JOINT INSOLVENCY EXAMINATION BOARD

DECEMBER 2007 EXAM (ENGLAND)

EXAMINERS' REPORT AND MARKING PLANS

ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS and RECEIVERSHIPS DECEMBER 2007

EXAMINER'S REPORT

QUESTION 1

This question required candidates to identify compliance breaches prior to review in an out-of-court administration process, the statutory steps required to allow the administration to be completed and for the Administrator to vacate office. The question then further required candidates to prepare draft receipts and payments accounts to accompany progress reports for each of the periods required by statute.

Overall the question was generally very poorly answered.

(a) Identify the compliance breaches that had occurred prior to your review. (3 marks)

This part was generally well answered.

Few candidates commented that the progress report did not appear to have been sent to the members or the Court.

(b) List the statutory steps that will need to be taken to complete the Administration and to enable the Administrator to vacate office. (5 marks)

This part was generally very poorly answered.

A large proportion of candidates listed 'practical'/'non-statutory' steps.
Some candidates recognised the need to apply for an extension with a smaller number listing the steps that would need to be taken to obtain the same.

Very few candidates mentioned the need to ensure creditors pass a resolution in favour of the administrator's discharge from liability.

(c) Prepare draft receipts and payments accounts to accompany the Administrator's progress reports for each of the periods required by statute up to and including the proposed conclusion of the Administration on 29 February 2008. (12 marks)

This part was generally very poorly answered.

Despite some candidates referring to the need to apply for an extension under part (b) few candidates included a receipts and payments account for the extension period.

There were a large number of 'attention to detail' errors in account headings (e.g. 16 Jul 07 to 16 Jan 08).

Good answers included a six-month receipts and payments account for the period 16/07/07 – 15/01/08 and a cumulative receipts and payments account for the period 16/01/07 – 15/01/08 and a final receipts and payments account for the period 16/01/08 – 29/02/08 and cumulative receipts and payments account for 16/01/07 – 29/02/08.

Good answers recognised the need to make a final distribution to the floating charge holder and showed 'nil' balance of funds in hand in the final account.

Poor answers included a prescribed part calculation, a distribution to unsecured creditors, a balance of funds in hand in the final receipts and payments account and incorrect period dates.

QUESTION 2

This question examined the contents of nominees' comments on CVA proposals and the ability to assimilate the facts given and set out a comparison of estimated outcomes between CVA best and worst case and liquidation best and worst case.

Overall the question was generally well answered.

(a) List the matters required to be included in Nominees' comments on CVA proposals. (6 marks)

This part was generally well answered.

Those candidates who had learnt and understood SIP 3 and properly explained the key points scored highly.

Candidates who simply wrote the words "fit feasible and fair" without further explanation of the point they were trying to make failed to score marks.

(b) Draft a comparative outcome statement, showing the estimated outcome of the proposed CVA on both a "best-case" and "worst-case" basis and also showing the estimated outcome of voluntary liquidation on both a "best-case" and "worst-case" basis. (14 marks)

This part was generally well answered with a number of candidates scoring very highly.

QUESTION 3

This question first required consideration of the factors that a bank would consider when deciding whether to appoint, or concur with the appointment of an Administrator or to appoint a Receiver itself. The second part required candidates to outline steps that a board of directors should take to protect the interest of creditors pending the appointment of an Insolvency Practitioner and then to indicate the consequences if those steps are not taken.

Overall the question was generally adequately answered.

(a) Outline the factors that the Bank would take into consideration when deciding whether to appoint, or to concur with the appointment of, an Administrator or to appoint an Administrative Receiver to the Company. (10 marks)

This part was generally adequately answered.

Most candidates covered off a number of the points however some key factors were consistently missed. Most candidates recognised that the Bank has more influence over the Administrative Receiver's strategy although few mentioned that the Administrator can be removed by creditors, has to report regularly to creditors and is required to seek approval to proposals from creditors - all key points that give unsecured creditors more influence over the conduct of the process (potentially to the detriment of the Bank).

A number of candidates failed to notice that receivership entitled the landlord to forfeit the lease and even fewer pointed out that relief from forfeiture is potentially available to an Administrative Receiver through the courts, again key points in this situation. Few candidates stated that in Administration there is likely to be greater co-operation from directors and hence an improvement in potential asset recoveries, such as trade debtors.

(b) Outline the steps that the board of directors should take to protect the interests of creditors generally, pending the appointment of an insolvency office-holder. Indicate the consequences that the directors may face if they do not take those steps. (10 marks)

This part was generally adequately answered.

Some basic points were consistently missed, such as stemming trading losses and preparing forecasts and a number of less important points were raised instead. This implied that students had rote learnt a long list of steps and were reproducing them rather than considering the key points in this situation. Candidates who dealt with the consequences separately from the steps and adopted a methodical approach scored highly and those scoring the highest marks explained each offence and then detailed the consequences for the directors

(c) Set out the procedural steps required to effect the appointment of an Administrator by the directors in the present circumstances. (10 marks)

This part was generally well answered.

The question stated that there was a winding up petition outstanding and therefore the procedure to appoint was via the Court. Some candidates did not appreciate this and detailed the out of court procedure. These candidates scored few if any marks. Other than this the question was generally answered well, although some candidates appeared unaware that the procedure for appointing an Administrator was in the open book, or they were unable to find it. Conversely, candidates who wrote the procedure out in detail scored highly, some obtaining maximum marks.

QUESTION 4

This question required consideration of the factors to take into account when deciding whether or not a company should continue to trade and the practical measures and controls to manage post-appointment trading. Finally, the question asked the candidates to outline the steps needed to market the business and assets for sale and the particular terms expected in a contract for sale by an Administrative Receiver.

Overall the question was generally poorly answered.

(a) Set out the factors that you should take into account when deciding whether or not to allow the Company to continue trading. (10 marks)

This part was generally adequately answered.

Generally, candidates' answers were correct as far as they went but they did not include enough points to score more highly. Many candidates wasted time by listing irrelevant information such as the legal position regarding the receiver's ability to trade. Some candidates did not seem to be sufficiently familiar with the financial aspects of the decision to trade and the impact that trading could have on the realisable value of tangible or intangible assets

(b) Outline the practical measures and controls that you should implement in order to manage post-appointment trading. (10 marks)

This part was generally very poorly answered.

Candidates seemed unfamiliar with detailed practical steps concerned with setting up the trading purchase order system and negotiating customers' written agreement to new trading terms before any goods are despatched.

A large number of candidates appeared not to have read the question in detail and included points in their answer which related to the decision to trade rather than the control of it. In the age of the pre – pack administration sale perhaps this reflects that post-appointment trading control is becoming increasingly rare.

(c) Outline the steps that you should take to market the business and assets for sale. (5 marks)

This part was generally inadequately answered.

Many candidates' answers to this part were similar, presumably based upon the same model answer provided by tutors, without applying this to the facts.

As a result many candidates stated that the receiver would obtain a valuation when marketing the assets, ignoring the fact that this would have already been obtained when deciding to trade in part (a).

Many candidates also stated that the marketing of the business and assets for sale would be undertaken by agents and that an auction would be a distinct possibility ignoring the fact that the question concerned achieving the sale of the business and assets as a going concern.

(d) When instructing lawyers to prepare the contract for the sale of the business and assets, outline and explain the particular terms that you would expect them to incorporate into the contract, recognising this is a sale by an Administrative Receiver as opposed to a sale by a solvent company. (5 marks)

This part was generally very poorly answered.

Many candidates seemed to have little detailed knowledge of an insolvency asset sale agreement. Many answers listed clauses that would appear in any business sale agreement.

JIEB ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS and RECEIVERSHIPS DECEMBER 2007

Exam Marking Plan

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

QUESTION 1

(a) Identify the compliance breaches that had occurred prior to your review. (3 marks)

Notice of administrator's appointment not sent to the registrar of companies within 7 days
Advertising of appointment of Administrator arguably not carried out as soon as reasonably practicable
Proposals not sent to creditors and registrar of companies within 8 weeks of appointment
Administrator's proposals not apparently sent to the members
Progress report was not sent within one month of the end of the period to which it relates.
Progress report was apparently not sent to the court
Asset realisations made by agents on behalf of the office holder should be shown gross, before the deduction of costs of realisation. Costs of realisation should be shown separately as payments.

(b) List the statutory steps that will need to be taken to complete the Administration and to enable the Administrator to vacate office. (5 marks)

Write to creditors for the purpose of obtaining consent for an extension to the period of the administration.
Consent may be written or signified at a creditors' meeting.
In this case consent means: Of each secured creditor and 50 % of the preferential creditors who take part in voting
The extension must not be for more than 6 months.
The request must be accompanied by a progress report for the period since the last report.
Consent will need to be obtained in this case no later than15 January 2008 (being the 12 month anniversary of the appointment).
Creditors must be given at least 14 days notice of a resolution to extend administration.
Therefore creditors must be in receipt of the progress report and ancillary papers no later than 1 January 2008.
When consent obtained, file notice of the extension with the registrar of companies and the court
Prepare a progress report for the period 16 July 2007 to 15 January 2008 and send to specified persons within one month
Prepare a final progress report for the period 16 January 2008 to 29 February 2008 and send to specified persons within one month
Persons to be sent progress reports are: The creditors The court The registrar of companies
Ensure creditors pass a resolution in favour of the administrator's discharge from liability.
File a notice of move from administration to dissolution (accompanied by final progress report) to The registrar of companies, and copy notice to The court The creditors

(c) Prepare draft receipts and payments accounts to accompany the Administrator's progress reports for each of the periods required by statute up to and including the proposed conclusion of the Administration on 29 February 2008. (12 marks)

There are three further discreet periods for which an abstract of receipts and payments must be prepared
First 16 July to the date of seeking the consent of the creditors to an extension to the period of administration.
The last possible day for obtaining consent to an extension is 15 Jan 2008.
Creditors require at least 14 days notice of a resolution to extend administration.
Therefore creditors must be in receipt of progress report and ancillary papers no later than 1 Jan 2008.
Therefore the period of account for a progress report in support of consent for an extension is from 16 July 2007 to any date between 11 December 2007 (date of review) and 1 January 2008. (Since there are no transactions during these later two dates, the period end date chosen should not affect the answer given.)
Cumulative account
Secondly 16 July 2007 to 15 January 2008
Cumulative account
Finally 16 January 2008 to 29 February 2008
Cumulative account

