

PROTECTING YOUR BUSINESS

In today's uncertain economy it is more important than ever that directors and shareholders consider the ownership structure of their business activities. Where a single company has two or more distinct businesses the risk of the future failure of one business wiping out the value of the other business(es) must be considered.

If a normal limited company operates two distinct divisions then the creditors of one business are creditors of the whole company and have recourse to the assets of the whole company; in a business failure this includes the assets of the other business. This means that if one business fails then it is highly likely that the good business will be dragged down and any value could be destroyed.

MVL

There are a number of ways a demerger can be achieved. One of the most useful methods is a "Section 110 Scheme". In a Section 110 Scheme the old company is wound up and the separate businesses are transferred to two or more transferee companies. The transferee companies are usually newcos incorporated for the purpose of the reconstruction, which means that going forward these companies are clean, but the transferee companies can be existing companies with the same or different shareholders.

The Section 110 Scheme involves the liquidation of the old company; therefore shareholders need to appoint a licensed insolvency practitioner to act as Liquidator. The liquidation will be a solvent liquidation, otherwise known as a Members' Voluntary Liquidation ("MVL").

The shareholders must pass a special resolution approving the Section 110 Scheme. Any dissenting shareholders have seven days to object to the Liquidator and they may then be excluded from the scheme.

Once the Liquidator receives the required approval, and after ensuring that he is happy that the rights of any existing creditors of the oldco will be protected, he will transfer the businesses to the transferee companies.

Disclaimer: This guide is prepared as a general guide only. No responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication can be accepted by the author or publisher. Always seek professional advice before acting. Moorfields Corporate Recovery Ltd is registered in England and Wales No 08910792. The company's registered office is at 88 Wood Street, London, EC2V 7QF. The Institute of Chartered Accountants in England and Wales authorises Simon Thomas, Arron Kendall and Nicholas O'Reilly to act as insolvency practitioners in the UK under section 390(2)(a) of the Insolvency Act 1986.



Telephone. 020 7186 1144
Web. www.moorfieldscr.com

Fax. 0207 186 1177
Address. 88 Wood Street, London, EC2V 7QF

Consideration for the transfers will be new shares issued by the transferee companies to the oldco. The Liquidator will arrange that these shares are immediately transferred to the shareholder of the oldco in settlement of their entitlement in the winding up.

Other uses of Section 110 Schemes

As well as managing the future trading risks there are other uses for Section 110 Schemes. These include:

- To separate one business for sale to a third party when the shareholders wish to keep the other businesses
- To resolve a shareholder dispute. The shareholdings of the transferee companies do not need to be in the same proportions as the oldco. This means that if there are two shareholders and business A is transferred to Newco 1 and business B is transferred to Newco 2, the shareholders could take one company each and then pursue separate strategies
- Remove burden of regulation on the whole enterprise if part is subject to regulatory requirements.
- Improve chances of raising finance if a risky business is separated into a different corporate vehicle.

To be considered

A Section 110 Scheme is a complex transaction and it is important that any directors considering undertaking such a reconstruction take advice before implementing on the procedure. Advice should be sought at an early stage from lawyers, tax advisors and from the Insolvency Practitioner who is to act as Liquidator. The principle matters that need to be considered are

- The transfer of the businesses may require the novation of numerous contracts, including employee contracts, property leases, service contracts, etc. Lawyers will be needed to advise on and draft these agreements. Sufficient time must be allowed to explain and agree these novations with counterparties.
- Taxation. If the transaction is correctly structured the transfer of the businesses to the transferee companies will not be subject to capital gains tax. However, there are many other tax issues that must be considered for the oldco, the transferee companies and the shareholders, such as capital gains tax on any future sale, income tax on potential distributions, inheritance tax and stamp duty land tax. An experienced tax advisor will be able to look at all these when determining the optimum reconstruction and will be able to liaise with HMRC to get pre-transaction clearance for the proposed reconstruction.
- Liquidators' indemnity. Normally the Liquidator will distribute the new shares in the transferee companies to the shareholders at the beginning of the Liquidation which will denude the oldco of its assets. This will be before creditors have had an opportunity to prove their claims. A responsible Liquidator will ensure that there are procedures in place to ensure that any creditors submitting valid claims will be paid. In order to do this he may require that the shareholders and/or transferee companies provide him with an indemnity.

