

**JOINT INSOLVENCY EXAMINATION BOARD**  
**NOVEMBER 2014 EXAMINATION (SCOTLAND)**  
**EXAMINERS' REPORTS AND MARKING PLANS**

## **INTRODUCTORY COMMENTS**

The comments in this introductory section have been inspired by comments made by the subject Examiners in their individual reports which are attached. The introductory comments are made either because they are of general application, or they reflect comments which have been made more than once in the Examiners' reports.

### **The application of knowledge to the facts of the question**

Many questions give candidates facts about a particular situation and require them to identify an issue or problem and to say how this should be dealt with or resolved. Previous Examiners' reports have referred to the fact that candidates are often able to identify the issue and the point of law which applies, but that far fewer are able to apply this knowledge to the facts of the question and to present coherent and workable solutions and/or advice.

It should be apparent to those who study the mark plans reproduced as part of this report and those attached to previous reports that the Examiners are often looking to candidates to set out clear advice and solutions based on the given facts and the relevant law and best practice. Those candidates who do not demonstrate that they possess the practical knowledge to provide a full answer with the required advice and solutions cannot be awarded the marks that can make the difference between passing and failing the examination.

There are still too many candidates who approach their answers by identifying an issue or point of law and by writing down, sometimes at inordinate length, all they know about that particular subject. This can, and too often does, result in Examiners being presented with pages of script which, whilst largely right in themselves, are irrelevant to the question. Too often, whole pages of script cannot be awarded any marks at all. Candidates who approach answers in this way are wasting time and, invariably, are amongst the weaker candidates who struggle to pass the examination.

### **Demonstrating a wider knowledge of insolvency**

All three Examiners make reference in their reports to many candidates' failures to refer to established case law or recent developments when presenting their answers. By not doing this, candidates miss out on marks which are available and do not give themselves the best chance of gaining higher holistic marks.

Candidates must ensure that they are aware of developments in the law and in the wider insolvency environment and are able to show this knowledge where possible in the examination. To do this, candidates will need to read widely and ensure that they are alert to, and absorb, what is going on beyond the confines of their formal studies.

### **Numbers and their presentation**

Questions involving the calculation and presentation of numbers are regularly set in all three papers. Many candidates demonstrate that they are comfortable with manipulating numbers and with their presentation. However, a sizeable minority of candidates still has difficulties with "numbers questions" and score very poorly. The manipulation and presentation of numbers is a key skill for Insolvency Practitioners and candidates who do not demonstrate this in their answers are always going to struggle to pass the examination.

### **Poor handwriting**

As in previous years poor handwriting was an issue for a few candidates. If candidates are aware that they have poor handwriting they must make a special effort to ensure that their answers are legible. Candidates who persist in using handwriting that is either illegible or difficult to read are putting themselves at a material disadvantage.

Candidates should note that the introduction of electronic marking means that scripts may now be considered by the examination team on a computer screen. Candidates will appreciate that it can sometimes be more difficult to read documents on screen, making it even more imperative to avoid poor handwriting.

### **The use of Butterworths Insolvency Law**

Some candidates indicated on their scripts that they had used the 15<sup>th</sup> edition of Butterworths. The “Notes to Candidates and Syllabus for the Examination” issued for the 2014 examination made it clear that the 16<sup>th</sup> edition of Butterworths would be used by Examiners when setting and marking the papers. Candidates who use out of date editions of Butterworths run the risk of getting things wrong.

### **The order of answering questions**

Candidates are, of course, free to answer questions in whatever order they choose. However, where an individual question is divided into specified parts with a stated number of marks being awarded for each part, it is often structured in that way in order to assist candidates’ thought processes. Candidates who approach “multipart” questions by answering the individual parts in a random order often fare less well than those who approach the question from the beginning and work through it in a logical order.

## JOINT INSOLVENCY EXAMINATION BOARD

### LIQUIDATIONS (SCOTLAND)

#### EXAMINER'S REPORT AND MARKING PLAN FOR THE 2014 SITTING

##### General comments

Some candidates were well prepared and showed a clear knowledge and understanding of Liquidations. However, although many candidates had an adequate knowledge of the insolvency legislation and consequently gained some marks, many failed to gain significant marks as they were unable to apply this knowledge to practical situations, indicating a lack of practical experience. These candidates also seemed to have no knowledge of relevant case law that interpreted/expanded upon the legislation and failed to discuss the practical problems and solutions to the various issues raised.

Some of the questions required straightforward numerical analysis: no difficult calculations were required. Some candidates failed to gain marks for the numerical parts: poor and inaccurate numerical answers indicated a lack of understanding of the issues raised in the question.

The inability to apply their knowledge to practical issues and the general lack of understanding of the insolvency legislation inevitably led to some candidates being awarded low holistic marks.

