Award in company law fundamentals

Lecture Title: Dissolution and Winding up

Diploma in Law (Malta)

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Bankruptcy vs. Insolvency

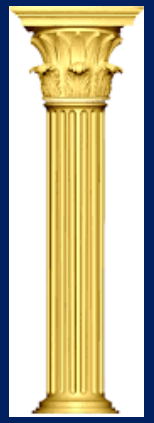
It is a common misconception that the terms bankruptcy and insolvency are interchangeable – however, there is a material and legal distinction.

The difference between the two is that one refers to the inability to pay debts by a company in terms of the Companies Act while the other refers to the suspension of payment of debts by a trader in terms of the Commercial Code.

Objectives of insolvency law

The effects of an insolvency may be both serious and far-reaching, potentially impacting the company itself, its officers, its employees, its creditors, and society at large. In order to address the severity of a state of insolvency, it is imperative for us to have a legal framework that is founded upon three pillars:

CERTAINTY



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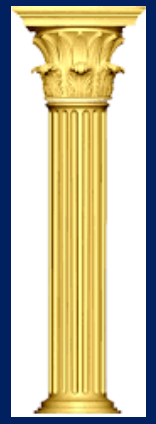
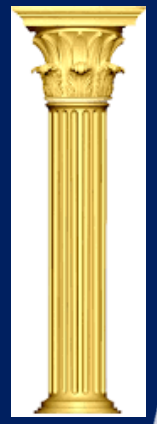


EXPEDIENCY



In turn, the following objectives stem from the three core pillars:

- Diagnosing insolvency quickly
- Balancing liquidation against re-organisation
- Collective rights
- Providing external and impartial management in a time of crisis so as to serve all the interests at stake in a fair manner
- Protecting the public.

CAUSES OF DISSOLUTION OF COMPANIES

WHAT WENT WRONG?

- Article 214 of the Companies Act sets out the instances in which a company:
    - **MAY** be wound up
    - **SHALL** be wound up

- A company **MAY** be wound up in any of the following 2 instances:

    1. **If the business of the company is suspended for an uninterrupted period of 24 months; or**

    2. **If the company is unable to pay its debts.**

WHEN IS A COMPANY UNABLE TO PAY ITS DEBTS?

Article 214 (5) states that a company is unable to pay its debts:

a) If a debt due by the company has remained unsatisfied in whole or in part after 24 weeks from the enforcement of an executive title against the company by virtue of any of the executive acts under Article 273, COCP (‘**CASH FLOW TEST**’); OR

b) If it is proved to the satisfaction of the court that the company is unable to pay its debts, account being taken of its contingent and prospective liabilities (‘**BALANCE SHEET TEST**’).

A company SHALL be wound up in any of the following 6 instances:

1) If the company has, by extraordinary resolution, resolved that the company be dissolved and wound up by the court;

2) If the company has, by extraordinary resolution, resolved that the company be dissolved and wound up voluntarily;

3) If the court is of the opinion that there are grounds of sufficient gravity;

4) If the number of shareholders of the company is reduced to less than 2 shareholders for more than 6 months (unless it is a private exempt single-member company);

5) If the number of directors is reduced to below the minimum prescribed by law (1 director for private companies, 2 directors for public companies); or

6) If the period fixed for the duration of the company in its M&As, has expired.

WHAT CONSTITUTES A 'GROUND OF SUFFICIENT GRAVITY' ?

- Together with the ground of inability to pay debts, this is the most resorted to ground for dissolution of a company.

- It is noticeable that the ground is coined in **general terms**. In fact, it is rooted in the English law concept of '**equity**', or what is '**just and equitable**'.

- It should be noted, however, that even though the concepts are similar, the English concept of equity is far wider and far-reaching than its counterpart at Maltese law – we do not adopt the concept *in toto,* but we have adopted and adapted certain aspects of it.

