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Small and state-funded: An empirical study of liquidations in Scotland

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Abstract

There is significant scope for empirical research in the field of corporate insolvency law. This paper seeks to make a valuable contribution to this field of research. It features analysis of data regarding all insolvent liquidations in Scotland that had their end point within a period of a year, specifically 1 October 2019-30 September 2020 (even if the liquidations commenced prior to that period). A dataset was compiled using information from final accounts documentation for liquidations available from the UK's companies register. Following the introduction, the paper provides background and context for corporate insolvency in Scotland, with particular reference to liquidation and the rules relating to creditors. The section also includes comparisons with the law of England and Wales. The paper then moves on to discuss the empirical methodology adopted and how the relevant data was obtained. This is followed by results and analysis focused on: the asset values of companies in the study, the lifespan of those companies, the timespan

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of their liquidations, the levels of liquidation expenses, the recoveries of creditors (including secured, preferential and ordinary unsecured creditors), and the role of HMRC in liquidations, as a petitioner and in terms of paying liquidation expenses. The paper contains a number of significant findings regarding each of these matters. It supports the case for a streamlined liquidation procedure for smaller companies and for the introduction of an official receiver in Scotland (while also justifying the existence of the official receiver in England and Wales). Lastly, after the identification of some limitations regarding the analysed data, the paper highlights potential lines of further research building upon this study, including expanding the time periods examined, comparing the data for Scotland with data for other jurisdictions, most obviously England and Wales, and the consideration of corresponding data for other insolvency procedures.

1 | INTRODUCTION

Large corporate insolvencies tend to dominate the headlines and academic attention.[1] Yet the vast majority of UK companies are small, and so the UK corporate database is dominated by such companies.[2] It therefore follows that most insolvencies relate to smaller companies. Perhaps the key issue in this context is, who receives what from the estates of these smaller companies? The archetypal corporate insolvency procedure is liquidation, and the various types of liquidation in the United Kingdom involve the appointment of a qualified insolvency practitioner as liquidator.[3] The costs that are then incurred in the liquidation process must be borne by the insolvent estate before

[1]For example, Carillion – see Andrew Keay, 'Financially Distressed Companies, Preferential Payments and the Director's Duty to Take Account of Creditors' Interest' (2020) 136 *Law Quarterly Review* 52; Xuedan Xiong, 'Time to Revisit Capital Maintenance on Profits Distribution: Lessons from Carillon and Beyond' (2020) 31 *European Business Law Review* 265. A major exception to this is the excellent study undertaken by Ronald Davis et al., *Micro, Small, and Medium Enterprise Insolvency: A Modular Approach* (OUP, 2018).

[2]See Department for Business, Energy & Industrial Strategy (National Statistics), *Business Population Estimates for the UK and Regions 2022: Statistical Release* (October 2022), available at: <https://www.gov.uk/government/statistics/business-population-estimates-2022/business-population-estimates-for-the-uk-and-regions-2022-statistical-release-html>; Jonathan Hardman and Guillem Ramírez Santos, 'Empirical Evidence for the Continuing Need to 'Think Small First' in UK Company Law' (2023) 24 *European Business Organization Law Review* 117. This also appears to be the position in other jurisdictions around the world – see Davis et al. (n 1), 10–14.

[3]See Insolvency Act 1986, sections 100, 135–140 and 171(4). There is an exception to this in England and Wales, as in some liquidations the official receiver is appointed and they do not need to be a qualified IP. See further below.

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most creditors receive anything.[4] An important related question here is, do these expenses dwarf creditor recoveries? If so, it may indicate that a new, simplified and cheaper liquidation procedure is required to streamline matters and avoid insolvency expenses swallowing the assets of the insolvent estate. This article tries to answer these questions empirically, by analysing recoveries from all insolvent liquidations in Scotland which concluded over a 1-year period – in other words, those insolvent liquidations of whatever length whose final date fell within the period of 12 months covered by our study, even if the liquidations commenced prior to that period.

Empirical research lets us 'test our assumptions about the world'.[5] It can act to verify or challenge analytical results.[6] The breadth of options that are available for empirical work means that it normally produces original research.[7] It was therefore well suited to explore the proportionate amount of assets in an insolvent estate that are eaten up by liquidation expenses. Here, following general insights into the corporate landscape, we have an analytical hypothesis that most liquidations are likely to involve companies with smaller estates and an assumption that the smaller a company, the greater proportion of its assets will likely be used to pay insolvency expenses. Both of these hunches were verified by our empirical data.

In particular, we identified all companies incorporated in Scotland whose insolvent liquidations (compulsory or creditors' voluntary) concluded within a 12-month period. It is worth noting that we do not mean those liquidations that lasted for 12 months or less. We mean, instead, those liquidations whose end date fell within the relevant 12-month period, however long the liquidations lasted and whenever they commenced. This sample provided us with clear results: of the 505 companies within our sample, the average total amount of assets per insolvent estate was only GBP 48,138.64. 196 (38.8%) of those companies had no assets at all,[8] 88 (17.4%) had average total assets between GBP 0.01 and GBP 4,999.99, 124 (24.6%) had total assets of between GBP 5,000 and GBP 49,999.99, and only 93 (18.4%) had assets of GBP 50,000 and over.[9]

The breakdown of recoveries from these estates demonstrates our hunch: the proportion of estate spent on insolvency expenses is on average higher the smaller the estate is.[10] For companies with total assets under GBP 5,000, almost all assets were used to pay insolvency expenses. For the next category, this dropped slightly to 92.25% of compulsory liquidation assets, and 86.35% of creditors' voluntary liquidation (CVL) assets, still dwarfing the rest of the estate. Even in the highest category, those with gross assets of over GBP 50,000, the average amount of the estate swallowed by

[4]Expenses will also include legal fees –see Hamish Anderson, 'The Professional Duties of the Lawyer in Business Insolvencies: An English Perspective' (1998) 7 *International Insolvency Review* 39.

[5]Alan Dignam and Peter Oh, 'Disregarding the Salomon Principle: An Empirical Analysis' (2019) 39 *Oxford Journal of Legal Studies* 16, 19.

[6]See discussion in Lynn LoPucki, 'A Rule-Based Method for Comparing Corporate Laws' (2018) 94 *Notre Dame Law Review* 263.

[7]Mathias Siems, 'Legal Originality' (2008) 28 *Oxford Journal of Legal Studies* 147.

[8]Reflecting the insight that the 'no-assets' case is 'a regular phenomenon in MSME insolvencies' in countries around the world – Davis et al. (n 1), 47.

[9]For the remaining four companies (0.8%) the total assets were not listed. The average total amount of assets per insolvent estate for our study excludes these companies.

[10]Throughout this article when we refer to the 'average percentage' we mean the mean of percentages. For example, if there were two companies, and one had a 50% recovery for preferential creditors and one had a 100% recovery for preferential creditors, we would list it as an average recovery rate of 75%, regardless of the comparative size of claims, asset base and recoveries between the two companies. This differs from where a percentage is calculated using total recoveries across all relevant estates divided by total assets across those estates, which can also allow an average to be produced. The latter can be somewhat skewed by a small number of very large estates, which usually have a lower proportion of recovered expenses.

insolvency expenses was 53.67% of compulsory liquidation assets and 52.37% of CVL assets. This demonstrates that most liquidations are small, and estates are consumed by insolvency expenses. Further, the smaller the estate, the higher the percentage is swallowed by insolvency expenses. These combine to provide a case for creating a new, streamlined insolvency process that reduces the proportion of expenses that are paid from estates in insolvent liquidations.

These results hint that there may be a large number of insolvencies in which the estate is not sufficient to pay for the insolvency expenses. Who pays then? Scotland becomes a useful jurisdiction for study in this regard, as there is no corporate state-backed public official to fulfil the same role as the official receiver does in England.[11] A creditor seeking to appoint a liquidator will often have to agree to underwrite the liquidator's expenses if it transpires that there are insufficient assets to pay for them,[12] otherwise the insolvency practitioner will simply refuse to accept the appointment. Exploring the data with respect to Scottish liquidations reveals that HMRC plays a considerable role in liquidations in Scotland. HMRC petitioned for the liquidation of 55% of compulsory liquidations within our dataset. HMRC also contributed to the insolvency expenses of 100 companies, or over half of those which they petitioned to have liquidated. The state – through HMRC – is financially supporting 31.2% of compulsory liquidations within our sample. This shows us that the lack of a streamlined insolvency process in Scotland means that the state is, effectively, paying insolvency practitioners to end the life of small companies. This is a sub-optimal solution, as if the company pays its taxes then state enforcement is not available through this route. We propose that our data indicates that at least one reform is drastically required: either the introduction of a streamlined insolvency process for smaller companies, or the creation of a Scottish equivalent of the official receiver, or both.

This research builds upon methods deployed in other recent research by the authors.[13] The article proceeds as follows. In part 2, we explore the background and context of liquidations in Scotland. Part 3 outlines how we identified our sample and extracted data from it. Part 4 outlines our empirical results and the conclusions arising from them. Part 5 identifies further research directions available from our methodology. Part 6 concludes.

2 | BACKGROUND AND CONTEXT

2.1 | Corporate insolvency in Scotland

As insolvency law in Scotland may not be particularly familiar to readers, it is helpful to provide a brief overview by way of context. Personal (non-corporate) insolvency law in Scotland differs

[11]See Insolvency Act 1986, section 136. There is also a precedent in non-corporate insolvency procedures in Scotland, where the Accountant in Bankruptcy has significant involvement and can be appointed as for example, trustee in a sequestration – see Bankruptcy (Scotland) Act 2016, section 51; <https://aib.gov.uk/>.

[12]See Jennifer Marshall et al., *European Cross Border Insolvency* (Sweet & Maxwell, Looseleaf), paragraph 27.7.15.0.