Q1 - RODRIGO WINDOWS LIMITED - IN ADMINISTRATION
ADMINISTRATOR'S ACCOUNTS OF RECEIPTS AND PAYMENTS

	ACTUAL 1st 6 months R 2.47	DRAFT In support of extension R 2.112	SIP 7	DRAFT 2nd 6 months R 2.47	SIP 7	DRAFT Final period R 2.47	SIP 7
	1 6 Months 16 Jan 07 - 15 Jul 07 £	2 Period 16 Jul 07- 11 Dec 07 £	Cumulative 16 Jan 07 - 11 Dec 07 £	3 6 Months 16 Jul 07- 15 Jan 08 £	Cumulative 16 Jan 07 - 15 Jan08 £	4 Final 16 Jan 08 - 29 Feb 08 £	Cumulative 16 Jan 07 - 29 Feb 08 £
Assets Not Specifically Pledged							
Book debts	450,000	150,000	600,000	150,000	600,000		600,000
Retentions	150,000	100,000	250,000	100,000	250,000	50,000	300,000
Work in progress	400,000	0	400,000	0	400,000		400,000
Stock	95,000	0	95,000	0	95,000		95,000
Plant, equipment & vehicles	100,000	0	100,000	0	100,000		100,000
Interest received	5,000	10,000	15,000	10,000	15,000		15,000
	1,200,000	260,000	1,460,000	260,000	1,460,000	50,000	1,510,000
Payments							
Administrators' fees & disbursements	-70,000	-30,000	-100,000	-30,000	-100,000	-25,000	-125,000
Other professional costs	-50,000	-10,000	-60,000	-10,000	-60,000		-60,000
Direct labour	-80,000	0	-80,000	0	-80,000		-80,000
Other trading costs	-50,000	0	-50,000	0	-50,000		-50,000
Finance agreement settlements	-25,000	0	-25,000	0	-25,000		-25,000
Distributions					0		
Arrears of wages and holiday pay	-25,000	0	-25,000	0	-25,000		-25,000
Prescribed part of net property set aside		0	0	0	0		0
Floating charge holder - RHBC Bank plc	-750,000	0	-750,000	0	-750,000	-395,000	-1,145,000
	-1,050,000	-40,000	-1,090,000	-40,000	-1,090,000	-420,000	-1,510,000
Balance of funds held	**150,000**		**370,000**		**370,000**		**0**
	1,200,000		1,460,000		1,460,000	50,000	1,510,000

QUESTION 2

(a) List the matters required to be included in Nominees' comments on CVA proposals. (6 marks))

The extent to which the nominee has investigated the company's circumstances.
The basis on which the assets have been valued.
The extent to which the nominee considers that reliance can be placed on the directors' estimates of the liabilities.
Information regarding the attitude of the directors, with particular reference to instances of failure to co-operate.
The result of any discussions between the nominee and any secured creditors or other interested parties upon whose co-operation the performance of the VA will depend.
Information on the attitude of any major unsecured creditors which may affect the approval of the arrangement by creditors.
Details of any previous history of failures in which any of the directors have been involved in so far as they are know to the nominee.
An estimate of the result for the creditors if the VA is approved, explaining why it is more beneficial for creditors than any alternative insolvency proceeding.
The likely effect of the proposal's rejection by creditors.
Details of any claims which have come to the nominee's attention which might be capable of being pursued by a liquidator or administrator should one be appointed.
Where the following conditions have not been met (Re Greystoke v Hamilton-Smith & Others)
The Company's true position as to assets and liabilities is not materially different from that which it has represented to the creditor to be
The directors' proposal has a real prospect of being implemented in the way it is to be represented it will be.
There is no already- manifest yet unavoidable prospective unfairness
If the nominee still recommends a meeting should be held, the reasons why he is making that recommendation and that the conditions have not been met is conspicuously brought to the attention of the court.
If not already dealt with in the proposal:
The source of any referrals to the nominee or his firm in relation to the proposed VA.
Any payments made or proposed to be made, to the source of such referrals.
Any payments made or proposed to be made to the nominee or his firm by the company whether in connection with the proposed VA or otherwise.
An estimate of the total fee to be paid to the supervisor together with a statement of the assumptions made in producing the estimate.
If the Company has in the previous 12 months put forward a proposal that has been rejected, a statement to that effect and why it is considered appropriate for the creditors to consider and vote on the new proposal.(Revised draft SIP 3 Sept 2006)

(b) Draft a comparative outcome statement, showing the estimated outcome of the proposed CVA on both a "best-case" and "worst-case" basis and also showing the estimated outcome of voluntary liquidation on both a "best-case" and "worst-case" basis. (14 marks)

Q2 - VIVID PLC

COMPARISON OF ESTIMATED OUTCOMES

	CVA Best case £	CVA Worst case £	Liquidation Best case £	Liquidation Worst case £
Assets not specifically pledged per statement of affairs				
Office equipment	0	0	5,000	5,000
Stock	0	0	15,000	15,000
R&D tax claim	260,000	0	260,000	0
Contribution to pay dividends and costs	40,000	100,000	0	0
Less costs of realisation and liquidation/CVA	-30,000	-30,000	-30,000	-20,000
Net assets available to preferential creditors	270,000	70,000	250,000	0
Preferential creditors	-20,000	-20,000	-70,000	-70,000
Surplus as regards preferential creditors	250,000	50,000	180,000	-70,000
Unsecured creditors				
Trade and expense creditors	-400,000	-400,000	-400,000	-400,000
PIT loan	0	0	-200,000	-200,000
Group creditor	-600,000	-600,000	-600,000	-600,000
	-1,000,000	-1,000,000	-1,200,000	-1,200,000
Total shortfall to unsecured creditors	-750,000	-950,000	-1,020,000	-1,270,000
Estimated dividend to preferential creditors (p in £)	100.0	100.0	100.0	0.0
Estimated cash dividend to CVA unsecured creditors (p in £)	25.0	5.0	15.0	0.0

QUESTION 3

(a) Outline the factors that the Bank would take into consideration when deciding whether to appoint, or to concur with the appointment of, an Administrator or to appoint an Administrative Receiver to the Company. (10 marks)

Appointment
The Bank can appoint an administrative receiver in this case
The appointment of an administrative receiver requires no prior notice to be given any person.
Company/directors' appointment -at least 5 business days notice of intention to appoint an administrator has to be given to any person entitled to appoint an administrative receiver or administrator
QFCH appointment-at least 2 business days notice of intention to appoint an administrator has to be given to a prior QFCH
Bank may consent to directors' choice of administrator or appoint its own administrator or administrative receiver.
Moratorium
Administrative receivership - no protection offered by a moratorium
Receivership will entitle landlord to forfeit the lease
Relief against forfeiture on condition of payment of ongoing rent
Duties
Primary duty of receiver is to repay Bank and preferential creditors
Administrator owes duty to all creditors
Control
More difficult to remove bank appointed administrative receiver than administrator
Bank has more ability to influence administrative receivers' strategy
No requirement for administrative receiver to report to creditors on a periodic basis
Administrator is required to seek approval to proposals from creditors
Administrator can sell business and assets subject to floating charge as if not subject to security and may deal with fixed charge property with court consent
Secured creditor can apply to court to realise security
Period of administration only lasts 12 months without extension – consent of creditors/court required
Liability & Costs
Receiver's agency is terminated on winding up. An administrator's agency cannot be so terminated
Receiver's fees are controlled by the bank rather than the general body of creditors in the case of administration
There is a cessation of accounting period on entering administration and therefore a new tax period is created
Therefore trading losses cannot be offset against future trading profits and chargeable gains
Corporation tax arising post appointment ranks as an unsecured claim against the company in receivership but as an expense in administration.
Rates are payable as an expense of administration but not in receivership
Realisations
Directors' cooperation may not be forthcoming in receivership
Consequently book debts might be more difficult to collect without active director cooperation
Administrator can challenge antecedent transactions whereas receiver cannot
Other
Administration recognised but lack of recognition for receivership in other jurisdictions – EC Regulation
Potential adverse publicity associated with receivership compared to administration as part of the rescue culture

(b) Outline the steps that the board of directors should take to protect the interests of creditors generally, pending the appointment of an insolvency office-holder. Indicate the consequences that the directors may face if they do not take those steps. (10 marks)

Steps the directors should take
Since the Company is insolvent the directors' principal duty is to the Company's creditors.
The position of creditors whose debts have already been incurred should not be prejudiced in any way.
Any liabilities accruing due to creditors as a result of allowing the Company to continue to operate should be paid in full when due.
The value of the Company's assets must therefore be preserved
No assets should be disposed of below their market value. Therefore any disposal contemplated outside the ordinary course of business should be on the basis of professional advice.
Trading losses must be stemmed/eradicated since losses reduce available net assets.
Therefore any short term contemplated trading must be supported by a detailed cash flow and profit and loss account.
No payments should be made to exiting creditors.
This is to ensure that the pari passu principle, i.e. the equality of creditors as between themselves, is preserved
It also ensures that the assets of the Company available to pay creditor claims are maintained intact.
It will however be justifiable to pay an existing creditor if absolutely necessary for protecting the value of the business and assets and therefore the interests of the creditors as a whole.
Customer deposits should be paid into a separate bank account and not mixed with Company monies.
Customer receipts should not be paid into an overdrawn bank account.
Hauliers owed money should not be used unless confirmation given that will not exercise a lien.
If in doubt take professional advice.
All material decisions affecting the Companies assets, liabilities and continued trading should be adequately documented in the event of a challenge at a later date.
Directors should not resign.
Consequences for directors of not taking those steps
A director who fails to take steps with a view to minimising the potential loss to creditors may be sued for wrongful trading by the liquidator if the Company goes into insolvent liquidation.
If the court finds for the liquidator the director can be made liable to make such contribution to the company's assets as the court thinks proper.
The level of that contribution is likely to reflect the addition losses sustained by creditors as a consequence of the director's failure. The court's jurisdiction is primarily compensatory rather than penal.
Failure to take steps to minimise the loss to creditors could lead to a finding that the conduct of a director of a company which has become insolvent makes him unfit to be involved in the management of a company.
A disqualification order or undertaking has the effect that for a specified period the director shall not be a director, a receiver or be concerned in the promotion formation or management of a company without the leave of the court, nor act as an insolvency practitioner. The period specified may be between 2 and 15 years.
Where, in the course of a winding up, it can be shown that trading has continued with intent to defraud creditors or for any fraudulent purpose, any persons who were knowingly parties can be made liable to make such contribution to the company's assets as the court thinks proper.
A finding of fraudulent trading can also lead to criminal prosecution entailing fines and custodial sentences.
Where an asset is disposed of for less than its market value, a subsequently appointed administrator or liquidator may seek to recover the amount of undervalue transaction from the transferee.
In such a case of a transaction at an undervalue the directors responsible may, if the company is wound up, also be liable in misfeasance proceedings with liability to account or contribute to the assets of the company
This is particularly so where the transaction was with a person connected with the company – i.e. a director or an associate of a director.
Where a payment is made to an existing creditor without proper justification, a subsequently appointed administrator or liquidator may challenge the payment on the grounds that it was a preference – that there was a desire to put the creditor into a better position than they would have been on a winding up. The desire to prefer is assumed if the creditor was a person connected with the company.
In such a case of a preference the directors may, if the company is wound up, also be liable in misfeasance proceedings with liability to account or contribute to the assets of the company.
This is particularly so where the preference was given to a person connected with the company – i.e. a director or an associate of a director.