##### Question 1

- (a) **Set out how you would address each outstanding matter in order to reach the position where the interim dividend can be declared. Where appropriate calculate the amount which should be accepted by you, as Liquidator, as a claim in the Liquidation or set out the further information you will require in order to calculate that amount. State your reasons and assumptions; (20 marks)**

##### NOTE: Ignore VAT

Candidates were required to resolve a series of issues before an interim dividend could be paid in a Creditors' Voluntary Liquidation following an Administration. The Liquidator had not been the Administrator. The issues included suggestions of impropriety by the Administrator, Liquidator's fees, directors' transactions and the Company's dealings with various types of shareholder.

Candidates were also required to set out a distribution statement.

This question was generally well answered, although not all candidates produced a clear distribution statement. There was a failure by most candidates to pick up on the fact that there would have been approval process for approval of the administrator's fees and similarly a process for approval of the liquidator's fees

Most candidates also did not know that set off would not apply as the assignation took place post administration.

One candidate suggested that a shareholder could offset uncalled capital against outstanding debts.

Nobody referred to the order of payment in a liquidation.

- (b) Prepare an estimated distribution statement, stating your further reasonable assumptions. (5 marks)**

The distribution statement was reasonably well done, but although the Corporation tax rate was given in the question information, some candidates ignored or used their own assumption.

## **Question 2**

- 2(a) Set out the entitlements of the employees in the Liquidations of each of the three Companies. (9 marks)**

Question 2(a) tested candidates' knowledge of the relevant dates of employee preferential claims in Liquidation in relation to other insolvency procedures, as well as the various other employee claims that arise. It required candidates to set out the entitlements of employees in three different companies that had entered Liquidation in different circumstances. The first Company was in Creditors' Voluntary Liquidation following the filing of Form 2.25B (Scot) at Companies House and the second was in Creditors' Voluntary Liquidation because of breaching a condition of a Company Voluntary Arrangement. The third Company was wound up by the Court when a Receiver had previously been appointed over its assets and undertaking.

Question 2(a) was generally poorly answered and just not interpreted correctly, completely missing the requirement to state the "relevant date" for each scenario. Most candidates seemed not to be aware that, for the purposes of the National Insurance Fund, the relevant date is date of Company Voluntary Arrangement and not the date of the Creditors' Voluntary Liquidation for the purposes of the payment of preferential creditors (Employment Rights Act 1996, sections 182 and 183). This was confirmed in Secretary of State for Business Enterprise and Skills McDonagh & Ors UKEAT/0287/12/ LA; Secretary of State for Business Enterprise and Skills v Pengelly & Ors, UKEAT/0312/12/ LA. Candidates seemed to be unaware of these decisions.

It would appear that every candidate incorrectly believed CVL resulted in automatic termination of employment.

- 2(b) In preparation for your meeting with George, write a file note addressing George's concerns and setting out the options for the Bank. Set out what further information you may need. Your note should include an explanation of the implications for the Bank if the Company goes into insolvent Liquidation. (16 marks)**

Question 2(b) tested candidates' ability to advise a secured creditor of a Company that was threatened with imminent insolvent liquidation. Whilst a low number of candidates, this was generally better answered. Some candidates struggled to advise the bank on the actions it could take to protect its position, but several provided clear advice. Those without practical experience were apparent.

Some candidates produced a Statement of Affairs, which was not a requirement of the question and did not result in many, if any marks being awarded for work which must have taken them some time in the exam.

## **Question 3**

- (a) Set out the main legislative and other sources that you would consult when considering cross border insolvency; (4 marks)**
- (b) Taking into account the specific circumstances of the Scottish Company, and making and stating any reasonable assumptions, set out, with reasons, where you consider the location of the Scottish Company's Centre of Main Interest to be; (5 marks)**

Question 3 tested candidates' knowledge and understanding of the issues arising in cross border insolvency. It gave information about a group of companies, variously registered in Scotland, Luxembourg and Jersey. The Scottish Company had branches in Scotland, France and Germany.

Question 3(a) and (b) tested candidates' knowledge of the main legislative and other sources that may be consulted when considering cross border insolvency and of the matters to be determined when seeking to establish a company's Centre of Main Interests (COMI).

Most candidates specified at least one source to which they would refer when considering cross border insolvency. A surprising number failed to refer to the Cross Border Insolvency Regulations 2006 (SI2006/1030) and case law but most referred to the European Insolvency Regulation (Council Regulation (EC) 1346/2000 on

Insolvency Proceedings). This scattergun approach is not conducive to scoring good marks. This part of the question should have provided some easy marks and it was disappointing to see how few marks candidates picked up.

In part (b) generally, candidates provided an adequate explanation of practical considerations in determining COMI but surprisingly few referred to the legislative resources they had just listed in part (a).