[13]See Jonathan Hardman and Nicholas Rowell, 'The UK's Director Daisy Chain: Empirical Evidence of the Interconnectivity of Directors of UK Publicly Traded Companies' (2023) 34 *European Business Law Review* 345; Hardman and Ramírez Santos (n 2); Jonathan Hardman and Alisdair MacPherson, 'The Empirical Importance of the Floating Charge in Scotland', in Jonathan Hardman and Alisdair MacPherson (eds) *Floating Charges in Scotland: New Perspectives and Current Issues* (EUP, 2022), 442–472; Jonathan Hardman, 'The Slow Death of the Scottish plc Listed in London: An Empirical Study' (2022) *Journal of Business Law* 118; Jonathan Hardman, 'Articles of Association in UK Private Companies: An Empirical Leximetric Study' (2021) 22 *European Business Organization Law Review* 517; Jonathan Hardman, 'The Moral Hazard of Limited Liability? An Empirical Scottish Study' (2018) 6 *Nottingham Insolvency and Business Law eJournal* 30.

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fairly significantly from the equivalent law in England and Wales and is largely devolved to the Scottish Parliament.[14] By contrast, there is far more uniformity amongst the jurisdictions in the sphere of corporate insolvency law, with many key elements reserved for the UK Parliament.[15] Nevertheless, certain components of corporate insolvency law and adjacent areas, such as the process of winding up (following commencement), transaction avoidance rules and security rights (including floating charges) and debt enforcement rights are devolved to the Scottish Parliament.[16] Combined with differences that pre-date devolution, this means that there are some notable distinctions between corporate insolvency law in Scotland and in England and Wales, which will be mentioned below.

In both jurisdictions, the same types of insolvency procedures are available: liquidation, administration, company voluntary arrangements, administrative receivership (in limited circumstances), schemes of arrangement and, since 2020, restructuring plans.[17] The procedure focused on in the present study is liquidation. However, at least some of the other procedures mentioned are of relevance, as various companies covered in the study passed through one or more of those procedures in an attempt to rescue the business before entering liquidation.

2.2 | Liquidation

Liquidation throughout the United Kingdom is divided into compulsory[18] and voluntary varieties, with the latter sub-divided into members' voluntary liquidation (MVL) and creditors' voluntary liquidation (CVL).[19] As MVLs do not involve insolvent companies, they were excluded from our study.[20] Historically, compulsory liquidations have been more commonplace in Scotland than CVLs but the position has been the opposite in England and Wales.[21] For example, between 2013 and 2019 inclusive, there were 3,945 compulsory liquidations and 1,965 CVLs in Scotland, compared to 21,822 compulsory liquidations and 75,221 CVLs

[14]The principal piece of legislation is the Bankruptcy (Scotland) Act 2016; see Donna McKenzie Skene, *Bankruptcy* (SULI, 2018).

[15]Scotland Act 1998, Schedule 5, Section C2. This includes: the modes of, the grounds for and the general legal effect of winding up and the persons who may initiate winding up; arrangements with creditors; and procedures giving protection from creditors.

[16]For further details, see Donna McKenzie Skene, 'Plus Ça Change, Plus C'est La Même Chose? The Reform of Bankruptcy Law in Scotland' (2015) 2 *Nottingham Insolvency and Business Law e-Journal* 285. Alisdair MacPherson, 'A Divided Kingdom? Insolvency Law in Scotland' (INSOL International, November 2021), 114, 116 ff.

[17]For discussion of the scope and meaning of insolvency proceedings, see Riz Mokal, 'What is an Insolvency Proceeding? Gategroup Lands in a Gated Community' (2022) 31 *International Insolvency Review* 418. Free-standing moratoriums in terms of Part A1 of the Insolvency Act 1986, as inserted by the Corporate Insolvency and Governance Act 2020, are also available under Scots law.

[18]I.e. winding up by the court.

[19]For the distinction between a MVL and a CVL, see Insolvency Act 1986, section 90.

[20]However, it should be noted that a handful of companies in our sample ultimately (and unexpectedly) had sufficient assets to enable a return to be made to shareholders (and so they were not ultimately balance sheet insolvent). If a company entered a MVL and it then transpired that it was actually unable to pay its debts in full, the liquidation would require to be converted into a CVL (see Insolvency Act 1986, sections 95–96), and so such a company would be captured by our data.

[21]The following data have been derived from the Insolvency Service's Company Insolvency Statistics, for which see: <https://www.gov.uk/government/statistics/company-insolvency-statistics-january-to-march-2023>.

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in England and Wales.[22] Since the COVID-19 pandemic, however, the number of CVLs in Scotland has exceeded the number of compulsory liquidations (1,619 and 657 respectively in 2020–2022 inclusive), and this remains the case despite a narrowing of the gap following the removal of restrictions on petitions for winding up imposed during the pandemic.[23] It should also be noted that both types of liquidation are significantly more common in Scotland than the other types of insolvency procedures combined.[24]

The precise reasons for the traditional popularity of compulsory liquidations in Scotland, including in comparison to England, are a matter of some speculation, but certain points of difference may offer (at least) a partial explanation.[25] It is less onerous to appoint a provisional liquidator when seeking compulsory winding up in Scotland than it is in England and Wales.[26] The appointment of a provisional liquidator may be appealing as they can provide protection for creditors by preserving the estate prior to granting a winding-up order by the court. Furthermore, in Scotland, there is less incentive for those involved in the insolvency industry and creditors to press for a CVL rather than a compulsory liquidation with respect to the appointment of a suitable liquidator. In particular, there is no official receiver or equivalent to act as a liquidator in compulsory liquidations,[27] and so rather than state participation, a private insolvency practitioner is always appointed in such liquidations.[28] Also, upon a winding-up order being made by a Scottish court, an 'interim liquidator' is appointed and they are required to seek nominations from creditors to have a liquidator appointed.[29] This duty is stronger and more inclusive of creditors than the equivalent duty applicable to the official receiver in England and Wales.[30]

Whatever the reasons for the differences regarding the comparative popularity of the liquidation processes between the two jurisdictions, the overall scheme is the same, and there is considerable overlap on many points.

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[22]Company Insolvency Statistics January to March 2023, Data Tables, Table 4: Registered Company Insolvencies, Scotland, 1 January 2013 to 31 March 2023, not seasonally adjusted; and Table 1b: Registered Company Insolvencies, England and Wales, 1 January 2013 to 31 March 2023, not seasonally adjusted.

[23]For those restrictions, see Corporate Insolvency and Governance Act 2020, section 10 and Schedule 10.

[24]Between 2013 and 2019 inclusive, there were 705 administrations, 57 CVAs and 44 receiverships in Scotland. For the period 2020 until 2022 inclusive, there were 163 administrations, 12 CVAs and 1 receivership in Scotland. See Company Insolvency Statistics January to March 2023, Data Tables, Table 4: Registered Company Insolvencies, Scotland, 1 January 2013 to 31 March 2023, not seasonally adjusted.

[25]Other reasons, such as the existence of more forceful creditors or more passive directors are also possible, but are difficult to evidence and depend on more heterogeneity between the two jurisdictions.

[26]For example, in relation to accompanying documentation and deposits – see Insolvency (England and Wales) Rules 2016 (SI 2016/1024), rule 7.33 onwards; and cf Insolvency (Scotland) (Receivership and Winding Up) Rules 2018 (SI 2018/347), rule 5.4 onwards.

[27]This contrasts with the position for personal insolvency, where Scotland's insolvency service, the Accountant in Bankruptcy, is heavily involved in various respects – see McKenzie Skene (n 14), Chapter 4.

[28]This may be considered counter-intuitive given the general perception, to some extent supported by political preferences, that England is more individualistic and Scotland is more collectivistic and state-oriented. See more broadly, the British Social Attitudes Surveys available at: <https://www.bsa.natcen.ac.uk/>.

[29]Insolvency Act 1986, sections 138–139.

[30]See Insolvency Act 1986, sections 136–137 and 139.

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2.3 | Creditors

Given that a significant amount of the project data involves recoveries by different classes of creditors and insolvency expenses, it is helpful to outline some ranking rules for competing claims here.[31] In broad terms, the law in Scotland in this area is largely aligned with England and Wales. Secured creditors ordinarily have the highest ranking priority and to the extent that property is encumbered by security rights (other than floating charges) it will not be available to other creditors or to pay for the expenses of the liquidation.[32] Security rights can often still be enforced despite the debtor's entry into liquidation but in some circumstances a liquidator will realise encumbered property and then distribute proceeds to the secured creditor and others, based on their priority (and after the deduction of the expenses of realisation).[33] The order of priority after security rights (excluding floating charges) is liquidation expenses, preferential debts (ordinary and then secondary), ordinary unsecured debts, post-liquidation interest on debts and postponed debts.[34]

As in English law, the existence of floating charges in Scots law complicates the ranking order.[35] The default position is that floating charges rank behind fixed security rights but in the vast majority of cases floating charges are accompanied by a negative pledge, which enables them to rank ahead of subsequent voluntary fixed securities (as well as later floating charges). The effect of a negative pledge is actually stronger in Scots law than in English law, as it applies automatically and does not depend on notice.[36] A further point of potential disparity with English law is whether floating charges are subordinated to liquidation expenses generally, as in English law (subject to rules of approval and authorisation in certain circumstances), or whether only expenses relating to realisation of charged property are prioritised. The relevant legislative provisions in the Insolvency Act 1986 that provide the position in England and Wales do not apply in Scotland.[37] However, the English law approach seems to be followed in practice, as confirmed by our study.[38] Floating charge holders in Scotland will normally only

[31]For ranking rules generally in Scots law, see Jonathan Hardman, *A Practical Guide to Granting Corporate Security in Scotland* (W Green & Sons, 2018), Chapter 9.

[32]Insolvency (Scotland) (Receivership and Winding up) Rules 2018 (SSI 2018/347), rules 7.27(1) and (6).