(c) Set out the procedural steps required to effect the appointment of an Administrator by the directors in the present circumstances. (10 marks)

Out of court appointment by the company or directors under paragraph 22 may not be made where a petition for winding up the company has been presented and has not yet been disposed of.
Therefore an application to the court under paragraph 12 for an administration order is the only route available to the company or directors
Pre-conditions to appointment of administrator are met, namely the company must not already be in administration, administrative receivership or liquidation nor has a provisional liquidator been appointed.
Hold a board meeting to pass a resolution recommending Administration as the most appropriate course of action in all the circumstances
Application for administration order prepared which should state:
Name of company and address for service
Name and address of person(s) proposed as administrator(S)
An address for service
Consent to act from proposed administrator should be attached and should state
Details of any prior professional relationship he has had with the company
That in his opinion it is reasonably likely that the purpose of administration will be achieved
An affidavit in support of the petition is prepared to contain the following information
A statement of the company's financial position
Specifying to the best of the applicant's knowledge and belief the company's assets and liabilities including contingent and prospective details of any security known or believed to be held by the company's creditors
Whether the secured creditor has power to appoint an administrative receiver
Any maters which in the opinion of those intending to make the application for the order will assist the court in deciding to make such an order so far as lying within the knowledge or belief of the applicant
Whether in the opinion of the person making the application, the EC Regulation will apply and if so whether the proceedings will be main or territorial proceedings
File application and supporting documents in court with sufficient number of copies for service
The court seals each copy of the application with date and time of filing and venue for the hearing and issues back to applicant sufficient copies for service.
An interim moratorium takes effect.
Service of the application to be effected by the applicant, his solicitor or by a person instructed by him or his solicitor, as soon as reasonably practicable and not less than 5 days before the date fixed for the hearing to
Any person who is or may be entitled to appoint an administrative receiver of the company
Any such persons as may be prescribed
The proposed administrator
The company
The application to be served on High Court Enforcement Officer/ anyone who has distrained
Affidavit of service and sealed copy of application to be filed with court as soon as reasonably practicable and not less than one day before the hearing
Court hears the administration application
The directors as applicants can appear or be represented
Court can make administration order only if satisfied that the company is or is likely to become unable to pay its debts and that the administration order is reasonably likely to achieve the purpose of administration.
Court issues 2 sealed copies of the appointment to the applicant who sends one copy to the administrator as soon as reasonably practicable.

QUESTION 4

(a) Set out the factors that you should take into account when deciding whether or not to allow the Company to continue trading. (10 marks)

Confirmation obtained as to validity of appointment and capacity to deal with assets crucial to trading
The likelihood of the company being placed into liquidation which would terminate the receiver's agency
Independent valuation of chattel assets shows a significantly higher value on a "going concern" basis compared to a "forced sale" basis.
Evidence of a reasonable prospect of realising value for goodwill, intellectual property rights or other intangible assets.
The likelihood of achieving a going concern sale of the business and assets.
A better prospect of maximising the value of book debts and/or work-in-progress
The ability to mitigate liabilities
The level of forecast profit/loss from continued trading
The level of funding required to support trading evidenced by a detailed cash flow forecast. The availability and cost of funding post-appointment trading
The level of employee actual and contingent claims and the impact of TUPER on a sale of business.
The impact of ROT
Ransom payments to suppliers/hauliers
Attitude of major customers
The terms on which existing customers are willing to transact including no set off
Credit-worthiness of customers to pay
The availability of raw materials/other inputs and the attitude of major suppliers
Evaluate environmental risks impacting on trading
Evaluate health and safety risks impacting on trading
Evaluate risks of claims arising in tort as a result of continued trading e.g. from arising out of product failures
The adequacy and attitude of the employees/labour force
Legal position re any necessary licenses
Adequacy of controls over trading
If leasehold property, the rent position and the ability to negotiate terms with the landlord
Where a factoring company is involved, confirmation that post-appointment sales will not form part of their security.
Confirmation that the directors support the decision for post-appointment trading
No significant production/process problems likely to affect production standards/quality
Obtain any necessary internal approval to trade e.g. following second/regional managing partner review.
Continued trading must not prejudice the position of the preferential creditors

(b) Outline the practical measures and controls that you should implement in order to manage post-appointment trading. (10 marks)

Purchases/payments
Establish new purchase order numbering system to distinguish receivership purchases from pre-appointment purchases
Review unexecuted purchase orders to determine whether the goods/services are still required. Cancel existing PO and replace with receivers' PO.
Review supplier terms and conditions
Receivers' PO to be countersigned by senior member of receivers' staff authorised for that purpose.
All goods inwards received after appointment to be verified against receivers' order prior to being accepted.
Ensure that purchasing system enables administrator PO to be matched to delivery note and invoice before payment is made.
All supplier payments to be approved by senior member of receivers' staff supported by PO, DN and invoice.
Overtime working to be approved in advance by receiver
Company credit cards/fuel cards and the like reviewed and either withdrawn or appropriate limits agreed.
Payroll to be scrutinised and authorised for payment.
Post-appointment trading performance to be reviewed in detail against forecasts at least weekly and any material variances investigated.
Take meter readings in respect of utility supplies at all locations as soon as possible.
Arrange a stock take as close to appointment as possible. Identify any potential ROT stocks and obsolete and slow moving stocks.
Establish any goods in transit
Ensure that receiver's trading liabilities are paid on time
Sales/receipts
Establish new goods outwards record to distinguish goods supplied during administration. No goods to be despatched until proper cut-off established.
No goods to be despatched with external hauliers owed money until written confirmation received from them that they will not exercise a lien over goods.
Customers confirm that they will pay post appointment invoices without deduction, counterclaim or set off of any kind.
Review credit limits with customers
Analyse cheques received between pre- and post-appointment sales. Bank cheques daily/promptly
Review costing system/pricing policy if appropriate.
General
Ensure that there is adequate site attendance/supervision by the receivers' staff
Ensure that company directors and employees are adequately briefed for the purposes of continued trading
Ensure proper cut off of all pre-appointment accounting records
Review key holders and general security arrangements
Establish control over all incoming mail faxes and documents
Establish control over all outgoing mail, email, faxes and documents. Ensure statutory publicity requirements complied with – name of administrative receiver and that the affairs, business and property are being managed by him.
All outgoing documents to state that receiver contracts as agent of the company without personal liability.
Ditto re Company website.
Arrange adequate insurance cover for the additional risks associated with continued trading – employee liability, fidelity, fire, theft, accidental damage and product liability. Consider terrorism damage.
Count petty cash and establish an imprest system.
Perform regular/weekly reconciliation of receivership cash book and bank statements

(c) Outline the steps that you should take to market the business and assets for sale. (5 marks)

Consult with the directors to identify persons amongst the Company's competitors, customers or suppliers most likely to be interested in acquiring the business and assets.
Establish whether the existing management team is interested and if so how they propose to raise the necessary finance.

Review trade magazines, business directories and the financial press to add to the list of potential purchasers.
Consider engaging specialist corporate finance advisers to identify potential buyers. They will have access to databases of potential buyers as well as an extensive network of contacts.
Consider advertising the business and assets for sale in a publication appropriate to the business in question; specialist trade magazines and the Financial Times are frequently used.
Prepare a sales memorandum/ brochure containing essential information about the business and the nature of the assets for sale in order to spark interest on the part of potential purchasers. You should not at this stage disclose confidential information such as names of customers and pricing structure.
Send the sales memorandum to the list of potential purchasers inviting them to register their further interest with the receivers' office. Retain contact details
Maintain a schedule of contact details of all those parties expressing further interest.
Arrange for those expressing further interest to visit the principal trading site(s). Ensure adequate supervision of those visits.
Prepare a confidentiality/non-disclosure agreement whereby prospective purchasers undertake not to use or pass on any confidential information they are given about the Company or its business.
Provide further detailed information as requested to those interested parties willing to sign a confidentiality undertaking.
Set a deadline for the receipt of offers in order to draw matters to a conclusion.
Obtain confirmation of adequacy of funding from prospective purchasers.
Instruct solicitors to prepare a draft contract of sale.

(d) When instructing lawyers to prepare the contract for the sale of the business and assets, outline and explain the particular terms that you would expect them to incorporate into the contract, recognising this is a sale by an Administrative Receiver as opposed to a sale by a solvent company. (5 marks)

In addition to the Company (as Vendor) and the Purchaser, the AR is also made a party to the transaction.
The Purchaser agrees to purchase such right, title and interest as the Vendor may have in the business and assets subject to the agreement.
Any failure by the Vendor to pass along any title, right or interest to or in any of the assets shall not be a ground enabling the Purchaser to rescind or treat the Vendor as in breach of the agreement or to claim a reduction of the price.
All sums payable under the agreement are to be paid to the AR or their named solicitors.
All warranties as to title, merchantable quality, fitness for purpose and condition are expressly excluded.
Any provision for the Purchaser to indemnify the Vendor will also be extended to the AR.
The Purchaser acknowledges that the terms and conditions are fair and reasonable in the context of a sale by a company in receivership and that the commercial risk to the Purchaser of such is reflected in the price, which would have been much higher on any other basis.
The Purchaser acknowledges that it places no reliance whatsoever on any representations by the ARs, their staff or their solicitors
The Purchaser acknowledges that it has relied entirely on its own inspection and enquiry as regards the assets to be transferred.
The ARs are given access to the business premises on reasonable notice and at reasonable times in order to complete the receivership.
The business records of the vendor will be available for inspection by the AR whilst the AR is in office in respect of the vendor.
The ARs are acting only as agents for the Vendor and without personal liability on their part.
Signed by named AR(s) on behalf of the Vendor. Also signed by named AR as administrative receiver on behalf of joint appointee (unless the joint administrative receiver also signs personally).
No title guarantee given in respect of business premises
Treatment of ROT
Treatment of book debts

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EXAMINER'S REPORT

The general standard was good and many candidates showed that they have a sound knowledge of some of the basic aspects of liquidations, reflected in many of the answers to question 4 and parts of question 1. Generally, candidates knew the purpose of a creditors' voluntary liquidation, what matters need to be investigated and were familiar with Statements of Insolvency Practice (SIPs) 2 and 4. They could also confidently deal with a company in members' voluntary liquidation which was facing insolvency and many made a reasonable attempt at setting out what they would look for if a purchaser of a business (pre-liquidation) chose only to take over certain creditors.

Nevertheless, some candidates indicated either a lack of knowledge of some technical aspects or were unable to apply basic insolvency knowledge to an unfamiliar situation. For example, in question 3(a), only the better candidates recognised that the licence in respect of the patent should be disclaimed. About half of the candidates recognised that petitioning the court and applying for the appointment of a provisional liquidator was an effective means of protecting dissipating assets in question 1(d). Many of them made the unnecessary point that the debt due must be at least £750 when clearly Mistier Ltd owed £50,000. Further, some of them wrongly assumed that even if the creditor was in a position to show inability to pay otherwise than a failure to meet a statutory demand, and therefore to petition and apply for a winding up order and the appointment of a provisional liquidator straightaway, needed to have owing to him at least £750. In addition, most candidates did not recognise the rule of double proof in question 1(b) and some failed to appreciate that the bank had a joint and several claim for the full amount of its debt both against Windy Ltd and the guarantor and, therefore no question of partial subrogation arose on payment by the guarantor, **after liquidation**, of only part of the debt. The bank could maintain its full claim in the liquidation unless and until it received full payment from the dividends and/or the guarantor. If the end result was that it received more than 100p in the £ from the two sources, it had to account for the surplus to the guarantor.

Although familiar with SIPs, only one candidate referred to the Control of Cases Guidance Paper in question 2(a)(i), but the better candidates gained marks by making sensible suggestions about how the particular problems, set out in the question, could be dealt with. Other published guidance candidates mentioned here were SIPs 2 or 9 but these were not particularly relevant to the question. Most attempted 2(b) but no-one referred to Rule 13.12 nor to the Turner & Newell judgment.

The answers to question 3 were disappointing. Candidates were familiar with retention of title but many failed to distinguish between the scenarios presented. In 3(b) some candidates suggested a claim for preference rather than the obvious claim for void disposition under section 127 in respect of the post petition payments. The payments did not fall within the relevant risk period for preferences (or, for that matter, transactions at an undervalue), which is fixed by reference to the period before the onset of insolvency, which includes the presentation of a winding up petition. Some candidates suggested, quite rightly in theory, a claim against the directors for misfeasance and/or wrongful trading but a claim under section 127 against the suppliers who received the payments would have been a better bet.

