JOINT INSOLVENCY EXAMINATION BOARD

NOVEMBER 2008 EXAM (ENGLAND)

EXAMINERS' REPORT AND MARKING PLANS

ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS and RECEIVERSHIPS NOVEMBER 2008

EXAMINER'S REPORT

General

This year the paper contained a 20-mark question on Law of Property Act receivers, and a 20-mark question on Company Voluntary Arrangements. There was also a 30-mark question dealing with a trading Administration and a further 30-mark question dealing with a "pre-pack" sale out of Administration. There was a broad mixture of both theoretical and practical aspects of the syllabus and experienced and well-prepared candidates should have been able to accumulate marks relatively straightforwardly. However, many candidates failed to display the standard of knowledge expected of them at this level. Relatively few candidates demonstrated adequately relevant practical knowledge or training and experience in their answers to the requirements set.

Question 1

This question focused on the appointment of a receiver under the Law of Property Act 1925, and required candidates to identify matters for consideration prior to accepting the appointment, the receiver's statutory and additional contractual powers and his duty of care. It also required candidates to relate the facts given to the receiver's strategy for realising the charged property.

Overall the question was not well answered.

The requirements were

(a) List the matters that you would consider before accepting the appointment. (3 marks)

This part was generally inadequately answered.

The majority of candidates made mention of a previous professional relationship or dealings with the borrower during the preceding three years.

Few candidates commented about agreeing the terms of engagement and basis of remuneration in writing with the appointor.

Still fewer considered seeking an indemnity from the appointor.

(b) Set out a Receiver's statutory powers under the Law of Property Act 1925. List the principal additional powers that you would expect to be contained in the charge document under which it is proposed to appoint you. (5 marks)

This part was generally adequately answered.

Most candidates were able to refer to one or more of the three statutory powers.

Some candidates thought that the power of sale was a statutory power conferred on a receiver rather than having to be dealt with contractually under the charge document.

(c) Outline the extent of your duty of care should you accept the appointment. (4 marks)

This part was generally poorly answered.

Whilst a number of candidates pointed to the duty as one of exercising reasonable care and skill, of keeping within his powers and acting in good faith, few candidates adequately identified the parties to whom the receiver owed his duty of care and the consequence of breaching that duty.

Few candidates discussed the duty in relation to the price obtainable on sale.

(d) Comment on the effect of the information obtained from Eddie Diamond & Partners upon your strategy for dealing with the charged property. (8 marks)

This part was generally very poorly answered.

Good answers recognised the possibility of a cooperative sale with the Administrative Receiver of all three units, yet the need for independent advice on the allocation of the sale proceeds.

Many candidates overlooked the basic option of negotiating terms with both the mains-services suppliers and the painting contractors.

Many candidates missed the significance of distinguishing the extraction and filtration system as a fixture as opposed to a chattel asset.

Question 2

This question concerned directors' proposals for a Company Voluntary Arrangement and covered the Nominee's letter of engagement, provisions in the proposal to deal with any breach of the arrangement and summoning the meetings to consider the proposal. It also required candidates to state how the Nominee should deal with certain types of claim for voting purposes.

Overall the question was adequately answered.

(a) List the main issues that you would cover in your letter of engagement to the directors dealing with your respective duties and obligations. (5 marks)

This part was generally poorly answered.

Many candidates focused on the role of the Nominee (and subsequently that of a Supervisor) and did not adequately cover the duties/obligations of the directors to whom the letter would be addressed.

Most candidates mentioned the steps necessary to obtain approval for and implement a CVA or the contents of a fully compliant CVA proposal.

Few candidates mentioned practical matters such as the quantum and payment of the Nominee's fees, which staff would be working on the assignment and that the directors should sign and return a duplicate of the letter to signify acceptance of its terms. Good answers included a consideration of such practical points.

(b) Draft appropriate amendments to the Proposal for discussion with the directors dealing with any breach of the arrangement by the Company and the consequences of such breach. (5 marks)

This part was generally inadequately answered.

Candidates who scored highly showed awareness of what would constitute a breach and a practical understanding of the process that a supervisor would need to follow.

Many candidates discussed a variation to the proposal post breach, which was not specifically requested in the question.

Good answers commented that the Supervisor should retain sufficient funds to enable him to present a winding-up petition in the event of failure and showed an awareness of the 'Trust' that should be created – both are points that should have been learnt by all candidates.

(c) Assuming that your Nominee's report to court on the Proposal is favourable, list the steps for summoning the meetings to consider the Proposal. (5 marks)

This part was generally adequately answered.

Many candidates scored highly in this part of the question. It was possible to score full marks by reference to the relevant Rules and demonstrates the importance of being comfortable with the 'open book'.

(d) Briefly state how you would deal with each of the following claims for the purposes of voting on the Proposal. (5 marks)

This part was generally adequately answered.

Very few candidates noted that the employees would be classified as 'associates'. A large majority of answers stated that employees would be necessary for the ongoing trade of the business and that their wages (including arrears) would therefore continue to be paid – the question did not direct candidates to answer in this way.

No candidates detailed the correct treatment of the ROT creditor's claim.

Many candidates incorrectly concluded that the Bank was a secured creditor.

Many candidates provided only one-word answers in the form of "Accept" or "Reject" rather than a brief explanation of the reasons.

Question 3

This question raised a number of employee related matters following the appointment of an Administrator, including the Administrator's initial letter to employees, the consequences of a failure to consult about a business transfer and obligations in relation to a pension scheme. The question then went on to require candidates to quantify the amount of the net property and prescribed part for inclusion in the Administrator's proposals and to draft proposals dealing with the exit route from Administration and the Administrator's release from office.

Overall the question was generally inadequately answered.

(a) Set out the main points you would have included in your initial letter to all employees explaining the effect of your appointment on their employment. (5 marks)

This part was generally poorly answered.

Very few candidates covered off all of the areas that would be included in standard letters.

Several candidates were also confused about the 14 day rule and the requirement to pay employees for qualifying liabilities only - a number thought that employee contracts were adopted wholesale.

(b) Outline the potential consequences for the Company of a failure to consult adequately about a prospective business transfer. (3 marks)

This part was generally very poorly answered.

Many candidates misinterpreted the question as asking about the risks for the Administrator in selling the business without taking proper professional advice. Some others seemed to think that they were being asked about antecedent transactions entered into by directors that the Administrator would investigate.

Whilst many candidates mentioned a claim for compensation (a "protective award"), few appreciated this was a joint and several liability of both the transferor and transferee or how an Administrator would seek to obtain an indemnity in respect of the liability from the purchaser of the business.

(c) State your statutory obligations in relation to the pension scheme. (2 marks)

This part was generally very well answered with many candidates scoring maximum marks.

(d) Estimate the amount of the net property and prescribed part for the purposes of the Administrator's proposals to creditors. (10 marks)

This part was generally well answered.

Candidates who were familiar with an estimated outcome template and could translate the information given in the question into figures performed well.

In view of the publicity regarding the *Brumark* case and *Spectrum Plus* in recent years it was surprising how many candidates incorrectly categorised the factoring surplus as a fixed charge asset.

Many candidates incorrectly assumed that the distraint over assets levied by HM Revenue & Customs was extinguished by the effect of the commencement of Administration.

(e) Draft provisions for inclusion in the Administrator's proposals dealing with how the Administration shall end and also how the Administrator shall be released from office. (10 marks)

This part was generally poorly answered.

Candidates' performance in this part suggested a lack of familiarity generally with this aspect of the syllabus and an inability to tailor their answer to the requirements of the question. Many candidates merely regurgitated every exit route from Administration they had been taught. A number of candidates discussed exit routes and then stated that they were not appropriate in this circumstance - an unlikely approach that an Administrator would adopt when drafting his proposals. Thus many scripts included a significant amount of irrelevant detail relating to, for example, ending the administration via a CVA or compulsory liquidation, allowing the administration to run on and then end automatically on the anniversary, or bringing the case to an end because the purpose either had been achieved or could not be achieved

Very few candidates made any attempt to deal with the Administrator's discharge.

Question 4

This question required consideration of the principal issues surrounding "pre-pack" sales in Administration. It then required candidates to prepare an estimated outcome statement and then to revise that estimated outcome on the basis of the facts being materially different in one respect.

Overall the question was generally inadequately answered.

(a) Draft a briefing note for your meeting with the directors outlining:

(i) the nature of a "pre-pack" sale;

(ii) the advantages and disadvantages of such sale in achieving realisations compared with alternative strategies;

(iii) any insolvency law or required practise provisions which moderate or control the conduct of such transactions by insolvency office holders; and

(iv) the matters to be addressed by the prospective Administrator in discussion with the directors to establish the suitability of the "pre-pack" sale presently envisaged by the board. (15 marks)

This part was generally inadequately answered.

Nearly all candidates had some notion of a "pre-pack" sale but many could not articulate it sufficiently to make clear the distinction from a normal sale by an Administrator.

In relation to the advantages, there were too many references to "continuity of business" and "preserving goodwill" as if it were an end in itself without relating back to the value the Administrator could therefore secure.

The majority of candidates made an adequate attempt at addressing the legal and regulatory issues although many candidates wasted time by recounting irrelevant details from SIP 13 by rote rather than applying it to the question.

Few candidates demonstrated adequately their practical knowledge and experience in assessing the suitability of the proposed "pre-pack" sale.

(b) Prepare an estimated outcome statement assuming that the "pre-pack" sale envisaged is completed promptly following your appointment as Administrator. (12 marks)

This part was generally adequately answered.

Among the most common errors were the incorrect categorisation of the factored book debt surplus and non-assigned debts as being subject to the fixed charge; inclusion of the R&D tax credit without taking account of set off, and incorrect treatment of the Corporation Tax as a fixed charge expense.

The inability to accurately manipulate relatively simple numbers also let some candidates down.

(c) Calculate the estimated recovery for BVE if, by having registered its floating charge at the time of granting the loan, BVE were able to appoint an Administrative Receiver to conclude the "pre-pack" sale to Newco. (3 marks)

This part was generally very poorly answered.

In many cases this part was not attempted.

It merely required candidates to appreciate following the appointment of an Administrative Receiver (made possible by the initial registration of the floating charge security), the treatment of the Corporation Tax liability as an unsecured creditor and the Bank's ability to rank as a floating chargeholder. All other facts remaining unchanged, the appointment of an Administrative Receiver enhanced the Bank's recovery by £700,000 over the appointment of an Administrator.