- (c) Making and stating any reasonable assumptions, write a file note setting out, with reasons, the issues that may be encountered if the Scottish Company were to be placed into Creditors' Voluntary Liquidation in Scotland and explaining how these issues may be resolved; (10 marks)**

Question 3(c) was poorly answered with some candidates gaining no marks at all. Most candidates missed the point of the question entirely. Even those candidates who had correctly answered parts (a) and (b) had failed to apply these answers to the circumstances of the question and did not discuss the issues in a meaningful way: most failed to draw on the case law that has developed.

- (d) Write a file note setting out, with reasons, how the Holding Company and the Jersey Company may each be wound up in Scotland. A detailed explanation of the procedures is not required. (6 marks)**

Question 3(d) required candidates to set out, without giving a detailed explanation of the procedures, how the Luxembourg and Jersey companies may be wound up in Scotland. Most missed the "forum shopping" point of the question entirely. This was very poorly answered, with candidates showing they had little knowledge and most gaining no marks at all whether they answered the question or not. Several candidates did not even attempt this part of the question.

Very few holistic scores were awarded in this question.

#### **Question 4**

- (a) Prepare a statement of affairs and deficiency account for the Company at 31 October 2014, setting out any reasonable assumptions you make. (8 marks)**
- (b) Taking into account the known specific circumstances of the Company, identify the issues that will need to be dealt with when placing the Company into Creditors' Voluntary Liquidation, as well as the issues that may be anticipated to arise during the Liquidation. (12 marks)**
- (c) Set out the issues that a Liquidator of the Company needs to consider in response to Clare's plan to establish a new salon. (5 marks)**

This question required candidates to consider a small, owner managed hairdressing Company with few assets that needed to be placed into Creditors' Voluntary Liquidation. This should have been a straightforward question for the well prepared and experienced candidate, but some seemed to struggle answering it. Candidates were unable or unwilling to set out the issues that need to be considered when a Company is about to enter Creditors' Voluntary Liquidation.

Question 4(a) required the preparation of a straightforward Statement of Affairs and Deficiency Account. There was a lack of attention to detail shown and in one case a complete lack of understanding of the layout of a statement of affairs.

Question 4(b) required candidates to set out the issues that need to be considered when placing the Company into Creditors' Voluntary Liquidation and anticipating those that may arise during the Liquidation. This was poorly done and missed some of the key information. Very few candidates considered issues such as compliance with money laundering regulations, payment of fees etc which would always be first priorities in accepting new instructions.

Question 4(c) required candidates to consider the shareholder/director's proposal to re-establish a hairdressing company, with the same name. Some candidates seemed to be more confident answering part (c), and there were some good answers, although few mentioned the need for Clare to take independent advice.

## LIQUIDATIONS (SCOTLAND)

### EXAMINER'S MARK PLAN FOR THE NOVEMBER 2014 SITTING

- 1(a) Set out how you would address each outstanding matter in order to reach the position where the interim dividend can be declared. Where appropriate, calculate the amount which should be accepted by you, as Liquidator, as a claim in the Liquidation or set out the further information you will require to calculate that amount. State your reasons and assumptions. (20 marks)

Candidates should be aware of/discuss the order of payment from the assets in a Liquidation. Supreme Court in *Nortel* ([2013] UKSC 52) summarised the order of payment from the assets in a Liquidation:

- Secured creditors;
- expenses of the insolvency proceedings;
- preferential creditors;
- floating charge creditors [*after prescribed part*];
- unsecured debts;
- statutory interest;
- postponed debts;
- shareholders

Candidates should also relevant legislation to consider/discuss when answering this question:

S107 – Distribution of company's property;

S115 – Expenses of voluntary winding up;

S175 – Preferential debts (general provisions);

S189 – Interest on debts

R4.66 - Order of priority of distribution

R4.67 – Order of priority of expenses of liquidation

R4.68 – Application of bankruptcy Act

i Mandible Ltd: concern about Administrator's fees:

- look at Administrator's response;
- look at level of fees, SIP 9 disclosure by Administrator, was this compatible with work done by Administrator;
- consider Administrator's SIP 9 report and whether further investigation needs to be done into the time spent by Administrator (assuming fees on a time cost basis) and/or other basis of remuneration and work done;
- Consider what approval process has been followed by the administrator
- consider R2.39 and 2.39B;
- consider costs of any investigation work compared to outcome for creditors (SIP 2 Para 5)
- if necessary, consider whether Administrator should be reported to her rpb via the Insolvency Service's Single Gateway

ii Additional invoice from Administrator:

- should be considered as part of i above;
- ensure properly approved in administration
- should be paid by Liquidator out of assets of which the Administrator had custody or control immediately before cessation [ Sch B1 para 99(3)]

iii Credit controller of Mandible Ltd:

