treatment:**

If a company is struggling financially, there can be pressure to pay certain creditors, mainly those with personal or professional ties to the directors. It's important to resist this urge and instead ensure that all creditors are treated equitably. Regular payments should be made in accordance with existing agreements, avoiding any indication of preferential treatment.

- **Conduct a solvency review:**

Before any major transaction, especially in a period of financial instability, conduct a thorough solvency review. This should include a balance sheet test, and a cash flow forecast to confirm that the company can meet its debts as they fall due. Keeping a record of this process can be a valuable defence if it is later scrutinised.

- **Seek professional valuations:**

Transactions involving the transfer or sale of company assets should be supported by independent valuations. This will help ensure that assets are being transferred at market value and can prevent transactions from being challenged as undervalue.

- **Get advice:**

When a company is facing insolvency, advice from an experienced insolvency practitioner is essential. Directors need to be aware of their fiduciary duties and the potential risks of antecedent transactions. An insolvency practitioner can provide guidance to ensure that directors act within the law and avoid personal liability.

As accountants, you play a crucial role in safeguarding your clients from the risks associated with antecedent transactions and potential clawbacks during insolvency. By keeping accurate records, advising on equitable creditor treatment, and ensuring proper valuations, you can help your clients get through financial distress and reduce their legal and financial exposure.

If you have any concerns about this topic, we advise you consult with an insolvency practitioner who can provide tailored advice and guidance, particularly when insolvency is imminent. An insolvency practitioner can ensure that your clients are protected and positioned to recover as much value as possible in challenging times. For help, please [get in touch](#).

Cash flow insolvent vs balance sheet insolvent: What's the difference?

There are two primary types of insolvency that you, as an accountant, should be aware of: cash flow insolvency and balance sheet insolvency. While they both indicate financial distress, the distinctions between them are significant and have implications for how a company might navigate its recovery or insolvency proceedings.

In this article we explain these two types of insolvency in detail, with a focus on how they differ and what they mean for an accountant managing or analysing a business in financial difficulty.

Cash flow insolvency

Also known as liquidity insolvency, occurs when a company does not have sufficient liquid assets to meet its current liabilities. In simpler terms, the company may have assets, but it does not have enough cash on hand or readily convertible assets to pay its debts as they fall due.

This type of insolvency is a short-term liquidity problem, which may or may not signal deeper financial issues. Common characteristics of cash flow insolvency include:

- **Inability to pay debts:** A company is considered cash flow insolvent when it cannot pay its creditors on time, even though it may have assets that exceed liabilities.
- **Short-term in nature:** The issue revolves around liquidity, meaning that the company may still be profitable on paper or may have valuable assets, but it lacks the immediate cash or cash-equivalents to meet its obligations.

- **Potentially solvable:**

Cash flow insolvency can sometimes be resolved by restructuring debts, securing short-term financing, or selling non-core assets to raise cash.

When advising your clients on cash flow insolvency, we suggest you encourage a proactive approach. It's crucial to assess the company's cash flow forecasts regularly and identify potential shortfalls before they become critical.

Balance sheet insolvency

Balance sheet insolvency, on the other hand, occurs when a company's total liabilities exceed its total assets. This means that, even if the company were to liquidate all its assets, it would still not be able to cover its debts.

Balance sheet insolvency reflects a deeper and often more severe financial problem compared to cash flow insolvency, as it indicates that the company's overall financial structure is unsustainable. Usually, this looks like the following:

- **Liabilities exceed assets:**

A company becomes balance sheet insolvent when the total value of its liabilities (debts) surpasses the total value of its assets (current and fixed).

- **Long-term solvency issue:**

This type of insolvency is typically more difficult to resolve as it indicates that the company has borrowed beyond its means or has experienced significant losses that have eroded its asset base.

- **Likely requires structural change:**

A balance sheet insolvent company often needs restructuring, either through raising new equity, negotiating with creditors to reduce the debt burden, or even entering formal insolvency proceedings like administration or liquidation.

