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Law

Each of these matters will be covered in the relevant sections below.

Company Voluntary Agreement versus Administration

A small company may apply for a company voluntary arrangement (CVA) under the Insolvency Act 1986. It grants an immediate moratorium period of up to 28 days, which would prevent creditors from taking and enforcing actions in the period leading up to the creditors meeting by seeking to promote an agreement between the company in difficulties and it's creditors, provided it is approved by 75% of creditors at the creditors meeting. In order to do this, the directors would need to submit to the nominee the terms of their proposed CVA together with a statement of the company's financial affairs. The nominee thereafter provides a statement governing whether in his opinion, the proposal has a reasonable prospect of approval and whether the company will have sufficient funds available to carry on business during the proposed moratorium. These must be filed after. This allows the directors to retain control, though under supervision of a qualified insolvency practitioner, but is usually used only where it seems viable that the company can continue to trade. It is noteworthy that a CVA is only available to small companies, defined in sections 382 and 465 of the Company Act[1]as companies meeting two or more of the following criteria. Having a turnover not exceeding £5. 6 millionHaving a balance Sheet not exceeding £2. 8 millionHaving no more than 50 employeesIt seems unlikely that Train 2 Perform (T2P) would meet this criteria with a previous turnover of £15 million and balance sheet of £4. 2 million and they therefore would be ineligible to apply for this, and would need apply for an Administration Order instead. Administration is largely concerned with rescuing companies as going

concerns or obtaining better realisations for creditors than what would be obtained through voluntary agreements or winding up. Following the Enterprise Act 2002, administration may be commenced without a court hearing though several formalities must be observed. The Insolvency Act[2]provides that on the making of a petition, a moratorium will come into effect preventing further action against the company. Assuming it is successful, an administration order will be made and an administrator appointed to take control of the company. Though the Enterprise Act[3]now means out of court appointments can be made without petitioning the courts, administration will relinquish control that the directors currently have. Unfortunately, as T2P's directors do not meet the requirements of being a small company, they would not be able to enter into a company voluntary agreement which would likely benefit them if the company has enough of a cash flow to keep trading. They could however still apply for an administrative order which though still requires a licensed Insolvency Practitioner, would have a similar effect and afford protection whilst a debt restructuring plan was carried out and presented to the courts. This might be best if they feel this is only a temporary matter, opposed to going through administration. The largest problem with this however is that if a moratorium is granted, this is only enforceable over unsecured creditors. T2P have one fixed, and two floating charges over the stock, and though they are still free to deal with the floating charged assets how they wish, as secured creditors, they are still able to intervene which may render obtaining a CVA pointless.

Charged Assets and their Creditors

Should the company go into administration and assets need to be sold, creditors with fixed charges, in this case Barly Bank, will be entitled to payment out of the charged asset before it is used for any other purpose. There priorities will still be governed by registration, under section 395[4]. If the security of a fixed charge does not cover the value of the debt, the balance will then have to be claimed as an ordinary creditor. The costs of realising fixed charge assets should be paid out of the value of the amounts payable from the sale of the assets. Section 245[5]stipulates a floating charge is prima facie invalid ifIt was made within 12 months before presentation… for an administration order…or, It was made at a time when the company was unable to pay it's debts…As T2P has only recently come into financial difficulties, and the floating charges were created in 2009, they will not be declared prima facie invalid. Barly Bank and Rocky Bank both have one floating charge each created in December 2009. They will be paid out of the charged assets, following repayment of fixed charge holders and the costs and expenses relating to receivers appointed to realise the charged assets and preferential claims in receivership. The Enterprise Act[6]and section 176A Insolvency Act,[7]now provides that for assets secured via floating charges created after 15th September 2003, the administrator is to make a prescribed part of the companies net property available for the satisfaction of unsecured debts, which will clearly apply in T2P's case. The calculation is based on 50% contribution where the value does not exceed £10, 000 and subject to the limits, where a property's value does exceed £10, 000, 50% of the first £10, 000 and 20% of the remaining value. This

must not exceed £600, 000 however as prescribed by s176A.[8]Therefore, Barly Bank would be entitled to the full £10, 000 floating charge as it is below 50% and 20% respectively of the £50, 000 value attributed to the stock, but Rocky Bank would only be entitled to £13, 000 of it's £45, 000 charge of the £50, 000 stock due to this restriction unless all unsecured creditors are paid off in full. Barly Bank would be entitled to the full amount assuming the asset value covered the debt for which it holds a fixed charge. It is worth considering, assuming there are other unsecured creditors, there preference will rank highest at fixed charge holders, then liquidators, then preferred creditors, then floating charge holders, then unsecured creditors and any surplus being used to pay off interest and shareholders.