[33]This latter approach is commonly used for certain types of involuntary security, such as the landlord's hypothec (for which it is now necessary) and some diligences (i.e., property rights arising due to debt enforcement processes), so long as they have not been rendered ineffective by the liquidation: see Andrew Sweeney, *The Landlord's Hypothec* (Edinburgh Legal Education Trust, 2021), Chapter 11; and Laura Macgregor et al., *Commercial Law in Scotland* (sixth edn) (W Green & Sons, 2020), Chapter 9.

[34]Insolvency (Scotland) (Receivership and Winding up) Rules 2018 (SSI 2018/347), rule 7.27(1).

[35]Floating charges were rejected at common law in Scotland but were introduced by legislation in 1961. The current legislative provisions are found in the Companies Act 1985, Insolvency Act 1986 and Companies Act 2006. For further details, see: Alisdair MacPherson, *The Floating Charge* (Edinburgh Legal Education Trust, 2020); Hardman and MacPherson (eds) (n 13).

[36]See Companies Act 1985, section 464(1)(a) and (1A). For further details on ranking matters relating to floating charges, see Jonathan Hardman and Alisdair MacPherson, 'The Ranking of Floating Charges', in Hardman and MacPherson (eds) (n 13), 345–399.

[37]Insolvency Act 1986, section 176ZA, which overrode *Buchler v Talbot* [2004] UKHL 9 in England and Wales. For the rules on approval and authorisation, see Insolvency (England and Wales) Rules 2016/1024, rules 6.44–6.48 and 7.112.

[38]See further below.

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receive payment after expenses have been paid, and they also rank behind preferential creditors[39] and the 'prescribed part', in the same manner as in English law.[40]

Of course, the larger a company is, the more likely it is to have a greater number and wider range of creditors (with reference to the different categories above). Our study shows, however, that even for many small companies the levels of claims by creditors and the types of creditors can be relatively diverse.

3 | EMPIRICAL METHODOLOGY

3.1 | Identifying the sample

Our first step was to compile our dataset. This involved identifying a sample of companies, and then extracting data from publicly available information to explore the size of the estates of insolvent companies within Scotland and any evident role for the state. We needed to ensure that our sample was complete and extrapolatable. To be complete, it must include *all* companies within the boundaries of the sample, to avoid any bias in sample selection. To be extrapolatable, it must be of a significant size to provide a meaningful insight into wider implications. We decided to make our sample complete by including all companies whose liquidation processes were completed within a certain period of time. A company only exists from the moment of time that it is added to the UK's central corporate registry (the register of companies maintained by Companies House).[41] The converse is also true – a company only ceases to exist when it is removed from the corporate register.[42] As such, this central registry was the appropriate place to obtain a complete sample from which empirical insights could flow.

To ensure an extrapolatable sample, we decided that we must include data in respect of all companies whose insolvent liquidations concluded within a period of 1 year (i.e. the end point of each liquidation was within that period irrespective of whether the starting point was outside that period). We considered the period of 1 year to provide sufficient extrapolatability to make our results meaningful for wider conclusions. We therefore needed to identify a list of all companies whose liquidation endpoint was within a 1-year period.

This information is not readily available from Companies House, so we identified documentation that Companies House does hold to manually extract relevant data from it. At the end of a CVL or compulsory liquidation, a liquidator is required to make up an account of the winding up, 'showing how it has been conducted and the company's property has been disposed of'.[43] Copies of the account are to be sent to, inter alia, the company's creditors and the registrar of companies (i.e. to Companies House) within specified time periods.[44] The final account must contain stipulated pieces of information, such as a summary of the liquidator's receipts and

[39]The category of preferential debts is the same as in English law – see Insolvency Act 1986, section 386 and Schedule 6, paragraph 8 onwards – and thus includes employee claims for unpaid wages to a limited extent and HMRC claims for certain unpaid taxes.

[40]Companies Act 1985, sections 463(3) and 464(6); Insolvency Act 1986, sections 175(2)(b), 176A.

[41]Companies Act 2006, section 16. See discussion in Susan Watson, 'The Corporate Legal Person' (2019) 19 *Journal of Corporate Law Studies* 137.

[42]For example, Insolvency Act 1985 section 201. See conceptual discussion in Sally Wheeler, 'The Corporate Way of Death' (1996) 7 *Law & Critique* 217.

[43]Insolvency Act 1986, sections 106(1) and 146(2).

[44]Insolvency Act 1986, sections 106(2)–(4) and 146(3)–(4).

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payments and a statement of the amount paid to unsecured creditors by virtue of the prescribed part.[45] Ordinarily, the accounts also provide much further information regarding the recoveries of different types of creditors.

The final accounts in insolvent liquidations are submitted to Companies House along with a LIQ14(Scot) form (for CVLs) or a WU15(Scot) form (for compulsory liquidations).[46] We therefore sought details of the names and numbers of companies that had filed these forms in the period between 1 October 2019 and 30 September 2020 inclusive. A freedom of information request was submitted to Companies House on 14 October 2020 and responded to with the requested information on 22 October 2020, including the dates when the appropriate LIQ14 or WU15 forms were accepted by Companies House.[47]

3.2 | Extracting the data

The next step was to access the final accounts documents for relevant companies using the register search function on the Companies House website.[48] From those documents, we extracted data relating to the total assets of the estate, recoveries of different categories of creditors, as well as 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 (such information being taken from the Companies House website too). All of this information was manually entered into the spreadsheet holding our dataset.[49]

Due in part to variability in the precise information included in the accounts for different companies and the presentation of the information, we adopted a consistent approach in how we recorded data and where we obtained it. Our category of recovered insolvency expenses is expansive and includes outlays and remuneration, including enforcement costs incurred by a liquidator relating to secured claims (where known). The figures for this category are limited to those recovered in the process itself, not where a third party has paid those expenses,[50] unless funds were provided to make payment and such funds are identified as an asset of the estate. If third-party funds are the only asset(s) of the estate, the amount of assets has been entered as zero, with corresponding distribution payments and expenses recovered also listed as zero.

For the total value of (ordinary) unsecured claims (which excludes preferential claims), the figure given in the accounts for claims received by the liquidator has been used. However, if there are separate figures given for received claims and agreed claims figures, the latter have been used. Claims of HMRC are frequently listed in the accounts separately from those of unsecured creditors, and this may be partly a legacy of HMRC's former status as a preferential creditor before the reforms made by the Enterprise Act 2002.[51] The data of course also pre-dates the partial reinstatement of HMRC's preferential status for certain tax debts by the Finance Act

[45]See Insolvency (Scotland) (Receivership and Winding up) Rules 2018 (SSI 2018/347), rules 4.30, 5.33 and 7.9.

[46]For the forms, see: <https://www.gov.uk/government/collections/companies-house-forms-for-insolvency-scotland>.

[47]Freedom of Information Request dated 14 October 2020 from Alisdair MacPherson to: <informationrights@companieshouse.gov.uk>, responded to on 22 October 2022 with reference number 'FOI 303–10-20'.

[48]See: <https://find-and-update.company-information.service.gov.uk/>. On the operation of such function, see Hardman, 'Articles of Association' (n 13). For limitations, see Hardman and Rowell (n 13).

[49]Jonathan Hardman and Alisdair MacPherson, 'Scottish Companies Who Have Filed Certain Insolvency Forms between 1 October 2019 and 30 September 2020′ (2021) [dataset], available at: <https://doi.org/10.7488/ds/3040>.

[50]Where a third party has paid expenses, this is noted as an additional comment.

[51]Enterprise Act 2002, section 251.

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2020.[52] Given HMRC's status as an ordinary unsecured creditor in the relevant time period, claims by HMRC have been included in the value of total unsecured claims. Where the narrative of the report in the accounts document does not give the total value of unsecured claims, the relevant figure from the statement of affairs has been used (and this also applies to the claims of preferential creditors).[53] The figures for returns to unsecured creditors include payments by virtue of the prescribed part,[54] which gives such creditors a ranking priority over floating charge holders to a limited extent, as noted above.[55]

In terms of preferential claims, accounts covered by the study sometimes list preferential claims within the wider category of unsecured claims; however, wherever possible we have sought to separately identify and include preferential claims in our dataset. Often the preferential claims in the study are made by the Insolvency Service, having been subrogated to employee claims after the employees have obtained payment from the National Insurance Fund.[56]

The category of secured creditors in the dataset includes floating charge holders, even though floating charge holders are frequently separated from other security holders in the accounts.[57] Secured creditors are only included in the dataset if the security has been identified as outstanding (non-satisfied) on the charges register for the relevant company at Companies House. If the secured creditor had actually been repaid and there is evidence confirming this, despite the 'live' entry in the charges register, the claim is listed as zero. Where expenses relating to the realisation of assets for a secured creditor are separately identified, they have been included as recovered insolvency expenses.

Finally, there are some further, usually minor, discrepancies and other points of uncertainty and interest across the accounts in the study. These have been separately noted for relevant companies as additional comments in the dataset.

4 | RESULTS AND ANALYSIS

4.1 | Base data

4.1.1 | Total assets

Our sample contains 505 companies whose liquidation concluded during our sample period (i.e. where the filing of the final accounts of the liquidation with Companies House occurred

[52]Finance Act 2020, sections 98–99, inserting paragraph 15D of Schedule 6 to the Insolvency Act 1986. HMRC's preferential status was reinserted for insolvency procedures from 1 December 2020 onwards.

[53]In cases where no figure is provided in the narrative of the report for the total unsecured claims but a dividend figure is given and the return to unsecured creditors is provided in the account, these latter two figures have been used to calculate the total unsecured claim amount. This can be represented as follows: $\frac{\textit{total amount paid to unsecured creditors}}{\textit{dividend rate (out of 100)}} x100 = \textit{total amount of unsecured claims}.$

[54]However, where there is a discrepancy between the prescribed part figure in the narrative of the report and the equivalent distribution figure in the account itself, the former is included in the prescribed part column of the spreadsheet and the latter figure is included in the unsecured creditor return column.