For example, the Bristol Bears, one of the English Premiership rugby clubs mentioned in a recent financial report and article by the Guardian. The report highlighted that Bristol Bears has accumulated debts of £60 million, making it one of the most indebted clubs in the league.

Now, imagine that Bristol has £50 million in total assets but £60 million in liabilities. This would mean that the club is balance sheet insolvent, as its liabilities exceed its assets by £10 million.

Even if the club sold all its assets, including its stadium, training facilities, and player contracts, it would still be unable to fully repay its creditors. This situation indicates that Bristol's financial issues are structural

and deeply ingrained, unlikely to be resolved simply by improving cash flow or liquidity management.

Instead, the club would likely need to consider restructuring or seek outside investment to address its debt burden.

Key differences between cash flow insolvency and balance sheet insolvency While both forms of insolvency are serious, they represent different types of financial problems and require different approaches to resolution.

1. Nature of the problem:

- Cash flow insolvency is about liquidity – it's an inability to pay debts as they fall due, but the company may still be solvent in the long term if it can restructure its cash flow.
- Balance sheet insolvency is a more fundamental issue – the company's liabilities exceed its assets, indicating that even selling all assets would not be enough to pay off all debts.

2. Time frame:

- Cash flow insolvency is a short-term problem and may be temporary if the company can secure financing or improve its cash flow.
- Balance sheet insolvency is a long-term issue that suggests deeper financial distress, often leading to formal insolvency proceedings.

3. Resolution approaches:

- A cash flow insolvent company might resolve its issues by restructuring debt, selling assets, or improving cash control.

- A balance sheet insolvent company usually requires more drastic measures such as a capital restructure, debt write-offs, or formal insolvency processes like administration.

4. Legal implications:

- In the UK, cash flow insolvency is often a trigger for directors to consider insolvency processes, such as entering administration, as they are unable to meet obligations as they come due.
- Balance sheet insolvency can also trigger formal insolvency procedures under the Insolvency Act 1986, where directors are required to act in the best interest of creditors, which may lead to liquidation if the company is beyond recovery.

Understanding the difference between cash flow and balance sheet insolvency is essential for accountants, particularly when advising businesses in financial distress.

Cash flow insolvency, while serious, may be addressed through short-term measures like refinancing or improving working capital. Balance sheet insolvency reflects a more severe financial imbalance that requires significant restructuring or formal insolvency proceedings.

Distinguishing between these two types of insolvency helps you in determining the most appropriate advice and actions to take to mitigate the impact on your client's business, its creditors, and its stakeholders.

For help, please **get in touch**.



The role of floating charges in insolvency: Technical and compliance

A floating charge is a type of security interest that hovers over a company's assets, allowing the business to continue using those assets in the ordinary course of its operations until an event of default occurs (e.g. insolvency). Once a company defaults or enters insolvency, the floating charge crystallises into a fixed charge, attaching to specific assets.

Floating charges are typically used by lenders when securing loans, particularly for businesses with fluctuating asset bases such as stock, receivables, or other current assets. The flexibility of a floating charge allows a company to maintain control over these assets while still providing security for the lender.

Floating charges play an important role when it comes to insolvency, particularly regarding securing debt and distributing assets during liquidation.

If you are an accountant advising your clients on financial difficulties, having an deep understanding of floating charges and their compliance implications can be helpful.

The creation and registration

Floating charges must be properly created and registered to be enforceable. Section 859A of the Companies Act 2006 requires that all floating charges be registered with Companies House within 21 days of their creation. Failure to do so will render the charge void against a liquidator, administrator, or other creditors.

It's worth noting that the details of the charge, such as the amount secured and the assets covered – must be accurately recorded in the charge documents. For accountants, this means ensuring your clients have the correct advice when securing a floating charge, particularly to ensure compliance with these registration requirements.

