**A picture containing drawing

Description automatically generated**

**Inside Story – December 2023**

**Small and State Funded – An Empirical Study of Liquidations in Scotland**

*Dr Jonathan Hardman, Senior Lecturer, University of Edinburgh, UK; Email: <jonathan.hardman@ed.ac.uk>;*

*and Dr Alisdair MacPherson, Senior Lecturer, University of Aberdeen, UK; Email: <alisdair.macpherson@abdn.ac.uk>*

*Introduction*

There is a significant degree of uniformity between corporate insolvency law in Scotland and in England and Wales, with many key elements reserved to the UK Parliament.[[1]](#footnote-1) The same types of corporate insolvency procedure exist in both systems, including liquidation in its various guises: members’ voluntary liquidation (MVL), creditors’ voluntary liquidation (CVL) and compulsory liquidation (winding up by the court). Nevertheless, there are differences in the relevant laws and insolvency practice. This is reflected in the fact that compulsory liquidations have historically been more commonplace in Scotland than CVLs, but the opposite is true for England and Wales.[[2]](#footnote-2) There are also differences in adjacent areas of law, such as the law of debt and the law of secured transactions, with these having an impact on insolvency outcomes.

Despite the contrasts between English law and Scots law and the availability of valuable data, there is a general absence of empirical analysis of corporate insolvency in Scotland.[[3]](#footnote-3) Consequently, the authors undertook a study to examine insolvent liquidations (i.e. CVLs and compulsory liquidations) for Scottish companies whose liquidations had their end point within a 12-month period.[[4]](#footnote-4) This enabled us to make a number of significant findings regarding the size of estates of liquidated companies, their lifespans and the duration of the liquidation procedures, as well as with respect to expenses, the role of state and the recoveries by various groups of creditors. The results of the study will appear in an article to be published in the *International Insolvency Review*.[[5]](#footnote-5)

*Acquiring the Data*

In order to compile a dataset, the authors identified the documentation containing the relevant information. This consisted of the final account that a liquidator has to file with Companies House (the companies register in the UK) at the conclusion of a liquidation.[[6]](#footnote-6) A freedom of information request[[7]](#footnote-7) was also submitted to Companies House to ascertain all of the companies for which final accounts had been filed between 1 October 2019 and 30 September 2020. The data received showed that there were 321 companies that had undergone a compulsory liquidation and 184 that had been through a CVL, amounting to 505 companies in total. This information was used to access the final account documents on Companies House to extract data relating to: total size of the estate (based on asset values), recoveries of different categories of creditors, expenses of the process, and this was supplemented by the date of incorporation of the company, the date of entry into liquidation and whether the company experienced another insolvency procedure prior to liquidation.[[8]](#footnote-8)

*Small & Slow Liquidations*

The data demonstrated that the estates of liquidated companies were, on average, small. A total of 196 of the companies had zero assets at the time of their liquidation and a further 88 had asset bases of under £5,000. Only 93 had aggregate assets valued at £50,000 or more. Given the apparent dominance of small companies in insolvent liquidations, and the absence of assets available to pay expenses and creditors, the authors’ view is that insolvency law should focus on providing a system that deals efficiently with such companies and minimises the costs of their liquidation.

Perhaps unsurprisingly, the companies with larger asset bases tended to have existed longer (from the date of incorporation to the commencement of liquidation). For instance, the average timespan of a company with a total asset value of zero that had been through a compulsory liquidation was 2,001 days, while for a company that had been through the same procedure, but with a total asset value of £50,000 or over, it was 5,136 days (i.e., more than double the timespan). A similar pattern also applies to the average length of liquidations. If the same example categories are used again, the relevant time periods are 479 days for a company with zero assets in a compulsory liquidation and 1659 days for a company in the same procedure, but with £50,000 or more in total assets. Yet although the time periods of liquidation for larger companies are understandably longer, those for smaller companies are not insignificant. As such, there is certainly scope to reform the law in order to limit the time and resource implications for at least some categories of small companies.

*Expenses & Recoveries*

The data also showed that, the smaller the estate was, the larger the percentage of the insolvency estate used to pay insolvency expenses was. Companies with under £5,000 net assets spent 100% of the estate on insolvency expenses for compulsory liquidations and 99.95% for CVLs. When we moved between £5,000 and £49,999.99, this dropped to 92.25% and 86.35% respectively, while when moving to £50,000 and over, this dropped further to 53.67% and 52.37% respectively. As such, the smaller the overall assets, the more of them were used to pay for insolvency expenses. As most insolvencies are of smaller companies, this indicates that a more streamlined insolvency process for smaller companies, which incurs lower insolvency expenses, may be needed.