[55]For further consideration of the prescribed part in relation to ranking, see Jonathan Hardman and Alisdair MacPherson, 'The Ranking of Floating Charges', in Hardman and MacPherson (eds) (n 13), 345–399, at 381.

[56]See the Employment Rights Act 1996, sections 166–170 and 182–190; Vanessa Finch and David Milman, *Corporate Insolvency Law: Perspectives and Principles* (3rd edn) (Cambridge University Press, 2017), 647–648.

[57]For a separate study focused on floating charges using the same dataset, see Hardman and MacPherson (above note 13).

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TABLE 1 Total asset amount.

Total asset amounts	Compulsory liquidations	CVLs	Total
GBP 0	134	62	196
GBP 0.01–GBP 4,999.99	47	41	88
GBP 5,000–GBP 49,999.99	72	52	124
GBP 50,000 and over	65	28	93
Total	318	183	501

Note: Total assets were not listed for 3 companies in the category of compulsory liquidations. Total assets were not listed in for 1 company in the category of CVLs.
Source: Authors' collected data.

within a 12-month period, however long the liquidation itself may have taken). Of these, 321 (63.6%)[58] undertook compulsory liquidations, and therefore final accounts were appended to forms WU15(Scot), whilst 184 (36.4%) undertook creditors' voluntary liquidations, therefore final accounts were appended to forms LIQ14(Scot). The total assets of all companies within the sample for which such information was provided (totalling 501) were GBP 24,117,460.60, meaning that the average total assets per sample company were GBP 48,138.64. There is only minor variability based on insolvency type – average assets for compulsory liquidations were GBP 47,834.66 per company, with average assets per CVL being GBP 48,666.88.

There is considerable bimodality of asset quantum, though. We divided companies into those with assets of zero value, assets of GBP 0.01 to GBP 4,999.99 (low value), GBP 5,000 to GBP 49,999.99 (medium value), and GBP 50,000 and above (high value). The results are displayed in Table 1 and we use these bandings through the majority of data set out below.

This demonstrates that 196 of the companies in the dataset (for which there is relevant information), being 39.1%, had zero assets at the time of their liquidations. For compulsory liquidations, this was 42.1%. If we add in those in the low-value category, we see that over half of both types of liquidation occurred where there were under GBP 5,000 of total assets within the company: 56.9% for compulsory liquidations (181 out of 318), and 56.3% for CVLs (103 out of 183). Those with assets under GBP 50,000 were the substantial majority – being 81.4% in aggregate.

We see here a picture of terminal insolvency processes in Scotland being dominated by smaller companies. It is well known that there are more smaller companies than larger companies in the UK marketplace.[59] This empirical evidence suggests that in addition to company law focusing on smaller companies, insolvency law needs to do so as well (at least in Scotland).[60] Our data immediately flags that most companies are smaller. We are therefore able to use our categories to ascertain whether the proportion of the estate which is utilised for insolvency expenses is the same for smaller companies and larger companies. However, the largest category of companies is those with zero assets. Even if insolvency expenses were directly proportional to estate size, resources are required to wind up companies, and those resources must be paid for by someone. A company with no assets – or few assets – immediately creates a policy

[58]Percentages are rounded to one decimal place throughout this article unless otherwise rounded.
[59]Hardman and Ramíres Santos (n 2).
[60]There is considerable evidence that this point is also true for other countries generally – see Davis et al. (n 1), Chapter 2.

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TABLE 2 Average length of days from incorporation to liquidation.

Total asset amounts	Compulsory	CVL
GBP 0	2,001	2,466
GBP 0.01–GBP 4,999.99	2,647	2,201
GBP 5,000–GBP 49,999.99	3,047	4,350
GBP 50,000 and over	5,136	6,680

Source: Authors' collected data.

problem: who will pay for the expenses necessary to ensure the winding up of the company properly? We explore further why this matters in the remainder of the present article.

4.1.2 | Timing of liquidations

Our data also revealed two interesting insights into time processes for liquidations. First, it unveiled the length of time between incorporation and liquidation, and second the length of time between the commencement of liquidation and the filing of the final accounts of the procedure.

First, the length of time between incorporation and liquidation is set out in Table 2.

We see here that companies with more assets generally take longer to enter into liquidation. This reflects the conventional wisdom that companies start small and then tend to grow until an insolvency event happens to them.[61] This is displayed graphically in Figure 1.

The lowest average across all types is for compulsory liquidations with GBP 0 assets, although there is limited difference for both types of process for companies with less than GBP 5,000 of assets. It should be noted, though, that the lowest average is still over 5 years between incorporation and liquidation. This seems to suggest that these processes are not being utilised by new companies set up but not yet trading, for whom a dissolution may be more appropriate.[62] Liquidation attracts significantly more costs than dissolution.[63] As such, this empirical evidence supports the simple transaction costs analysis that would suggest that the risk would be the other way around[64] – of dissolutions being attempted where liquidation was more appropriate. It therefore seems as if, notwithstanding low asset bases, liquidations were the most appropriate form of process for companies within our sample.

The other interesting time function our data unveiled was the length of liquidation. This is set out – broken down across the same categories – in Table 3.

[61]For example, David Evans, 'The Relationship between Firm Growth, Size, and Age: Estimates for 100 Manufacturing Industries' (1987) 35 *Journal of Industrial Economics* 567; Alex Coad, Agusti Segarra and Mercedes Teruel, 'Like Milk or Wine: Does Firm Performance Improve with Age?' (2013) 24 *Structural Change and Economic Dynamics* 173.
[62]A company that is effectively dormant for 3 months can be merely dissolved – see Companies Act 2006, section 1004.
[63]Whilst dissolution is undertaken by the company, a qualified insolvency practitioner must liquidate the company –see Insolvency Act 1986, section 171(4). It should be noted that dissolution can also be initiated by the Registrar of Companies – see Companies Act 2006, section 1000.
[64]Parties looking to achieve a set joint end are more likely to use the route that incurs lowest costs to achieve – see Oliver Williamson, 'Comparative Economic Organization; The Analysis of Discrete Structural Alternatives' (1991) 36 *Administrative Science Quarterly* 269; Oliver Williamson, 'Assessing Contract' (1985) 1 *Journal of Law, Economics and Organization* 177.

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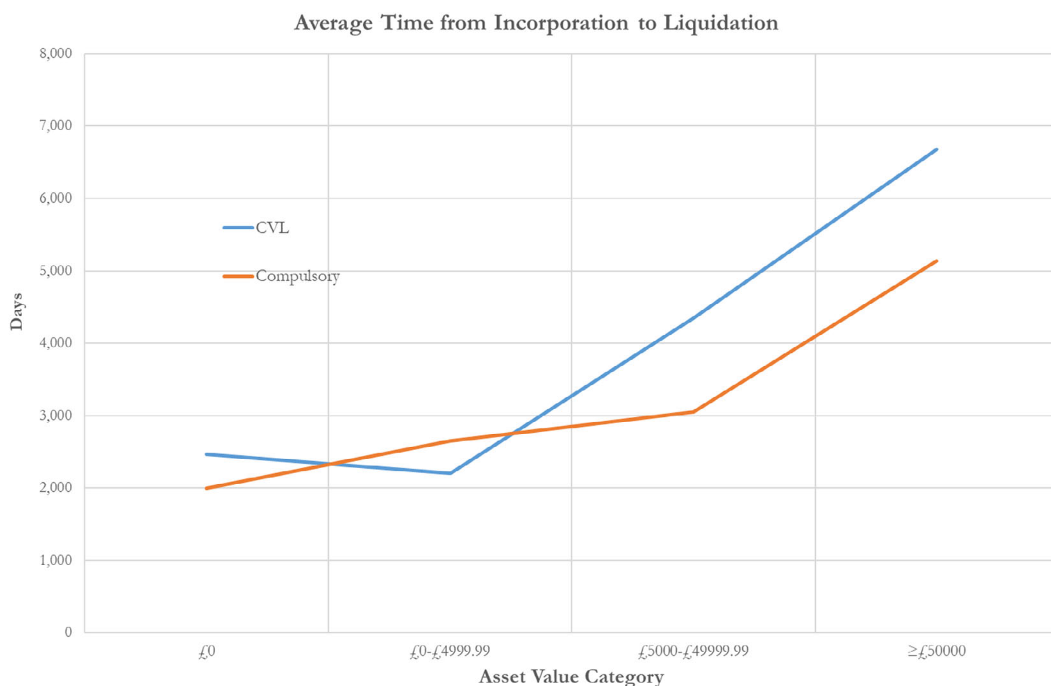

FIGURE 1 Average time from incorporation to liquidation. *Source*: Authors' collected data.

TABLE 3 Average length of liquidation in days.

Total asset amounts	Compulsory	CVL
GBP 0	479	559
GBP 0.01–GBP 4,999.99	543	606
GBP 5,000–GBP 49,999.99	1,020	1,155
GBP 50,000 and over	1,659	1,853

Source: Authors' collected data.

The length of insolvency proceedings can depend on many things, but at least part of the input will be the complexity of the insolvency proceedings.[65] The more assets and claims there are against the insolvent estate, the more time will be incurred in managing the estate, making the process take longer (and most likely making it more costly). It is therefore unsurprising that the average length of liquidation is longer for companies with larger asset bases. Both compulsory liquidations and CVLs follow the same patterns, with CVL time lengths being slightly longer than compulsory liquidations. This is shown graphically in Figure 2.

Average liquidation lengths for companies with GBP 50,000 or higher total assets were over three times the average length of liquidation for companies with no assets. However, even for those companies with no assets the length of liquidation was not immaterial – being 559 days

[65]For a recent discussion with insights from Poland, see Joanna Kruczalak-Jankowska, Monika Masnicka and Anna Machnikowska, 'The Relation between Duration of Insolvency Proceedings and Their Efficiency (with a Particular Emphasis on Polish Experiences)' (2020) 29 *International Insolvency Review* 379.

