



C O R P O R A T E

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## PHOENIX FROM THE FLAMES - DON'T GET BURNT

### Introduction

The current economic difficulties has seen an increasing use of the “pre-pack” transaction, whereby an agreement for the sale of the business and assets of an insolvent company is negotiated prior to the commencement of formal insolvency proceedings, and completed almost immediately afterwards. Frequently this has involved the acquisition of the business and assets by a former director or other individual who was involved in the management of the insolvent company, who then continues to trade through a new company with a similar name to the old one. The UK insolvency legislation has been carefully drafted to ensure that this is only possible provided certain formalities are complied with, and failure to comply will lead to serious criminal and financial consequences for the individuals concerned, and also opens up a potential new avenue for creditors to recover debts which they had previously written off and considered worthless.

### Current Law

The Insolvency Act 1986 addresses the “Phoenix Problem”, which prohibits directors or shadow directors of a company which has gone into liquidation from acting for five years after the date of liquidation as a director of a company with a similar name which might suggest an association with the insolvent company. This extends to any director of the insolvent company in the 12 months prior to the liquidation, and restricts the director from being either directly or indirectly concerned in the formation, promotion or management of the second company, even if he is not a director. It also extends to any name by which the liquidating company was known (including any trading name) during the final 12 months of its life.

If a director breaches the above legislation, and doesn't fall within the exemptions set out below, he will be exposed to criminal liability and will be personally liable for the debts of the second company. This could be of particular significance if this second company subsequently experiences financial difficulties.

### Exemptions

There are three possible methods by which a director can avoid the penalties set out above. Firstly, leave of the court may be granted to the director concerned. Secondly, the prohibition does not apply where the company with a prohibited name has been known by that name for the whole of the 12 month period and has not been dormant during that time. Finally, provided the new company has acquired the whole, or substantially the whole of the business of the insolvent company from an insolvency practitioner, it may give notice to the creditors of the business in the prescribed manner. The timing of the notices is crucial; if the business is bought *before* the original company has entered liquidation, then the notices can be served within 28 days of the acquisition, whereas in the event the business is bought from a liquidator then the notices must be served before the new business commences trading under the prohibited name with the involvement of the relevant director.

### Group Companies

The provisions could also cause difficulties for any Group wishing to insolvently liquidate a company in its Group, in circumstances where there are several companies trading with similar names in different fields, with a number of shared directors. In such circumstances, even if the relevant companies' business does not overlap with the insolvent company, any director of the insolvent company may be prohibited from being involved with other Group companies with a similar name. This won't apply if the other companies have been trading with the same name for over a year, but it is possible to foresee real difficulties for dormant companies which a Group may wish to use within a 5 year period from the date of the relevant insolvent liquidation. In these circumstances the only options open to the directors (apart from changing the names of the existing companies) is either to make sure that all the debts of the offending group companies are paid and hope the directors do not face criminal prosecution, or more prudently, to apply to the court for permission to act.

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### Sole traderships/ unincorporated businesses

A similar problem to that set out above for Group companies applies for unincorporated businesses, where they do not wish to purchase the business of the old company. In such a case, the directors of insolvent companies will be prohibited from an involvement in the management etc of an unincorporated business with a prohibited name, even if the business has been trading under the same name for many years. The director will be faced with the same options as set out above, and prudently should apply to the court for permission to act going forward.

#### Conclusion - What you need to do

The likelihood of being caught out by the application of the above legislation has increased dramatically, as creditors have spotted a real opportunity to recover so called "bad debts" from the directors personally. Indeed this opportunity has been exploited by finance companies purchasing seemingly worthless bad debts for a nominal amount and then proceeding to sue the directors of the insolvent companies.

If you find yourself in the circumstances set out above, or foresee a likelihood that they will arise in the near future, it is recommended that you seek professional advice as soon as practicable. It is possible to avoid the serious penalties which could arise from breach of the legislation if you act speedily.

#### Help is at hand

We are very experienced in dealing with the impact of the Insolvency Act 1986, and will be able to advise you as to whether you are or are likely to be affected, and the options available to you. We are used to acting very swiftly as the situations frequently require.

### Contact details



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If you would like to receive more information regarding the contents of this newsletter or information on any other company law related matters then please do not hesitate to contact one of our Company / Commercial partners on **0161 832 4666**.

Julian and John specialise in all aspects of company / commercial work, mainly acting for SMEs but also undertaking international work such as joint ventures and manufacturing agreements.

## how we can help your business

We are a medium sized city centre firm with a high degree of expertise in our chosen fields. We therefore provide a level of service which is comparable to that offered by many a national and international law firm, whilst retaining a personal interest in our clients and their businesses.

We believe passionately in training and developing all the members of our team to ensure that our clients continue to obtain the highest quality of advice and support.



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