Similar dynamics play out when recoveries received by creditors are explored. Only 27.3% of the sample had outstanding security listed at Companies House. In 23.6% of cases, where there was a secured claim, the secured creditor received nothing. Only 10.4% of companies with secured creditors paid them in full during the liquidation. In the sample, 65.9% of companies had no preferential claims. Where preferential claims were paid out, in 71.2% of cases they were paid in full. The return to preferential creditors increased with higher gross assets: where assets were less than £5,000 (but higher than zero), preferential creditors in compulsory liquidations received 0.00% (nil) return, and in CVLs received 0.67%. Between £5,000 and £49,999.99, these numbers increased to 9.20% and 48.19% respectively, while growing to 43.46% and 75.77% respectively for estates of £50,000 and over.

As would be expected, the same dynamics follow unsecured returns – with no returns for estates with under £5,000 of assets, rising to 2.00% for compulsory liquidations and 5.12% for CVLs, when considering estates with a value between £5,000 and £49,999.99, and to 17.64% and 23.05% respectively when moving to £50,000 of assets and over. The currently applicable rules result in all classes of creditors losing out in most liquidations (for small companies) to insolvency expenses. In addition, the data shows that creditors often obtain little or no dividend due to the amount of liquidation expenses incurred and the size of the estate.

Scotland lacks an official receiver and so these insolvency expenses are being paid to private insolvency practitioners (subject to the payment of outlays). One of the biggest surprises in our data, though, is how frequently His Majesty’s Revenue and Customs (the UK’s principal tax authority) petitions for compulsory liquidations. 55% of our sample of compulsory liquidations, representing 16% of total assets, were petitioned for by HMRC. It seems that HMRC contributed to the insolvency expenses of 56.8% of these companies. This demonstrates that the state still pays for a large number of insolvencies, albeit through imperfect means.

*Limitations & Caveats*

The sample data has the usual limitations of data of this type. Companies House records may not be perfect in respect of the continued existence and enforceability of security. Security could be used for enforcement prior to liquidation. An earlier administration or other procedure may have resulted in the repayment of secured creditors, and/or other creditors, prior to the liquidation. It can also be difficult to compare the data as between two companies. There may be errors in the data. The dataset was compiled during the days of COVID lockdowns, which could skew results. The authors do not think that any of this matters to the overall picture, but have to acknowledge that these caveats and limitations exist.

The authors are of the view that this work opens the ground for future research and hope that more granular data is found. Moreover, the authors hope that the dataset could be expanded: by time (to cover a longer period), by jurisdiction (to compare between jurisdictions), by insolvency process (to compare processes). All of this points to a potentially exciting empirical research agenda in corporate insolvency law.

*Summary*

As outlined above, the data reveals a number of key insights. Most liquidations in Scotland relate to companies with smaller asset bases. Although the average duration of liquidation procedures for these companies is shorter than for larger companies, the time and expense involved is not insignificant. A greater proportion of assets is diverted to insolvency expenses the smaller that the estate is. The authors think that this presents the case for a more streamlined and cheaper insolvency process for smaller companies. The authors are also of the view that this supports the case for an official receiver in Scotland and helps justify it in England and Wales. Without one in Scotland the state pays anyway, just through an imperfect and informal back door.

1. See Scotland Act 1998, Sch 5, Section C2. [↑](#footnote-ref-1)
2. For the relevant data, see the Insolvency Service’s Company Insolvency Statistics, available at:

   <[https://www.gov.uk/government/statistics/company-insolvency-statistics-april-to-june-2023/commentary-company-insolvency-statistics-april-to-june-2023](https://www.gov.uk/government/statistics/compa7ny-insolvency-statistics-april-to-june-2023/commentary-company-insolvency-statistics-april-to-june-2023)>. Since the COVID-19 pandemic, however, the number of CVLs in Scotland has exceeded the number of compulsory liquidations. [↑](#footnote-ref-2)
3. Of course, this issue is not just limited to Scotland. [↑](#footnote-ref-3)
4. These liquidations often commenced many years before the period examined by the authors in their study. [↑](#footnote-ref-4)
5. To be published in late 2023/early 2024. [↑](#footnote-ref-5)
6. The accounts are submitted along with a form known as a LIQ14(Scot), for CVLs, or a WU15(Scot), for compulsory liquidations. For more details, see: <<https://www.gov.uk/government/collections/companies-house-forms-for-insolvency-scotland>>. [↑](#footnote-ref-6)
7. Freedom of Information Request dated 14 October 2020 from A MacPherson to <[informationrights@companieshouse.gov.uk](mailto:informationrights@companieshouse.gov.uk)>, responded to on 22 October 2022 with reference number “FOI 303-10-20”. See also the Freedom of Information Act 2000. [↑](#footnote-ref-7)
8. For the compiled dataset, see “Scottish Companies Who Have Filed Certain Insolvency Forms between 1 October 2019 and 30 September 2020”, available at: <<https://datashare.ed.ac.uk/handle/10283/3909>>. [↑](#footnote-ref-8)