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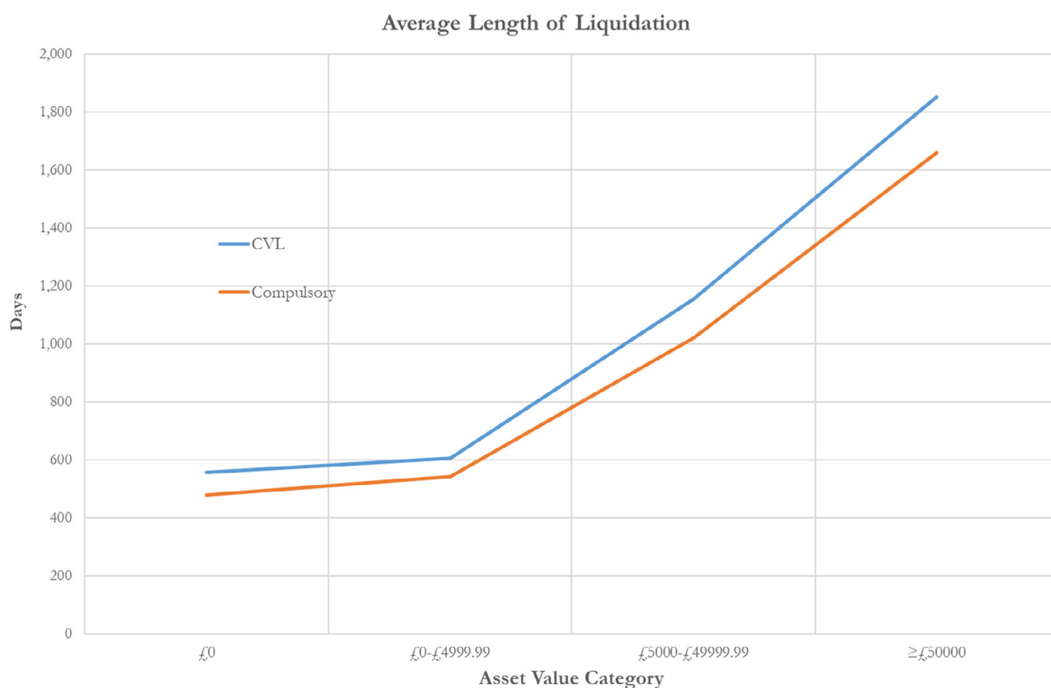

FIGURE 2 Average length of liquidation. *Source*: Authors' collected data.

for CVLs and 479 days for compulsory liquidations. As such, whilst the insolvency process of companies with larger estates takes longer, it is not insignificant for companies with no assets. Throughout all these processes, an insolvency practitioner and their supporting staff must be retained, and someone must bear these costs. For companies with substantial assets, this is not a concern as those assets can pay liquidation expenses. However, for companies with low or minimal assets, the same policy question arises as noted above: who should pay if there is a shortfall?

So far, then, we have a number of clear outcomes. First, companies in the sample have small asset bases. Second, they have been incorporated for a not insignificant length of time, implying trading history, and therefore implying that liquidation is the appropriate process.[66] Third, liquidations take time, even for those with low or no assets, which strongly implies that liquidation will incur costs to be paid by the estate, and potentially others if the estate is insufficient.

4.2 | Liquidation expenses

This brings us to the issue of liquidation expenses. Table 4 sets out the average percentage of total assets used for liquidation expenses.[67]

For companies with no assets, there were of course no assets from the estate to pay expenses. We discuss this further at point 4.4 below.

[66]Based on our dataset, it is unclear to what extent the companies in our study were inactive in the period prior to entering liquidation or were 'zombie' companies, for which, see Finch and Milman (n 56), 131–132 and 198.
[67]See above note 10 for what is meant by the average percentage here.

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For companies with assets of less than GBP 5,000, all the assets were used to pay expenses in compulsory liquidations, and the average CVL percentage of assets that were paid towards insolvency expenses was 99.95%. For our medium value category, the figures drop slightly, but not considerably. The average percentage of assets in compulsory liquidations used to pay insolvency expenses was 92.25%, and for CVLs this was 86.35%. As noted above, companies with total assets under GBP 50,000 represent 81% of liquidations reflected in our dataset. For most liquidations, then, the vast majority of assets are swallowed up in insolvency expenses.

It is also worthwhile to highlight the average value of assets in comparison to the average recovered liquidation expenses across the different value categories in our sample.[68] This is presented graphically in Figure 3.

Even when we move to the larger estates, a significant portion of assets is exhausted by insolvency expenses. This demonstrates that, in an average case, most assets in liquidations in Scotland are utilised to pay insolvency expenses. This will, of course, be different if assets are material, as whilst insolvency expenses are likely to rise, they will not do so proportionally to increased assets (each extra GBP 1 of assets is unlikely to be matched by an extra GBP 1 of liquidation expenses). This is reflected by the data shown in Figure 3 – recovered insolvency expenses grew at a lower rate than total assets. This tells us, then, that existing liquidation mechanics and expenses may well be appropriate for the largest of companies.

However, most liquidations are not in respect of the largest of companies. In the majority of liquidations, most money goes to insolvency practitioners (to cover their fees and expenses of the procedure). We do not consider incurring liquidation expenses itself to be inappropriate – no doubt the current processes require such time and costs to be incurred.[69] As well as expenses relating directly to the administration of the estate, sometimes expenses are incurred for public interest purposes including reporting on debtor conduct for disqualification purposes.[70] However, the level of costs incurred in a usual liquidation is higher than it is in a larger company, even though the latter is likely to draw more attention. We consider that insolvency expenses should hold roughly proportionately to the total amount of assets (subject to necessary outlays for all liquidations that will be proportionately greater for smaller companies), with a policy debate over the appropriate level. That the proportion utilised in paying expenses increases as the estate grows smaller demonstrates that existing liquidation processes are not fit for purpose for smaller companies. That the majority of liquidations have smaller asset bases indicates clearly that this is an acute problem. This seems to suggest that a streamlined process for smaller companies, that does not incur the same costs as the present liquidation processes, and so can be of a more fixed proportion of assets even for smaller companies, may be appropriate to minimise leakage of assets to insolvency expenses.

There is an element of streamlined procedure already available, which allows a court-appointed liquidator to apply to the court for dissolution of the company if the realisable assets are insufficient to cover the expenses of the winding up.[71] However, this is inadequate to address the issues identified in the present article, for a number of reasons, of which three are

[68]If percentages were to be produced using these figures, they would correspond to the second type mentioned in note 10 above, rather than those in Table 4.

[69]For recent discussion, see Meng Seng Wee and Yan Yu Kiu, 'Principles and Rules on Insolvency Practitioners' Remuneration' (2021) 30 *International Insolvency Review* 383.

[70]The data within our dataset does not enable us to sufficiently distinguish between these different types of expenses so as to identify their relative proportions. However, it can reasonably be suggested that the introduction of a Scottish equivalent to the official receiver would result in a reduction in the incurring of private costs to achieve public benefits.

[71]Insolvency Act 1986, section 204.

TABLE 4 Average percentage of total assets used for liquidation expenses.

Total asset amounts	Compulsory	CVL
GBP 0	N/A	N/A
GBP 0.01–GBP 4,999.99	100.00%	99.95%
GBP 5,000–GBP 49,999.99	92.25%	86.35%
GBP 50,000 and over	53.67%	52.37%

Source: Authors' collected data.

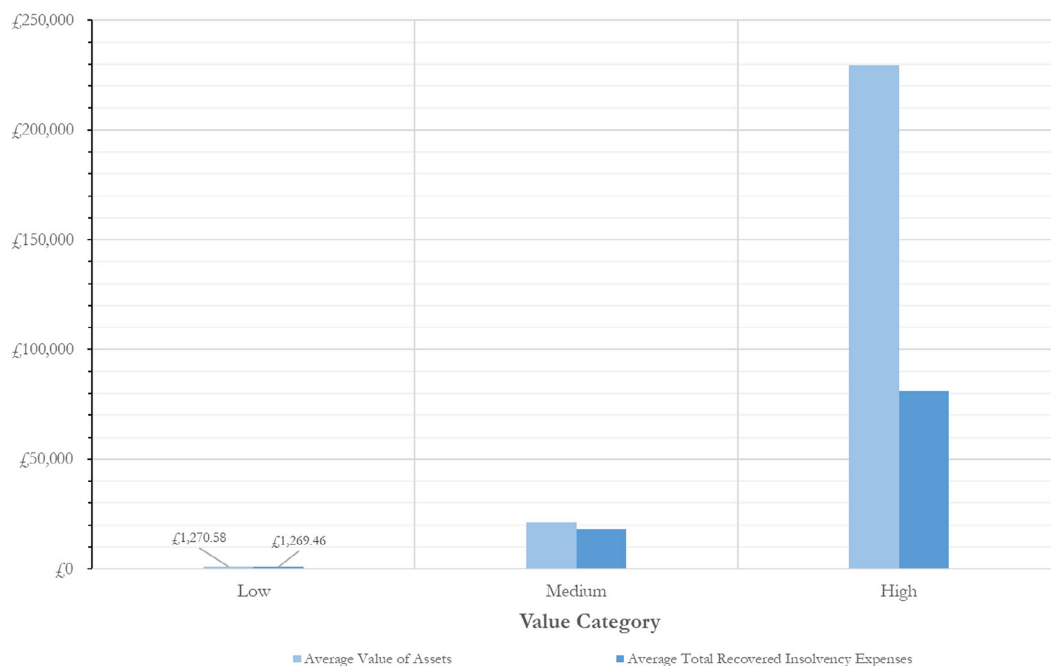

FIGURE 3 Insolvency recoveries. *Source*: Authors' collected data.

particularly pertinent. First, courts retain discretion as to whether to allow this mechanism to be utilised, and have made it clear that they will explore in depth whether they think such an approach is justified in the circumstances.[72] This means that it can hardly be seen as an automatic right and is likely to incur costs. Second, and linked to this, it requires an appointed liquidator to make the application. The liquidator is thus first appointed and then can apply to the court for early dissolution. The liquidator is unlikely to accept the initial appointment if they think that there is a chance that there will be a shortfall in their fees. This is compounded by the fact that the application can only be made when 'it appears to the liquidator that the realisable assets of the company *are* insufficient to cover the expenses of the winding up' (emphasis added).[73] The application therefore can only be made where the liquidator will already suffer a shortfall and does not cater for situations where they expect that they will if

[72]For example, *Re MHC Construction Ltd* 2010 SLT (Sh Ct) 193.