- explain Liquidator entitled to remuneration;
- needs approval for basis of fees;
- Advice that the liquidation committee will be approving;
- Appeal process to Sheriff
- SIP9

iv Sternum Ltd – need to verify that Administrator approved the work provided for £30,000 during the Administration, If so this should be paid as expense of Administration, and remaining £170,000 will be unsecured claim in Liquidation. If not approved by Administrator, the unsecured claim will be £200,000.

v Humerus Limited remains a debtor for £40,000. Pelvis Limited remains a creditor for £150,000. Even though the debts have been assigned to Humerus Limited, Humerus Limited cannot set off the amounts as assignment occurred after date of Administration. Common Law doctrine of set off.

vi Ron Dopey: provided that the transaction for purchase of stationery was at arm's length (which it seems to

be) Ron is a creditor for £75,000. The director's loan account for £100,000 will need further investigation.

As a director Ron is connected with the Company and is an associate of the Company (s249 and see also s436)

vii Debt of £2million. Liquidator will need to enter into negotiations with the debtor. Schedule 4 paragraph 3 - sanction required.

viii Preference dividend – ranks after unsecured creditors (including interest):

$£1m \times 7\% \times 0.5 = £35,000$ .

Preference share capital also ranks after all creditors (including interest) but before shareholders. It seems that there will be insufficient funds to pay anything to the preference shareholders, either in respect of the dividend or the capital.

S74(2)(f)

ix £190,000 loan, provided verified, will be an unsecured creditor which will rank ahead of the preference dividend.

x Liquidator should make a call on ordinary shares for the unpaid element.  $10,000 \times 10 \times 60p = £60,000$   
Schedule 4 paragraph 3 sanction required.

See also, s74 – liability as contributories of present and past members, s74(1) and (2)(d)

s79

s80

s150

x Ordinary shareholder will remain an unsecured creditor and this amount will rank ahead of any repayment of share capital. No set off.

s74

**1(b) Prepare a distribution statement, stating your further reasonable assumptions. (5 marks)**

Bank interest – disclose separately on R & P. Liquidator will need to pay tax on the income. Is an expense. CT rate = 20% (small profits rate) and 21%

Cash transferred to Liquidator from		
Administrator		£1,500,000
Call on ordinary shares		£ 60,000
Less Administration expenses		
Administrator's fees	£(100,000)	
Agent's fees	£( 50,000)	
Sternum Limited	£(30,000)	
		£180,000
Less Liquidator's expenses		
Liquidator's fees (say)	£( 50,000)	£(50,000)
Bank interest - say 5 months = £5,000 less corporation tax @20% [check] = £4,000	£ 4,000	
Debt collected by Liquidator £2,000,000 x 10%	£200,000	£204,000
Available for distribution		<u>£1,534,000</u>
Preferential creditors (paid in administration)	0	
Floating charge creditors (paid in administration)	0	
Prescribed part (n/a)	0	
Unsecured creditors		
Admitted by Administrator for voting purposes		£(10,000,000)
Sternum Limited	£(170,000)	
Ron Dopey	£ ( 75,000)	
Loan from preference shareholder (not in respect of preference shares)	£(190,000)	£(435,000)
Unsecured creditors in Liquidation		£(10,435,000)
Dividend to unsecured creditors 1,451,000/10,370,000 x 100 pence = 13.99 pence/£		£1,534,000
Loss to unsecured creditors		£(8,901,000)
Unpaid preferential dividend	£35,000	
Preferential share capital	£1,000,000	
Loss to preferential shareholders		£(1,035,000)
Loss to ordinary shareholders		£(100,000)



**2(a) Set out the entitlements of the employees in each of the Liquidations of the three Companies. (9 marks)**

**Employee entitlement on redundancy**

**Preferential status**

IA 1986 s386 and Sch 6

Employees can claim (using Form RP1), subject to a maximum of [£464]:

- Arrears of wages, up to a maximum of 8 weeks
- Up to six weeks' accrued holiday pay (maximum of one year's entitlement – can't carry over)
- Pay in lieu of notice – statutory entitlement only
- Protective award - classed as arrears of pay for purpose of limits
- Redundancy pay – statutory entitlement only (based on length of service)
- Occupational pension scheme – lowest of 12 months' contributions or 10% of 12 months' pay, or amount certified as payable.

Discussion of:

- relevant date for employees in different circumstances of the three companies;
- different definition of "insolvency" in ERA 1996;
- Relevant date when CVA precedes CVL = date of CVA (confirmed by EAT decisions in *Secretary of State for Business Enterprise and Skills McDonagh & Ors UKEAT/0287/12/ LA*; *Secretary of State for Business Enterprise and Skills v Pengelly & Ors, UKEAT/0312/12/ LA*).