JIEB ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS and RECEIVERSHIPS NOVEMBER 2008

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

Slack Foods Ltd

(a) List the matters that you would consider before accepting the appointment. (3 marks)

Satisfy yourself that you are suitably qualified to accept such appointment:
Should not accept appointment where clearly not in the interests of the prospective appointor that an appointment is made.
Should not accept appointment if you have had a professional relationship or dealings with: • Borrower • Appointor • Assets • Someone connected with the borrower (S.249) • Associate of borrower (s435) During the preceding three years unless satisfied that no conflict arises and it is appropriate to accept the appointment. In all cases must first disclose all such professional relationships and dealings to the appointor.
Should agree terms of engagement and basis of remuneration with appointor in writing.
Should take all appropriate steps to satisfy yourself that the appointment can validly be made Charge validly executed and formalities of appointment complied with. Charge registered in relevant time limits. Instrument of appointment is in required form and adequately describes assets over which appointed
Ascertain whether appropriate to trade, whether advisable to trade and any power in the charge
Ascertain what licences or registrations are applicable and consider the steps to maintain, transfer or obtain new ones
Consider how best to secure the asset(s) subject to the appointment – both physical protection and protection against financial consequences of loss or damage through insurance
Consider seeking an indemnity from the appointor where the potential liabilities arising could exceed the likely value of the asset(s)

(b) Set out a Receiver's statutory powers under the Law of Property Act 1925. List the principal additional powers that you would expect to be contained in the charge document under which it is proposed to appoint you. (5 marks)

Statutory powers
The power to demand and recover all income of which he is appointed receiver.
The power to insure against loss or damage by fire, if required by the appointor in writing, to the extent the mortgagee may have insured and only out of any money received by him.
The power to apply all monies received in discharge of all rents, taxes, rates and outgoings whatever affecting the mortgaged property.
Additional powers
The power of sale
The power to trade or manage
The power to deal with employees The power to raise or borrow money
The power to appoint solicitors and other agents
The power to take possession The power to retain out of money received his reasonable remuneration (and to disapply S109 (6) – 5% commission rule)
The power to do all such other things reasonably and property necessary for realising the property

(c) Outline the extent of your duty of care should you accept the appointment. (4 marks)

A receiver is subject to a common law duty of care. It is outside and in addition to his contractual duties.
A duty to use reasonable skill and care in the exercise of the powers conferred on him and the manner in which he carries out his duties
A duty to keep within his powers and to exercise his powers in good faith.
When exercising the power of sale, a duty to obtain the best price reasonably obtainable on sale in all the circumstances. (The best price is not necessarily the highest price)
He should not sell at the "worst possible" time and in choosing the time to sell must exercise a reasonable degree of care.
The duty extends to the manner in which the asset is marketed e.g. if it has an alternative use value.
This duty will usually be owed to the Appointor/Mortgagee and to the Borrower/Mortgagor and any other person who has a sufficient interest in the asset (i.e. all those interested in the equity of redemption).
Where a receiver acts in breach of that duty of care and a party to whom the duty is owed suffers any loss or damage in consequence, the receiver may be personally liable for that loss or damage.

(d) Comment on the effect of the information obtained from Eddie Diamond & Partners upon your strategy for dealing with the charged property. (8 marks)

Marketing
LPA receiver could consider commencement of marketing of Unit 6 by his own agents, Eddie Diamond & Partners, in isolation to the other adjacent Units being marketed by RS Smart for the Administrative Receiver. Seek agent's advice.
However as a third party has already expressed an interest in acquiring all three units as a whole, a co-operative sale with the AR may prove cost effective.
The LPA receiver could offer marketing instructions to RS Smart on the same basis as instructed by the AR but on the precondition that no sale could be progressed to completion without prior agreement as to the allocation of sale proceeds.
The LPA receiver could retain his own agents to advise on any proposed allocation of sale proceeds.
Provide that if allocation agreement cannot be reached by negotiation, the parties will submit to arbitration (through the president of RICS).
Mains services
Ascertain the amount of the arrears
Ascertain whether any of the mains services are required for Unit 6 for marketing purposes or generally for the protection of the appointor's interest (e.g. to power an intruder alarm for insurance purposes).
S233 IA does not apply to LPA appointments and so public utilities can demand payment of arrears as a prerequisite for future supply. They may not however appreciate the distinction between an AR and LPA receiver and may therefore extend the benefit of S233.
Negotiate suitable terms with existing supplier. Alternatively consider switching supplier. Accepting the supply into the LPA receiver's own name may be little different in practical terms from an AR giving a personal undertaking under S 233.
Refurbishment works
Seek advice from marketing agents as to whether the incomplete redecoration of Unit 6 is likely to adversely affect the value obtained on sale.
If agents advise completion of redecoration, ascertain whether it is feasible to use an alternative contractor to complete the works and obtain a fixed price quotation.
If it is necessary to retain the existing unpaid contractor to complete the works, negotiate a settlement. Be aware of potential personal liability for adopted contacts (S.37).
Extraction and filtration system
The distinction between fixtures and fittings and chattels is not always easy to make but is important as F&F form part of the mortgaged property.
The distinction depends on the degree of annexation and the object and purpose of annexation.
Generally the more extensive the degree of attachment to the land, the greater the likelihood that an asset will be classified as a fixture or fitting as opposed to a chattel.
The distinction can be important for both marketability and value.
Specific legal advice is usually necessary.
Ascertain whether encumbered/unencumbered

QUESTION 2
Logistica Consulting Ltd

(a) List the main issues that you would cover in your letter of engagement to the directors dealing with your respective duties and obligations. (5 marks)

Directors to confirm no knowledge of a material professional relationship within the previous three years or any other reason affecting objectivity why the appointment should not be accepted
The procedure within the Nominee's firm for handling complains
The principal members of the Nominee's staff who will be engaged on the assignment
The Nominees fees and terms of payment
An explanation of the essential procedural steps to obtain approval for, and to implement, a CVA
An outline of the essential contents of a fully compliant CVA Proposal
Emphasise that whilst Nominee may assist with preparation of the Proposal, the directors remain responsible for its accuracy.
The importance of full disclosure of the company's assets and liabilities and any other material matters and the consequences of not making full disclosure including the winding up of the company.
That it is a criminal offence to make false representations for purpose of obtaining creditors' consent to a CVA.
That when finally drafted the Proposal should be thoroughly re-checked by the directors for accuracy and any alterations or amendments notified to the Nominee.
That the role of the Nominee is to critically examine the Proposal and to bring to the attention of creditors any matters which he considers relevant but which are not included in the Proposal.
The importance of cooperation both before and after implementation of the CVA without which the company may be subject to winding up proceedings instituted either by creditors or by the Supervisor.
Directors to sign duplicate of letter of engagement to serve as a letter of instruction for the Nominee to commence his work.

(b) Draft appropriate amendments to the Proposal for discussion with the directors dealing with any breach of the arrangement by the Company and the consequences of such breach. (5 marks)

The Supervisor shall retain sufficient funds to enable him to present a winding-up petition, in the event of failure of the CVA
However no petition shall be presented unless a resolution approving such a course of action is passed at a creditors meeting summoned to consider such a resolution; and the requisite majority necessary shall be a majority in excess of three quarters in value of the creditors present in person or by proxy and voting on the Resolution.
Except that if the Supervisor shall in his discretion conclude that a situation or urgency has arisen or circumstances developed which leads him to conclude that a Petition should be presented forthwith, then he shall be entitled to proceed with such Petition without first calling a meeting of creditors
The CVA will be deemed to have failed if :
The Company fails to pay a voluntary contribution within (say) 7 days of the due date

The Company fails to comply with any of its other obligations or is prevented from so doing, or:
A winding-up Order is made against the Company; an Administrative Receiver is appointed over the Company; an Administration Order is made in relation to the Company; an LPA receiver is appointed in respect of any assets.
False or misleading information was contained in any document supplied by the Company or its Directors for the purposes of obtaining the CVA
All monies paid to the Supervisor shall be held by the Supervisor upon trust for the Creditors of the Company bound by the Arrangement. The subsequent Liquidation or Administration of the Company or the Appointment of a Receiver shall not, unless the Court otherwise determines, terminate the Trust hereby created and any implied termination is hereby negated.

(c) Assuming that your Nominee's report to court on the Proposal is favourable, list the steps for summoning the meetings to consider the Proposal. (5 marks)

The members and creditors' meetings should be summoned for the time, date and place specified in nominees' report to court
Ensure the date; time and venue are convenient for creditors, having regard to their location.
The meeting must be held between 10:00 and 16:00 on a business day.
The meetings may be held on the same day or where not on the same day must be within 7 days of each other
In either case the creditor's meeting must be held in advance of the company meeting.
The meetings must be held not less than 14 days and not more than 28 days from the date of the Report being filed in court.
Confirm venue booking.
The minimum notice period of fourteen days excludes the day of sending the notice and the day of the meeting.
Notice of the creditors' meeting must be given to all creditors of whose claim the person summoning the meeting is aware.
Accompanying the notice of the meeting should be:
Extract of Rule 1.19 (creditors' meeting)
Extract of Rule 1.20 (members' meeting)
Copy director's proposal
Copy or summary S of A
Comments on the proposal
Forms of proxy
Complete certificate of posting.
Convenor of meeting may request attendance by directors and officers on not less than 14 days notice.

(d) Briefly state how you would deal with each of the following claims for the purposes of voting on the Proposal. (5 marks)

(i) Twelve special proxies voting in favour of the Proposal from employees with claims for accrued holiday pay totalling £20,000;

A person is an "associate" of a company if he is employed by that company
An employee is therefore "connected" with the company (within the meaning of S.249)
These votes should therefore be left out of account in determining if more that half in value of the creditors have voted against any resolution (R 1.19(3))

(ii) Eight general proxies for the chairman from trade creditors and suppliers totalling some £80,000;

A proxy holder shall not vote in favour of any resolution which would directly or indirectly place him in a position to receive any remuneration out of the insolvent estate, unless the proxy specifically directs him to vote in that way.
Since the chairman of the creditors' meeting is the nominee, he should not admit these claims to vote if he or an associate is the proposed supervisor.

(iii) A special proxy from a landlord voting against the Proposal claiming the cost of unspecified dilapidations amounting to £30,000;

This represents a debt for an unliquidated amount or whose value is not ascertained.
For voting purposes the debt shall be valued at £1 unless the chairman agrees to put a higher value on it.
It has been held that the treatment of unspecified dilapidations in this manner is the correct treatment.
The nominee should attempt to quantify it if he can.

(iv) A special proxy from a supplier voting against the Proposal for an outstanding debt of £25,000. The supplier is validly claiming retention of title in respect of goods with an estimated re-sale value of £15,000; and

For the purposes of entitlement to vote, there is no statutory provision in CVA proceedings requiring a seller of goods under a retention of title agreement to deduct from his claim the estimated value of any rights arising under that agreement
A secured creditor is entitled to vote only in respect of the balance of his debt after deducting the value of his security as estimated by him.
Retention of title does not amount to "security" (see S 248 IA 86)

(v) A special proxy from Indigo Bank Plc for £160,000 being the outstanding balance of a loan granted under the Small Firms Loan Guarantee Scheme, which provides a government guarantee to the lender covering 75% of the loan. The Company has provided no security for this loan. The proxy is in favour of the Proposal.

There is to be left out of account a creditor's vote in respect of any claim or part of a claim where the claim or part is secured
"Security" means (England & Wales) any mortgage, charge, lien or other security
The government guarantee of the Bank's lending in this case does not amount to security.
The claim for £160k should therefore be admitted for voting for the full amount.