[73]Insolvency Act 1986, section 204(2).

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they carry out work in the future. Once more, this disincentivises liquidators from utilising such provision wholesale. Whilst this procedure helps liquidators who unexpectedly find themselves facing a shortfall, it does not assist in cases where it is evident that the company has insufficient assets, or potentially where there is even doubt that there may be. Third, it does not extend to those cases where there is enough to pay the expenses but this leaves little or nothing else for other creditors.

4.3 | Recoveries of creditors

Of our sample, 138 companies (27.3%) had security listed as outstanding at Companies House, represented by 56 companies who had gone through CVLs (30.4%), and 82 (25.5%) companies who experienced compulsory liquidation. Overall, 32 companies with security listed as outstanding had no secured claim advanced. This represents 23.2% of the companies in the dataset with security registered as outstanding. This further evidences that the presence of outstanding security at Companies House is not an accurate reflection of the likelihood that security listed as outstanding remains relevant in liquidation. The amount of claim for another 53 (38.4% of those who had security listed as outstanding) was not listed in the documentation.

The combination of there being no secured claim to make, and the high proportion of insolvency expenses meant that secured creditors received GBP 0 for 95 companies within our sample with security listed as outstanding, being 68.8%. The dataset evidences that there were 25 companies (out of the 106 in which the secured claim was not evidently zero) for which there was definitely a secured claim, but no amount recovered. That means that in 23.6% of cases with a definitive secured claim, the secured creditor received nothing. Secured credit is the most secure of all forms of credit and ordinarily would enable the secured creditor to be paid ahead of liquidation expenses.[74] However, as noted above, floating charges generally rank behind liquidation expenses in English law and the data in our sample appears to demonstrate that this is followed in practice in Scotland. The high proportion of outstanding floating charges compared to other outstanding security in our dataset, which we have discussed in detail elsewhere,[75] helps explain how insolvency expenses could significantly exceed the recoveries of secured creditors in our study. Only 11 companies (10.4% of those where a secured claim is likely to have been made) paid all secured creditors in full, with 13 (12.3%) repaying secured creditors less than half the amount of the secured claim. It therefore appears that liquidation is not being used by fixed or floating security holders for the purposes of achieving significant levels of recoveries, or if it is being so used, relevant parties are often mistaken to do so.

This picture involving a relatively low level of recoveries is reflected further down the creditor rankings; 333 (65.9%) companies had no preferential claims. It was unknown in 77 companies whether a preferential claim existed. Preferential claims were only paid for 52 companies (10.3% of the total dataset), with it being unknown in 4 companies whether preferential creditors were paid. Where they were paid, 37 (so 71.2% of where they were paid) preferential creditors were paid in full. The level of recoveries of preferential creditors compared to secured creditors is explained by the fact that although preferential creditors generally rank behind secured creditors, as well as liquidation expenses, they rank ahead of floating charge holders, who constituted a large number of the secured creditors in the dataset.

[74]See Insolvency (Scotland) (Receivership and Winding Up) Rules 2018 (SSI 2018/347), rule 7.27.
[75]Hardman and MacPherson, 'Empirical Importance' (n 13), 454–460.

TABLE 5 Average % preferential returns.

Total asset amounts	Compulsory	CVL
GBP 0	0.00%	0.00%
GBP 0.01–GBP 4,999.99	0.00%	0.67%
GBP 5,000–GBP 49,999.99	9.20%	48.19%
GBP 50,000 and over	43.46%	75.77%

Source: Authors' collected data.

TABLE 6 Average % ordinary unsecured returns.

Total asset amounts	Compulsory	CVL
GBP 0	0.00%	0.00%
GBP 0.01–GBP 4,999.99	0.00%	0.00%
GBP 5,000–GBP 49,999.99	2.00%	5.12%
GBP 50,000 and over	17.64%	23.05%

Source: Authors' collected data.

As would be expected from the foregoing, preferential creditors obtain lower returns the smaller the asset base of the company. Table 5 provides average preferential creditor returns across the total asset categories utilised above. It demonstrates the intuitive interpretation of the above – that preferential creditors get a higher percentage return the more assets that there are in the company's estate. For companies with under GBP 5,000 of assets – the majority of our dataset – returns to preferential creditors were negligible.

As would be expected, this squeeze occurs even more strongly for non-preferential unsecured creditors. Four hundred and five companies (80.2%) provided no return to such unsecured creditors at all (despite the potential availability of the prescribed part in some cases). In only five companies (1.0%) were unsecured creditors paid in full. Once more, companies with larger asset bases provided an average higher return to creditors than those with smaller asset bases. This is shown in Table 6.

Ordinary unsecured creditors only begin to, in an average case, see any form of return when total asset values exceed GBP 5,000. They only start to obtain a meaningful return when asset amounts reach GBP 50,000 or higher.

This further shows the theme outlined in the foregoing. Insolvency expenses, evidently, squeeze out those lower down the recovery chain than them. Insolvency expenses consume a higher proportion of assets the smaller the asset base of the company is. As a result, percentage recoveries for other categories of creditors are lower in smaller companies and grow as the asset pool grows. This shows that preferential and ordinary unsecured creditors of smaller companies face more losses when the companies enter liquidation compared to those of larger companies. This further presents evidence for the need for a streamlined procedure for smaller companies, to reduce the relative rate of insolvency expenses recovered in comparison to that which exists in larger companies.

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TABLE 7 Petitioners for compulsory liquidation.

Category	Number	% by number	% of Total asset value
Company	3	1%	1%
Creditor	21	7%	11%
Creditors	4	1%	2%
Director	9	3%	2%
Directors	31	10%	16%
HMRC	176	55%	16%
Member	1	0%	0%
Members	4	1%	1%
Member & Creditor	1	0%	2%
Not stated	70	22%	39%
Unknown	1	0%	11%

Source: Authors' collected data.

4.4 | The role of HMRC in liquidations

Our data revealed the breakdown of the petitioners with respect to compulsory liquidations within our sample.[76] This is set out in Table 7. Here, we see that HMRC has a significant role in bringing about liquidations. HMRC petitioned for liquidation for 176 companies that then entered compulsory liquidation, being 54.8% of the companies within our sample set. There is, of course, no formal legal requirement in the United Kingdom that a company be put into an insolvency procedure at any time.[77] This data suggests, though, that HMRC – a body of the state – is playing a key role in petitioning for liquidation. Table 7 also shows the percentage of the total asset amounts represented by the companies petitioned by the relevant category. Here we see that HMRC's 54.8% of petitions reflect only 16% of total assets. The implication is clear: HMRC is petitioning for the liquidation of smaller companies.

HMRC seems to play a key role in satisfying liquidation expenses where there is a shortfall, too. The data reveals that HMRC paid the expenses for 35 companies, and partially paid for the expenses for 35 companies. The accounts for 30 further companies that HMRC petitioned to put into liquidation stated that a third party paid the liquidation expenses. It would not seem to be a particularly large leap of logic to interpolate that this is likely to be HMRC. Should this be the case, then HMRC contributed to the insolvency expenses of 100 companies,[78] being 56.8% of those in relation to whom they petitioned for liquidation. More than this, though, it means that the state is, in its capacity as a creditor, financially supporting 31.2% of compulsory liquidations whose end date fell within our sample period.

[76]For who may petition for a liquidation, see Insolvency Act 1986, section 124.

[77]Instead, we rely on other tools to achieve the same end – particularly personal liability for directors. See for example, Insolvency Act 1986, sections 212–214; *BTI 2014 LLC v Sequana SA* [2022] UKSC 25; Andrew Keay, 'Wrongful Trading and the Liability of Company Directors: A Theoretical Perspective' (2005) 25 *Legal Studies* 431; Kristin van Zwieten, 'Director Liability in Insolvency and its Vicinity' (2018) 38 *Oxford Journal of Legal Studies* 382.

[78]Should it not be the case, then further research should focus on identifying the mysterious benefactor for insolvency expenses.

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This demonstrates that in Scotland there is significant state involvement in practice but in a less formalised way than exists in English law due to the role of the official receiver. A body of the state acts as a creditor to enforce its rights to put the company into terminal liquidation, especially in smaller companies, and then pays a private party to undertake the insolvency process.

There are evident weaknesses of a system that relies on the state as a creditor to carry out this role, as it implies that if HMRC is not owed any funds then the function will not be fulfilled. It may be that introducing a streamlined insolvency process for smaller companies would obviate the need for such a role to be fulfilled. However, we believe that our data indicates that in Scotland the circle should be squared by the introduction of a state-sponsored insolvency official, for smaller companies, to incur the insolvency expenses, akin to the official receiver in England and Wales.[79] There is also already a precedent in Scots law in non-corporate insolvency law, as the Accountant in Bankruptcy is appointed as trustee in sequestration in some cases, including where there are insufficient assets to attract a private insolvency practitioner.[80] By contrast in liquidations in Scotland, the state pays anyway, and through an imperfect mechanism. If HMRC did not underwrite liquidation expenses, it is perhaps unlikely that another creditor would be willing to do so, particularly since other creditors have less of a public service purpose and so lack the incentive. For example, whilst HMRC may care to push for insolvency so that recalcitrant directors can be investigated by the Insolvency Service,[81] a trade creditor is less likely to factor such public service purpose into their private decision making. Formalising the basis on which the state is involved and removing the mechanism by which the state pays private parties to liquidate a company should be advantageous in general terms.