The ground is, therefore, open to interpretation and is purposely left wide enough to incorporate new circumstances that may arise. Nevertheless, it is possible to identify circumstances our Courts have deemed to constitute grounds of sufficient gravity, and which may be grouped as follows:

A. **LOSS OF SUBSTRATUM**

B. **DEADLOCK**

C. **MISMANAGEMENT**

D. **QUASI-PARTNERSHIP**

E. **BUBBLE COMPANY**

F. **OPPRESSION OF MINORITIES**

The modes of winding up of companies

SOLVENT DISSOLUTION

INSOLVENT DISSOLUTION

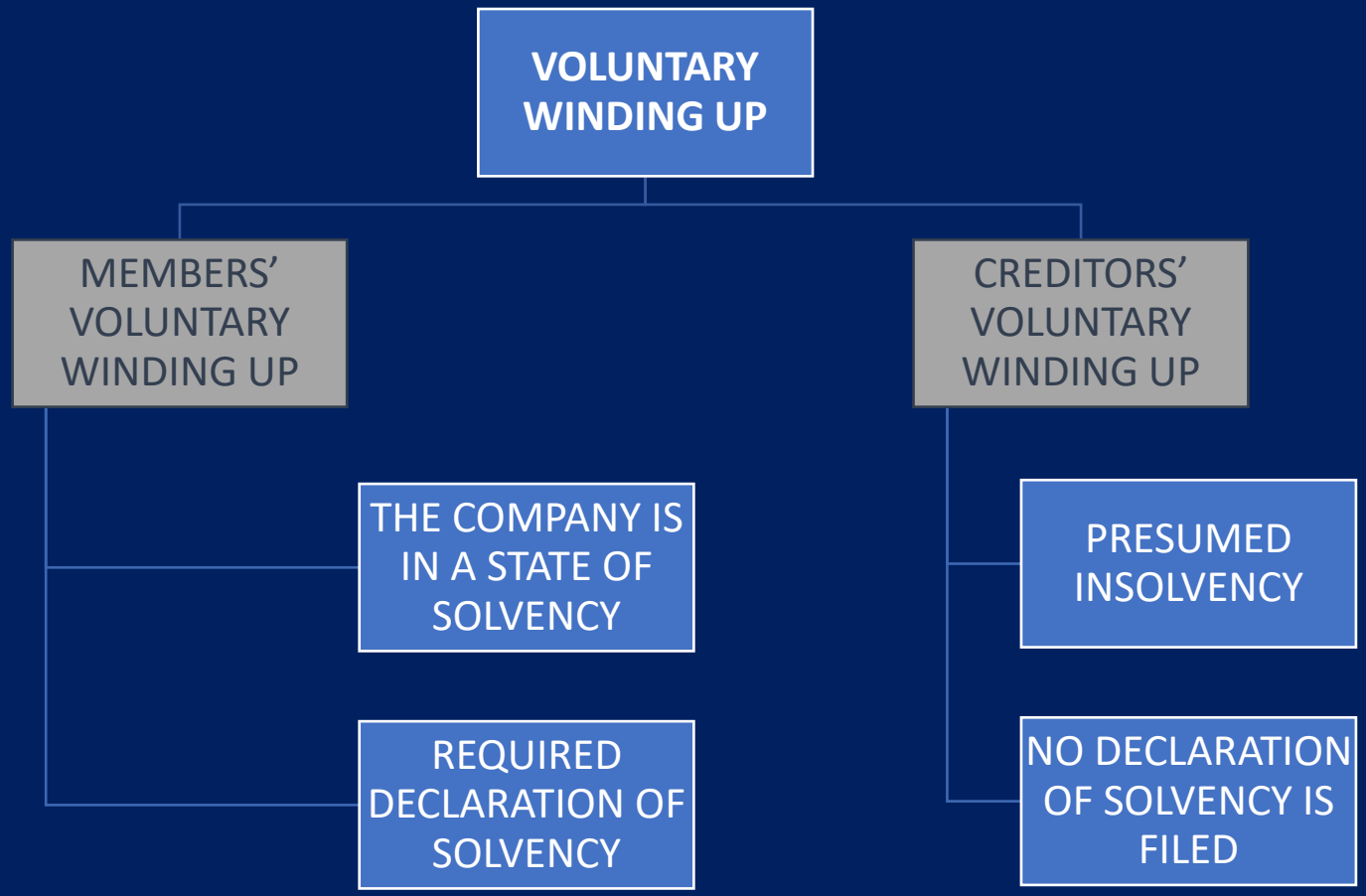
Solvent Dissolution → the Company is able to pay its debts, as it has sufficient assets to settle liabilities.

Insolvent Dissolution → the Company is unable to pay its debts, as it has insufficient assets to settle liabilities.