QUESTION 3
Arrowstorm (Tyres) Ltd

(a) Set out the main points you would have included in your initial letter to all employees explaining the effect of your appointment on their employment. (5 marks)

You are the appointed administrator, the Company having entered administration under Part II IA 1986 on 20 October 2008.
As administrator you act as agent of the Company and as an officer of the court.
The appointment does not of itself mean that the Company is either going into liquidation or ceasing to trade immediately.
The purpose of administration is to facilitate the rescue of the Company but if that is not reasonably practicable to implement the next best alternative in the interests of the creditors generally.
Your appointment as administrator did not bring contracts of employment to an end.
Neither the administrator nor his firm have either become the employer or adopted contracts of employment.
Employees remain employees of the Company exactly as they did before the appointment.
The Company is continuing to trade under the supervision of the administrator to whom all decisions affecting the Company must be referred for approval.
During the period of the administration, wages and salaries are paid out of funds coming into the hands of the administrator from the Company's continued trading and any sale of its assets.
If the Company terminates employment contracts, any claims arising will be dealt with in accordance with the law.
The Employment Rights Act 1996 provides for certain claims of employees to be paid out of Government funds.
If employment contracts are terminated, assistance will be given to ensure that claims under the Act are made as promptly as possible.

(b) Outline the potential consequences for the Company of a failure to consult adequately about a prospective business transfer. (3 marks)

An employee is entitled to complain to a tribunal about inadequate consultation and to make a claim for compensation (a "protective award") against either or both of the transferor and transferee.
The tribunal may award such sum not exceeding 13 weeks' (90 days') pay as it thinks just and equitable having regard to the seriousness of the failure.
The transferor and transferee are joint and severally liable for the failure to adequately consult about the transfer with affected employees.
Where an award is made against a transferee, it will have a right of recourse against the insolvent transferor.
Whether such a liability should be treated as an unsecured debt or as an administration expense is not completely beyond doubt (now clarified in Haine & Sec of State v Day June 2008 – provable debt in liquidation proceedings).
In practice the administrator will normally require that as part of the sale and purchase agreement, that the transferee indemnifies the transferor against any such liability.

(c) State your statutory obligations in relation to the pension scheme. (2 marks)

Where an *occupational pension scheme* has been identified
Give Notice of the appointment of an administrator within 14 days of appointment or within 14 days of the date on which you became aware of the pension scheme to:
The Pension Protection Fund
The Pensions Regulator, and
The trustees or managers of the pension scheme
Confirm as soon as reasonably practicable whether or not the a scheme rescue has been possible

(d) Estimate the amount of the net property and prescribed part for the purposes of the Administrator's proposals to creditors. (10 marks)

	Receipts & Payments to date £	Anticipated Receipts & Payments £	Projected Outcome £
ASSETS SPECIFICALLY PLEDGED			
Freehold and leasehold properties	420,000	0	420,000
Goodwill	47,500	0	47,500
Gross Realisations	467,500	0	467,500
Realisation Expenses			
Administrator's and legal and professional costs	-	(46,750)	(46,750)
Trading loss	-	(8,250)	(8,250)
Net Realisations	467,500	(55,000)	412,500
Fixed charge holder - Magenta Bank Plc		(412,500)	(412,500)
	467,500	(467,500)	-
ASSETS NOT SPECIFICALLY PLEDGED			
Plant and equipment	325,000		325,000
Stock and WIP	33,000	-	33,000
Book Debts	-	24,500	24,500
Cash at bank - set off applied	-	-	-
Gross Realisations	358,000	24,500	382,500
Payments			
Administrator's and legal and professional costs	-	(38,250)	(38,250)
Trading loss		(6,750)	(6,750)
HMR&C distraint		(23,000)	(23,000)
Corporation tax	-	(12,500)	(12,500)
Available for preferential creditors	358,000	(56,000)	302,000
Arrears of wages and pension contributions		(3,000)	(3,000)
Net property	358,000	(59,000)	299,000
Prescribed part set aside for unsecured creditors	-	(62,800)	(62,800)
Available for floating charge holder	358,000	(121,800)	236,200
Floating charge holder - Magenta Bank Plc	-	(236,200)	(236,200)
	358,000	(358,000)	-

Explicit statement that unoccupird business rates not payable as an expense

(e) Draft provisions for inclusion in the Administrator's proposals dealing with how the Administration shall end and also how the Administrator shall be released from office. (10 marks)

In order that the purpose of the administration may be fully achieved it will be necessary to remain in office as administrator to ensure that all outstanding matters following the sale of the business and assets are concluded.
Following these events it is proposed to finalise distributions to the secured and preferential creditors.
This will then only leave the distribution of the prescribed part set aside under Section 176A for the unsecured creditors.
However, an administrator does not have a general power to make a distribution to unsecured creditors and may only do so if the court gives permission
If no such application is made by the administrator in this case, then as soon as he is satisfied that he has fully discharged his duties as administrator and that the purpose of the administration has been fully achieved, he would propose to implement the provisions of Paragraph 83 of Schedule B1 to the Act whereby on the registration of a notice sent to the Registrar of Companies, his appointment as administrator shall cease to have effect and the Company will automatically be placed into creditors voluntary liquidation.
The liquidator for the purpose of the winding up shall be: (a) a person nominated by the creditors of the company in the prescribed manner and within the prescribed period, or (b) if no person is nominated under paragraph (a), the administrator
The administrator confirms that as part of his proposals he seeks nomination as liquidator in the subsequent winding up of the Company. Creditors may nominate a different person as the proposed liquidator provided that the nomination is made after the receipt of the proposals and before the proposals are approved.
Alternatively if an application is made by the administrator in this case seeking the court's permission for him to make a distribution to unsecured creditors, then as soon as he is satisfied that he has fully discharged his duties as administrator and that the purpose of the administration has been fully achieved, he would propose to implement the provisions of Paragraph 84 of Schedule B1 to the Act. Under these provisions, on the registration of a notice sent to the Registrar of Companies, his appointment as administrator ceases to have effect, and at the end of three months the Company will automatically be dissolved.
Where an administrator sends such a notice of dissolution to the Registrar of Companies, he must also file a copy of the notice with the court and send a copy to each creditor of the Company, and on application by any interested party the court may suspend or disapply the automatic dissolution of the company.
The administrator proposes to seek the consent of the secured and preferential creditors to his prospective discharge as administrator by a resolution passed pursuant to Paragraph 98 of Schedule B1 to the Act. It is proposed that the date of discharge should coincide with the date on which the appointment as administrator ultimately ceases to have effect. This will be the date that the Notice of move from administration to CVL, or Notice of move from administration to dissolution, is registered by The Registrar of Companies.

QUESTION 4
Advanced Bio Power Ltd

(a) Draft a briefing note for your meeting with the directors outlining:

(v) the nature of a "pre-pack" sale;

It is an asset realisation strategy in the context of impending or actual insolvency.
An arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator, and the administrator effects the sale immediately on, or shortly after, his appointment.
It frequently involves the sale of a business back to the incumbent management team but may equally involve a sale to a non-connected third party.

(vi) the advantages and disadvantages of such sale in achieving realisations compared with alternative strategies;

It can be the best way of extracting value from a difficult situation.
This is particularly so when the value of a company's business can be significantly diminished very quickly due to damage to reputation and loss of customers through negative publicity or loss of key staff following the commencement of a formal insolvency process.
This is often the case with "people businesses" or regulated businesses that are difficult or impossible to trade in insolvency.
It can also be used where there is a lack of available funds to keep the business trading whilst the Administrator looks for potential buyers.
It can be the best way to maximise the realisation of goodwill.
Trading risk is eliminated.
The main disadvantage centres on the perception held by many unsecured creditors that businesses/assets have not been openly marketed and that had such marketing been undertaken, a better price would have been obtained for creditors.
Unsecured creditors are generally not consulted and are presented with a fait accompli. Consequently the process is often seen as opaque and suspicious.
The concern amongst unsecured creditors is heightened when the existing management is connected with the purchase.

(vii) any insolvency law or required practice provisions which moderate or control the conduct of such transactions by insolvency office holders; and

In a series of cases the courts have held that were the circumstances of the case warrant it, the administrator has the power to sell assets without the prior approval of the creditors or the permission of the court. (T&D Industries Plc; Transbus International Ltd; DKLL Solicitors)
An administrator's conduct is subject to challenge on the basis that his actions unfairly harm the interests of creditors/members (P 74)
His conduct is also subject to challenge on the grounds of misfeasance (P 75)

In order to avoid the risk of such challenges the administrator should ensure that any exercise of his power is in good faith in furtherance of the purpose of administration.
The administrator must perform his functions in the interests of the company's creditors as a whole P3(2) Where the objective is to realise property in order to make a distribution to secured or preferential creditors, the administrator has a duty to avoid unnecessarily harming the interests of the creditors as a whole (P3(4)).
IPs are regulated by codes of practice of their professional bodies and if judged to have acted improperly, will be subject to disciplinary proceedings.
SIP 13 makes clear that an IP should not assist a client in conduct which will undermine public confidence in insolvency procedures or assist directors in any conduct which amounts to misfeasance.
SIP 13 sets out steps that IPs should take to ensure that all transactions are conducted on a fully arm's length basis and that documentation should be retained to provide such evidence.
Whilst SIP 13 is directed to acquisitions by directors its principles apply equally to acquisitions by other parties.

(viii) the matters to be addressed by the prospective Administrator in discussion with the directors to establish the suitability of the "pre-pack" sale presently envisaged by the board. (15 marks)

Administrators' duties
The administrator has a duty to perform his functions in the interests of the company's creditors as a whole (Para 3(2) Sch B1).
He also has a duty to avoid unnecessarily harming the interests of the creditors as a whole (Para 3(4) Sch B1).
He must be able to demonstrate that the outcome of a pre pack sale is consistent with these duties.
Value issues
This will likely entail demonstrating that he has obtained the best price reasonably attainable for the Company's assets in all the circumstances.
He will therefore need to establish:
The extent of marketing activities already carried out by the company.
The extent of marketing activities that can feasibly be carried out by the administrator.
Any valuations obtained of the business and the underlying assets.
The alternative courses of action for dealing with the company's affairs and their estimated financial outcomes.
Whether it is appropriate to trade the business and offer it for sale as a going concern during the administration
The working capital requirements of the business to enable continued trading and potential funders of that requirement.
The desirability or otherwise of consultation with the company's major creditors including secured creditors.
Precise details of the assets intended to be subject to the prepack sale.