IA 1986, s387 defines relevant date for determining existence and amount of preferential debt:

S387(3)(c) relevant date is date of CVL resolution unless, inter alia, the company is being wound up following administration pursuant to para 83 of Sch B1 (moving from admin to CVL);

S387(2) – relevant date for company in CVA = date of admin if company in admin or if not date of CVA;

S387(2a) – relevant date for company in CVA preceded by moratorium = date of filing

S387(b) – if court winding up, not preceded by admin,

**s387**

**"The relevant date".**

(1) *This section explains references in Schedule 6 to the relevant date (being the date which determines the existence and amount of a preferential debt).*

(2) *For the purposes of section 4 in Part I (meetings to consider company voluntary arrangement), the relevant date in relation to a company which is not being wound up is—*

(a) *if the company is in administration, the date on which it entered administration, and*

(b) *if the company is not in administration, the date on which the voluntary arrangement takes effect.*

(2A) *For the purposes of paragraph 31 of Schedule A1 (meetings to consider company voluntary arrangement where a moratorium under section 1A is in force), the relevant date in relation to a company is the date of filing.*

(3) *In relation to a company which is being wound up, the following applies—*

(a) *if the winding up is by the court, and the winding-up order was made immediately upon the discharge of an administration order, the relevant date is the date on which the company entered administration;*

(aa) *if the winding up is by the court and the winding-up order was made following conversion of administration into winding up by virtue of Article 37 of the EC Regulation, the relevant date is the date on which the company entered administration;*

(ab) *if the company is deemed to have passed a resolution for voluntary winding up by virtue of an order following conversion of administration into winding up under Article 37 of the EC Regulation, the relevant date is the date on which the company entered administration;*

(b) if the case does not fall within paragraph (a) (aa) or (ab) and the company—  
 (i) is being wound up by the court, and  
 (ii) had not commenced to be wound up voluntarily before the date of the making of the winding-up order, the relevant date is the date of the appointment (or first appointment) of a provisional liquidator or, if no such appointment has been made, the date of the winding-up order;  
 (ba) if the case does not fall within paragraph (a), (aa), (ab) or (b) and the company is being wound up following administration pursuant to paragraph 83 of Schedule B1, the relevant date is the date on which the company entered administration;  
 (c) if the case does not fall within paragraph (a), (aa), (ab), (b) or (ba), the relevant date is the date of the passing of the resolution for the winding up of the company.  
 (3A) In relation to a company which is in administration (and to which no other provision of this section applies) the relevant date is the date on which the company enters administration.  
 (4) In relation to a company in receivership (where section 40 or, as the case may be, section 59 applies), the relevant date is—  
 (a) .....  
 (b) in Scotland, the date of the appointment of the receiver under section 53(6) of (as the case may be) 54  
 (5).

...

Section 182 of the ERA 1996 states:

*“If, on an application made to him in writing by an employee, the Secretary of State is satisfied that—*

- (a) the employee’s employer has become insolvent,*
- (b) the employee’s employment has been terminated, and*
- (c) on the appropriate date the employee was entitled to be paid the whole or part of any debt to which this Part applies,*

*the Secretary of State shall, subject to section 186, pay the employee out of the National Insurance Fund the amount to which, in the opinion of the Secretary of State, the employee is entitled in respect of the debt.”*

ERA 1996, s185 defines “appropriate date” for arrears of pay and holiday pay as the date the employer became insolvent.

For unfair dismissal and protective awards, it is the later date of dismissal, insolvency or the date the tribunal made the award. For any other claim, it is the later of insolvency or dismissal.

ERA 1996, s 183(3) defines “insolvency”

- (a) if a winding up order .. has been made, or a resolution for voluntary winding up has been passed, with respect to the company,*
- (aa) if the company is in administration for the purposes of the Insolvency Act 1986,*

.....

- (c) if a voluntary arrangement proposed in the case of the company for the purposes of Part I of the Insolvency Act 1986 has been approved under that Part of that Act.*

### **Fibula Plc**

No impact on change of procedure on employees if enter CVL using para 83. i.e. employee claims at date of admin or date of redundancy, if later.

Relevant date for employee claims = date of admin, if exit from admin to CVL using para 83.

If, for any reason exit to CVL is not through para 83, relevant date would be date of resolution to wind up.

In addition to any statutory claims, the employees may have claims for any contractual obligations that they had entered into with Fibula Plc.

Note: The commencement of a CVL does not automatically terminate employees contracts of employment as the liquidator is an agent of the company and not an officer of the court.

The remuneration of any employees assisting the office holder will be an expense of the office holder.