Dissolution and winding up may take the form of:

1. Voluntary Winding Up (members or creditors)
2. Court Winding Up

Voluntary Winding Up



Voluntary Winding Up

- This may be a **members'** or **creditors'** voluntary winding up.
- The fundamental distinction between a members' and a creditors' voluntary winding-up is that in the former, a state of solvency is essential and must be accompanied by a declaration of solvency; whereas a creditors' winding-up presumes insolvency.

Members' Voluntary Winding Up

The process of a members' voluntary winding up:

STEP 1

THE DIRECTORS MAKE A SWORN DECLARATION OF SOLVENCY

STEP 2

AN EXTRAORDINARY RESOLUTION IS THEN PASSED

STEP 3

FOLLOWING WHICH, A LIQUIDATOR IS APPOINTED

STEP 4

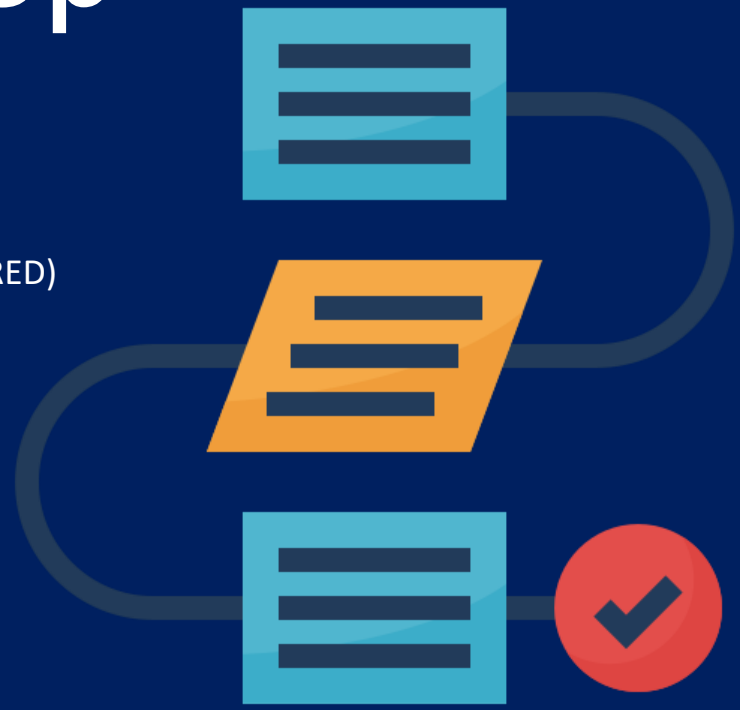
WHERE WINDING-UP CONTINUES FOR MORE THAN 12 MONTHS, LIQUIDATOR CONVENES A MEETING TO REPORT ON STATUS OF WINDING-UP PROCESS

STEP 5

UPON COMPLETION OF THE LIQUIDATION A FINAL MEETING IS CALLED

Creditors' Voluntary Winding Up

The process of a creditors' voluntary winding up:



STEP 1

EXTRAORDINARY RESOLUTION PASSED COMMENCING PROCESS (NO DECLARATION OF SOLVENCY IS REQUIRED)

STEP 2

A LIQUIDATOR IS APPOINTED

STEP 3

CREDITOR'S MEETING IS CALLED

STEP 4

DIRECTORS MUST CAUSE A FULL STATEMENT OF THE POSITION OF THE COMPANY's AFFAIRS + LIST OF CREDITORS + ESTIMATED AMOUNTS OF THEIR CLAIMS

Creditors' Voluntary Winding Up

The process of a creditors' voluntary winding up:

STEP 5

WHERE WINDING UP CONTINUES FOR MORE THAN 12 MONTHS, THE LIQUIDATOR MUST COVENE A MEETING OF THE MEMBERS TO REPORT ON THE STATUS OF THE WINDING UP PROCESS

STEP 6

FINAL MEETING IS CALLED UPON COMPLETION OF LIQUIDATION WHEREBY THE LIQUIDATOR'S FINAL ACCOUNTS ARE LAID BEFORE THE GENERAL MEETING OF THE COMPANY + CREDITOR'S MEETING

STEP 7

COMPANY'S ASSETS DISTRIBUTED TO CREDITORS

STEP 8

THE REGISTRAR WILL FOLLOWING RECEIPT OF THE ACCOUNT + SCHEME OF DISTRIBUTION + AUDITOR'S REPORT (IF ANY), REGISTER THEM. ON THE EXPIRATION OF 3 MONTHS FROM PUBLICATION OF A NOTICE IN A GOVERNMENT GAZZETTE, THE COMPANY WILL BE STRUCK OFF