Consequently what assets are intended to be excluded from the sale
The consideration for the sale, terms of payment and any condition of the contract that could materially affect the consideration
The impact of TUPE, if any, on the proposed terms of the sale
The identity of the proposed purchaser and any connection between the purchaser, the directors shareholders or secured creditors of the company.
Whether any directors have given guarantees for amounts due from the company to a prior financier and whether it is proposed that that financier is financing the new business.
Any options, buy-back arrangements or similar conditions attached to the contract of sale.
The timetable for the proposed sale and how it is intended to manage the company's affairs in the interim including the availability of funding for essential payments.
New co issues
The prospective purchaser should be advised to seek its own independent professional advice.
Nevertheless the administrator will want to satisfy himself as to the financial viability of the purchaser
To satisfy himself that there is a real prospect that a prepack sale to the proposed purchaser can be concluded.
Where all or part of the consideration for the sale is on deferred payment terms, or
Where the rationale or justification for the prepack hinges on the continuity of the underlying business in order to optimise the realisable value of assets or mitigate liabilities (e.g. collectability of debts; assignment of leasehold obligations).
The administrator will therefore want to see evidence of adequate funding being put in place by the purchaser to sustain future operations.
That it has obtained the necessary licences, permissions and registrations allowing it to trade.
That where a similar name is being adopted, that directors of the company who will be directors of the purchaser and who are key to the future success of the purchaser are independently advised in relation to S 216 IA (prohibited names).
That any practical issues or difficulties affecting trading that may arise on the discontinuance of old co and commencement of new co are anticipated and planned for (e.g. consultation with transferring employees; termination of essential equipment leases)
Tax implications

(b) Prepare an estimated outcome statement assuming that the "pre-pack" sale envisaged is completed promptly following your appointment as Administrator. (12 marks)

ADVANCED BIO POWER LTD

	Administration Estimated Outcome £	Administrative Receivership Estimated Outcome £
ASSETS SPECIFICALLY PLEDGED		
IPR	1,000,000	1,000,000
Leasehold	300,000	300,000
	1,300,000	1,300,000
Realisation Expenses		
Pre-appointment consultancy fees	(20,000)	(20,000)
Administrator's fees	(50,000)	(50,000)
Legal & professional fees	(25,000)	(25,000)
Administrator's disbursements	(5,000)	(5,000)
Net Realisations	1,200,000	1,200,000
Fixed Charge holder - Banco Verde Esmeralda	(2,200,000)	(2,200,000)
Shortfall c/d	(1,000,000)	(1,000,000)
ASSETS NOT SPECIFICALLY PLEDGED		
Plant & machinery	800,000	800,000
Office fixtures, fittings & furniture	30,000	30,000
Stock of consumables	70,000	70,000
Surplus of factored book debts (750k-690k)	60,000	60,000
Book Debts (not assigned)	40,000	40,000
R&D Tax credit - £50k set off	–	–
	1,000,000	1,000,000
Payments		
Pre-appointment consultancy fees	(20,000)	(20,000)
Administrator's fees	(50,000)	(50,000)
Legal & professional fees	(25,000)	(25,000)
Administrator's disbursements	(5,000)	(5,000)
CT on IPR @ 30%	(300,000)	0
Available for preferential creditors	600,000	900,000
Preferential creditors	0	0
Available for floating charge holder	600,000	900,000
Floating charge holder - Banco Verde Esmeralda	0	(1,000,000)
Available for unsecured creditors	600,000	0

(c) Calculate the estimated recovery for BVE if, by having registered its floating charge at the time of granting the loan, BVE were able to appoint an Administrative Receiver to conclude the "pre-pack" sale to Newco. (3 marks)

Unsecured creditors		
Banco Verde Esmeralda	(1,000,000)	(100,000)
Unsecured loans	(1,650,000)	(1,650,000)
HMR&C £90k PAYE + £80k VAT - R&D £50k	(120,000)	(120,000)
Trade & expense creditors	(230,000)	(230,000)
HMR&C -CT £300k	-	(300,000)
	(3,000,000)	(2,400,000)
Deficiency as regards the creditors	(2,400,000)	(2,400,000)
Summary of estimated recovery for Banco Verde Esmeralda		
Outstanding indebtedness	(2,200,000)	(2,200,000)
Less recovered under:		
Fixed Charge	1,200,000	1,200,000
Floating Charge	-	900,000
Unsecured creditor dividend	200,000	0
Estimated shortfall to Banco Verde Esmeralda	(800,000)	(100,000)

LIQUIDATIONS EXAMINATION 2008

EXAMINER'S REPORT

General

There was a wide spread of marks. This year a "holistic" element was introduced to the marking to separately reflect the quality of a candidate's arguments and the structure of the answers. Candidates who used a "kitchen sink" approach, that is who wrote everything they knew about a topic without giving any thought to what was required in the question, tended to achieve lower holistic marks.

This year the examination was 3.5 hours – the extra half hour being suggested reading time. There is little evidence that candidates wisely used this time for reading. All questions required the candidates to use the scenarios in the questions to illustrate their answers and, while many were content to write about the statutory and legal aspects of a question (sometimes giving detail not required), few seemed to consider linking what they were writing about to the situations in the questions. Consequently, candidates lost "holistic" marks.

Question 1

Question 1(a) required candidates to consider the ethical issues arising in various situations and was reasonably well answered. Question1(b) was poorly answered, hardly any candidates suggested that a better course of action for the creditors may be for the liquidator to apply for administration. Those candidates who answered 1(b) set out the initial steps in the liquidation and how they would realise the assets.

Question 2

The answers to question 2 were disappointing. Parts 2(a) and (b) required the candidate to prepare a statement of affairs and deficiency account from straight forward information. While this presented no problem for some, most candidates struggled. A statutory format was not asked for, but candidates were expected to produce a coherent layout indicating, for example, that assets which were subject to security should be presented with the amount owed to the secured creditor. Common errors included deducting the assumed retention of title value from assets but then not deducting the same amount from unsecured creditors. Some candidates included prepayments, accrued income and the deferred tax asset as assets in the statement of affairs. Candidates also struggled to produce a coherent deficiency account even though each candidate's statement of affairs was used as the reference point for marking. Many candidates seemed to be confused that there was no "balancing figure" in the deficiency account: for simplicity the question required that the statement of affairs be drawn up on the same date as the balance sheet.

In part 2(c) most candidates were able to identify the definition of inability to pay debts in section 123 of the Insolvency Act 1986 but few gave examples from the question (this may have been a consequence of the inadequate answers to 2(a) and (b)).

Part 2(d) was poorly answered: few candidates suggested that a "Centrebind" procedure may be appropriate. Some candidates suggested provisional liquidation (and were awarded a mark).

Question 3

Question 3 was generally well answered. Part 3(a) asked for the procedure for paying a dividend and this was generally well answered. Part 3(b) asked the candidates to calculate the amount available to pay a dividend which required them to set out the liquidation expenses and part 3(c) was a straightforward question about how to deal with an EC creditor claim. Sometimes candidates were confused between part 3(b) and (c).

Part 3(d) required candidates to calculate the claims on the assets in liquidation, again this was reasonably well answered although some candidates were unsure about how to treat the various shareholder claims.

Question 4

Part 4(a) required candidates to set out, in a letter, the responsibilities of directors of a financially troubled company. This was reasonably well answered although candidates did not provide examples from the question, despite being asked. Part 4(b) asked for a discussion of the remedies available – there was a range of answers: from very good to poor. Part 4(c), which required a discussion of how the options discussed in part 4(b) could be funded, was generally poorly answered, if at all.

QUESTION 1

(a) Set out, with reasons, the steps that you, as Liquidator, should now take in the context of your statutory and professional obligations. (6 marks)

Steps to be taken as Liquidator - statutory obligations
S95(1) states that if at any time the Liquidator forms the opinion that the Company is unable to pay its debts and the interest payable thereon(s189), within the period stated in the Declaration of Solvency(s89),
- hold a creditors meeting within 28 days (s95(2)(a))
- send notices of the creditors' meeting to creditors by post not less than 7 days before the day on which the meeting is to be held (s95(2)(b))
- advertise the creditors' meeting in the Gazette and once at least in 2 newspapers circulating in the relevant locality in which the company's principal place of business within Great Britain was situated (s95(2)(c)) and if the place of business was situated in different localities at different times during the 6 months (s95(7)) immediately preceding the day on which were sent the notices summoning the company meeting at which it was resolved that the company be placed into MVL, then the advertising requirements apply to these localities as well (s95(5)). If no place of business in GB, then reference to localities replaced by registered office (s95(6)).
- during the period before the day on which the creditors' meeting is to be held, furnish creditors free of charge with such information concerning the affairs of the company as they may reasonably require. (s95(2)(d))
- make out a statement of affairs (s95(3)(a)), verified by affidavit (s95(4))
- lay the statement of affairs before the creditors' meeting (s95(3)(b))
- attend and preside at the creditors' meeting (s95(3)(c))

The Liquidation becomes a CVL from the day on which the creditors meeting under s95 is held (s96)

Whether or not to remain as Liquidator - Ethical considerations
Should you become liquidator?
Consider (discussion required):
- self interest threat
- self review threat
- integrity, objectivity, professional competence and due care principles

CVL following MVL can have serious consequences for directors – they may be fined or be criminally liable if make a declaration of solvency without having reasonable grounds that the company will be able to pay its debts with interest within the period specified (s89(4)). If the Liquidator was also advising the directors about the declaration of solvency, the directors may have an action against the Liquidator as advisor in these circumstances.
The discussion should have regard to the ethical guidance.
Extract from draft ethical guide **Conversion of Members' Voluntary Winding-up into Creditors' Voluntary Winding-up**
Where an *Insolvency Practitioner* has accepted appointment as liquidator in a members' voluntary winding up and is obliged to summon a creditors' meeting because it appears that the company will be unable to pay its debts in full within the period stated in the directors' declaration of solvency, the *Insolvency Practitioner*'s continuance as liquidator will depend on whether he or she believes that the company will eventually be able to pay its debts in full or not.
- If the company will not be able to pay its debts in full and the *Insolvency Practitioner* has previously had a significant professional relationship with the company or a personal relationship with a director, former director or shadow director thereof, the *Insolvency Practitioner* should not accept nomination under the creditors' winding up.
- If the company will not be able to pay its debts in full but the *Insolvency Practitioner* has had no such significant professional or personal relationship, the *Insolvency Practitioner* may accept nomination by the creditors and continue as liquidator with the creditors' approval, subject to giving careful consideration to principles referred to in this Code.
- If the *Insolvency Practitioner* believes that the company will eventually be able to pay its debts in full the *Insolvency Practitioner* may accept nomination by the creditors and continue as liquidator. However, if it should subsequently appear that this belief was mistaken, the *Insolvency Practitioner* should then resign, and may not accept re-appointment, if he or she has previously had a [material][significant] professional relationship with the company or a personal relationship with a director, former director or shadow director.

