

JOINT INSOLVENCY EXAMINATION BOARD

*Joint
Insolvency
Examination
Board*

Joint Insolvency Examination (Scotland)

Tuesday 2 November 2010

ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS and RECEIVERSHIPS (3.5 hours)

ANSWER ALL FOUR QUESTIONS

**QUESTIONS 1 AND 2 CARRY TWENTY MARKS EACH
QUESTIONS 3 AND 4 CARRY THIRTY MARKS EACH**

SUBMIT ALL WORKINGS

The Examiner will take account of the way material is presented. Candidates should answer the questions set - and marks will not be awarded for extraneous material.

Note: References to legislation are to that which was in force on 30 April 2010. References to 'the Act' are to the Insolvency Act 1986 as amended.

References to Sections, Schedules and Rules are to Sections and Schedules of the Act and to Rules of the Insolvency (Scotland) Rules 1986 as amended.

References to Sections and Rules of other Acts, Regulations and Orders will mention the Act, Regulation or Order.

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- 1(a) Your firm is approached by the directors of Liman Ltd (“the Company”), a manufacturer of specialist engineering equipment. The Company is a well established business which, until recently, traded profitably.

The accounts of the Company show the following results:

Type of accounts	12 months to 29 October 2010 £'000	12 months to 31 March 2010 £'000
	Management	Statutory audited
Trading, profit and loss account		
Turnover	7,900	5,550
Cost of sales	(6,000)	(4,000)
Gross margin	<u>1,900</u>	<u>1,550</u>
Overheads	(1,400)	(750)
Operating profit	<u>500</u>	<u>800</u>
Exceptional items	(600)	-
Interest payable	(300)	(50)
Net (loss)/profit before tax	<u>(400)</u>	<u>750</u>
Balance sheet		
Fixed assets	<u>6,000</u>	<u>2,150</u>
Current assets	700	600
Current liabilities	(1,200)	(300)
Net current (liabilities)/assets	<u>(500)</u>	<u>300</u>
Long term liabilities	(3,500)	(50)
Net assets	<u><u>2,000</u></u>	<u><u>2,400</u></u>
Other information		
Number of employees	<u>40</u>	<u>52</u>

In April 2010 the Company was awarded a large three-year contract by Oxbow Machinery Ltd (“Oxbow”). As a result, the business invested heavily in recruitment and additional plant and equipment. In August 2010 Oxbow’s bank withdrew its funding and Oxbow was placed into Administration.

As a result the Company was left with a significant bad debt of £500,000 and excess capacity.

Following this setback the Company undertook a business restructuring programme making ten staff redundant. The Company also intends to sell its excess plant and machinery imminently.

Your investigations identify the following:

- There are significant creditor arrears:
 - HMRC - £80,000 of which £60,000 is overdue. HMRC correspondence indicates that it may shortly be taking steps to wind up the Company
 - Suppliers – of the total amount owed, over £450,000 is at least 60 days overdue for payment
 - Employee redundancy payments due - £40,000
 - Payments to finance companies are in arrears
 - Landlord – the Company is two months in arrears
- The Company’s overdraft, secured by a bond and floating charge, is at its limit. Discussions with its bank show that it is willing to support the business by maintaining the current facilities.

Having conducted a review of the business and discussed the options with management you conclude that in these circumstances a Company Voluntary Arrangement (CVA) would be appropriate. Due to imminent creditor action you consider it appropriate to seek a moratorium.

Requirements

Your principal asks you to prepare points for a letter to management outlining:

- (i) **A brief summary of the steps that a company needs to take in order to obtain court protection through a Voluntary Arrangement Moratorium.**
 - (ii) **The relevant eligibility requirements for a CVA moratorium and how these would be applied in the above circumstances. For this purpose assume that the CVA was filed in court on 29 October 2010.**
- (10 marks)**

1 (b) Meetings of members and creditors are convened for the purpose of considering the (CVA) proposal.

- (i) Bayou Finance Ltd

Mr Jones, a representative of Bayou Finance Ltd attends the meeting in person and brings to it a validly completed proxy form and a proof of debt in the amount of £36,500. The claim relates to a CNC machine supplied to the Company under a lease purchase agreement. The claim comprises:

Rental arrears	£10,000	(1 payment)
Termination charges	£ 6,500	
Future finance payments	£20,000	(2 payments payable in equal instalments in 12 months and 24 months time)

You have a valuation by your agent showing that the machine is currently valued at £20,000 and a review of the agreement shows that the convening of meetings to consider a CVA results in an automatic termination of the agreement.

(ii) Adam Brookes

Mr Brookes, a former employee and estranged husband of one of the directors, attends the meeting in person bringing with him a proof of debt form in the amount of £7,275. The Company's records indicate that the employee is owed £7,500 in respect of notice pay.

A discussion with management highlights that the Company is attempting to recover some equipment that the employee failed to return upon his departure. Mr Brookes confirms that he has reduced his claim by £225 to reflect the value of the equipment in his possession.

