Briefing Sheet

Compulsory liquidation

What is compulsory liquidation?

A compulsory liquidation comes not in response to the business owners or managers seeking closure but in response to action by a creditor. This may be a supplier, or HMRC applying for a winding up petition which, if not defended and withdrawn, may ultimately lead to the business being closed down and any assets being liquidated to meet debts.

How does compulsory liquidation proceed?

A winding up petition will normally be issued as a last resort by a creditor who has pursued a debt for a significant period and exhausted all other recovery options. Deals to pay may have been agreed but not maintained or it might simply be that the debtor company does not communicate with the creditor(s). A creditor may already be working with a solicitor to collect the debt and, when nothing is achieved, a decision is made to wind the company up.

The application for a petition will be granted by the Court where it can be proved that the debt is undisputed, attempts to recover have been undertaken, and the debtor has not paid. A petition will be issued and a date to hear the petition fixed. Once the petition is correctly served, the company has a period to pay the debt or to defend the action. This is costly as the action is always in a High Court and so requires a barrister to attend any hearing.

The petition can be advertised in the London Gazette 15 days or more before the hearing. High street banks and lenders monitor such advertisements and will normally freeze the bank account of the company in question. This effectively prevents any further trading and any further dissipation of assets.

Even if the debt is paid, with all costs, the issuance of the petition requires a winding up hearing in the High Court. Between the payment and hearing there is the opportunity for another creditor to join the petition and use it in seeking payment of a different debt, aiming to jump the queue ahead of other unsecured creditors.

Permitting a company to be wound up in this manner should be avoided at all costs. It is possible to stop compulsory liquidation, but this demands speedy action if the petition has been issued. Once the case has reached the Courts, the chances are that the company will be wound up and the Official Receiver appointed to deal with the company's affairs.

Executive summary

Seeking a winding up order against a company is a very serious action for any creditor to take, not least because of the cost. It normally reflects a failure by the directors not only to settle the company's obligations but also to deal with an insolvent position in a professional manner. A company on the receiving end of such a winding up petition will find its ability to continue in business severely affected.

If the Crown takes the action to wind up the company, the liquidator is Court appointed and will investigate the actions of the officers of the company. If wrongful trading can be proved, legal action for recovery against the directors will follow. Once directors form the view that there is no reasonable prospect of avoiding an insolvent winding up, it is vital they take all reasonable steps to protect the remaining assets of the business and to act responsibly to minimise the loss to creditors.

Have a question?

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