Provisions applicable to every voluntary Winding Up

- *Distribution of Assets (Art.287)*
- *Powers and Duties of the Liquidator (Art.288)*
- *Powers of the court to remove the liquidator (Art.289)*
- *Notice of appointment (Art.290)*
- *Binding arrangement (Art.291)*
- *Questions to the court (Art.292)*
- *Costs of voluntary winding up (Art.293)*

Court Winding Up

This may take place either:

1. Subsequent to an extraordinary resolution;

2. Discretionary; or

3. Compulsory

An application to the court may be made by the directors, members, debenture-holder(s), creditor(s) or contributory(ies).

1. Subsequent to an extraordinary resolution

- Shareholders pass an extraordinary resolution to dissolve the company and be consequently wound up, either by the court or voluntarily.

2. Discretionary power to order dissolution

A company **may** be dissolved and wound up by the court in the following cases:

i. If the business of the company is **suspended for an uninterrupted period of 24 months**; or

ii. The company is **unable to pay its debts**, i.e. a debt due by the company has remained unsatisfied in whole or in part after 24 weeks from the enforcement of an executive title against the company, or it is proved to the satisfaction of the court that the company is unable to pay its debts, account being taken also of contingent and prospective liabilities of the company.

These are alternative tests.

3. Compulsory power to order dissolution

A company **shall** be dissolved in the following cases:

i. The number of members of the company is reduced to below 2, and remains so for more than 6 months (other than in the case of a single member company);

ii. The number of directors is reduced to below the minimum and remains so reduced for more than 6 months (**the court may allow a "cure period" not exceeding 30 days, on good cause being shown**);

iii. The court is of the opinion that there are **grounds of sufficient gravity** to warrant the dissolution and consequential winding up of the company; and

iv. When the period, if any, fixed for the duration of the company by the memorandum or articles expires, or a particular event occurs, as contemplated by the memorandum or articles, and the company has not passed a resolution to be wound up voluntarily (**the court may allow a "cure period" not exceeding 30 days, on good cause being shown**).

The role of the court

In the event that an application for the winding up of a company is made, the Court enjoys a wide discretion in that it may:

- **Proceed to issue the winding up order; or**
- **Give any other direction or order (including provisional orders) as it deems fit and attach any term or condition thereto.**

- Winding up is thus not automatic, and the Court will take all the circumstances into consideration, evaluating the possibility of the company to continue as a viable going concern, as well as assessing which option is likely to be in the best interests of the creditors of the company as a whole.

Once a winding up application is made to the court:

- ✓ The company, or its creditors, may apply to the court for a stay of judicial proceedings against the company (protecting the state of affairs);
- ✓ Any disposition of property of the company made after the date of deemed dissolution shall be void, unless the court otherwise directs;
- ✓ Any act or warrant (precautionary or executive, other than a warrant of prohibitory injunction), issued or effected against the company after the date of deemed dissolution, shall be void;

Once a winding up order has been made, no action or proceedings shall be instituted against the company or its property, except with the consent of the court and subject to such terms as the court may impose.

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• KEY PLAYERS

OFFICIAL RECEIVER

SPECIAL MANAGER

PROVISIONAL ADMINISTRATOR

LIQUIDATOR

THE OFFICIAL RECEIVER

- Upon a winding up order being made, a statement of affairs of the company is made to the Official Receiver (who is a senior officer of the MFSA), stating the ***assets***, ***debts*** and ***liabilities*** of the company, and a description of its ***creditors*** and any ***security*** held by them.

- On receipt of this statement of affairs, the Official Receiver will carry out such preliminary investigations as he deems fit, and submit a report to the court on the share capital of the company, estimated assets and liabilities, and causes of failure.

i.e. The Official Receiver takes a snapshot of the company as at the time of the winding up order

THE PROVISIONAL ADMINISTRATOR

- May be appointed by the Court between the **winding up application and the winding up order (i.e. provisional),** to carry out such functions and powers in relation to the ***administration*** of the property and ***business*** of the company, as the court specifies.