1(a)(ii) Discuss, with reasons, the issues that you will consider with regard to your position as liquidator designate. How, if at all, would your answer differ if your appointment were to be jointly with an insolvency practitioner from another firm? (5 marks)

Discussion required around ethical principles and conceptual framework:
Any ethical decisions about accepting appointment should be taken in the context of the 5 main principles:

- integrity
- objectivity
- professional competence and due care
- confidentiality
- professional behaviour

The conceptual framework helps IPs identify the threats to the fundamental principles and determine whether or not there are any safeguards that may be available to offset them. There are 5 categories of threats:
(a) Self-interest threats, which may occur as a result of the financial or other interests of a practice or an *Insolvency Practitioner* or of an immediate or close family member of an *individual within the practice*;
(b) Self-review threats, which may occur when a previous judgement made by an individual *within the practice* needs to be re-evaluated by the *Insolvency Practitioner*;
(c) Advocacy threats, which may occur when an *individual within the practice* promotes a position or opinion to the point that subsequent objectivity may be compromised;
(d) Familiarity threats, which may occur when, because of a close relationship, an *individual within the practice* becomes too sympathetic to the interests of others; and
(e) Intimidation threats, which may occur when an *Insolvency Practitioner* may be deterred from acting objectively by threats, actual or perceived.
In this case, the main principles to consider are integrity and objectivity. If you accept the appointment can you be independent and objective in the appointment as liquidator?
Here there is a self interest threat. The work in the department is slow and you need the fees.
There is also a familiarity threat. The personal relationship between one of the directors and the tax partner – may affect your judgement when carrying out your responsibilities as Liquidator (eg in filing D returns, pursuing the directors for wrongdoing, prior transactions)
You need to consider what safeguards are available to counter the threats, Safeguards specific to an appointment may include:
(a) Involving and/or consulting another *Insolvency Practitioner* from within the *practice* to review the work done.
(b) Consulting an independent third party, such as a committee of creditors, a licensing or professional body or another *Insolvency Practitioner*.
(c) Involving another *Insolvency Practitioner* to perform part of the work, which may include another *Insolvency Practitioner* taking a joint appointment where the conflict arises during the course of the appointment.
(d) Seeking directions from the court.
An *Insolvency Practitioner* should exercise judgment to determine how to best deal with an identified threat. In exercising this judgment, an *Insolvency Practitioner* should consider what a reasonable and informed third party, having knowledge of all relevant information, including the significance of the threat and the safeguards applied, would reasonably conclude to be acceptable. This consideration will be affected by matters such as the significance of the threat, the nature of the work and the structure of the *practice*.
Whether the *Insolvency Practitioner* takes or continues an appointment will depend on what threats there are and whether, in that event, the introduction of safeguards would overcome those threats. Sometimes, though, the mere perception of risk or conflict will tend to undermine confidence in the practitioner's objectivity, and so make acceptance or continuation unwise.
The *Insolvency Practitioner* must not only be satisfied as to the actual objectivity which he or she can bring to their judgement, decisions and conduct, but also must be mindful of how they will be perceived by others.
Where a threat cannot be eliminated, an *Insolvency Practitioner* should evaluate the significance of such threat. If the threat is other than trivial, safeguards should be considered and applied as necessary to reduce them to an acceptable level, where possible. In considering the significance of any particular matter, qualitative as well as quantitative factors should be taken into account.
An Insolvency Practitioner will encounter situations where no safeguards can mitigate a threat. Where this is the case, an *Insolvency Practitioner* should conclude that it is not appropriate to accept an *insolvency appointment.*
Discussion of above – consideration of whether or not a joint appointment with a liquidator from another firm will ameliorate any problems in the light of the ethical guidance.

1 (a)(iii) Discuss, with reasons, whether or not you may accept the appointment as Liquidator. (4 marks)

Discussion of role of the Liquidator and whether he should, effectively, investigate himself.
Consideration of ethical principles/guidelines
Discussion whether a joint appointment may ameliorate the problem.
Need to protect interests of creditors – will a joint liquidation be more expensive than just a sole appointment? So don't accept appointment?

1(b) Set out the steps that you, as Liquidator, may take to ensure a maximum return for creditors. Discuss the relative merits of any alternative courses of action. (5 marks)

Options (discussion required)
- go to court to rescind winding up (R7.47) and try rescue with no procedure, not a good idea as creditors are pressing. Any application must be made within 7 days of making the order (R7.47(4))
- the Liquidator may propose a CVA (s1(3)(b)). The Liquidator will normally act as nominee and may then proceed to call meetings of members and creditors under s3(2).
- the court may by order stay or sist all proceedings in the winding up (s5(3)(a)). The court shall not make an order (s5(4)) for 28 days from the date of the meeting when the Liquidator must report the result of the meeting to the court, creditors, and members and to allow any member to appeal if the results of the members' and creditors' meetings were different (s4A).
- the court may give such directions with respect to the conduct of the winding up as it thinks appropriate for facilitating the implementation of the CVA. (s5(3)(b))
- The most likely option is that the Liquidator may apply for an administration order (SchB1, para 38). If the court makes an administration order it will discharge the winding up order
The court may make consequential provisions including, for example, concerning the release of the liquidator, the payment of liquidation expenses, any indemnity given to the liquidator, and the handling or realisation of any assets in the hands of the liquidator.
- Where the company is in liquidation the affidavit in support of the petition must, in addition to the matters mentioned in R2.4) also contain details of the Liquidation proceedings, the liquidator, the liquidator's appointment, and the reason why administration has since been considered appropriate, plus any other matters the Liquidator considers appropriate in respect of matters arising in connection with the Liquidation.(R2.11)
- the court may make an administration order in relation to a company only if satisfied
(a) that the company is or is likely to become unable to pay its debts; and
(b) that the administration order is reasonably likely to achieve the purpose of administration. (SchB1, para 11)
The Liquidator will need to consider the purpose of the Administration – will it be to rescue the Company as a going concern? Will this be achievable within 12 months?
The Liquidator will need to consider the exit route of the Administration – will it be return Company to directors (see above) or CVA? If CVA, it is probably better to exit directly from the Liquidation to CVA. Consider relative costs of the options.
If decide best option to remain in compulsory liquidation – actions to take include whether to trade for better realisation of assets; the liquidator will need sanction for local bank accounts, etc

QUESTION 2

Using the information provided in the draft balance sheet, profit and loss account and associated notes, and stating any assumptions made by you,

(a) Prepare a statement of affairs for the Company as at 31 October 2008, making and explaining estimates of any contingent or prospective liability at a level that you regard as commercially realistic. (9 marks)

Statement of Affairs as at		
Presentation/layout		
	Book value	***Estimated to realise***
	£'000	*£'000*
Assets specifically pledged		
Freehold land and buildings – out of town	*600*	*700*
Freehold land and buildings – city centre	*170*	*200*
Less due to Towncity Bank Plc	*(1,615)*	*(1,615)*
Deficiency carried down	*(845)*	*(715)*
Motor vehicles	*100*	*45*
Less due to hire purchase company	*(130)*	*(130)*
Deficiency carried down	*(30)*	*(85)*
Assets not specifically pledged		
Fixtures and fittings		
Greenhouses (etr = (500 – 100) x 20%)	*500*	*80*
Assets subject to ROT	*200*	
Less due to ROT creditor	*(200)*	*nil*
Remaining fixtures and fittings	*300*	*nil*
Stocks (W/down 75% = 0, 25% x 50%)	*1,005*	*125*
Debtors	*50*	*25*
Prepayments	*40*	*nil*
Deferred tax asset	*70*	*nil*
Cash at bank and in hand	*15*	*15*
Estimated total assets available for preferential creditors	*1,980*	*245*
Preferential creditors – unpaid wages	*(50)*	*(50)*
Estimated surplus as regards preferential creditors	*1,930*	*195*
Estimated prescribed part of net property where applicable (to carry forward)	*nil*	*nil*
Estimated total assets available for floating chargeholders		
Debts secured by floating charges	*nil*	*nil*
Estimated prescribed part of net property where applicable (brought down)	nil	nil
Estimated total assets available for unsecured creditors	*1,930*	*195*
Trade creditors	*(1,165)*	*(1,165)*
Add back ROT creditor	*200*	*200*
Other taxes and social security	*(820)*	*(820)*
Accruals and deferred income (155 less accrued preferential wages of 50 = 105 (incl 100 in respect of Christmas Club deposits)	(105)	(105)
Agents fees to be added to creditors	(2)	(2)
Cash deposits held by agents and to be returned to customers 20		
Less fees to be returned to customers (20)	0	0
Shortfall to Towncity Bank brought down	*(845)*	*(715)*
Deficiency to HP creditor	*(30)*	*(85)*
Estimated deficiency as regards creditors	*(837)*	*(2,497)*
Issued and called up share capital	*(100)*	*(100)*
Share premium	*(100)*	*(100)*
Estimated deficiency as regards members	*(1,037)*	*(2,697)*

Using the information provided in the draft balance sheet, profit and loss account and associated notes, and stating any assumptions made by you;

(b) Prepare a deficiency account for the Company as at 31 October 2008. (4 marks)

EITHER

2(b) Deficiency Account as at		
Shortfall of shareholders' funds per balance sheet	(1,035)	
Increase in value of property	*130*	
Decrease in value of:		
Motor vehicles	*(55)*	
Greenhouses	*(420)*	
Remaining non-ROT fixtures and fittings	*(300)*	
Stocks	*(880)*	
Debtors	*(25)*	
Write back of prepayments	*(40)*	
Write back of deferred tax	*(70)*	
Increase in creditors because of agents' fees	*(2)*	
Estimated deficiency as regards members	*(2,697)*	

OR

2(b) Deficiency Account as at		
Equity shareholders' funds per balance sheet	(835)	
Increase in value of property	*130*	
Decrease in value of:		
Motor vehicles	*(55)*	
Greenhouses	*(420)*	
Remaining non-ROT fixtures and fittings	*(300)*	
Stocks	*(880)*	
Debtors	*(25)*	
Write back of prepayments	*(40)*	
Write back of deferred tax	*(70)*	
Increase in creditors because of agents' fees	*(2)*	
Less back share capital and share premium (100 + 100)	*(200)*	
Estimated deficiency as regards members	*(2,697)*	

(c) State, with reasons and in the light of the tests laid down by the Act, whether or not you consider the Company to be insolvent. (4 marks)

Tests in Act
IA 1986 s123(1)(e) – "If it is proved to the satisfaction of the court that the company is unable to pay its debts as they fall due."
Examples of lack of cash – s123(1)(a) and (b)
(a) debts > £750
Executions, or other process, issued on a judgment, decree or order of any court in favour of a creditor is returned unsatisfied in whole or in part. Examples from question.
IA 1986 s123(2) – A company is also deemed unable to pay its debts if it is proved to the satisfaction of the court that the value of the company's assets is less than the amount of its liabilities, taking into account its contingent and prospective liabilities.
Examples from question.
Mention – going concern compared to break up basis (accruals v cash basis)
How does this company pass these tests?
Refer to balance sheet in question
Link balance sheet to statement of affairs
Mention various creditors who are pressing, etc

(d) Assuming that the Company is insolvent and that Liquidation is the best option. Set out, with reasons, the procedure that you recommend in this case. (3 marks)

About 75 % of the stock will only last 2 weeks. It is, therefore, appropriate to take action to protect the stock, ie not to allow the value of the assets to fall.
CVL likely to be fastest route: S166 The Liquidator may convene a meeting of members at short notice (if permitted by the memorandum and articles of the Company) to protect the stock and to try to sell it before the plants die. (The creditors' meeting must be called and held no later than 14 days after the members meeting and with not less than 7 days' notice – s98).
S166 states that the powers of the Liquidator shall not be exercised except with the leave of the court.
Leave of the court is NOT required in relation to the power of the Liquidator:

- to take into his custody or control all the property to which the Company is or appears to be entitled;
- to dispose of perishable goods and other goods the value of which is likely to diminish if they are not immediately disposed of; and
- to do all such other things as may be necessary for the protection of the Company's assets.