Overall, then, we see most liquidations in Scotland where the end date fell within our sample period represent smaller companies. Most assets were absorbed by insolvency expenses, with the proportion increasing the smaller the asset base of the company. This creates an inevitable squeeze on the recoveries of other creditors. It also produces a risk that estate assets will not be enough to pay insolvency expenses. Here, the state often steps in to both petition for insolvency, and also fund shortfalls. It does so through informal means. The clear policy outcome from this research is that Scotland needs to:

a. introduce a streamlined insolvency process for liquidations with smaller asset bases – one that does not incur such liquidation expenses;
b. formalise the state's role in the payment of insolvency expenses for smaller companies; or
c. do both.

4.5 | Limitations in data

Whilst we believe the foregoing conclusions to be robust and reasoned, it should be noted that there are a number of potential limitations in the data that we have reviewed. First, we note above the uncertainty as to whether those listed at Companies House as secured creditors still have outstanding security in their favour. We have tried to mitigate the effects of this by not principally focusing on secured creditors in our analysis. However, the UK's insolvency and

[79]For example, Insolvency Act 1986, section 136.

[80]See above note 11 and McKenzie Skene (n 14), paragraphs 10–08–10–09 and 10–54 onwards.

[81]For example, Company Directors Disqualification Act 1986, section 4.

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security rules do provide an inherent limitation on the data available. We can divide rights in security into those of primary relevance only in insolvency, and those that play a wider debt support role – known as collateral security in the US literature.[82]

We have each argued elsewhere that floating charges are, at least in Scotland, best seen as having an insolvency function, given that their enforcement is limited to the insolvency context.[83] But fixed security tends to operate as collateral security in Scotland: the various types of rights in security can be enforced outside of insolvency procedures.[84] It is therefore possible that such enforcement occurred *before* the accounts were prepared and filed by insolvency practitioners, and perhaps even before the procedure commenced. And it is consequently plausible that asset amounts were much higher, but depleted by private enforcement and realisation by secured creditors. Such a finding would clearly speak to the wide-ranging debate on the fairness and efficiency of allowing real rights in security in the first place.[85] However, we do not think that this would matter: preferential creditors and ordinary unsecured creditors would miss out anyway. Even if the problem is not companies with limited assets having these depleted by insolvency expenses, but are instead dominant secured creditors enforcing pre-liquidation, the problem of allocation between the remaining constituents remains the same. The foregoing analysis indicates that too great a proportion is being syphoned to insolvency expenses, often with funds provided by the state.

Second, the foregoing may or may not apply equally between different insolvency procedures. We deliberately focused only on insolvent liquidations. And whilst we noted where liquidation was preceded by another procedure, we did not examine the recoveries in those procedures.[86] It could therefore be that excluding them from the sample portrays an incomplete picture, especially if alternative insolvency processes were used for larger companies. Whilst this may be the case, our data does demonstrate issues within the insolvency processes that we *did* include. As such, as noted below, we consider including other insolvency procedures to be an interesting direction for future research, but not one that negates our current conclusion.

Third, it should be noted that records at Companies House are not designed to be deployed in the way we have utilised them. They are designed to be able to search for an individual company and to access certain information relating to that company.[87] As such, the standardisation

[82]See discussion on use of the term in Jonathan Hardman, 'Some Legal Determinants of External Finance in Scotland: A Response to Lord Hodge' (2017) 21 *Edinburgh Law Review* 30, 38–40.

[83]See, respectively, MacPherson (n 35), especially Chapter 6, and Jonathan Hardman, 'Hohfeld and the Scots Law Floating Charge', in Hardman and MacPherson (eds) (n 13).

[84]For example, for security over land, see Conveyancing and Feudal Reform (Scotland) Act 1970, section 19; for security over corporeal (tangible) moveables, see *North-Western Bank Ltd v Poynter, Son and Macdonalds* (1894) 22 R (HL) 1.

[85]Alan Schwartz, 'The Continuing Puzzle of Secured Debt' (1984) 37 *Vanderbilt Law Review* 1,051; Lucian Bebchuk and Jesse Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy; (1996) 105 *Yale Law Journal* 857; Lynn LoPucki, 'The Unsecured Creditor's Bargain' (1994) 80 *Virginia Law Review* 1887. For an overview from a UK perspective, see Louise Gullifer and Jennifer Payne, *Corporate Finance Law: Principles and Policy* (third edn) (EUP, 2020), 350–358.

[86]For 10 of the companies in our study, liquidation was preceded by administration only, for a further 2, liquidation was preceded by a CVA and administration, and for 3 more, liquidation was preceded by a CVA only. Regarding moving from an administration to a CVL, see Insolvency Act 1986, Schedule B1, paragraph 83(2).

[87]For discussion of the development, see Jonathan Hardman, 'The Butterfly Effect: Theoretical Implications of an Apparently Minor Corporate Transparency Proposal' (2021) 50 *Common Law World Review* 180, 185–187.

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of the material available is something that is lacking.[88] There is therefore a lack of uniformity. We cannot verify the grounds on which certain decisions were taken by relevant insolvency practitioners from the publicly available information alone. Insolvency practitioners and firms adopt different policies on a number of different issues, both in substance and in reporting style. We have tried to minimise the effect of this as much as we can by operating on a series of standard rules outlined in our methodology section. We also consider that the rationales for such decisions are less important than the substantive outcomes of the decisions. It is this that we seek to measure and study, rather than speculate about rationales. As such, whilst some of the data is inevitably fuzzy, we have done our best to standardise the results.

Fourth, compiling our dataset involved manually transposing figures from scans of documents uploaded to Companies House. There is thus the possibility of human/transposition error at a number of stages of the analysis: errors in initial reports prepared by insolvency practitioners, by Companies House employees when, for example, scanning documents,[89] or by the authors in compiling our dataset will inevitably affect our conclusions. We have tried to mitigate this as much as possible, and also believe that our focus on aggregates helps to minimise the risk of individual transposition errors.

Fifth, our sample consists of those companies whose liquidation ended during the first stages of the COVID-19 pandemic. There were clearly a number of adjustments made to insolvency law in respect of the pandemic.[90] We think that the risk of our data being skewed is low due to the long-term nature of liquidations.[91] The liquidations that we have reviewed will have started prior to the onset of the pandemic, with most activity in the liquidation having also occurred prior to that point, and as such the likelihood that the data was skewed by the onset of the pandemic is low. It could be argued that the longer term changes from the pandemic make such pre-pandemic data of less relevance. We agree that it will be interesting to compare our results to those arising in the post-pandemic world. However, this will involve a comparison of liquidations commenced during or after the pandemic, which will take a large number of years to work through.

5 | FURTHER RESEARCH

We think that there are a number of logical developments regarding the research outlined in this article.

[88]For discussion of this problem in respect of stewardship, see Suren Gomtsian, 'Debtholder Stewardship' (2023) 86 *Modern Law Review* 395. And for consideration of reporting by IPs in other contexts, see Yvonne Joyce and Eileen Maclean, 'The Quality of IP Reporting: A Cause of Creditor Confusion?' (*Recovery News*, January 2020), available at: <https://www.r3.org.uk/technical-library/recovery/recovery-news/more/29242/page/1/the-quality-of-ip-reporting-a-cause-of-creditor-confusion/>.

[89]Mistakes do happen – For example, the filing of insolvency forms against the wrong company – see *Sebry v Companies House* [2015] EWHC 115 (QB).

[90]For short term adjustments, see Jonathan Hardman, 'The Law and Economics of Lockdown Mitigation: Bankruptcy Errors in the United Kingdom' (2021) 30 *International Insolvency Review* 344. For longer term implications, see Aurelio Gurrea-Martínez, 'The Future of Insolvency Law in a Post-Pandemic World' (2022) 31 *International Insolvency Review* 385.

[91]Further evidenced by the average length of liquidations outlined in our dataset.

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5.1 | More granular analysis of the dataset

First, we consider that the data we have gathered could be interrogated on a more granular level. We see two particular methods by which this could be achieved. First, additional matters could be included within the dataset from the sample. For instance, the dataset could be expanded to include how and when fixed security holders proceed with enforcing their security interests as liquidation of their debtor approaches (given the paucity of non-floating security interests in the study that remained outstanding during the liquidation). It is currently unclear whether this could be extrapolated from the documentation available or whether additional research methods would be required. In any event, it would be valuable to explore the extent to which the overall value of a debtor's assets would be enhanced by precluding or limiting the ability of a secured creditor to enforce in close proximity to liquidation and instead only allowing a liquidator to deal with the encumbered property as part of the estate, by realising the property and giving effect to the security holder's priority.[92]

Second, we could explore further subdivisions within the data outlined. It would be possible to revisit the accounts of companies in the study to separate out the remuneration of liquidators from outlays that may be considered necessary expenditures (where this is possible). Such work would allow for a clearer understanding of the proportion of expenses that is constituted by these different categories and could assist with determining how best to deal with the liquidation of companies where expenses exhaust the assets or do so to a large extent. Whilst we consider our existing conclusions to be clear and unequivocal, such further research would provide important refinement as to where exactly the problem of high insolvency expenses arose, and would help target the response, and further refine our current formulation.

5.2 | Other normative conclusions

The dataset supports the clear normative conclusions outlined in this article. Viewing the same data from different perspectives could provide additional normative outcomes. For example, the data would also provide an empirical basis for reform focused on insolvency processes and ranking of rights for Scotland and the wider United Kingdom. The low level of recoveries by virtue of the prescribed part and even preferential claims in many cases may support bolstering the priority status of these parties (e.g. against secured creditors) or finding ways to minimise insolvency expenses, if the agreed policy favours increasing the recoveries of such claims. Various policy assumptions made, or positions advanced, in insolvency literature could be tested by reference to our dataset.