### **Metatarsals Plc**

Employees who are employed by companies which had entered CVA and subsequently entered into liquidation are not entitled to be paid out of the National Insurance Fund (See - Secretary of State for Business v McDonagh and others UKEAT/0287/12 and UKEAT/0312/12).

Payments from the NI Fund includes: arrears of pay holiday pay, notice pay, basic award for compensation for unfair dismissal, some payments re apprentices (s184, ERA 1996).

Relevant date is date of CVA and not date of CVL for the purposes of the payment of preferential creditors from the National Insurance Fund. The employees will have an unsecured claim in the liquidation for these

amounts.

If employees had no arrears at date of the CVA, but had arrears of wages/holiday pay that had accrued during the CVA, they will have no preferential claim in the liquidation. In addition, there is no “expenses regime” (compared to administration) that permits the liquidator to pay the arrears that occurred in the CVA. They will have an unsecured claim in the liquidation.

### **Phalages Limited**

Can be 2 relevant dates.

Relevant date for 12 employee claims is date of receivership and date of liquidation for 3 employee.

**2(b) In preparation for your meeting with George, write a file note addressing George’s concerns and setting out the options for the Bank. Set out what further information you may need. Your note should include an explanation of the implications for the Bank if the Company goes into insolvent Liquidation. (16 marks)**

Structure of file note

IP would need to check that charges are registered (and if there are any prior ranking charges) and review terms/dates of charges and should explain this to George.

### **Solvency of Company**

From the information available the only asset of any value may be the land, which has a book value of £300,000

Assume that the business does not have a value and so the goodwill will be worth £0;

Stocks are on site and WIP is uncertified and so, in practical terms, there is not likely to be much value here. You would need to have more information about the WIP.

Trade debtors have a book value of £500,000 of which £450,000 is due from Pisiform Plc which is in CVL. The remaining £50,000 maybe collectable but more information is needed on this debt to give any opinion. George would need to be made aware that, in insolvencies, debt collections often achieve less than book value.

The Company has only one client and, unless it can find another client soon then it will have to enter into an insolvency procedure.

### **Will Company have to notify Bank before entering CVL?**

George has not mentioned the date the Bank’s floating charge was created.

If it was created on/after 15 9 03: the Company must give the Bank five business days notice, in writing that it intends to pass a winding up resolution. Unless the Bank consents in writing to the passing of the resolution within that 5 day period, the Company cannot pass the resolution until the end of the 5 day period (s84(2B)).

S100(4)

This time period will give the Bank the opportunity to take other action (see below).

If the floating charge was created before 15 9 03: the Company does not have to give the Bank this notice.

Caveats can be lodged in Sheriff Courts and Court of Session on behalf of the Bank to give the Bank notification of any petition for winding up of the Company.

Nevertheless, in a CVL the members usually pass a winding up resolution on the same day as the s 98 creditors’ meeting and all creditors’ must be given 7 days’ notice of the meeting, as well as the meeting to be advertised in the Gazette and so the Bank should have some notice.

The shareholders meeting and creditors’ meeting may take place up to 14 days apart (s98(1A)(a) – “Centrebind”. This will occur to protect the assets and the Liquidator has restricted powers (s166) in the period between the members’ and creditors’ meetings.

### **Will the Bank be notified if the Company is wound up by the Court?**

As directed by the court

### **What options are available to Bank?**

Application of the Bankruptcy Act Schedule 1 paragraph 5

Court winding up – Bank, or another creditor, could petition court. Court may appoint a provisional liquidator

Receivership: available if floating charge created before 15 9 03, can appoint a receiver even if liquidator has been appointed.

Call up Standard securities. If residential properties note Home Owner and Debtor Protection Act issues.

Administration: if floating charge created on/after 15 9 03, can appoint administrator Sch B1, para 14. Also before if qualifying per Sch 14.

In any case, Bank may discuss situation with the directors and suggest that Company/directors appoint an administrator SchB1, para 22

CVA – the circumstances of the Company make it unlikely to be suitable for a CVA

Turnaround – in or out of CVA or admin. Consider how to finance a turnaround – bank or elsewhere.

### **Considerations for the Bank**

#### **Insolvent Liquidation**

Bank does not lose its security (see above re voting for unsecured element)

Alternatively, could negotiate fee with Liquidator to sell property on its behalf.

If cannot agree a fee would have to follow the normal remuneration approval route.

#### **CGT:**

- the sale of the parcels of land will trigger a CGT liability if sold from a Company in Liquidation.
- receivership (if floating charge created before 15 9 03) will avoid triggering a CGT liability.
- Similarly receivership will avoid CGT liability if no Liquidation

More information will need to be gathered about whether there will be a chargeable gain (regardless of whether or not a receiver has been appointed).

Any CGT will be deducted from the proceeds of sale. A CGT liability will be avoided if the Company does not enter Liquidation [or Administration].