In 3(g) some candidates suggested applying to the court for directions in respect of the apparently excessive petition costs of the solicitors rather than the more obvious and easier course of requiring the costs to be assessed by the court which made the winding up order through a costs judge or an assessment officer.

There were three parts to question 4 which were intended to assist candidates' consideration of the purpose of a creditors' voluntary liquidation, investigations in order to recover assets and reporting on directors' conduct. The question was well answered but some candidates seemed to have answered in reverse order (c, b, a). Whilst there was no penalty for answering the question in a different order, candidates may have clarified their thoughts by answering in the order given and consequently may have gained extra marks. Many candidates did not address the issues which hindered reporting directors' conduct.

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Exam Marking Plan

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

QUESTION 1

(a) Set out the immediate practical steps, and, if those steps do not result in a resolution of the problem, the legal and procedural steps that you, as Liquidator, should take. Set out the consequences for the Liquidator. (4 marks)

Rainy Ltd
Practical steps
Verify claim. – Do directors' accept validity of claim? How was it omitted from the declaration of assets and liabilities? Do directors have reasons for omission?
Discuss with directors.
Was there an indemnity from the parent – is the indemnifier prepared to make up the deficit? Discussion.
The declaration of solvency will have been signed by the directors (or if over two directors the majority) (IA 1986 s89 (1)) and that it is an offence to make a declaration without having reasonable grounds for the opinion that the company will be able to pay its debts in full, together with interest at the official rate, with the period specified and the directors are liable to imprisonment or a fine, or both. (IA 1986 s89(4)).
If claim is correct, the directors may wish to mitigate the risks which could arise and it may be possible that they directors will agree to pay some/all of the shortfall.
Legal steps
If correct and the company is unable to pay its debts and the interest (IA 1986 s189)on them [within the time stated] in the Declaration of Solvency (IA 1986 s89) (max one year), the liquidator must call a creditors' meeting within 28 days (IA 1986 s95(2)(a))
Creditors must be given 7 days notice of the meeting (IA 1986 s95(2)(b))
Notice of the meeting must be advertised in London Gazette and two local newspapers in which the company's principal place of business was situated in the 6 months before the start of the liquidation (s95(2)(c).
Before the creditors' meeting the liquidator has to provide creditors free of charge with such information concerning the company's affairs as they may reasonably require (IA 1986 s95(2)(d)) and this duty must be stated in the notice to the meeting.(IA 1986 s95(2))
At the meeting, the liquidator must act as chairman (IA 1986 s95(3)(c)
Prepare and present to the meeting a statement of affairs on Form 4.18 (IA 1986 s 95(3)(a), (b) and IA Rules 1986 Sch 4). The statement of affairs must be at the date that the liquidator formed his opinion that the company would not be able to pays its debts in full within the period stated in the declaration of solvency.
With effect from the date of the creditors' meeting, the liquidation will be a CVL ((IA 1986 s96(a))
The creditors' meeting will be treated as though it were the first meeting of creditors convened in a CVL (IA 1986 s96(b)) and so it will be able to appoint a liquidator in place of the members' appointee (IA 1986 s100(2)) and appoint a liquidation committee (IA 1986 s101(1))
Consequences for liquidator
The replacement of the liquidator by the creditors appears to be a removal by a general meeting of creditors for the purposes of IA 1986 s173 and, unless the creditors have voted against it, he will obtain his release when notice that he has vacated office is given to the Registrar of Companies (IA 1986 s173(2)). If the creditors vote against his release he will need to apply to the Secretary of State (IA 1986 s173(2)(b).
The MVL liquidator will not be able to take appointment as CVL liquidator if he was auditor, but also even if he was not auditor he will be conflicted from taking appointment as CVL liquidator, as the advice that he gave the company when entering into MVL will need to be investigated.
If there were no reasonable grounds for signing the declaration of solvency, the creditors' liquidator will have a duty to report the circumstances of the liquidation to the DTI under the reporting provisions of the CDDA 1986 and so disqualification proceedings may also follow.

(b) Reply to the solicitor's letter explaining, with reasons, whether or not the solicitor's proposition is correct. (4 marks)

Answer in form of letter to Bob from liquidator.
Rule against double proof is a common law principle that there cannot be two proofs in respect of the same debt.
A guarantor cannot prove in the liquidation, as a contingent creditor or otherwise, unless the principal debtor has not or is no longer entitled to prove (e.g. because the guarantor has paid him in full). Until that happens, no right of subrogation arises.
See Re Fitness Centre Ltd [1986] B.C.L.C. at 521, per Hoffmann J.
The test to be applied when deciding whether or not the rule against double proof applies is a broad one, and is simply whether the two competing claims are in substance claims for payment of the same debt twice over. It is necessary to look at the substance of the transactions which have given rise to the potential application of the rule to determine which claimant has the better right.Barclays Bank Ltd v TOSG Trust Fund Ltd [1984] A.C. 626, applying Oriental Commercial Bank, Re (1871) L.R. 7 Ch. App. 99
As a general proposition, the rule against double proof is going to apply wherever the existence of one liability is dependent upon and referable only to the other liability. To allow both liabilities to rank independently for dividends would produce injustice to the other creditors. The rule is designed to prevent a distortion of the pari passu principle, which would occur if both proofs were admitted in full.
If Bob does not accept the Liquidator's explanation of the legal position and wishes to continue with his claim then, subject to further evidence or explanations which Bob may wish to submit, within say 10 days, the liquidation will have no alternative but to formally reject the proof (he must prepare a written statement of his reasons and send it to the claimant whose proof has been rejected. R4.82(2)).
In these circumstances, if Bob is dissatisfied with the liquidator's decision he may apply to the court for it to be reversed or varied.R4.83, within the period stated in the notice of rejection.

(c) Set out the issues to be considered by, and the remedies available to, the Liquidator. (4 marks)

Carroty Ltd
The main issue for the Liquidator to consider is the sale of the business so soon before the CVL:
Discussion required, including:

- Was the consideration at market value?
- Was the deal structure intended to leave some creditors (HMRC and landlord) behind? Or was this unavoidable because of the requirements/demands of the purchaser?
- Could the directors have achieved a better deal?
- Did the directors treat all creditors fairly and equally in proportion to their claims?

If the assets were not sold for the market price (and the liquidator should take steps to ascertain whether or not this was the case) – there may be a remedy for a transaction at an undervalue (IA 1986 s 238).
Note a preference may also be a transaction at undervalue.
Note for marker: The strict legal effect of a purchaser taking over some liabilities and not others is the same as if the vendor company has received the amounts of the liablities taken over as part of the consideration and had itself then paid off those liabilities from those amounts to the creditors taken over. The short circuiting of the mechanics of payment as in the scenario did not have the effect of taking the transactions out of the preference position.
If the assets were not sold at a market price the liquidator may also have an action against the directors for misfeasance (IA 1986 s212)
If the business and assets were sold at market price – there will have been no transaction at undervalue or misfeasance.
Did company become insolvent as a result of the transaction or was it already insolvent? Was the value correct?
In this case, there may be a possible action for preference (IA 1986 s239) but the directors could argue that the deal was imposed upon them by the purchaser (i.e. commercial pressure) and they were not desiring to prefer any particular creditors.
May be a claim against the directors for fraud s423. Hill v Spread Trustees

(d) Advise Hubert on the immediate actions that Smog can take to prevent Mistier's assets from further dissipation and on the procedures involved. Explain any risks to Smog of taking immediate action. (8 marks)

Petition for winding up order (IA 1986 s124, IR1986, R4.7) – on grounds either that the company is unable to pay its debts (s123(1)(e)) (note - there is no mention in the question that a demand was made for the arrears).
Petition must be advertised but not before expiry of 7 days (R4.11(2)) and this may be too long in the circumstances.
On hearing the petition the court can make .."any order it thinks fit."
Apply to court for a provisional liquidator in order to protect the assets/records in the company's possession or under its control, s135
An application for a provisional liquidator can be made at any time between the presentation of the petition and the making of a winding up order (s135(1)).
The applicant must show (R4.25(2):

- why the appointment should be made (that otherwise the company's assets would be dissipated in this case)
- who is proposed as provisional liquidator
- if proposed prov liq is not OR, that the person proposed consents and is, to the best of the applicant's belief, a qualified insolvency practitioner
- if proposed prov liq is not OR, whether the OR has been informed of the application and has been sent a copy
- whether a scheme of arrangement has been proposed or is in force
- whether an administrator or administrative receiver is acting
- whether a liquidator has been appointed for the company's voluntary winding up
- the estimated value of the assets over which the prov liq will be appointed

The Creditor, as creditor or as petitioner, may apply for the appointment.(R4.25(1)).
- the court order appointing the liquidator will specify the functions he is to carry out
Adequate security needs to be provided to support the appointment (R4.28)
The provisional liquidator must be an insolvency practitioner and is an officer of the court
If necessary, a provisional liquidator can appoint a special manager
Other remedies (non-insolvency):
- freezing order
- seize and search
- order in relation to property (preservation or sale)
- order to deliver up goods

Risks to creditor
Cost/benefits
- a licensed insolvency practitioner may also be appointed (Official Receiver in default)
- court may not make an appointment if it considers that there are insufficient reasons for taking control of the company's affairs away from the directors before making the winding up order.
Maybe better to talk to insolvency practitioner before application to explain Creditors/applicant's position.
- costs:
- need to consider whether there are sufficient assets to recover, after costs of provisional liquidation.
[If OR appointed, applicant/creditor has to deposit with OR, or otherwise secure to his satisfaction, such sum as the court may direct to cover his remuneration and expenses (before an order appointing OR as provisional liquidator is made)]
[If the sum is insufficient the OR may apply to the court for an order requiring an additional sum to be deposited or secured ((R4.27(2))[
[The order appointing the insolvency practitioner as provisional liquidator may be discharged if the additional sum is not deposited or secured within 2 days (R4.27(2)]
The deposit is payable as an expense of the liquidation if a winding up order is made (R4.27(3))
May not get money back there may be a quicker way to settle the dispute. Provisional liquidation may cause business to close

QUESTION 2

(a)

(i) State the problems that are caused by the backlog of insolvency cases, using the above scenarios as mere general examples. In relation to delegation and control of cases handled by the insolvency practitioner firm, state the main points that are recommended to be addressed in the published guidance. (6 marks)

Guidance on procedures for delegation and control of cases may be found in the Insolvency Guidance Paper – Control of Cases

Delegation

Note this is a small firm and the requirements to delegate work needs to be considered accordingly.
Delegation can take on a number of forms, including:
delegation of work to staff in the practitioner's own office, or to subcontractors;
delegation of work to staff within a firm but in another location;
taking a reduced role on an appointment taken jointly with an Insolvency Practitioner in the practitioner's office;
taking a reduced role on an appointment taken jointly with an Insolvency Practitioner within the same firm but in another location;
allowing a specialist Insolvency Practitioner within a firm to take responsibility for all work of a specific type;
allowing a specialist within a firm to handle work of a specific type (e.g. tax);
sharing work on an agreed basis on an appointment taken jointly with a practitioner from another firm;
employing another firm to give specialist advice (e.g. tax), or to undertake specific work (e.g. an investigation); and
allowing a practitioner in a former firm (following either the practitioner's move to another firm or retirement) to take responsibility for appointments for a short time pending the transfer of cases.
For each of the above examples (and in other circumstances where delegation takes place), the practitioner must be satisfied at all times
that work is being carried out in a proper and efficient manner, appropriate to the case.