(iii) Loch Estates Ltd

The Company's landlord has submitted a valid proxy form and proof of debt for £18,000. This claim comprises two elements under the same tenancy agreement:

	£
Arrears of service charges and insurance	5,000
Unscheduled dilapidations	<u>13,000</u>
	<u>18,000</u>

The Chairman of the meeting has asked for your advice on how the above claims should be treated for voting purposes and the amount for which they should be permitted to vote.

Requirements

Set out in note form your advice to the Chairman of the meeting in respect of each claim. (10 marks)

(20 marks)

2. You have been appointed Administrator of Coulthard (UK) Ltd (“the Company”) a manufacturer of electronic monitoring equipment for the environmental market. In the absence of any securities registered against the Company the appointment was made pursuant to Paragraph 22 of Schedule B1 of the Act.

The following reservation of title claims have been received.

(i) Massa Ltd

Massa Ltd (“Massa”) supplied printed circuit boards for incorporation into the electronics of the Company’s main product. Your investigations reveal:

- The supplier is claiming title to a shipment of 2,000 boards with a cost of £20,000 delivered 4 weeks prior to your appointment. These goods were ordered over the telephone.
- The boards have been incorporated into the finished goods of which there were 1,400 at the date of your appointment.
- Massa are the sole supplier and manufacturer of this product and have been supplying the Company for a number of years.
- The creditor list of the Company indicates that Massa are owed £23,500 at the date of appointment.
- Massa has provided you with a copy of its invoices each containing the following clause:

“Title to the goods shall only pass to the purchaser upon the purchaser having paid to Massa Ltd all sums due from it under this contract and all other contracts between Massa Ltd and the purchaser.”

- In order to access the circuit boards, the cover of the finished product must be removed by unscrewing a bolt. The boards are clipped into place and secured with a screw.
- You expect to be able to sell the finished goods for £100 per unit but without the board they would be scrapped.

(ii) Prost Ltd

Prost Ltd (“Prost”) supplies bulk raw material plastic for use in the casing of the Company’s products. Your investigations reveal the following:

- Prost wishes to claim title to 2 tonnes of raw material plastic delivered in the week prior to Administration. The cost of this material is £500 per tonne.
- Prost also wishes to claim title to the moulded casings of the finished goods and work in progress. Prost has shown that this material can be returned to its original state through a process of forced removal of affixed components and by melting the casings.
- The raw material plastic is a commodity product which the Company sourced from two suppliers; Chitwood Ltd (“Chitwood”) and Prost.
- When the goods are delivered they are placed into a large storage unit. The raw material plastic from each supplier is identical and is placed in the same container.
- Chitwood has also submitted a claim for 1 tonne of raw material plastic delivered on the same day as the last shipment from Prost.
- At the date of appointment there were 1.5 tonnes of raw material plastic in the storage unit.
- Both Chitwood and Prost have provided relevant documentation to support their assertion that they had a valid all monies reservation of title clause incorporated into the contract.

- Chitwood is owed £2,500.
- You are not dealing with Chitwood's claim as part of this exercise.
- The raw material plastic is not required by the Company during the Administration.

(iii) Gubby Ltd

Gubby Ltd ("Gubby") has been trading with the Company for a number of years and supplies electronic sensors. Your investigations reveal the following:

- Gubby has claimed for £19,175 of goods delivered as follows:

Date	Description	Units	Cost per unit £	Total price £	Units sold by the Company	Remaining at appointment
02/10/2010	Model 4565A	1,000	5.45	5,450	1,000	nil
15/10/2010	Model 3333B	1,500	6.00	9,000	750	750
03/11/2010	Model 4565A	500	5.45	2,725	200	300
10/11/2010	Model 6667Q	250	8.00	2,000	nil	250
Total claim				<u>19,175</u>		

- None of the above goods are identifiable to particular deliveries however the part number inscribed onto each unit is unique to Gubby.
- Model 4565A has previously been supplied to and paid for by the Company. The first delivery of the other models are those above.
- Gubby has provided you with a copy of its terms and conditions of trade which state:

"Notwithstanding collection, the property in the goods shall not pass to the Customer until the Customer has paid in full the price of the goods. In the event of the sale of the goods by the Customer he shall hold the proceeds of sale in trust for the Company. The Company may trace all proceeds of sale of the goods received by the Customer through any bank or other account maintained by the Customer."

- Gubby requires orders to be placed using its own stationery which incorporates its terms of trade.
- The remaining stock is required during the Administration.

The Company does not have its own terms and conditions of trade.

Requirements

- (a) For each supplier outline the matters to be considered when assessing the validity of the claim, whether you consider their reservation of title claim is valid and any practical suggestions for dealing with the claim. (12 marks)
- (b) Draft a note outlining what legal and practical steps suppliers may generally take should they disagree with any decision regarding the validity of their reservation of title claim. Explain how an Administrator should deal with this situation. (8 marks)

(20 marks)

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3. You have been approached by the directors of Hoyt Ltd (“the Company”) as it is experiencing significant financial pressures. The directors wish to place the Company into Administration and immediately purchase the business back from the Administrators.

