Carter Clark
Financial Recovery

Briefing Sheet

Phoenix companies

What is a phoenix company?

A phoenix company is the name given to the process where the business and assets of one limited company are transferred to another legal entity. Often some or all of the directors remain the same and, in some cases, the new company has the same or a similar name to the failed business. The phoenix company will usually operate in the same sphere as its predecessor but is normally prevented from using the same or a similar name unless one of the exemptions available under the Insolvency Act apply.

Why use a phoenix company?

Insolvency law accepts that many businesses struggle in their early days and some may fail as a result of factors outside their control. While an insolvency process may allow the company to settle matters with its creditors, the failure does not necessarily mean that the business has no potential. Occasionally, the concept and the skills of the company's directors and staff still offer a marketable resource and, with the debt problem settled and some adjustment to operation to take account of mistakes made, there is a case for starting the business again. This can offer some continuity for both suppliers and employees.

How is a phoenix company established?

It is necessary for the management of the failing company to reach an agreement with the Insolvency Practitioner on a price to purchase the assets. This includes not only the physical assets, but also intangible assets such as websites, trademarks and goodwill. The Insolvency Practitioner is obliged to obtain the best possible price and will often rely on the advice of independent agents. Nevertheless, a going concern sale will often be of more benefit to creditors than a forced sale and also preserve jobs for the phoenix company. It is advisable to keep creditors informed of plans in advance and not to present them with a fait accompli – the court may interpret this as sharp practice. Transparency is the key, by advertising the involvement of the directors in the new business and circulating creditors of the failed company prior to taking part in the management of the phoenix.

Are there restrictions to the use of a phoenix company?

It is perfectly legal to form a new company from the remnants of a failed company. In addition, a director of a failed company can become a director of a new company unless he or she:

- is subject to a disqualification order or undertaking;
- is personally bankrupt;
- is subject to a bankruptcy restrictions order or undertaking.

Executive summary

Starting a phoenix company is an accepted way of revitalising a business that has suffered because of external factors but which has viability somewhere in its business model. If done according to the regulations, with the agreement of an Insolvency Practitioner and – if necessary – with relevant notification to the courts and creditors, a phoenix can give management a second chance at getting their ideas to work.

However, the process must be carried through in a way that reflects both the spirit and the letter of the regulations: the courts have proved willing to punish quite severely those they believe to be seeking to offset debt and carry on trading.

Have a question?

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Regretfully this opportunity has been misused in the past. Some directors have deliberately forced their companies into insolvency in order to buy back the assets at a reduced price while disposing of liabilities. Regulations now make this more difficult and any insolvency practitioner must ensure that the best price is obtained for a business and its assets.

The law also attempts to safeguard the creditors of the new company, many of whom may have suffered losses in the insolvency of the predecessor company. This protection can include making the directors of any new company personally liable for the old company's debts. As a result it is vital to follow the rules, be transparent, and take independent legal advice.

Advantages/disadvantages of using a phoenix company?

Regulation affecting phoenix companies has considerable room for interpretation by the courts, so what is permissible cannot always be guaranteed free of risk of challenge. While the background aim of securing continuity and not punishing entrepreneurship may favour a management buy-out, misuse of phoenix companies has sensitised the courts and they are ready to deal harshly with those who appear to be seeking unfair advantage.

The procedures are readily available and legal but need to be handled with great care to avoid stepping on the wrong side of the law. Expert advice and total transparency are essential.

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