Control

In determining the procedures to be put in place to ensure that an appropriate level of control can be established in relation to delegated work,
it is recommended that a practitioner have regard to the following matters:
the structure within a firm, and the qualifications and experience of staff;
the need for the practitioner to be involved in setting case strategy at the outset, depending on the nature, size and complexity of the case;
the procedures within a firm to ensure consultation by joint appointees, other practitioners, and staff;
the extent to which levels of responsibility are defined, and the circumstances in which a reference to, or approval by, the practitioner is required;
whether there are clear guidelines within a firm to deal with the administration of cases at locations remote from the practitioner;
the ways in which compliance and case progress are monitored, and then reported to the practitioner;
the frequency of case reviews, and who carries them out;
the systems for dealing with correspondence received and, in particular, complaints;
the process by which work is allocated on a joint appointment with a practitioner from another firm, the rationale for that split, and the controls to be put in place, subject always to statutory requirements; and
the way in which specialist advisers (including agents and solicitors) and sub-contractors are chosen and engaged, and how their work is monitored.
Insolvency Practitioners are aware that they may be required to justify their decisions and demonstrate that appropriate levels of control
have been established. It is recommended that for firm wide procedures, guidance is set out in writing, and that on a case by case basis,
contemporaneous working papers or file notes are prepared.
Illustrate/discuss answer by referring to scenarios in the question – including:

- Was Joe sufficiently briefed?
- There is no evidence of case strategy and of how staff were briefed when taking over the files (especially as there seems to be a high staff turnover)
- How experienced were the staff?
- Were there enough staff?
- Should the joint appointee have had more involvement in the case with the lead partner?

Problems caused by the backlog, such as assets reducing in value, creditors/debtors hard to trace, costs increasing, complaints being made.

(ii) Set out the practical, legal and regulatory steps that need to be taken to close Platus Ltd. (11 marks)

Needs to **declare and pay dividend**.
The liquidator has a duty to declare and distribute dividends when sufficient funds are available, subject to the retention of such sums as are necessary for the expense of the winding up. R4.180
Prepare a projection account showing how it is proposed to distribute the available funds, making such reserves as are appropriate and necessary.
Ensure that full provision is made for the expenses of the winding up (paying final costs - tax, VAT, agent's fees, etc) R4.218.
Before paying a dividend to creditors of any class, ensure that all creditors of prior classes have been paid or provided for in full.
Before paying any dividend, the liquidator must provide for:-

- Any debts due to persons who might not have had sufficient time to tender and establish their proofs.
- Any debts, which are the subject to, claims which have not yet been determined.
- Any disputed proofs and claims.

Where any assets remain unrealised at the time of a dividend payment, ensure that the above calculations take into account future potential costs that might arise in making the further realisations.
If not already done, advertise for claims before any distribution being made. R11.2(1A)
Always record circulars by way of certificate of postage, showing whom the circular was sent to. R12.4
If, within the 4 month period from the last date of proving, the Liquidator has had no cause to postpone or cancel the dividend, proceed to declare it. R11.5
R11.2
Before declaring a dividend give notice of intention to do so to all creditors who have not proved their debts and to any EC liquidator who has been appointed in relation to the company. It may be appropriate to send such notices by recorded delivery.
The notice shall give a date up to which proofs may be lodged and this shall not be less than 21 days from the date of the notice. R 11.2(1), R11.2(2)
Give notice of dividend to all creditors who have proved their debts and to any EC liquidator who has been appointed in relation to the company. R11.6
Where a creditor assigns his debt, he must first give notice of this assignment to the liquidator, who must then pay the dividend to the assignee. R11.11
Where a proof is altered after the payment of a dividend apply R11.8. The creditor is not allowed to disturb the distribution but is entitled to be paid, out of any money for the time being available for the payment of any further dividend, any dividend(s) which he has failed to receive.
Where a proof has been received from secured or partly secured creditor, seek confirmation before any distribution is made whether or not the creditor wishes to revalue that security. R11.9
Post liquidation interest creditors cannot receive anything until all pre-liquidation debts have been paid in full. Bower v Morris (1841) Cr & Ph 351

Payment of dividend

Need to agree claims - question states already agreed
If funds are in IP Banking, apply in writing to the Secretary of State who may either authorise payment to the liquidator of the sum required by him, or may direct cheques to be issued to the liquidator for delivery by him to the persons to whom the payments are to be made. Ins Regs 1994, Reg 8(3)
Distribute dividend payable orders (DPO) when received.
The dividend may be distributed simultaneously with the notice of declaring it.
A declared dividend may be postponed with the Court's permission where a rejection of a proof is being challenged. R11.4

- two employees cheques not cleared. If not cleared within 6 months, the Liquidator may take some steps to ascertain their whereabouts. One course of action is to use the Department of Work and Pensions forwarding service – as long as you know the employees' NI numbers.
- funds would have to be paid into the ISA as unclaimed dividends

Closing

Take steps to deal with the remaining funds and ensure all bank accounts are closed (also need to reconciling bank account).
Obtain confirmation from agents and advisors that there are no outstanding matters. Also, need VAT/tax clearance, final tax returns, bordereau, confirming insurance cancelled, etc

If appropriate, call a final meeting of the liquidation committee
Once the company's affairs have been fully wound up the liquidator must call general meeting of company and meeting of creditors and lay a final account before them, 28 days' notice is required. (s106, R4l126)
Advertise meetings in the London Gazette at least one month before. IA 106(2)
The report shall contain a statement as to the amount paid to unsecured creditors by virtue of application of s176A (prescribed part) R4.126(4)
Note quora need not be present, unless resolutions are to be passed. S106(5)
Prepare final report. This should include a summary R & P, narrative description regarding asset realisations and costs, appropriate SIP 9 disclosure. S106(1)
Send final report, final meeting notices, proxy forms, receipts and payments account and authority forms, together with any Notice of Dividend, to creditors and members.
Send copies of final report, final receipts and payments account etc to directors, liquidator's agents, solicitors, bankers and guarantors for information.
Obtain consent to chair meeting if necessary. IA 106, R 4.56
Take minutes of final creditors' meeting. IA 106
Ensure that Regulation 13 form is completed place a copy on file. IPR 2005, Reg 13
Within one week following the meeting, send to the Registrar of Companies:
A copy of the final report and a return of the holding of the final meetings or a statement that the meetings were duly summoned but at one or both of them no quorum was present. S106(3), 106(5), Form 4.72
The liquidator obtains his release when he vacates office by filing the returns of the final meeting with the Registrar (provided the creditors have not resolved against his release). S171(6)(b), S173(2)(e)
Withdraw name from any display at Jones & Smith registered office on dissolution (3 month after final meeting).
Make appropriate diary notes to destroy or otherwise dispose of the books, papers and other records of the company after one year from date of dissolution usually 15 months from date of final meeting. Ins Regs 1994 Reg 16(2)
File review, check no outstanding correspondence or check statement of affairs to be sure that assets realised
something needed to be done about the patent
all claims must be adjudicated within 7 days of deadline for proving

(b) Set out the issues Joe should consider on the basis of this information. (3 marks)

Possible asbestos claims
Rule 13.12 permits future tort claims to be admitted to proof in Liquidations (commencing on or after 1.6.06) The Rule extends the interpretation of 'debt' to include claims founded in tort where all of the elements required to bring an action against the company exist at the time the company goes into liquidation or enters administration, except for the fact that the claimant has not yet suffered any damage and does not therefore, at that time, have a cause of action against the company.
This gives the Liquidators practical problems – should, and how much, funds should be reserved to distribute for claimants who have not yet suffered any damage?
A possible course of action is to take expert advice on the likelihood of the factory's asbestos harming the former employees and making an assessment of the amount of damages that may arise.
The Liquidators could keep the case open and wait for claims or could set up a trust fund for future claimants?
The court has power to fix exclude creditors not proving in time – s153. Presumably the court will wish to be fair to all creditors.
Also Liquidator can seek court directions – s112.
See Turner & Newell case.
Inspect company's insurance policies.

QUESTION 3

For each of the following issues, (a) to (g), which have arisen after your appointment, state the legal and practical steps that you, as Liquidator, could take. If there is more than one possible course of action, explain the advantages and disadvantages of each option and state, with reasons, which option you prefer. (30 marks)

(a) Flexible package patent

Main issue is whether or not to disclaim the licence agreement or whether to spend more funds and sell the patent.

There may be a funding issue – consider disclaiming (little cost) compared to spending a possibly unknown amount and so retain the licence fees.

Is there a value in the patent? May need to seek advice from a patent agent.

Disclaim s178

The powers are not there to enable the trustee or liquidator to make a gratuitous profit and may not be used for that reason. Nor can they be operated so as to frustrate the right of a purchaser to specific performance of a contract to acquire assets from a bankrupt or company in liquidation. 199Freevale Ltd v. Metrostore (Holdings) Ltd [1983] Ch 495 quoting with approval a bankruptcy case Pearce v Bastable [1901] 2 Ch. 122Pearce v. Bastable [1901] 2 Ch 122.

A liquidator may, by giving the prescribed notice on Form 4.53, disclaim any onerous property and he may do so even if he has taken possession of it, endeavoured to sell it, or otherwise exercised rights of ownership in relation to it.

Onerous property is defined in s 178(3) as:

(a) any unprofitable contract; and

(b) any other property of the company which is unsaleable or not readily saleable or is such that it may give rise to a liability to pay money or perform any other onerous act.

Disclaimer operates so as to determine, as from the date of the disclaimer, the rights, interests and liabilities of the company in or in respect of the property disclaimed. The rights and liabilities of any other person arc not affected except so far as is necessary to release the company from any liability; though not the statutory liability under Insolvency Act s 178(6) of the Act to compensate any person who had sustained loss and damage in consequence of the disclaimer. Any person interested in the property can apply in writing to the liquidator requiring the liquidator to decide whether he will disclaim or not, and if 28 days have expired from such a notice, the liquidator cannot then disclaim if he has not already done so.

The party affected by the disclaimer can prove in the liquidation for the amount of loss suffered by him as a result of the disclaimer.

The party affected by the disclaimer can apply to the court for a vesting order on such terms as the court decides. One of the terms the court can impose is that the value of the asset vested should be taken into account in computing the claim admissible in liquidation.

Practical issues eg obtain and read contract

Set off

(b) Payments out of bank account

The commencement of the liquidation is the date of the petition.

IA 1986 s127 states that in a winding up by the court, any disposition of the company's property made after the commencement of the winding up is void unless the court orders otherwise.

To have validation there must be value given and received. (Re Grey's Inn Construction Co Ltd [1980] 1 WLR 711 – where the company is insolvent the main purpose of s127 is to ensure all creditors are paid pari passu),

A transaction is likely to be validated if the assets company have not been depleted by the transactions, for example if continued trading has resulted in no loss to the creditors,

A transaction is not likely to be validated if there has been some preference – eg if there was a guarantor.

A transaction which has depleted the assets will not be validated.

Re Grey's Inn Construction Co Ltd [1980] 1 WLR 711 – it made no difference whether the bank account was overdrawn or in credit for a disposition to have occurred. Although this has since been criticised for being too wide.

These funds cannot be recovered from the bank.

Bank of Ireland v Hollicourt (Contractors) Ltd [2001] 1 WLR 906 – The Court of Appeal held that payments made by cheque out of a company's bank account to a third party involve no disposition of the company's property to the bank – which just acts as the company's agent in making a disposition in favour of the third party – and that this is so whether the account is in credit or overdrawn.