Crystallisation of floating charges

The process of 'crystallisation' is a key technical issue to be aware of. Once a floating charge crystallises, it converts into a fixed charge, meaning it attaches to specific assets. Crystallisation typically occurs upon:

- The company's insolvency or liquidation.
- The appointment of an administrator.
- The cessation of the company's business.
- Other default events stipulated in the charge agreement.

For accountants, advising on when a floating charge may crystallise is important, as this

can drastically alter the financial standing of a business. For example, once crystallised, the company may lose access to assets that were critical to its operations, further exacerbating financial distress.

Priority of floating charges in insolvency

One of the most important compliance issues surrounding floating charges is their ranking in the distribution of assets during insolvency. Floating charges rank lower than fixed charges and certain preferential creditors, such as employees' wage claims and contributions to occupational pension schemes.

However, the introduction of the Insolvency Act 1986 created the idea of a 'prescribed part,' a portion of the company's assets that must be set aside for unsecured creditors before the floating charge holder can be paid. As of 6 April 2020, the prescribed part cap was increased to £800,000 for debts exceeding £10 million, making it a more significant consideration for creditors holding floating charges.

Accountants advising clients in insolvency must be aware of this limitation, as it affects the recoverability of debts secured by floating charges. While floating charge holders still have priority over unsecured creditors, the prescribed part can significantly reduce their expected recovery.

Fixed charges vs floating charges

It's essential to understand the distinction between floating and fixed charges when discussing insolvency with clients. Fixed charges are secured over specific assets

(e.g., property or machinery), and the borrower cannot deal with these assets without the lender's consent. In contrast, floating charges cover a class of assets that can fluctuate, such as stock or receivables. In an insolvency situation, fixed charges generally take precedence over floating charges, which is why lenders often seek fixed charges where possible. However, for many businesses, particularly those with a dynamic asset base, a floating charge offers the necessary flexibility.

Floating charges and administration

When a company enters administration, an administrator is appointed to manage the business and assets to either rescue the company or achieve a better result for creditors than liquidation. Under Schedule B1 of the Insolvency Act 1986, administrators must consider the interests of all creditors, including those holding floating charges.

A critical technical point for accountants to note is that floating charge holders have the power to appoint an administrator under Paragraph 14 of Schedule B1, if their charge covers substantially all the company's property. This process is known as a 'qualifying floating charge appointment.'

Avoiding pitfalls and compliance with floating charge regulations

Ensuring compliance with the floating charge regulations is critical to protecting clients from potential pitfalls. Failure to register a floating charge, inaccuracies in charge documentation, or misunderstanding the ranking of creditors can result in financial losses during insolvency proceedings.

Here are some key compliance points to keep in mind:

- **Registration deadlines:**
Ensure that floating charges are registered within 21 days at Companies House to avoid them becoming void.
- **Accurate documentation:**
The charge must clearly state the assets and debt covered, and any crystallisation triggers should be explicitly outlined.
- **Understand creditor ranking:**
Be aware of the prescribed part and how it affects the floating charge holder's recovery in insolvency.
- **Monitor financial distress:**
Advise clients to closely monitor their financial position, especially in relation to triggers that could crystallise a floating charge.

Floating charges are a flexible but complex tool in securing debts, mainly for businesses with fluctuating assets.

However, they come with specific technical and compliance challenges, especially in insolvency situations.

If you are an accountant advising your clients, an understanding of how floating charges work, their ranking in insolvency, and the importance of proper registration can make a significant difference in ensuring their clients are informed and compliant.

For more information on this subject, please feel free to get in touch.



CAREFUL CONSIDERATION IS NEEDED BEFORE TAKING OUT ANY FORM OF FINANCE AND SPECIALIST ADVICE SHOULD BE SOUGHT. IF YOU HAVE ANY QUESTIONS, PLEASE CONTACT US.

Newman & Partners Insolvency
Lynwood House
373/375 Station Road
Harrow
Middlesex HA1 2AW

T: 020 8357 2727
F: 020 8357 2027

E: insolvency@newmanandpartners.co.uk
W: www.newmanandpartners.co.uk

Newman & Partners
Licensed Insolvency Practitioners