Such normative policy considerations need not be squarely within the legal sphere. In addition, the project dataset can serve as a useful reference point for extra-legal research that is focused on the types of companies that have concluded liquidation processes in the selected year and what this can reveal about wider society and the economy in Scotland. Furthermore,

[92]This approach exists in other systems, such as in the USA, where there is an automatic stay (subject to relief being given by the court) under both Chapter 7 (Liquidation) and Chapter 11 (Reorganization) of the Bankruptcy Code – see US Code: Title 11, §§ 362–363. The same is true to varying degrees in France and Germany – see Reinhard Bork, *Corporate Insolvency Law: A Comparative Textbook* (Intersentia, 2020), paragraphs 7.13–7.22 for an overview and relevant sources. Of course, in the jurisdictions of the UK, administration (a rescue procedure) involves a moratorium on the enforcement of security and this is only lifted with the consent of the administrator or the permission of the court – Insolvency Act 1986, Schedule B1, paragraph 43(2).

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finance-oriented research could evaluate the effectiveness and efficiency of liquidation in dealing with failed companies.

5.3 | Expanding the dataset

The final evident method for further research would be to expand the dataset. We propose three further extensions of the research which would result in increased information.

5.3.1 | Expanding by time

First, we can expand our dataset by increasing the sample to include liquidations completed before or after the chosen time period. Given that the data in this study only covers companies for which final accounts were submitted over a 1 year period, there is significant scope to use the same approach for other years, whether earlier or more recently (or a combination). It would be desirable to understand the effects that the COVID-19 pandemic may have had on the administration of insolvent estates by liquidators, including the length of the liquidations and whether it impacted the recoveries of creditors. Examining data covering the period since the partial reinstatement of HMRC's preferential status would help show the extent to which their level of recovery has increased and how this has affected other parties. It would also show whether HMRC has become more or less likely to petition for the winding up of a debtor company following its (re-)elevated status in liquidation.

Furthermore, future research could assess the impact of the awaited new non-possessory pledge in Scots law, which is due to be introduced in 2024 by virtue of the Moveable Transactions (Scotland) Act 2023.[93] The apparent ability of the new fixed security to cover wide categories of moveable assets[94] may harm the interests of lower-ranking creditors (including preferential creditors) and this could necessitate revisiting the ranking priority of this form of security.

5.3.2 | Expanding by jurisdiction

Second, we can expand by jurisdiction. The foregoing demonstrates a clear policy position for Scotland. We believe that the need for streamlined liquidation for smaller companies is likely to apply to both jurisdictions, and that this research should help defend the value of the office of the official receiver from any future challenge. It would also be of interest to

[93]See Part 2 of the Act, particularly section 43 onwards. For discussion of the proposals preceding the legislation, see Andrew Steven, 'Reform of Moveable Transactions Law in Scotland', in Orkun Akseli and John Linarelli (eds), *The Future of Commercial Law: Ways Forward for Change and Reform* (Hart, 2020), 318; Jonathan Hardman, 'Three Steps Forward, Two Steps Back: A View from Corporate Security Practice of the Moveable Transactions (Scotland) Bill' (2018) 22 *Edin L Rev* 266; Alisdair MacPherson, 'The Future of Moveable Security in Scots Law? Comments on the Scottish Law Commission's Report on Moveable Transactions' [2018] *Jur Rev* 98.

[94]The legislation appears to enable the security to cover very broad classes of property, such as 'all present and future moveable property' belonging to the grantor (excluding various incorporeal moveable property not able to be covered by the statutory pledge). By contrast, in the USA, UCC Article 9 §9-108(c) provides that super-generic descriptions are not sufficient.

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compare the data available for Scotland with the equivalent data for England and Wales (and potentially other systems). The methodology used in the present study could be used for England and Wales without any real difficulty and there would be ready comparability, given the shared data source of Companies House and the fact that various aspects of the relevant law are uniform. Nevertheless, obtaining equivalent data for companies south of the border could help us understand how the recoveries of classes of creditors are affected by certain differences in laws and culture in the jurisdictions. Significantly, it would likely highlight levels of recovered insolvency expenses where there is an official receiver (as in England and Wales) compared to where there is not such a party (as in Scotland). This could help to bolster or undermine the case for the introduction of an equivalent in Scotland.

5.3.3 | Expanding by insolvency process

The third clear area for future research is to include additional insolvency processes. The acquired, and acquirable, data for insolvent liquidations could also usefully be compared with data for recoveries of creditors and expenses in rescue procedures such as administration, which is also a procedure that can involve distributions to creditors. This would assist with understanding whether and to what extent such procedures are of benefit to creditors as a whole and to particular classes of creditors. Obtaining comparable data for administration is not, however, as simple as for liquidation, given that there is no precise equivalent of the accounts analysed in the present study.[95]

In addition, empirical work on the outcomes for creditors in insolvency procedures can provide some assistance to courts when they are being asked to sanction cross-class cramdowns in a Part 26A restructuring plan.[96] The court must, inter alia, consider that none of the members of the dissenting class would be any worse off than in the event of the 'relevant alternative'[97]; this is whatever the court considers would be most likely to occur if the arrangement were not sanctioned.[98] The relevant alternative is ordinarily (another) insolvency procedure and therefore empirical data showing the likely recovery of certain types of creditors in such procedures could bolster the court's assessment, which is principally (and understandably) based on the particular facts in any given case.[99]

[95]It is, though, not impossible – see findings from 2018 in *Contractualised Distress Resolution in the Shadow of the Law* 14 May 2018, available at: <http://www.codire.eu/wp-content/uploads/2018/07/National-Findings-UK-formatted-clean.pdf>.

[96]Companies Act 2006, sections 901F-901G.

[97]Companies Act 2006, section 901G(3). The compromise or arrangement must also have been agreed by 75% or more of a class of creditors who would receive a payment or have a genuine economic interest in the company, in the event of the relevant alternative – section 901G(5).

[98]Companies Act 2006, section 901G(4).

[99]In deciding whether to sanction restructuring plans, courts have frequently included indicative figures regarding the levels of recoveries of creditors in such a plan and the relevant alternative – see for example, *Re Great Annual Savings Co Ltd* [2023] EWHC 1141 (Ch); *Re Nasmyth Group Ltd* [2023] EWHC 988 (Ch); *Re Houst Ltd* [2022] EWHC 1941 (Ch).

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More generally, there is only a limited number of examples of empirical analysis of insolvency law in England and Wales and across the wider United Kingdom.[100] It is an area that is ripe for further research and it is hoped that the present contribution increases the appetite for such work.

6 | CONCLUSIONS

Our empirical data thus verified our hunches. Liquidations in Scotland are mostly for companies with smaller asset bases. A greater proportion of those assets is diverted to insolvency expenses the smaller the estate is. This demonstrates a need to create a simplified version of liquidation for companies with smaller asset bases. We believe that the similarities between England and Scotland in terms of corporate and corporate insolvency law, and also the general corporate landscape, means that this is likely to be extrapolatable to English law too but further research would help verify this.

One key difference between the law of liquidations in the two jurisdictions is the lack of an official receiver in Scotland. Yet in Scotland, the state still has a key role in practice in petitioning for compulsory liquidation and paying for liquidations. The state's role is currently informal and skewed through HMRC as a tax authority and as a creditor. It is time to put the state's involvement onto a formal footing that avoids the diversion of funds from the state to private parties. The Accountant in Bankruptcy, a Scottish government agency and statutory official, already plays a key role in non-corporate insolvency law in Scotland and can be appointed as trustee in sequestration (bankruptcy), and so may be considered best placed to take on an equivalent role in relevant insolvent liquidations. Other bodies could also feasibly undertake such a role.[101] We are agnostic as to the best way to achieve the policy need identified by this article.[102] As well as this, we also believe that our conclusion helps justify the value of having an official receiver under English law. Previous proposals to introduce an official receiver in Scotland have been unpopular on the grounds of, primarily, cost to the public.[103] We believe that our research will contribute to any future debate in this sphere: the public is bearing the cost anyway, through imperfect mechanisms.

[100]See Peter Walton and Lézelle Jacobs, *Corporate Insolvency and Governance Act 2020 – Final Evaluation Report* (November 2022), available at: <https://www.gov.uk/government/publications/corporate-insolvency-and-governance-act-2020-evaluation-reports/corporate-insolvency-and-governance-act-2020-final-evaluation-report-november-2022>; Kayode Akintola, 'The Prescribed Part for Unsecured Creditors: A Further Review' (2019) 32 *Insolvency Intelligence* 67; Régis Blazy and Nirjhar Nigam, 'Corporate Insolvency Procedures in England: The Uneasy Case for Liquidations' (2019) 47 *European Journal of Law and Economics* 89; Kayode Akintola, 'The Prescribed Part for Unsecured Creditors: A Pithy Review' (2017) 30 *Insolvency Intelligence* 55; Kayode Akintola, 'What is Left of the Floating Charge? An Empirical Outlook' (2015) *JIBFL* 404; Riz Mokal, *Corporate Insolvency Law: Theory and Application* (Oxford University Press, 2005), for example, 191–192.

[101]For example, the Insolvency Service, of which the official receiver is a part, could take on the role for Scotland too, subject to issues regarding devolution.

[102]See Davis et al. (n 1), Chapter 4 for some practical steps that could be taken to help achieve the policy need identified in this article.

[103]See Scottish Law Commission, *Report on Bankruptcy and Related Aspects of Insolvency and Liquidation* (Scot Law Com No 68) (1982), 12–15; Accountant in Bankruptcy, *Consultation on Bankruptcy Law Reform: The Report of the Summary of Responses* (2012), 7, 93–95.

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Data-driven normative conclusions represent a novel approach to insolvency law, and we believe that there is a bright research agenda available by utilising not only our dataset and conclusions but also the methodology that we have deployed in this article.

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