S166 restricts the powers of the Liquidator until the creditors' meeting because of possible abuse of his position, following the decision in re Centrebind Ltd, Re [1967] 1 W.L.R. 337. A person appointed Liquidator by the members in a creditors' voluntary winding up is liquidator until the creditors do something about it, though the meeting of members which appointed him was called at short notice (to which the members agreed) and the statutory first meeting of creditors has not been held. A person so appointed moved to stay proceedings on a distress levied on the company. His locus standi was challenged, but held, that he was Liquidator.
The Liquidator must attend the s98 meeting of creditors and report to it an any exercise by him of his powers (s166(4)).
Could consider the appointment of provisional liquidator to protect assets, but in the circumstances, CVL (using centrebind) is likely to be more cost effective and quicker.

QUESTION 3.

(a) Set out the procedure generally for paying a dividend to creditors. (8 marks).

The Liquidator needs to invite creditors to prove and to accept or reject proofs

A creditor proving in the immediately preceding administration is deemed to have proved in the liquidation (R4.73(8)) but it is unlikely that the administrator will have formally proved the debts (except for voting purposes). In this case the administrator did not pay the prescribed part and so it can be assumed that the debts have not yet been proved.
Liquidator may require claims to be in writing (R4.73(2)) (there is no proof of debt form but many IPs use a modified Form 4.25) and may, if necessary, require formal proof verified by affidavit (R4.77);

The debt may be accepted for dividend in whole or in part but if the Liquidator rejects a proof he must send the creditor a written statement of the reasons for rejection (R4.82)

If proof rejected or creditor dissatisfied with liquidator's decision regarding proof, creditor has 21 days to appeal to the court.(R4.83)

A proof may be varied or withdrawn at any time with the agreement of the Liquidator and creditor. (R4.84)

The Liquidator must:

- Make provision for debts in R4.182
- The Liquidator may accept late proofs (R11.3(2))
- deal with all outstanding creditors' proofs by admitting, rejecting them (in whole or in part) or by making such provision as he thinks fit(R11.3(1)).
- Proof of debt may be in any form (R4.73(6))

Notice of intended dividend (R11.2)

Before declaring a dividend, the Liquidator must give notice of intention to do so to all creditors (and any member state liquidator) who have not proved their debts.

The notice should specify the last date for proving, which should be at least 21 day from that of the notice.

The notice would specify an intention to declare a dividend (specified as interim or final) within the period of 4 months from the last date of proving.

In the case of a first dividend (which this one is), unless he has previously advertised and invited creditors to submit claims, he should give notice by public advertisement of notice of intended dividend (R11.2(1A)) – see below. Alternatively the Liquidator may advertise for claims.

The dividend may be sent with the notice of intended dividend.

The Liquidator needs to consider:

- Compare to statement of affairs (although whether or not a creditor is included in the statement of affairs does not mean that the claim is correct but it is indicative)
- Examine supporting documents – in company's records and/or supplied by creditor.
- The quantum of the claim. (R4.86)
- All debts are provable – whether present or future, certain or contingent, ascertained or sounding only to damages (R12.3).
- Certain debts are not provable – see R12.3(1)(b) - including any obligation arising under a confiscation order made under s1 Drug Trafficking Offences Act 1986, or parts 2,3 or 4 of the Proceeds of Crime Act 2002.
- Certain claim are not provable until all other claims have been paid in full, including interest. Including claims arising under s382(1)(a) of the Financial Services and Markets Act 2000. Any claim which is to be postponed.

The Liquidator needs to establish whether the claim is preferential, non-preferential or secured. In this case the preferential and secured creditors have been paid.

The Liquidator must review proofs for details of any security held. (R4.82). A secured creditor who fails to disclose its security risks losing that security as being forfeit. (R4.96)

Note special provisions and date for proving of certain debts is date of administration rather than liquidation

- Mutual credit and set off (R4.90)

- Periodic payments (eg rent) (R4.92)

- Foreign currency debts must be converted at middle exchange rate on the London Foreign Exchange Market at the close of business at date of liquidation, or in absence of such rate as Court determines.(R4.91)

- Interest on claims (R4.93) .

f debt is due by virtue of a written instrument and payable at a certain time, or payment has been demanded with interest, at rate specified in s 17 of the Judgements Act 1838 at date of liquidation. (Interest may also be provable if subject to the Late Payment of Commercial Debts (Interest) Act 1998).

Debts payable at a future time (4.94
R11.13) when the company went into liquidation or (for cases commencing on or after 1.4.05), where a company has entered administration on that date.
The claim is rebated according to the formula. For the purpose of dividend (and for no other purpose, the amount of the creditor's admitted proof (or, if a distribution has previously been made to him, the amount remaining outstanding in respect of his admitted proof) shall be reduced by [a percentage] calculated as follows (for cases commencing on or after 1.4.05):

$$\frac{X}{1.05^{n}}$$

Where X = the value of the admitted proof and
n = the period beginning with the relevant date on which the payment of the creditor's debt would otherwise be due expressed in years and months in decimalised form.

Before paying any dividend, seek confirmation from the creditor that the claim received is that creditor's final claim.

The cost of proving a debt remains the responsibility of the creditor. R4.78

The liquidator must allow access to the proofs in his possession to any creditor or contributory ortheir agents. R4.79

The liquidator is not obliged to deal with any proof lodged out of time, but may do so at his/her discretion. Record reasons for any decisions made. R11.3(2)

Before declaring dividend, give notice of intention to do so to all creditors who have not proved their debts. The notice should specify the last date for proving, which should be at least 21 day from that of the notice. The notice would specify an intention to declare a dividend (specified as interim or final) within the period of 4 months from the last date of proving. .

Record the notices sent to creditors for the file by way of a certificate of postage. This will help in case of a future dispute. R12.4

Within 7 days from the last date of proving deal with every creditors' proofs (in so far as not already dealt with) by admission or rejection, in whole, or in part or by making such provision as is thought fit in respect of it. R11.3
The Liquidator has discretion to accept late proofs (R11.3(2)).

Agree final claims and list them.

The Liquidator must apply the property of the company pari passu (s107) ie equally amongst the creditors in proportion to their claims (subject to rights of preferential and secured creditors).

The Liquidator must:

- Make provision for debts in R4.182

- The Liquidator may accept late proofs (R11.3(2))

- Must deal with all outstanding creditors' proofs by admitting, rejecting them (in whole or in part) or by making such provision as he thinks fit(R11.3(1)).

- Proof of debt may be in any form (R4.73(6))

(b) Set out how you would resolve the outstanding matters before agreeing and admitting creditors' claims for dividend in this Liquidation. Calculate the amount available to pay a dividend. State any assumptions that you make. (12 marks)

The Liquidator needs to pay any unpaid administration expenses. See Sch B1, para 99, "The former administrator's remuneration and expenses shall be —

charged on and payable out of property of which he had custody or control immediately before cessation…"

These will be paid before the expenses of the liquidation, out of the funds handed to the liquidator by the administrator.

The Liquidator needs to decide what are the administration expenses (as opposed to claims in the liquidation).
The Liquidator should consult with the previous administrator and, request evidence of the outstanding expenses.
The Liquidator should verify that the administrator's fees were properly approved (by the relevant creditors) in the administration.
The Liquidator needs to take care to establish whether a particular amount demanded is an expense or a claim, in accordance with the Rules.
The Liquidator needs to ensure that Liquidation expenses are paid, or provided for, in the correct priority R2.418.
Liquidation expenses will include, for example, the liquidator's remuneration and a resolution of creditors will be needed for this.
Office rent and rates not an expense because disclaimed lease – will be a claim in the Liquidation.
At the date of Liquidation there are five ordinary shareholders each holding 4,000 £1 shares with 60 pence paid.
Liquidator should make a call for the 40 pence per share unpaid. (s165(4)) – no sanction required for CVL liquidator to make call.

Amount available for dividend	**£**	**£**
Surplus from administration		750,000
Call on shares 4,000 x 40 x 5 pence		8,000
Bank interest - say		6,600
Less administration expenses:		
1 Administrator's outstanding fees	15,000	
2 unpaid electricity	2,000	
4 unpaid factory rent	10,000	
9 Smithjones – assumed expense of administration	18,000	
Less liquidation expenses:		
3 Time costs and further provision (5,000 + 20,000)	25,000	
5 tax on interest at 20% (say 6 months interest) £1,100 x 6 x 20%	1,320	(71,320)
Available for dividend		693,280

(c) Explain how the Italian creditor's claim should be dealt with. (2 marks)

Italian creditor
Euros 50,000 should be translated to £ at date of the date of administration where liquidation follows administration. Ie £1 = Euros 0.74 (R4.91)
When writing to Italian creditor need to include appropriate notices with headings in Italian, as required by EC Insolvency Regulations

(d) For each outstanding claim, calculate the amount which should be accepted by you, as Liquidator, or the further information required to calculate the amount. State your reasons and, where applicable, give calculations. (8 marks)

6 The Company had issued 20,000 5% cumulative preference shares. At the date of Liquidation, the dividend for 2008 was outstanding but had not been declared.

Arrears of preference dividend are not payable on winding up, unless they have been declared, or are conferred expressly or by necessary implication by the articles (Re Catalinas Warehouses and Mole Ltd, [1947] 1 All ER 51)

Preference dividends are payable out of profits and so they will be paid after the unsecured and postponed creditors and any interest (even in the case of cumulative preference shares (in the sense that if a dividend is missed in one year for lack of distributable profits, it is still payable out of future years' profits in addition to dividends referrable to those future years), no right to dividend and, hence, no debt arises unless and until there is a formal declaration of dividend.

It is doubtful whether an undeclared dividend on preference shares which under the Article has not become a debt or contingent by the time of liquidation is provable at all.

Even a dividend which has been declared and has become a debt is only a deferred debt not not ranking for dividend in competition with the other creditors (ordinary or deferred for any other reason) (Section 74(2)(f)). A preference shareholder in this position may be entitled a capital distribution on winding up (if the Articles so provide).
There are not sufficient funds to pay preference dividends
7 One preference shareholder has written to you claiming that he is owed £120,000 comprising £110,000 which he lent to the Company in 2002 and £10,000 preferential dividend which was not paid for 2008.

Preference shareholder also has an unsecured of £110,000.