The Provisional Administrator:

- takes care of the day-to-day administration of the company
- does not substitute the directors, as these continue to exercise their powers and duties
- has an ordinary administrative and supervisory role

THE SPECIAL MANAGER

The Court may, on an application of the liquidator or provisional administrator, appoint a Special Manager if it is satisfied that the nature of the estate or business of the company, or the interests of the creditors or contributories generally, requires such appointment.

As the term implies, the role of the special manager is of a ***technical*** nature and is restricted to the functions and powers entrusted to him by the court. The court thus affords protection to the other key players in the liquidation process, as well as to the creditors of the company.

THE LIQUIDATOR

Qualifications to act as a liquidator:

- **Advocate**
- **Accountant/Auditor**
- **Person registered with**
- **the Registrar as fit and proper**

A person may not, however, act as liquidator if he has held the office of director (including shadow director) or company secretary or has held any other appointment with or in connection to that company, at any time during the 4 years prior to the date of dissolution of the company.

THE LIQUIDATOR

Upon being appointed, all the powers and duties of the directors and company secretary cease, and are instead vested in the Liquidator, including the powers to:

- ✓ Institute or defend legal proceedings f/o the company
- ✓ Carry on the business of the company conducive and beneficial to its winding up
- ✓ Pay creditors according to their ranking at law
- ✓ Make compromises or arrangements with creditors/contributors
- ✓ Sell assets or raise security on assets

The Liquidator must render account of his administration (which accounts may be subject to an audit on request of the court), and his office will terminate once he has realised all the property of the company, and made a final distribution to creditors and shareholders.

RANKING OF CLAIMS

Where assets are *sufficient* to meet liabilities:

- All debts and claims shall be admissible as proof, with a just estimate being made of such debts and claims as may be subject to contingency or unascertained damages or for some other reason do not bear a certain value.

Where assets are *insufficient* to meet liabilities:

- The rights of secured and unsecured creditors,
- and ranking of debts, shall be regulated by the
- law for the time being in force
- (pari passu vs. preferential creditors

Offences in the context of an insolvency and winding-up

- The Companies Act sets out a number of offences, which may arise:
  - **In the months leading up to the insolvency and winding up**
  - **During the actual winding up procedure**

- The most important of which are the offences of:
  - **FRAUDULENT TRADING**
  - **WRONGFUL TRADING**

FRAUDULENT TRADING – Article 315 (1)

"If **in the course of a winding up** of a company, whether by the court or voluntarily, it appears that any business of the company has been carried on with **intent to defraud** creditors of the company or creditors of any other person or for any other fraudulent purpose, the court …

may, if it thinks proper to do so, **declare that any persons who were knowingly parties** to the carrying on of the business in the manner aforesaid **be personally responsible, without any limitation of liability for all or any of the debts or other liabilities of the company** as the court may direct".

WRONGFUL TRADING – Article 316 (1)

"where a company has been dissolved and is insolvent and it appears that a person who was a **director** of the company knew, or ought to have known prior to the dissolution of the company that there was no reasonable prospect that the company would avoid being dissolved due to insolvency…"

The court may order such director to make a contribution towards the assets of the company.

Examples of wrongful trading: Transactions below fair value or par value, disproportionate remuneration, failure to preserve assets or to collect debts due to the company.

FRAUDULENT TRADING VS. WRONGFUL TRADING

FRAUDULENT TRADING	WRONGFUL TRADING
During winding up (any type)	During insolvent dissolution
Fraudulent intent	No need to prove fraud
Any person involved	Directors only
Personal & unlimited liability	Contribution to assets
Application by liquidator/official receiver/creditor/contributory	Application by liquidator

THE CORPORATE RECOVERY PROCEDURE

THE RATIONALE - LIGHT AT THE END OF THE TUNNEL?

The primary aim of the company recovery procedure is to allow, if practicable, companies in financial difficulty to recover rather than to be put into liquidation.

The procedure is intended to be an alternative to the liquidation of a troubled business. It is not however intended to make effective insolvency or to merely postpone an inevitable crash.

TAKING ACTION:

DIRECTORS' DUTIES WHEN COMPANY IS IN FINANCIAL DIFFICULTY

- Where the directors of a company become aware that the company is **unable to pay its debts or is imminently likely to be unable to pay its debts**,

- They must **convene a general meeting** within 30 days of awareness (to be held within 40 days of notice),

- For the purpose of reviewing the company's position and determining the steps to deal with the situation, including whether to **dissolve the company or to apply for a company recovery application under Article 329B**.