Example

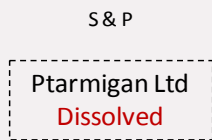
S and P set up a company, Ptarmigan Ltd. Ptarmigan purchases some land in Scotland. Part of the land is developed into a golf course and the rest is used for shooting.

The golf course and shooting estate both trade successfully, but are both owned by Ptarmigan.



Sometime later an American purchases the adjacent land and develops a championship golf course. Ptarmigan is unable to compete and its golf course business fails. It is placed into insolvent liquidation, the shooting business has to be closed and the assets sold to pay the company's liabilities

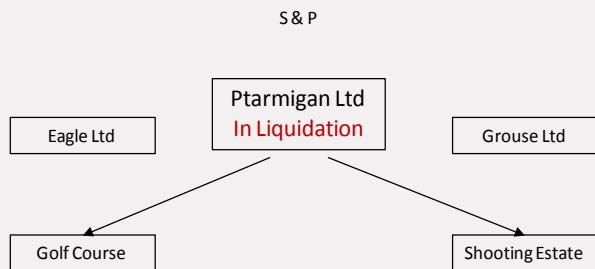
Ultimately Ptarmigan is dissolved and S & P are left with nothing.



If S and P had planned properly they could have separated the business and protected the shooting business from the losses of the golf course.

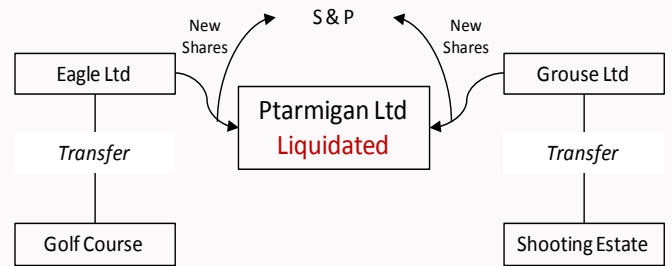
Section 110 Scheme Step 1

S and P incorporate two new companies, Eagle Ltd and Grouse Ltd. Ptarmigan is placed in MVL and a Liquidator appointed.



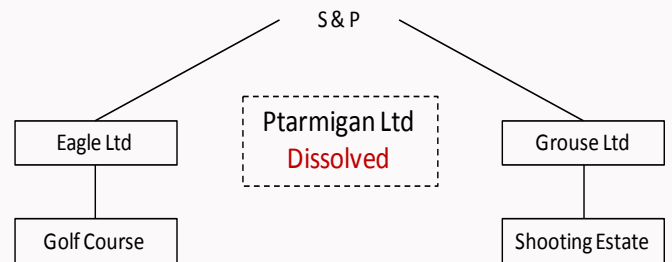
Step 2

The Liquidator enters into the Section 110 arrangement. He transfers the golf course to Eagle Ltd and the shooting business to Grouse Ltd. In return for the transfer of the businesses Eagle and Grouse issue new shares to the Liquidator, who then defects the shares to S and P.

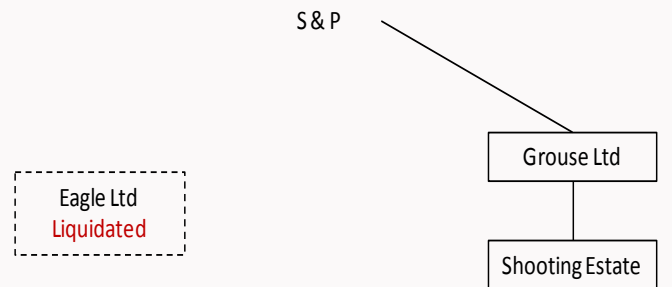


Step 3 – final position

The MVL of Ptarmigan is completed and the company is dissolved. S and P now own two companies with separate businesses.



If the golf course business were to fail now, the shooting business would not be affected. S and P would only lose their investment in the golf course.



CAN WE HELP?

If you would like to discuss how Moorfields can assist in placing your company into MVL, or any of the issues raised above, please contact:

Simon Thomas
020 7186 1144

Web. www.moorfieldscr.com
Address. 88 Wood Street, London, EC2V 7QF