The loan is not owed to him in "his character of a member" - section 74(2)(f)

The loan may or may not be time-barred, depending on two factors:

- the date in 2002 on which he lent the money - if say in the middle of September, then it is not time-barred, since by September 2008 liquidation had already taken place and thereupon the limitation period had ceased to run.

- the date on which the loan became repayable. If it was for a fixed period, then time did not begin to run until the expiry of that period. If it was repayable on demand, then, arguably, the period did not begin to run until the first demand was made.

The rationale for the courts making the limitation period stop running in a liquidation was:

- a liquidation imposes restrictions on the right of creditors to take enforcement court action (although it may be taken subject to the leave of the court which the court will grant if the only object of taking court action was to stop the claim getting time-barred, if indeed the time was otherwise continue to run).
- and more importantly, upon the liquidation a statutory trust arises in respect of the companies assets and liabilities, so that the credirors debts are extiguished and replaced by a new right to share the company's assets for dividend purposes.

As above there are not sufficient funds to pay preference dividends.

9 Smithjones Ltd
R4.90
£10,000 owing pre-administration will be set off against the £13,000 debit balance at the date of administration.

If the £18,000 arose during the administration – it is either an expense of the administration or (depending upon how it arose) a claim in the liquidation. Candidates need to state assumptions.

QUESTION 4

(a) Write a letter to the directors setting out their responsibilities in relation to the Company both as regards the past events described above and the recommended future course of action in the light of the present circumstances. (12 marks)

General issues

- *CA 2006 – include responsibilities*
- overriding duty as a director is to act in the best interests of the company and its creditors. Failure to do so may expose you to claims of misfeasance or breach of duty.
- At any time when you knew or ought to have concluded that insolvent liquidation is unavoidable, you have an obligation to take such action as appropriate to protect the interest of creditors. Failure to do so renders you liable to claims for wrongful trading under section 214 of the Insolvency Act 1986.
- Transactions at undervalue and preferences, as defined by the Insolvency Act 1986, may be set aside by any liquidator. To this end you should protect the assets for the benefit of the creditors and incur such expenditure as is necessary for this purpose.
- No deposits should be accepted unless banked in a separate bank account held on behalf of the depositors.
- No further payments should be made to any outstanding creditors.
- No further credit should be taken and any goods or services required must be paid for immediately and certainly before the date of the proposed liquidation.
- Delivery of all further goods or services ordered previously, and no longer required, should not be accepted.
- No disposal of the company's goods should be made to any creditor or customer who is owed money by the company and who will claim a set-off.

No disposal of the company's assets should take place. This does not include stocks that are sold in the ordinary course of business.

- Credit cards issued to directors and senior personnel should no longer be used.
- All assets of the company should be properly insured and the appropriate premiums dealt with.
- If the company's bank account is overdrawn, no further funds should be paid in.
- No creditor claiming retention of title to goods previously supplied by him should be permitted to remove any goods pending the appointment of a liquidator (unless the validity of the claim has been ascertained). As a compromise, the sale proceeds of the goods concerned should be paid into a separate bank account pending liquidation.
- No other creditor should be permitted to receive goods previously supplied by him under any circumstances

A strategy of continued trading may only be carried out if you do not incur further credit.
No goods of the company should be despatched on carriers who are owed money by the company
Dealings with any creditor should only be continued with caution. Attempts should be made to ensure that no lien, set-off, etc could occur
A sale of the business may constitute a transaction at undervalue if it is sold for less than its full market value.
Also, if a sale of business is to a connected person, it is especially important that any sale be at fair value.
The directors have a duty to take every step to minimise the loss to creditors and so the board of directors will have to consider any offers for the business.

Specific issues

(3) The only assets appear to be £15,000 in the Company's bank account and debtors of £50,000.
(5) Trade creditors are owed at least £3,500,000.

This indicate insolvency.
(9) Unknown to the directors, since November 2007 Henry had obtained further credit from key suppliers by giving them false accounting

This requires further investigation. Need to look at list of creditors, balance sheet/statement of affairs. Otherwise possible criminal offence? Also, consider misfeasance (s212)?
(9) Unknown to the directors, since November 2007 Henry had obtained further credit from key suppliers by giving them false accounting
Consideration of practical issues.

(b) Assuming that the Company is wound by the court on 10 October 2008. Discuss what steps you, as Liquidator, may take to increase the amount available to creditors. Your discussion should compare remedies available. (12 marks)

Discussion must relate to specific issues in question.
(1). Since its inception the Company has paid £20,000 per month for use of various plant and equipment, including a JCB, which Leo owns.

Is the hire charge in (1) a market rate?
Also consider in (1) whether there has been:
Wrongful trading (s214)?
Preference (s239)?
Misfeasance (s212)?
(2) The Company also pays the sub-contractors directly, even though Leo, through his business as a sole trader, is responsible for hiring them. Leo charges a management fee of £5,000 per month for arranging the sub-contractors. The sub-contractors are currently owed £100,000.

From the information in (2) consider
Wrongful trading (s214)?
Transaction defrauding creditors (s423)?
Misfeasance (s212)?
In (2) also consider
Who is the contract with?
Is the company responsible for the sub-contractors?
Are the sub-contractors employees?
(4) The Company has never prepared financial or management accounts and it is difficult to distinguish what work Leo does on his own account and what work he does for the Company.
(4) The Company has never prepared financial or management accounts and it is difficult to distinguish what work Leo does on his own account and what work he does for the Company.

Molly has responsibility for the accounts but all directors should "ascertain" what the financial position is – s214.
(6) Stephen loaned the Company £40,000 in August 2005, for which he received 20% interest per annum. He had no security for the loan which was repaid in January 2008.

Consider:
Extortionate credit transaction (s244)?
Wrongful trading (s214)?
Preference (s239)?
(7) Inspection of the bank statements reveals:

- *that Molly and Stephen draw £1,000 per month each in salaries and Leo draws £5,000 per month salary.*

A total dividend of £500,000 was paid in August 2008.

Consider here that Molly and Stephen draw modest salaries but this may not be sufficient to protect them from actions for wrongful trading (Re Produce Marketing).
Leo – higher salary – also may have had more knowledge of financial position
Was the Company able to pay a dividend? i.e. Were there realisable profits out of which to pay a dividend?
(8)It appears that during the last year some of the Company's cash receipts and some Company cheques were paid directly into Leo and Molly's personal bank account. They maintain that the payments were made to finance the hiring of labourers, hire purchase payments for the machinery and other payments for the benefit of the Company.

(8) requires further investigation.
Need to look at list of creditors, balance sheet/statement of affairs.
Otherwise possible criminal offence?
Also, misfeasance (s212)?
Fraudulent trading (s213)?
Transactions defrauding creditors (s423)?

(9) Unknown to the directors, since November 2007 Henry had obtained further credit from key suppliers by giving them false accounting

Henry has committed a criminal offence
Was Henry a shadow director?
The Company may also be liable for fraudulent trading (s213)
Morris v Bank of India [2005] EWCA Civ 693; [2005] B.C.C. 739; [2005] 2 B.C.L.C. 328; [2005] B.P.I.R. 1067
It could be appropriate to attribute knowledge of fraud to a company, even though a person with knowledge of the fraud had acted dishonestly, in breach of his duty to his principal and employer and in circumstances in which he would not have passed on his knowledge to his employer.
(10). On 26 September2008 a creditor, for £25,000, petitioned for the winding up of the Company. Since that date the following amounts have been paid out of the Company's bank account:

Creditors	*£165,000*
Wages	*£100,000*
Happy Garages	*£5,000*
Leo	*£70,000*

The amount paid Happy Garages was for repairing Leo's daughter's damaged car which her uncle had given her as a 21st birthday present in July. The £70,000 paid to Leo comprised his £5,000 monthly management fee plus £65,000 for work done on tendering, unsuccessfully, for a large contract.

Dispositions of funds made after the commencement of the winding up (which is the date of the petition) is void unless the court orders otherwise (s127).
It may be possible to apply to court for validation of the £165,000 paid to creditors and the £100,000 paid in wages.
The amount paid to Happy Garages is a personal expense and will need to be repaid by Leo's daughter.
The £70,000 paid to Leo will need to be carefully looked at.
Compare remedies
c. Discuss the problems associated with funding the steps discussed in b. (6 marks)
Are there assets/funds available to pay for investigation and any subsequent legal actions?
Actions commenced by liquidators, including for wrongful trading, are not actions owned by the company i.e. actions which are bestowed on the office-holder by legislation.
The liquidator will be able to seek indemnity from company assets there are likely to be other claims on company assets which will enjoy priority over his or her right to indemnity.
Costs associated with the fighting of cases can come within the term "winding up expenses" in r.4.218(1)(a)
Need the consent of the preferential and/or floating charge holder to use realisations for litigation costs and the liquidator's expenses which are incurred in the preparation of, or during the course of any legal proceedings, exceeding £5,000 (and cost for arbitration or dispute resolution) in accordance with r 4.218A
Problem of champerty – if someone funds action and wants "fruits of action". This may be champertous, see Ward v. Aitken and Others' Re Oasis Merchandising Services Limited [1995] B.C.C. 911.
Liquidator could be insured for adverse costs.

PERSONAL INSOLVENCY NOVEMBER 2008

EXAMINERS REPORT

GENERAL

As usual this paper sought to test candidates' knowledge using typical examples met in practice. There were some very good answers but once again some candidates failed to tailor their answer to the question preferring answers instead which appeared to have been learnt by rote. In real live cases a rote answer is unlikely to be a full answer so candidates should not expect such an answer to be satisfactory in the context of this exam. Similarly as in past years, some candidates wasted time by unnecessarily repeating the content of a question. Neither of these flaws is new but they are referred to in the hope that they might be tackled in the future.

QUESTION 1

The first part of this question sought to test the candidates' knowledge of disclaimer and sanction to compromise a debt. Disclaimer was covered reasonably well but many candidates missed the need to obtain sanction to compromise the debt and one or two rambled around the merits of the offer. A large number of candidates failed to set out the procedures to be adopted.

The second part required the candidates to set out steps to close the case. Many candidates failed to mention the need for a remuneration meeting but otherwise this part was reasonably well done.

The last part of this question required a receipts and payments account. Most candidates coped adequately with the foreign debt, the debt to wife and the dividend but often VAT was poorly dealt with. Layout was frequently untidy.

QUESTION 2

The first part of this question sought to test the candidates' understanding of the ethical issues in the context of the case in question. Most candidates understood the potential problem of a material professional relationship but few dealt with the self review threat. Almost no-one considered the possibility that a non-formal appointment might be acceptable.

The second part of the question asked candidates to compare and contrast bankruptcy and voluntary arrangements on one hand and non-formal ways of dealing with debts (debt management plans, consolidation loans, informal agreements) on the other. It also asked the candidate to discuss the advice that would be given to the debtor.

Most candidates had a reasonable knowledge of the range of possibilities. "Doing nothing" which was mentioned quite often scored no marks as it is not a way of dealing with debt.

When it came to providing appropriate advice candidates were less fluent and sometimes confused.