If there has been a disposition, the liquidator needs to look to the suppliers.

(c) Employment of staff

Court winding up acts to automatically terminate employment (Re Reid v Explosives Co Ltd (1887) and re Measures Bros (1910))

But if the Liquidator wishes to continue the business of the company and employ certain employees for this purpose, the notice of dismissal constituted by the winding up order can be waived in which case the employee's employment continues under his existing contract (Re English Joint Stock Bank Ex p. Harding (1867) L.R. 3 Eq. 341)

If the Liquidator is not trading but wishes to retain some employees, their employment contracts will have been broken. McEwan v Upper Clyde Shipbuilders Ltd (1972) 7 I.T.R. 296; Day v Tait (1900) 8 S.I.T. 40; Golding and Howard v Fire Auto and Marine Insurance Co [1968] I.T.R. 372

Liquidator can pay employees and the Secretary of State normally treats the redundancy as occurring at the time of the eventual dismissal by the Liquidator

For the avoidance of doubt, if employment continued should be in name of company to ensure that there is no doubt that the subsequent redundancy costs are costs of the liquidation.

Liquidator should write to employees informing them that it is the company in Liquidation that is employing them.

TUPE Regs SI2006/246 - applies to Liquidator selling business and not to Liquidator (in any case continued employment is unlikely to be regarded as a transfer because a court winding up will be a relevant insolvency proceedings opened with a view to Liquidation of the assets).

Liquidator will need to pay the arrears of the staff he is keeping on (as an expense of the Liquidation), otherwise they probably won't agree to work for him).

Claims for unpaid stocks (iv, v, vi)

(d) Linear Ltd

Generally for ROT:

Need to ascertain if there is a valid retention of title clause and, if there is, do the circumstances of this claim comply with it.

Need to obtain a copy of the terms and conditions of trade, a copy of the Company's acceptance of those terms and details of the balance due.

If the Company has accepted the terms, the Liquidator needs to ascertain the precise nature of the conditions. The clause may be

"simple" – reserving the supplier's title to particular goods until they are paid for or

"extended to secure the price of all goods supplied, or all monies due, or it may expressly claim the proceeds of sale or manufacture of the goods supplied or

It may do both.

- any dispute will turn on the precise conditions agreed. Welsh Development Agency v Export Finance Co [1992] BCLB 148 – the court held that it had to examine the agreement as a whole to determine if it was a sale of goods, charge or mortgage.

Generally, claims to recover the goods supplied will often succeed, but claims to proceeds or products can usually be resisted.

The Liquidator should beware that he may face claims that he is personally liable if he resists the suppliers' valid claims (*also the liquidator may be liable for conversion)*

The supplier must establish that the retention clause is part of his contract with the Company.

- the clause may be resisted if it has not been agreed by both sides
- the timing of the clause is also important – if the invoices are endorsed with the clause, this will be ineffective in relation to contracts already raised but may be effective for subsequent invoices.

The status of an extended retention of title clause securing payment for all goods supplied or of all moneys owing is not settled.

The Sale of Goods Act does not restrict ROT conditions but it also does "not apply to a transaction in the form of a contract of sale which is intended to operate by way of mortgage, pledge, transaction in the form of a contract of sale which is intended to operate by way of mortgage, pledge, charge or other security."

- the clause must retain the full legal title to the supplier (Re Bond Worth [1980] Ch 228).
- retention clauses on stock confer authority on the buyer to resell the goods in the ordinary course of business, expressly or by implication.

The onus will be on the supplier to establish the amount of the buyer's debt, in the case of an "all goods" or "all monies due" clause this will be similar to the amount of the buyer's debt. A simple retention clause may be more difficult and, unless there is a running account (when the rule in Clayton's Case may be used) it will be necessary to establish the extent to which the supplier accepted particular payments as discharging particular debts.

- it may not be commercially expedient to pursue the case, so need to look at the amount of what is disputed compared to the costs.
An effective "all monies clause" can be created – Armour v Thyssen Edelstahlwerke AG [1990] All ER 481)
If there is a valid ROT clause:
Can outstanding amounts be traced to invoices? (may need to carry out Clayton's Case type exercise. It may also depend upon how good the Company's accounting records are.
Can invoices be traced to the specific goods. This may depend upon how the goods are identified – eg are batches of chemicals identified by serial numbers and are these numbers on the invoices?
Practical issues – eg stock count, segregate stock
In this case, did account clear? ie was it possible to have an ROT claim at all?

(e) Wavier Ltd
- **Mixed goods -** if the goods supplied have been mixed with goods from other sources (as in this case), it may be that the Company has "disposed" of his own stock first.
- generally, where the purchaser mixes the supplier's goods with others to form a composite amalgam in which the supplier's goods lose their distinct identity, and can no longer be returned in an "as received" state, title otherwise retained by a supplier will be lost. Borden (UK) Ltd v Scottish Timber Products Ltd [1979] 3 WLR 672 chemicals were mixed to form new chemical compounds. The Court of Appeal held that the supplier had no proprietary claim against the insolvent purchaser's manufactured products, and that any interest retained or acquired by the seller in those products would have amounted to a registrable charge.
In the absence of an express contractual provision, it can be argued that either
- title to manufactured products will vest in the purchaser, regardless of whether any of the materials were supplied by him,
- or the supplier and purchaser become co-owners of the mixed product
(discussion required)
Clough Mill v Martin [1985] 1 WLR 111 – buyer and seller can agree as a matter of contract where title to contract vests. The contract may provide that seller and buyer be tenants in common of the co-mingled goods to the extent of their respective interests. But a term to the effect that product would remain the seller's property until raw materials were paid for was struck down in Clough Mill as a registrable charge.
The relevant term provided that:
"If any of the material is incorporated in or used as material for other goods before [payment in full] the property in the whole of such goods shall be and remain with the Seller until such payment has been made, or the other goods have been sold … and all the Seller's rights … in the material shall extend to those other goods."
The Court of Appeal held that this clause created a charge over the products, which was void for non-registration.
The courts are generally reluctant to apportion ownership of product between supplier and manufacturer eg Modelboard Ltd v Outer Box Ltd [1992] BCC 945.
[Re London Wine Co (Shippers) [1986] PCC 121 – the court held that each category of wine held for customers remained the property of the Company. The contention that the Company held the bulk wine as a whole on trust for each customer failed as to create such a trust it must be possible to ascertain with certainty not only what interest of the beneficiary was but also the property attached to it.]
See also, he Sale of Goods Act 1979 which provides:

- if there is a contract for a sale of a specified quantity of unascertained goods in a deliverable state forming part of a bulk which is identified by the parties, and the bulk is reduced to (or less than) that quantity, and there is only one buyer to whom goods out of that bulk are due, the goods are appropriated to the contract at the time the bulk is so reduced and property than passes to the buyer.
- A buyer of goods forming part of a bulk which is identified by the parties, who has paid some or all of the purchase price in advance, is to be an owner in common of the bulk, and that property in an undivided share of the bulk is transferred to the buyer.
- A person who has become an owner in common is deemed to consent to dealings with the property by other owners in common.

In this case the chemical composition was changed (and therefore the nature of the product) and o the claim would fail.

(f) Parallelogram Ltd

Parallelogram's claim will depend upon the nature of the contract with the Company.
E Pfeffer Weinkellerei-Wieneinkauf GmbH & Co v Arbuthnot Factors Ltd [1987] BCLC 522: the buyer assigned to the seller future book debts payable upon resale of wine but then re-assigned those debts to secure finance from a factoring company. The seller's claim to book debt proceeds were bound to fail since the factoring company had given first notice of its rights to sub-purchasers. The judge also had regard to the fact that the seller's claims against book debts were expressed to be defeasible upon settlement of the buyer's debts. The terms relied upon were therefore indicative of a registrable charge.
nb Detailed knowledge of this case is not required, rather a reasoned argument on what happens once funds received from factoring company and possibility of the clause being a registrable charge.

(g) Petitioning creditor's costs

R4.218(h) – petitioning creditor's costs must be paid in the priority indicated in R4.218(h)
The costs should relate to the preparation of the petition and court fees.
The Liquidator should ask for an analysis of the costs to ensure that they are in respect of the preparation of the petition and the court fees.
If the Liquidator believes that the costs are too high, for example, the solicitors' hourly rates, he could ask (as a matter of negotiation) the petitioning creditor to submit a more reasonable fee.
If the petitioning creditor and the Liquidator do not agree on the quantum, the Liquidator may ask for the costs to be assessed by the court which made the winding up order through a costs judge or an assessment officer – see R7.34 (1)
The creditors or the committee can require the Liquidator to have the costs taxed/*assessed* (R7.34(2)).
It may be possible to negotiate with solicitors

QUESTION 4

(a) State the main purposes of a Creditors' Voluntary Liquidation. Set out what factors should be considered when deciding whether to commence an investigation into the affairs of a company in Creditors' Voluntary Liquidation. (5 marks)

A procedure for winding up or bringing the affairs of a company to an end in circumstances where the company is insolvent (unable to pay its debts within the meaning of s123).
See s107
- to realise the company's assets and
- after the payment of costs, to distribute the proceeds among the creditors (and shareholders) according to their respective rights and interests (pari passu)

Following from this:
- duty to identify and recover the assets
- to determine the property (as defined in section 436 of the Insolvency Act 1986) and liabilities of the company and to identify any actions which could lead to the recovery of funds.
- to identify and agree creditors' claims

There is a secondary purpose, imposed by the Company Directors' Disqualification Act, to report on the conduct of directors (but not to investigate that conduct).
Any practical factors mentioned

(b) Taking into account the circumstances of the Parent's Liquidation and the information that has come to light since your appointment, set out the practical and legal steps that you, as Liquidator, may take to investigate the Parent in order to achieve the main purpose of the Creditors' Voluntary Liquidation. (15 marks)

Practical steps (before using any legal measures) include:
- request statement of affairs/if not forthcoming prepare estimated statement of affairs
- compare statement of affairs/estimated statement of affairs with last audited accounts and last management accounts
- prepare deficiency account
- search Companies House register
- search Isle of Man Companies Register
- Write to Heureux Ltd requesting details of how the debt arose.

- Review company records for availability of cars in the period when it was claimed no cars were available.
- send questionnaire requesting details of Company's dealings to directors and key staff.
- seek to interview directors and staff
- seek to interview Company's professional advisors, including auditors
- analyse Company's bank accounts for unusual transactions.
- talk to subsidiary's liquidator to ascertain if there were any unusual transactions with the Company, ascertain the inter-company balance and the reasons for it.
- ask creditors for information (should have done so at s98 meeting) and write to creditors, usually in first letter to creditors, requesting information.
- read Company's minutes/minutes of management meetings
- SIP 2 – need to consider which directors and company staff need to interview
- review books and records for any recent connected party transactions

Legal steps

Rights of action include (see SIP 2):

Insolvency Act 1986

Section 76 Redemption or purchase of own shares
Section 127 Avoidance of property dispositions etc.
Section 128 Avoidance of attachments etc.
Sections 150 and 165 Uncalled capital
Section 212 Misfeasance and misapplication etc. of property
Sections 213 and 215 Fraudulent trading
Sections 214 and 215 Wrongful trading
Section 238 Transactions at an undervalue
Section 239 Preferences
Section 244 Extortionate credit transactions
Section 245 Avoidance of floating charges
Section 423 Transactions defrauding creditors

Companies Act 1985

Sections 135 to 141 Unauthorised reduction of capital
Sections 151 to 181 Unlawful assistance/redemption in the purchase of own shares
Section 277 Unlawful distributions to members
Sections 320 - 322B Unlawful property transactions
Sections 330 - 341 Unlawful loans

S234 – getting in company's property (any person has in his possession or control any property, books, papers or records to which the company appears to be entitled) – in CVL, liquidator has to apply to the court to require person to deliver, convey, surrender or transfer the relevant property (compared to a compulsory winding up, liquidator can exercise this power – R4.185). The liquidator should probably write to the person first: requesting the property and also stating that he can ask the court to order the person to deliver up the property.