“Agency” status of Liquidator in relation to Company compared to receiver.

Consider timing of sale of land and appointment of Liquidator.

If floating charge created before 15 9 03 – Bank may still appoint receiver

No Scottish equivalent?

#### **Costs/expenses of liquidation and impact on Bank:**

Rule 4.32, but this is the Leyland DAF issue which was rectified in England and Wales, but not in Scotland.

#### **Litigation expenses**

No Scottish equivalent.

#### **Preferential creditors**

These must be paid out of the proceeds of the floating charge (in any procedure) ahead of any payment to the charge holder. S386 and sch 6.

Note preferential creditors are not paid out of standard security assets.

#### **Prescribed part creditors**

If the floating charge was created on/after 15 9 03: a prescribed part of the floating charge must be set aside to pay the unsecured creditors (s176A and Insolvency Act 1986 (Prescribed Part) Order 2003 (SI2003/2097) (Applies to any procedure, n/a to receivership as it is only effective for charges created on/after 15 9 03)

#### **Court winding up**

Above applies to court as well as CVL – court winding up may be more expensive?

#### **Would Administration have a better outcome for Bank than Liquidation?**

Administration is a collective procedure and, although purpose may be to realise property in order to make a distribution to.... Secured or preferential creditors...(SchB1 para 3(1)(c)), Administrator must consider interests of all creditors (para 3(2))

Property sale will trigger CGT liability in administration as in liquidation.

Bank would have more control over who is to be Administrator and very little control over the appointment of a Liquidator, but once appointed both office holders have to act independently and in the best interests of creditors.

Preparation of estimated outcome statement

**3(a) Set out the main legislative and other sources that you would consult when considering cross border insolvency; (4 marks)**

European Insolvency Regulation [Council Regulation (EC) 1346/2000 on insolvency proceedings].

Cross Border Insolvency Regulations 2006 [SI2006/1030]  
- UNCITRAL model law

S426 Insolvency Act 1986

- co-operation between courts exercising jurisdiction in relation to insolvency

S221 – winding up of unregistered companies

Statutory judgment enforcement regime: Foreign Judgments (Reciprocal Enforcement) Act 1933

Case law – both UK and European court

Common law

**3(b) Taking into account the specific circumstances of the Scottish Company, and making and stating any reasonable assumptions, set out, with reasons, where you consider the location of the Scottish Company's Centre of Main Interest (COMI) to be; (5 marks)**

COMI:

EC Regs and Uncitral Model Law: it is presumed that a corporate debtor's COMI is the location of the company's registered office, unless there is proof to the contrary (*article 3, Insolvency Regulation and article 16(3), Model Law*).

In determining the location of a debtor's COMI in the EC Regs, importance must be given to:

- the place where the debtor company has its central administration;
- Where the bodies responsible for the management and supervision of a company are in the same place as its registered office, and
- where the management decisions of the company are taken from.

[Interedil Srl (in liquidation) v Fallimento Interedil Srl and another [2011] EUECJ C-396/09]

Discussion: UK Company registered office in Edinburgh; main accounting department in Edinburgh; consider location of creditors; French and Scottish branches equal size; location of directors and where decisions are taken – France or Scotland? Directors – Holding Company (Luxembourg); Anthony where is he located?

COMI:

- must be ascertainable to third parties (Re Daisytek ISA Limited (2003) (unreported))
- in order to rebut the registered office presumption it must be shown that the head office functions take place elsewhere

(Re Eurofood IFSC Limited [2005] BCC 1021)

The Court of Appeal: Eurofood clearly established that: each company has its own COMI; and the head office presumption can be rebutted only by objective factors ascertainable by third parties. These factors should already be in the public domain and what a typical third party would learn as a result of dealing with the Company.

Matters that could only be established on enquiry should be excluded. The proper course therefore was to start with the presumption of COMI based on the registered office address. A non-exhaustive list of relevant issues to be considered was (in no order of importance):

- who are the companies creditors/customers and where are they based?
- under what law does it contract with creditors/customers?
- where do its banking relationships take place? — where do customers contact/ correspond with the company?

where is its head office?

from where does it conduct business?

where are its employees based?

where are directors based?

where are shareholders based?

where is its management based?

where do board meetings take place?

where are administrative and accounting functions carried out?

where are the majority of its assets based?  
where are the main bank accounts of the company based? where are the annual accounts filed?  
Where are the auditors based?  
(Re Stanford International Bank Ltd (in liquidation) [2010] EWCA Civ 137)

See also: BRAC Rent-A-Car International Inc, *Re* (2003) EWHC 128; (2003) 1 WLR 1421 Ch D

**3(c) Making and stating any reasonable assumptions write a file note setting out, with reasons, the issues that may be encountered if the Scottish Company is placed into Creditors' Voluntary Liquidation in Scotland and explaining how these issues may be resolved; (10 marks)**

File note

Discussion required around the following issues (NB. no knowledge of French, German or other foreign insolvency processes is necessary)

**CVL Liquidator in UK**

- assume COMI of UK Company in UK and so main proceedings can be instituted in UK (art 3(1))

Liquidator will need to apply to court on form 4.30 (R4.82) for confirmation of appointment as voluntary liquidator. This is for the liquidator's appointment to be recognised under the EC Regs

There seems to be a possibility of an insolvency appointment in France. An insolvency appointment is also possible in Germany.