- Most recognised that the debtor's job might be affected by formal insolvency but then referred to the likelihood of an income payments order/agreement in bankruptcy.
- Some candidates seemed to think that the only form of IVA was a 5-year protocol compliant one!
- Most candidates spotted that creditors should be paid in full but many failed to point out that the cost of whatever was to be done would be borne by the debtor and was therefore an important issue for him.
- Most candidates realised that bankruptcy would be the most expensive process but suggested that this was a problem for the creditors when on the facts they would be paid in full.
- Some candidates spotted that the debtor could take a lump sum from his pension fund but no-one seemed to realise that he could continue to work
- Very few candidates made the point that the debtor might cut his expenditure and seek to live within his means.

QUESTION 3

The first part of this question asked candidates how they would treat a personal injury debt and a matrimonial debt for the purposes of paying a dividend. Most candidates were aware that the lump sum and costs would be provable but were less sure how to treat the personal injury debt.

The second part asked the candidates to set out what investigatory and recovery action might be taken given the facts of the case. Most candidates spotted the potential undervalue on the matrimonial settlement identified the practical action to be taken and referred to both *Mountney v Treharne* and *Haines v Hill.*

The preference to the business associate was also reasonably well dealt with but the void disposition of the table was frequently missed.

The third part of this question asked the candidate to summarise the offences committed by the debtor and to set out the action that might be taken against him. This was generally well done. Quite a few candidates referred to excessive pension contributions. Given that the pension fund was described in the question as being "of little value" this seemed rather perverse. No marks were given.

QUESTION 4

This was the least well-done question, possibly because it was the last in the paper but also because it was evident that many candidates' understanding of partnerships in an insolvency context was weak.

The first part of this question asked the candidate to advise the newly bankrupt debtor who was a partner with his wife in a plumbing business, whether he should stop trading. Many candidates correctly identified that bankruptcy brought the partnership to an end but very few realised that the business would continue under the control of the non-bankrupt partner.

The second part of the question sought to test the candidates' knowledge of annulment on the grounds that an order should never have been made. Most identified the annulment point but some then failed to deal with the fact that the debt was disputed or appreciated that the undisputed portion had to be paid if the petition was to be annulled.

The third part of the question asked the candidates to "set out the statements of affairs which are relevant to advising on this case". A substantial number of candidates failed to appreciate that there were three relevant statements of affairs in this case notwithstanding the use of the plural in the question. Well prepared candidates however, scored highly on this section.

The final part of the question asked the candidates to set out the range of options available in this case. Some candidates identified that payment in full was likely and that IVAs were probably the way forward but the quality of discussion was rather mixed.

PERSONAL INSOLVENCY NOVEMBER 008

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) Explain how you would deal with the two unrealised assets setting out in note form the procedures to be adopted. (7 marks)

Disclaimer
Onerous asset – environmental liability
Discussion of process
  Identify interested parties
  Trustee signs copy notices which are stamped by Court
  Notices served on interested parties
  Disclaimer releases trustee from personal liability
  and crystallises debt

Sanction to compromise debt
  Committee or SoS approval
  Report setting out debt due, offer, reasons for compromise

(b) Set out in note form the other steps you would need to take to close the case. (6 marks)

Notice of intention to pay a dividend
  To all known creditors *r11.2*
  21 days' notice
  pay dividend within 4 months of proving
  public advertisement if none previously
Notice of declaration *r11.6*

Remuneration meeting – time costs or scale rate
  Creditors' Committee decision
  If no committee general meeting
  Category 2 costs need approval
Pay petitioning creditor costs
Pay VAT
Review files and check all issues cleared
Update IP record
Cancel insurance
Reconcile to ISA account
Final report
Final meeting
Cancel bordereau

(c) Prepare a receipts and payments account assuming that you had completed your administration of the estate, making any appropriate estimates. (7 marks)

Inclusion of compromised debt Correct treatment of VAT Dividend generally - correct treatment of foreign debt - correct treatment of debt due to wife - landlord's claim

	£	
Creditor's deposit	400	
Equity in matrimonial home	7,000	
Book debts	14,600	
Cherished number plate	1,500	
Plant and machinery	600	
Book debt	1,872	
VAT	3,251	
	29,223	
Official Receiver's fees	1,715	
Bond	125	
Secretary of State fee	4,628	
Solicitor's fees	1,200	
Remuneration	7,000	
Disbursements	400	
Petitioning creditor costs - say	1,000	
VAT payable	1,746	
VAT	1,505	
	19,319	
Surplus	9,904	
Creditors		
Builditezee	12300	
HMR&C	28500	
Mrs Cheetah		Deferred
Stateside Liners	2666	US2.10/£
Landlord - say	3600	uncertain
	47066	

QUESTION 2

(a) Set out the ethical issues you should consider before taking any appointment in this case. (5 marks)

Material professional relationship
Need for objectivity
And to be seen to be independent
Informal appointment may not be precluded
Is the firm a creditor?
Any self review threat?
Money laundering

(b) Compare and contrast the advantages and disadvantages of formal insolvency procedures (Bankruptcy and Individual Voluntary Arrangement) with non-formal ways of dealing with debts and discuss the advice you would give to Mr Panther. (15 marks)

Loss of employment in formal insolvency
what does contract of employment say?
might need to avoid formal insolvency process
Informal processes
- avoid stigma of bankruptcy
- cheaper
- but need the debtor to be proactive
- they are not binding on creditors

Consolidation loan
- cheaper
- may be secured

Informal agreement
- lower monthly payment
- may obtain interest holiday
- needs debtor to be proactive

Peter could use his pension fund
- £20k lump sum
- No need to retire
- not a bankruptcy asset
- insufficient to pay creditors in full

Substantial equity in the house - remortgage
- Peter's share £110k
- But re-mortgage might be too expensive?
- has effect of converting unsecured debt into secured debt
- Could sell the house

Cut living expenses
- children to pay for themselves
- live within their means

Formal debt management plan
- could be expensive and protracted
- one monthly payment
- no mechanism to bind silent creditors

IVA
- cheaper than bankruptcy but given the assets all procedures would need payment in full
- may protect the house as an excluded asset or only realised if necessary
- may fail even if debtor not at fault (*re Keenan)*

Costs of Bankruptcy probably greatest.
Since there should be a surplus this option should be avoided

Bankruptcy offences/restrictions to be considered
IVA interim order could prevent creditor action
- but in these circumstances credit and loan companies may be prepared to give a period of grace – say 3 months – while re-mortgaging or obtaining consolidation loan – could be difficult in current market

Clarity and quality of discussion

QUESTION 3

(a) Set out how you would treat the debts to Mrs Jellicle and Mrs Macavity in the event that you were to pay a dividend. (4 marks)

Debt due to Mrs Jellicle is provable but Mr Macavity will not be released on discharge (*s281 (5) IA86*)
Debt due to Mrs Macavity may be partly provable (lump sum and costs) and partly not (arrears of maintenance). None released on discharge

(b) Assuming that what Mr Cougar tells you is true, consider and set out the investigatory and recovery action that you might take. (17 marks)

Transfer at an undervalue
Transfer of matrimonial home to wife is challengeable – but *Haines v Hill*
Although transfer must be completed (*Mountney v Treharne*)
Register restriction at Land Registry
Obtain valuation
Check mortgage outstanding
Obtain solicitor's files (*s366 IA86*)
Watch for 3 year time limit imposed by *s283A IA86*
Preference
Payment of associates debt within 2 years of Bankruptcy Order a preference
May also be a void disposition *s284(2) IA86*
Contact Mr Skimbleshanks
Instruct solicitors if necessary
Void disposition
The table should not have been disposed of to his mother – breaches *s284 IA86*
Claim the table
Do DVLA search re the Ferrari
Obtain evidence from Mr Cougar – accounts and working papers
Seek injunction over vehicle pending establishing ownership
Spanish property may be difficult to recover but EU Regs apply
Obtain evidence from solicitor's files
Check valuation, title and occupancy
Ex wife may be cooperative and provide information
Examine Macavity, publicly if necessary

(c) Summarise the offences committed by Mr Macavity and set out what action might be taken against him. (9 marks)

Bankruptcy Restriction Order/Undertaking
Suspension of discharge
Gambling (a consideration for a BRO) but not an offence in itself
False Statement of Affairs – a criminal offence
Non-disclosure (*s353 IA86)* and concealment of assets (*s354 IA86)* – criminal offences
Failure to co-operate with the Trustee -
Fraudulent disposal of property – *s357 IA86*

QUESTION 4

(a) Advise whether Frank Felix should accede to the Official Receiver's instruction to stop trading. Set out your reasons. (3 marks)

No – it is a partnership and the business and assets belong to partnership. The bankruptcy estate has an interest in the partnership which is under the control of the solvent partner

(b) On the assumption that what Frank Felix has told you is true, how might he be advised to deal with the bankruptcy order? (7 marks)

Could seek to show that the Bankruptcy Order should never have been made and therefore annul *(s282 IA86)* for

a) failure to properly serve
b) disputed debt – in whole or part
   (but part debt needs to be settled to avoid order being made anyway)
c) apply for a stay
d) still needs to deal with the petition

(c) On the assumptions that

- **the petition was properly served on Frank;**
- **the VAT debt is agreed at £32,000; and**
- **work in progress is worth £5,000;**

prepare the statements of affairs which are relevant to advising on this case. (10 marks)

Three statements of affairs – two sole and the partnership

		Mr F	Mrs F	Partnership
	Book Value	Est to Realise	Est to Realise	Est to Realise
	£	£	£	£
Bank	1,500			1,500
Tools and equipment	2,500			2,500
Stock	1,500			1,500
Debtors	6,500			6,500
WIP	5,000			5,000
Endowment policy	7,500	7,500		
Matrimonial home	270,000			
	-230,000			
	40,000	20,000	20,000	
		27,500	20,000	17,000
Creditors				
VAT	32,000			32,000
SA Tax	5,500	5,500		
Trade creditors	4,500			4,500
Credit card - Mr	1,500	1,500		
Credit card - Mrs	1,000		1,000	
Partnership deficienc	19,500	9,750	9,750	
		16,750	10,750	36,500
Surplus/deficiency		10,750	9,250	-19,500

Important points for Statements of Affairs

- 3 separate estates
- treatment of house as a joint, not partnership asset
- correct allocation of creditors
- partnership deficiency ranks in personal estates

General presentation and accuracy

(d) Based on the statements of affairs prepared in answer to question 4 (c) and other information provided in the question set out the range of options available. (10 marks)

Should be able to pay in full. Bankruptcy inappropriate as costly.
IVA would preserve profitable business – PVA not sufficient as would not deal with bankruptcy
Contributions would be available but may not be sufficient to save the house.

	£	
Profit	35,000	
Personal allowances	10,450	
Taxable	24,550	
Tax and NI at 30%	7,365	
Net profit	27,635	
Domestic outgoings	24,000	
	3,635	
Contributions	300	per month

Re-mortgage might be possible – but may be too costly
General discussion