S235 – duty to cooperate with office holder, includes:

S235(2) – duty to give information about the company and its promotion, dealings and affairs or property as liquidator may at any time reasonably require and duty to attend on liquidator as he may reasonably require

S235(5) penalty for non-compliance – can be fine, or daily default fine for continued non-compliance

S235(3) – those who must co-operate include: officers of company; employees, former employees (up to one year); directors/officers/employees of another company (within one year) which is an officer of that company. No court order is necessary.

S236 – court, on application of liquidator, can summon to appear before it:

- any officer
- any person known or suspected to have in his possession any property of the company or supposed to be indebted to the company or
- any person who the court thinks capable of giving information concerning the promotion, formation, business, dealings, affairs or property of the company (s236(2)0

s236(3) – the court can require the person to submit an affidavit containing an account of his dealings with the company or to produce any books, papers or other records in his possession or under his control relating to the company

This is a private examination (compared to a public examination under s133 which is not available to a liquidator in a CVL).

Note R9.6(1) – the court may order the costs of proceedings, under s235, 236, be paid by the respondent, if the court considers that the examination was made necessary because information had been unjustifiably refused by the respondent.
R9.6(2) – where court makes an order under 237(1) (to deliver up property in his possession which belongs to the insolvent) or s237(2) (to pay any amount in discharge of a debt due to the insolvent) – the costs of the application for the order may be ordered by the court to be paid by the respondent.
Otherwise, costs shall be paid out of company in liquidation (R9.6(3).
Note main purpose of investigation is to recover assets and so consider costs and benefits before entering into any investigation, especially if there are court appearances which may be costly.
Generally when trying to obtain information from the directors
- should ask them first and so write with either specific questions and/or, through the use of a questionnaire
If fail to submit statement of affairs – note powers of compulsion
S235 – duty to cooperate with office holder. Have an meeting with individual directors, if possible have in attendance shorthand writer to take notes of meetings
If all informal means have failed – the liquidator can apply for the court to examine the directors. This is more likely to be necessary when requesting information from the Parent's auditors, the liquidator of the Subsidiary, the former wife of D and her business associate.
Note also, if suspect any criminal wrongdoing – duty to report to Secretary of State (IA 1986 s218)
Also, duty to report offences to NCIS under Money Laundering Regulations.
Also, offences of fraud, deception – s206 - 211

Transaction with IOM company

- use s235 to question Dick and, if necessary, other directors
- use s236 to question Freda and Graham

May have difficulties of examining Isle of Man residents under s236 – Re Seagull Manufacturing Co Ltd – an application under s236 is territorially limited to persons within the jurisdiction of the English court. Otherwise the liquidator may need to seek the co-operation of the Isle of Man Court under s436.

Amount due from Subsidiary

As this is now in liquidation, the Liquidator needs to consider whether he can trace the funds going out of the Subsidiary, ie was it used as a means of transferring the funds elsewhere.
Will need the assistance of the Subsidiary's Liquidator and/or the Official Receiver (who has power to investigate the affairs of the Subsidiary).
Should write to subsidiary and its Liquidator and request information.
May use s236 to question the auditors and s235 to question directors and former employees.
Note – SIP2 – liquidator needs to satisfy himself as to the validity of transactions with connected companies/associated persons.

Heureux Ltd

- there may be wrongdoing/criminality and so it may be necessary to inform Secretary of State/NCIS.

(c) State the matters that the Liquidator is required to report about the directors, apart from the matters listed in Schedule 1 of the Company Directors' Disqualification Act 1986. Explain the issues that may hinder any reporting. (10 marks)

Main issues to be reported

These are in addition to the matters contained in CDDA 1986, Sch 1 – Matters determining unfitness – which are explicitly not required here.
- SIP 4 – the Liquidator should include other matters which he believes to be relevant.
The Disqualification Unit attaches particular importance to the following:
attempted concealment of assets or cases where assets have disappeared or a deficiency is unexplained
appropriation of assets to other companies for no consideration, an undervalue, or on the basis of unreasonable charges for services;
preferences;
personal benefits obtained by directors;
overvaluing assets in accounts for the purpose of obtaining loans, or other financial accommodation, or to mislead creditors;
loans to directors in making share purchases;
dishonoured cheques;
use of delaying tactics;
non payment of Crown debts to finance trading;
phoenix operations;

misconduct in relation to operation of a factoring account;
taking of deposits for goods or services ultimately not supplied; and
cases where criminal convictions have resulted.
Practitioners should not take a pedantic view of isolated minor compliance failures, but should form an overall view of a director's conduct when deciding whether report is appropriate.
Details of the conduct giving rise to the decision to submit a report should be included, and specific examples of alleged findings should be given wherever possible. It is recognised that in some cases substantive information not be available, but the report, in the light of other information already held by the Disqualification Unit in deciding whether to recommend to the Secretary of State that it is in the public interest for an action to be brought in the event of the director being involved in other insolvencies.
The following matters should be dealt with within the body of the report:

- the position on any civil recovery actions;
- the adequacy of the accounting records;
- evidence available in support of insolvent trading;
- professional advice taken by the directors, and specific correspondence which sheds lights on directors' conduct, for example with banks, solicitors, accountants or creditors.

Where the practitioner has been unable to quantify, or otherwise comment on the amounts involved in the alleged conduct due to cost or other considerations then an explanation to that effect should be included in the
Matters hindering reporting
Any concealment/misconduct is just speculation at this stage but must report (or submit interim report) within 6 months (Disqualification Unit must bring proceedings within 2 years of date of liquidation and so there is a need to report speedily).
He is probably better to submit an interim report at this stage
- Liquidator needs to ensure that there are no defamatory statements in the report, especially when reporting suspicions. He needs to be aware that the report may be discoverable in any proceedings

PERSONAL INSOLVENCY DECEMBER 2007

EXAMINERS REPORT

As in past years this paper sought to test candidates' knowledge using typical examples met in practice. Often candidates failed to tailor their answer to the question preferring answers instead which appeared to have been learnt by rote. Similarly as in past years, candidates frequently wasted time by repeating the content of a question. Neither of these flaws is new and ought to be tackled.

QUESTION 1

This question was generally poorly answered. While most candidates knew of the *Administration of Insolvent Estates of Deceased Persons Order 1986*, many did not know that death brings an IVA to an end or that an IVA ceases when it passes the duration set out in the proposal unless there has been a variation approved by the creditors. Candidates also did not appear to know that the effects of severing a joint tenancy on death can be challenged by a trustee in bankruptcy (s421A IA 86).

The financial comparison of the outcomes was better dealt with.

QUESTION 2

This question was about a failing IVA and was typical of a real life example. The most common deficiencies were:

- Very few candidates recognised that supervisor's fees had been drawn in contravention of the terms of the IVA. Given the quite proper emphasis on SIP 9 this failure was somewhat concerning.
- A substantial number of candidates thought that the debtor was in default.
- Many candidates did not seem to know that R3 standard terms and conditions provide a mechanism for varying an IVA
- Very few candidates seemed to know that the supervisor has a statutory charge for his fees in the event of bankruptcy
- Some candidates thought that the uncle's debt should be deferred
- A number of candidates failed to provide a report thereby losing marks

QUESTION 3

(a) This question was generally well answered although many candidates wasted time in recording irrelevant obligations of the Bankrupt and powers of the Trustee.

(b) While there were some good answers to this part of the question there were a number of repeated deficiencies

- Virtually no-one recognised that there may have been a voidable disposition
- Many candidates did not recognise the patent as an asset
- Funding action was often overlooked

QUESTION 4

(a) This question was answered well by some candidates and answers were presented in a methodical way. There were two repeated misconceptions

- Some candidates thought that the long lease should be disclaimed
- Some candidates thought that the rental income could only be claimed under an income payments order

(b) The estimated outcome statement was reasonably well presented. A small proportion remembered Capital Gains Tax and some remembered to put it in the body of the estimated outcome statement. Similarly a few candidates understood that VAT on fees was irrecoverable. It may be appropriate to remind candidates that it is necessary to have an appreciation of tax issues.

PERSONAL INSOLVENCY DECEMBER 2007

EXAM MARKING PLAN

The marking plan set out below was that used to mark this question. Markers were encouraged to use discretion and to award partial marks where a point was either not explained fully or made by implication. More marks were available than could be awarded for each requirement. This allowed credit to be given for a variety of valid points which were made by candidates.

QUESTION 1

Prepare a memorandum for your own use setting out the issues that might arise at this meeting, how you would deal with them and what solutions you might propose. (20 marks)

Clarity, style and presentation of memorandum
Death brings an IVA to an end
- *Administration of Insolvent Estates Order 1986 schedule 1, part 3 para.4*
But could the terms of the IVA take precedence over the Order?
Does not matter - since the IVA was not varied it ended on 16 March 2005
Strongmaster Ltd v Kaye 2002 BPIR 1259
Supervisor should notify court of debtor's death
Supervisor may have been negligent
- Mrs Peacock should have been advised to take independent legal advice
- Mrs Peacock did not know about the terms of the IVA
- he did not pursue the realisation of the equity in Nettlebed Cottage
- he did not extend the terms of the IVA

The trust survives in respect of the £12,000 collected
-together with any interest earned
- will cover Supervisor's outstanding fees
Supervisor should have petitioned for Mr Peacock's bankruptcy *(s.276 !A86)*
- failure to realise equity in Nettlebed cottage
- culpability of debtor does not matter - *re Keenan 1998 BPIR 205*
- omission of shares in Swallowtail PLC may constitute a material misstatement

Could make an Insolvency Administration Order under
- *Administration of Insolvent Estates of Deceased Persons Order 1986*
- Supervisor may petition

On Mr Peacock 's death Mrs Peacock becomes the sole owner of Nettlebed Cottage as the surviving joint tenant
- this asset used to be lost to the estate but following Insolvency Act 2000 application can be made by trustee appointed pursuant to an Insolvency Administration Order "requiring the survivor to pay to the trustee an amount not exceeding the value lost to the estate" s421A IA 86
- petition for the administration order must be presented within 5 years of death
- and immediately before death he was beneficially entitled to an interest in the property as joint tenant

The assets available to Mr Peacock's creditors are as follows

	£	£
Shares		18,000
IVA funds	12,000	
less Supervisor's fees	-5,000	
		7,000
		25,000
Funeral fees		-2,000
		23,000
Creditors		68,000
Shortfall		-45,000

The pension fund proceeds are not available
This takes no account of the Executor's solicitor's costs
The estate is insolvent
Could seek an Administration Order under *Administration of Insolvent Estates Order 1986*

- then make application under *s.421A IA86*
- but may be sledgehammer to crack a nut – a formal administration would be costly with regard to both trustee's fees and ad valorem

Formal Administration Order

	£	£
Funds needed		
Creditors		68,000
Less paid by Supervisor		-7,000
Interest - say one year at 8%		5,440
		66,440
Trustee's fees and costs - say		5,000
		71,440
Gross up for ad valorem charge		14,223
		85,663
Funds from estate	23,000	
Les paid to IVA creditors	-7,000	
		16,000
Additional Funds needed		69,663

- Mrs Peacock to be asked to raise sufficient funds to discharge creditors in full possibly plus interest as this will be cheaper
- Pension fund proceeds and enhanced equity in property arising from life policy should suffice
- Either solicitors or you could act in informal administration which is permitted by *Administration of Insolvent Estates Order 1986.para.4*

QUESTION 2

Draft a report to your Principal setting out how he might proceed, illustrating the options with financial estimates. (20 marks)

Clarity, style and presentation of report

Current state of IVA

Contribution of 30 November not paid but not yet in default

£4000 needs to be spent

Will have to petition for bankruptcy if not resolved by variation

Supervisor's fees have been paid in contravention of IVA. Needs immediate action to pay back

Bankruptcy option

Funds from IVA will be used up in Trustee's fees leaving Trustee being owed £750

- dividend will be negligible
- supervisor will have statutory charge for his costs
- uncertainty about actual sale proceeds

Assume that business will be closed and contents sold.