Having determined that a quick sale of the business is desirable, you establish that there may be a number of parties that could be interested in acquiring the business. You therefore advise management to conduct an accelerated marketing process.

Requirements

- (a) **Set out the main sections that should be included in a sales memorandum and list the main contents to be included within each section. (15 marks)**
- (b) **Following a period of marketing the business for sale you conclude that the offer from the incumbent management team would represent the best outcome to creditors.**
- (i) **Outline and explain the main matters for consideration before you could accept the appointment as Administrator of the Company. (7 marks)**
- (ii) **Outline the disclosure requirements of an Administrator following a disposal of the business to the directors under a ‘pre-packaged’ sale and list the matters that should be disclosed to creditors following such a sale. (8 marks)**

(30 marks)

PLEASE TURN OVER

4. Your principal has been appointed Administrator of Fastpharm Ltd (“the Company”).

The Company is a distributor of medical supplies to a number of hospitals and pharmacy chains in the United Kingdom. Over the last three years the Company has spent £2 million on developing a unique order and stock distribution system for its customers that gives it a significant competitive advantage in a highly price and service sensitive market. This spend has been funded by Pippin Bank plc (“the Bank”) which is owed £1.5 million secured by a first ranking bond and floating charge over all assets, save for the book debts which are subject to a priority agreement and invoice discounting arrangement.

Whilst the stock system provides cost and other benefits to the Company’s customers, due to the nature of its supplies, any disruption to supply will result in an immediate switch to the Company’s competitors. In this event it is likely that the value of the business will be significantly damaged. The Bank is keen for the business to be sold as a going concern to minimise the shortfall it may be facing.

Your firm has been approached by a number of parties, including the management team, interested in acquiring the trade and assets of the business. Initial conversations with interested parties indicate that it will take up to four weeks for them to be in a position to conclude a deal.

Prior to your principal’s appointment you investigated the possibility of continuing to trade during the Administration. These investigations revealed the following:

The order book shows that the expected sales invoicing (net of VAT) over the next four weeks is expected to be:

Week commencing 1 November 2010	£250,000
Week commencing 8 November 2010	£200,000
Week commencing 15 November 2010	£150,000
Week commencing 22 November 2010	£300,000

The Company’s invoice discounter, Gala Finance Ltd (“Gala”), has agreed to provide a facility for trade undertaken by an Administrator. Gala will immediately advance 70% of the invoices raised and in the circumstances has agreed not to charge interest or fees for the provision of this facility.

Customers pay strictly 30 days after delivery and have agreed not to cancel any outstanding orders.

Following negotiations with employee representatives and a significant number of redundancies the Company agreed to pay all remaining employees weekly for the work undertaken during that week. Total net weekly wages amount to £12,000. PAYE and National Insurance (both employee and employer) amount to £6,000 per week.

The key suppliers of the business have agreed to support the ongoing trade but require payment upon delivery. The goods that the Company supplies are held in stock at the suppliers’ warehouses located nearby and as such there is no lead time for delivery. The cost of these goods equates to 75% of the net sales price.

Overheads and other costs amount to £25,000 per week plus VAT.

Your agents have provided the following valuations:

	Book value £'000	Going concern £'000	Break up £'000
Intellectual property and goodwill	2,000	1,000	50
Stock	200	200	200

The stock figure does not take account of reservation of title claims, which are expected to account for 35% of the stock value. You have agreed with these suppliers that you will pay for the stock as it is used. This stock value comprises high volume items, all of which can be sold in the normal course of business and you intend to sell the existing stock before purchasing additional items from suppliers.

Having spoken to a number of interested parties you have established that, due to the short lead time for supply, they have no concerns should there be no remaining stock when the business is acquired.

The Bank acknowledges the importance of selling the business as a going concern and has indicated it may be willing to fund trading should the invoice discounting facility be insufficient.

The company charges VAT at a rate of 17.5% and the due date in relation to the administration trading falls after the four-week period.

Requirements

- (a) **Prepare a weekly cash flow forecast for the 4 week trading period, showing the expected weekly trading receipts, payments, bank balance and funding required from Pippin Bank plc. Show also the trading transactions that will fall outside the trading period and the total outcome. (20 marks)**
- (b) **Prepare a note for your principal outlining**
- (i) **The financial impact on the estate of continuing to trade the business during this period assuming that the costs of monitoring the ongoing trade will be £20,000 per week. (4 marks)**
 - (ii) **The potential personal risks that trading at a loss may have to an Administrator. (4 marks)**
 - (iii) **Steps that ought to be considered to minimise the risk to the Administrator associated with trading at a loss. (2 marks)**

(30 marks)