Horatio's training sessions

Horatio is one of three directors at T2P. He has offered personal training sessions for which he has accepted money paid in advance, and failed to provide any of these. On top of this, he has supposedly used the money obtained to fund an extension to his own home. Directors have statutory duties under the Company Act.[9]These include but are not limited toacting within the companies constitution and to exercise powers for proper purposesTo promote the success of the companyTo declare interests in existing and proposed transactions or arrangements[10]Clearly, there has been a breach of these duties. Principle (a), is based on the common law principle outlined in Hogg.[11]Horatio has not exercised his power as a director for proper purposes of the company, which they were conferred. Section 172[12]outlines that a director must act in the way he considers, in good faith, would most likely promote the success of the company for the

benefit of the members as a whole. By accepting payment and not providing the service he has offered, he has shown no regard tothe likely consequences of his decisionthe interest of his employeesthe need to foster relationships between the business and it's customers, the need to maintain T2P's reputation or the need to act fairly as between members of the company. All of these duties extend from section 172,[13]but are not limited to promoting the success of the business. Under section 177,[14]a director is obliged to declare any interest in a proposed transaction[15]or arrangement with the company, in meeting or writing. The fact he has used the company to provide personal training sessions at one of their branches, which he did not declare would render Horatio in breach of this duty too. There is no reason to believe that this obligation should be waived either, as a conflict of interest would then arise with the other directors who are not profiting from the assumed non payment of tenancy to work there, or conflicts of interest with other employees who's business is being taken. Consequences of the breach of statutory duties are the same in common law and equitable principles are applied, and these duties would be enforceable. Therefore, the members, which are the directors would be able to commence derivative actions, which may be ratified by an ordinary resolution of the members of the company. Assuming they are the only shareholders, if both of them voted, they would have the majority vote to enforce this.[16]Horatio however, has made a secret profit from his activities,[17]which were not disclosed or paid over to the company. In Cook,[18]it was held directors are accountable to the company for any profit made, and that the term secret, meant ' failure to obtain permission',[19]to which, Horatio did not. Therefore,

any secret profit must be paid over to the company, even if the company itself could not have made that profit.[20]Though directors do generally not owe any direct duty to a person dealing with the company, subject to s172[21]regarding third party interests. Horatio did make himself liable through claiming an authority to bind his company, which he did not have. Although section 40[22]validates the contracts Horatio has entered into, it provides that the company can hold liable to account Horatio for any loss caused through breaching the duty owed to the company provided that the contract has been entered into in good faith. This is assumed unless the contrary is proven.[23]

The sale of the undervalued equipment

The sale of equipment to Horatio's brother at a gross undervaluation[24]also throws up a few conundrums. First, the fact the equipment was sold to Horatio's brother would likely mean that Horatio had a vested interest in the transaction. As discussed above, section 177[25]requires a director to declare any interest he has in a transaction made. It seems seems unlikely this was done, and assuming they are close being relatives, it seems plausible that Horatio stood to gain something that benefited his brother. The issue though primarily concerns section 190,[26]wherea director.. is to acquire from the company a substantial non-cash asset; orthe company is to acquire a substantial non-cash asset from one of it's directors…Substantial non-cash assets are defined by section 191[27]asExceeding more than 10% of the companies net asset value and is more than £5000; orexceeds £100, 000Clearly, as the equipment was valued at £350, 000, it would be considered substantial under 191(b),[28]but substantial property

transactions require approval by the members, through ordinary resolution, unless made on the basis that it will be obtained.[29]It seems unlikely that an ordinary resolution was passed, or that Horatio assumed that Roberto or Basil would agree to this later, seeing as he never told them as they only found out upon visiting the two sites last week. Due to this, any contracts made in contravention of this would be voidable by the company; unless affirmed, the company has been indemnified, third party rights have been acquired, or restitution of the money paid or the relevant asset is no longer possible.[30]Assuming that the equipment is still available, and T2P have the £5000 consideration paid, the contract would be voidable and both parties would be returned to their previous positions, resulting in T2P obtaining their equipment back through paying back the £5000. Though liability of Horatio might be avoided where he could prove he took all necessary steps to comply with section 190,[31]on the face of it, it seems very unlikely he did. It is also worth considering, that even if the transaction could not be voided under this section, if the company were to go into administration, the transaction would be considered a transaction at an undervalue under section 238[32]assuming it had not been made in good faith.[33]Provided the transaction was made at a relevant time, it may be set aside. The relevant time is when both the below requirements are met.[34]... transaction at an undervalue, the transaction takes place within two years before commencement of winding up...a preference...six months before that date. The company is insolvent at the time of the transaction or becomes insolvent as a result. This would render the transaction void, and the contract would be rescinded.

Removal of a director

In light of all that has happened with Horatio, it might be advisable that Roberto and Basil consider his removal.[35]Section 168[36]provides that directors can be removed by an ordinary resolution, (majority vote) subject to any special voting rights attained.[37]Irrespective of anything in the Articles, section 168[38]will prevail and override anything contradictory, and provided Horatio is fully compensated, he may be removed.