Petitioning costs	1,500
OR's fee	1,715
OR's costs	300
Supervisor's fees and costs	3,800
Trustee's fees	3,000
Trustee's costs	500
	14,025
Available for creditors	975
Creditors	
HM R&C	45,000
VAT	12,000
Sundry creditors	5,000
former Trustee in Bankruptcy	750
Uncle and Aunt	28,000
	90,750
Dividend	£0.011

There could also be post-IVA creditors

IVA Variation Option 1

Seek a contribution holiday and extend the duration of the IVA by six months.

- Dividend will be unchanged
- creditors likely to understand the unforeseen nature of the problem and may therefore be sympathetic
- uncertainty of actual sale proceeds eliminated

	£
Contributions	45,000
Expenses	
Trustee in Bankruptcy fees	4,500
Supervisor's fees and costs to completion	7,500
	12,000
Available for creditors	33,000
Creditors	
HM R&C	57,000
Sundry creditors	5,000
	62,000
Dividend	£0.532

IVA Variation Option 2

Sell business as a going concern.

- Dividend will be paid sooner
- Costs will be less
- May overcome the possibility that the Camberwells cannot afford to spend £4000

	£
Contributions	3,750
Sale of business	35,000
	38,750
Expenses	
Trustee in Bankruptcy fees	4,500
Supervisor's fees and costs to completion	6,000
	10,500
Available for creditors	28,250
Creditors	
HM R&C	57,000
Sundry creditors	5,000
	62,000
Dividend	£0.456

Seek third party contributions within IVA

QUESTION 3

In a memorandum to your Senior Manager

(a) set out the obligations of the Bankrupt and the powers of the Trustee in Bankruptcy which might be relevant in this case. (8 marks)

Debtor has obligation to co-operate - s*333 IA86*
Seek a postal redirection order - *s371 IA86*
Re Foxley
Obligation of the bankrupt, banker or agent of the bankrupt to deliver up property to the trustee - *s312 IA86*
Seizure of bankrupt's property or books papers or records in the possession of the bankrupt or a third party on the application of the Trustee to court - s*365 IA86*
Appearance before the court (could be by affidavit) of bankrupt and those who appear able to give information about the bankrupt's affairs - *s366 IA 86*
Public examination of the bankrupt - *s290 IA86*
Power of arrest to enforce - *s364 IA86*
Order for the production of documents by the Inland Revenue –*s.369 IA 86*
Trustee can apply to suspend discharge - *s279 (3) IA86*

(b) identify and evaluate the possible realisations in this case and detail the initial steps to be taken to achieve those realisations. (22 marks)

Form style and clarity of memorandum

Trustee could also
- Inspect court file in relation to the petition
- Do a search for directorships at Companies House
- Employ a reputable enquiry agent
- Internet search
- Correspond with debtor's accountant

Payments to Zbank Mortgages Limited
Payments of £1600 per month suggest that there may be a substantial loan from mortgage company, probably for a property.
May be disposition of assets after issue of petition – *s.284 IA86* or may be concealing assets – s353 IA86
Action
- Write to mortgage company seeking information about loan
  - purpose
  - details of property involved
  - sum advanced and sum outstanding
  - name and address of any lawyers involved
  - Do Land Registry search

13 Vetch Way
May be a transfer at an undervalue – *s339 IA86*
- within relevant time of 5 years
- value is "significantly less " than value of consideration – *s339 3 c IA86*
- insolvent or made insolvent by the transaction
  - except requirements are presumed to be satisfied where transfer to an Associate – defined by *s435 IA 86*
  - estranged wife is an Associate

Possible problems arising from such a claim

- Divorce may have involved a financial settlement. This could still be attacked as a TUV but consideration may have been given
- Valuer may be wrong – internal inspection may result in change of opinion
- Mr Yellow and the former Mrs Yellow may be able to defend the claim that he was insolvent or became insolvent
- Funding an action – funds are limited – could consider one of the legal action funding companies
- Ex Mrs Yellow may have mortgaged the property so that there is no equity and she has no other assets

Action

- Do Land Registry search
- write to ex Mrs Yellow seeking:
- details of divorce settlement
- details of solicitors involved
- appointment for surveyor to make internal inspection
- write to Mr Yellow seeking
- details of divorce settlement
- details of solicitors involved

V&C Cars Limited

The sums involved and the creditor's evidence suggest that there might be a hidden asset in the form of classic or vintage car(s)

Action

- Write to V&C Cars Ltd seeking
- details of purchases
- copies of invoices and other supporting documentation
- current whereabouts of assets
- Do a company search on V&C Cars Ltd to ensure that it is an unconnected third party
- Do a search at the DVLA

Mrs Yellow's House and Car

Given the nature of Mrs Yellow's employment, her ownership of a £350,000 house and a Porsche car is a least worthy of investigation

Action

- Write to Mrs Yellow seeking
- details of when the house and car were purchased
- evidence to explain the source of the funds
- Do Land Registry search on property
- Do DVLA search on car

Patent for a Lightweight Battery

This intellectual property may prove to have some value

Action

- Write to Mr Skipper seeking
- details of the patent registered
  number
  description
  whereabouts of certificate
- Write to Mr Yellow seeking the same information and details of any parties interested in the patent
- Also ask for details of know how, design rights and any trademarks

General discussion

QUESTION 4

(a) Set out in the form of a memorandum to your senior manager how you would like him to deal with each of the assets in this case. (16 marks)

Form of memorandum
Tenanted Factory Unit
Obtain - copy of the lease
- up to date valuation
- advice on rent review

Liaise with mortgage company confirming payment of mortgage
and extent of debt
- consider possible threat of mortgagee taking recovery proceedings given Mr Blue's bankruptcy

Check insurance and seek open cover if necessary
Collect the rent
Register Trustee's interest at the Land Registry
23 Chalkhill Road
Liaise with mortgage company confirming payment of mortgage
and extent of debt
- consider possible threat of mortgagee taking recovery proceedings given Mr Blue's bankruptcy

Issue notice to Mr and Mrs Blue "as soon as reasonably practicable" that property falls within s.283A IA86 – form 6.83
Consider transferring into own name
Write to Mrs Blue to see if she wishes to purchase equity
Check insurance and seek open cover if necessary
21 Thistle Avenue
Obtain matrimonial Order and other papers
Obtain market valuation
Liaise with mortgage company confirming payment of mortgage
and extent of debt
Issue notice to ex- Mrs Blue "as soon as reasonably practicable" that property falls within s.283A IA86 – form 6.83
Property may be low-value home – s313A IA 86
The Court in determining the value of the bankrupt's interest shall disregard the part of the value of the property in which the bankrupt's interest subsists which is equal to the value of
a) loans secured by mortgage…
b) any other third party interest
c) the reasonable costs of sale – Insolvency Proceedings Monetary Limits Order 1986 para 5
After costs of sale and mortgage could be £1000 or less
Offer ex-Mrs Blue equity – relatively modest
Hairstreak PLC
Obtain share certificates and sell
Notify registrar of interest
5 Nettlebank
Check valuation and if satisfactory seek to surrender, assign or disclaim as onerous property – *ss315 and* need to serve notice of disclaimer on sub tenant
Also consider whether sub-tenant's rent is up to date.
Rolex watch
Check that it is real!
Insure and store securely
Sell but remember requirement to
a) give notice in writing claiming property; and
b) replace with "reasonable replacement" -

(b) Prepare an estimated outcome statement including the relevant notes, on the assumption that no further assets are disclosed and making appropriate estimates where necessary. (14 marks)

Assets	Note	Estimated to Realise	
		£	£
Factory Unit	1	200,000	
less mortgage		-125,000	
			75,000
23 Chalkhill Road		350,000	
		-285,000	
			65,000
21 Thistle Avenue	2		0
Hairstreak PLC shares			14,000
5 Nettlebank			0
Rolex Watch			8,000
Rent			15,000
			177,000
Secretary of State fees	3		29,750
Official Receiver's fees	4		1,715
Official Receiver's costs	5		300
Trustee fees - realisations			13,850
Trustee fees - distributions	6		5,126
Mortgage payments			7,000
Costs of sale of property	7		9,625
Costs of replacement watch	8		500
Petitioning creditor	9		1,500
Irrecoverable VAT	10		5,058
Capital Gains Tax	11		3,789
			78,213
Available for creditors			98,787
Provable creditors comprise	12		
HM R&C		350,000	
Landlord	13	5,000	
Ex wife lump sum		30,000	
Ex wife costs		10,000	
			395,000
Dividend			£0.250

Notes to Estimated Outcome Statement

1. Factory unit shown at current valuation.
   Comment that this could be higher following rent review

2. £nil realisation assumes low value property. Could also be shown as a small realisation from ex-wife

3. SoS fee is calculated as (Value of realisations-£2000) x 17% - *Insolvency Proceedings Fees Order 2004*

4. Official receivers fee is flat rate - *Insolvency Proceedings Fees Order 2004*
5. Official Receiver's costs are estimated

6. Trustee's fees and costs are on scale rate – no resolution

Realisation Fee (*Schedule 6 IR 1986*)

On first	5000	20.00%	1000
On second	5000	15.00%	750
On	90,000	10.00%	9000
On balance	62000	5.00%	3100
	162000		13850

Distribution fee (*Schedule 6 IR 1986*)

On first	5000	10.00%	500
On second	5000	7.50%	375
On	85,027	5.00%	4251
	95027		5126

7. Costs of sale of property are estimated at 1.75%

8. Cost of replacement wristwatch under s308 IA 86 is estimated
   Cost of agents fees say 5%
9. Petitioning creditor's costs are estimated

10. Irrecoverable VAT is an expense of the estate – 17.5% of fees and costs

11. Capital Gains Tax is estimated as follows

	£	£
Factory Unit	200,000	
Cost	140,000	
		60,000
Costs of sale		3,500
Irrecoverable VAT		613
Gain		55,888
Business taper relief		41,916
Tapered gain		13,972
Shares	14,000	
	10,000	
	4,000	
Taper relief	0	
		4,000
Annual exemption		8,500
		9,472
Tax at 40%		3,789

There is no CGT on the sale of the home.

12. Lump sum and costs are provable, congestion fines and maintenance arrears are not - *r12.3 2(a) IR 86*

13. Landlord's claim