ARTICLE 329B (COMPANIES ACT)

Accordingly,

"Where a company is unable to pay its debts or is imminently likely to become unable to pay its debts, **a company recovery application may be made to the Court** requesting the Court to place the company under the company recovery procedure and to **appoint a special controller** to take over, manage and administer the business of the company for a period to be specified by the Court".

This application may be made by:

- ✓ Extraordinary Resolution of the Company
- ✓ Resolution of the Board of Directors
- ✓ Demand by Creditors representing > ½ in value of total creditors

The Court will examine all the circumstances, and will only accede to an application if it considers that the order would likely achieve either:

(a) the survival of the company as a going concern in part/whole; or

(b) the sanctioning of a compromise or arrangement between the company and its creditors and/or shareholders

The Court shall take into account all circumstances, specifically:

the best interests of the creditors, shareholders, and the company itself, and the possibility of safeguarding employment

Owing to the seriousness of the situation, **the Court must make its decision in 20 days from the date of the application**, and where an application is made, and throughout the duration for which the order is in force, the following rules apply, known as **protective mechanisms:**

- ✓ Winding up applications are stayed
- ✓ Execution of monetary claims against company are stayed
- ✓ Interest accruable is stayed
- ✓ No Precautionary or Executive Warrants/Enforcement of Security/ Judicial Proceedings/Termination of Lease, except with the consent of the Court

THE SPECIAL CONTROLLER

Must be an individual who enjoys proven **competence and experience in the management of business enterprises**, and is willing to accept the appointment, and has **no conflict of interest** in doing so.

His functions and powers include:

- ✓ Taking the property of the company into his control and custody
- ✓ To manage and supervise the business of the company (he should carry on that business that is conducive to its recovery)
- ✓ The powers of the directors are suspended, and are only exercisable with the consent of the special controller

WHERE TO NEXT?

NO REASONABLE RECOVERY

If at any time, it results to the Special Controller, after consulting committees (if any) of the creditors/members, that it would serve no useful purpose for the company to continue with the said procedure, he shall forthwith apply for the termination, containing his detailed and comprehensive reasons therefor.

On receipt of this termination application, the Court shall order the winding up by the Court ⟶ conversion to liquidation proceedings.

REASONABLE RECOVERY

If ay any time (or on termination of his appointment), it results to the Special Controller, after consulting committees (if any) of the creditors/members, that the affairs of the company have improved to the extent that it is in a position to pay its debts, shall apply for the termination of the recovery procedure, containing his detailed and comprehensive reasons therefor.

This power is also vested in the directors/shareholders of the company if they are satisfied that the company's affairs have improved to such extent.

COVID-19: Companies Act Amendments

The **Companies Act (Suspension of Filing for Dissolution and Winding Up) Regulations, 2020 (the "Regulations")** were published on the 15th of September 2020 with a view of regulating the suspension of rights relating to the filing of winding up applications as well as the suspension of the applicable provisions on wrongful trading:

- By virtue of the Regulations, **the rights of persons empowered under the provisions of the Companies Act to file winding up applications (debenture holders, creditor/s), are being suspended**, with effect from the 16th March 2020. These rights will remain so suspended up until the lapse of 40 days from the date on which the Minister responsible makes an order to lift the said suspension.

- Likewise, any action or proceeding in court for the dissolution and winding up of a company filed by any debenture holder or creditor/s in the Registry of Courts and Local Tribunals on or after the 16th March 2020 shall be **stayed** for a period of 40 days following an order of the Minister to lift such suspension.

COVID-19: Companies Act Amendments

- Nevertheless, **the Court retains the discretion to order the filing or hearing of applications for winding up in terms of the Companies Act**, where it is satisfied that the **circumstances claimed in the application for winding up arose prior to the 16th March 2020.**

- Where a winding up order has been made in relation to a company, in respect of which, had it not been for the suspension contemplated in the Regulations, an application for dissolution and winding up would have been filed by the interested parties, the **deemed date of dissolution** shall be the date upon which a debenture holder, creditor/s files a judicial letter in court against the company informing it of the circumstances warranting its dissolution and not the date of filing of the winding up application. This provision of the regulations will remain valid for a period of 6 months following the lifting of the suspension by the Minister.

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