**Secondary proceedings**

There may be secondary proceedings in France and/or Germany (art 17 – 28)

EC Regs Art3(3) – any secondary proceedings must be winding up proceedings.

**Reason for secondary proceedings**

The existence of main proceedings allows the opening of secondary proceedings without the Company's insolvency being examined in the country where secondary proceedings are proposed (Art 29)

**Must be an establishment**

EC Regs Art 3(2) – where COMI is in one EC state, the courts of another EC State have jurisdiction to open insolvency proceedings against the Company only if it has an establishment in that state.

A French Court refused jurisdiction to open proceedings in respect of an Italian registered company as it had no establishment in France. (This judgment was set aside on appeal, on the grounds that the liquidator's application was not intended to "open" insolvency proceedings but to join the Italian company to the proceedings already opened). *Rastelli Davide e C Snc v Hidoux* (in his capacity as liquidator appointed

**Law applicable** is law of country of main proceedings, whether or not there are secondary proceedings (Art 37)

**Conflict of law issues** (Art 5 – 15) – generally law applicable in country of secondary proceedings: security rights; set-off; retention of title; contracts relating to immovable property; payment systems and financial markets; contracts of employment; effects on rights subject to registration; Community patents and trade marks; detrimental acts; protection of third party purchasers; and effects on pending lawsuits.

Employee problems in Germany dealt with under German law.

Retention of title problems in Germany also dealt with under German law.

Where a company was subject to main proceedings in Italy and secondary proceedings in the UK – the assets in the UK would be distributed in accordance with UK insolvency law [*Re Alitalia Linee Aeree Italiane SpA, Connock & Boyden v Fantozzi* [2011] EWHC 15 (Ch), [2011] BPIR 308]

### **Synthetic insolvency:**

- to retain value of assets (Anthony considers value in whole of business) UK Liquidator will want to protect assets in France and Germany.

The liquidator in the main proceedings can lose control of the assets if there are second proceedings.

This may hamper the sale of the business and/or not achieve maximum value for the assets.

To avoid secondary proceedings, the UK Liquidator may come to an agreement with the French and/or German creditors

Collins and Aikman: main proceedings of 24 companies in 10 EC jurisdictions, the administrators were mostly able to avoid secondary proceedings by entering into discussion with creditors in each of the different countries and provided them with assurances that their priorities as creditors in the local jurisdictions would be respected in the absence of secondary proceedings. The assurances were subsequently ratified by the court

[Collins & Aikman Europe SA Collins & Ors, Re Insolvency Act 1986, Court of Appeal - Chancery Division, June 09, 2006, [2006] EWHC 1343 (Ch)]

Nortel

MG Rover [High Court, Birmingham District Registry, 11 May 2005, HHJ Norris WC, Case Nos 2375-2382 of 2005 (unreported)]?? and French Supreme Court (commercial chamber) 27 June 2006, No. 03-19.863]

If there are no secondary proceedings the Liquidator should take steps to dismiss the employees in France and Germany (under relevant laws) as well as in the UK

Practical issues in general

**3(d) Write a file note setting out, with reasons, how the Holding Company and the Jersey Company may each be wound up in Scotland. A detailed explanation of the procedures is not required. (6 marks)**

### **Holding Company**

COMI seems to be in Luxembourg

It is possible to change COMI, but is it worthwhile in the given circumstances? i.e. is the insolvency regime in Scotland more favourable than in Luxembourg (no knowledge of Luxembourg proceedings) as rescue of the Holding Company is unlikely?

EC Regs – preamble para 4 states that it is necessary to avoid transferring assets or judicial proceedings from one jurisdiction to another to obtain a more favourable legal position (i.e. to avoid forum shopping)

It is possible to change COMI by moving registered office and/or central and financial administration to another jurisdiction to benefit from a more favourable insolvency process.

It was held that the COMI had moved to England from Luxembourg (even though the registered office was in Luxembourg) because the head office and principal operating address had moved to England, creditors had been notified of the change of address, a press release had been issued, a London bank account had been set up and the Company had been registered as an overseas company under the Companies Act.

Although the change of COMI was allowed because of the availability of restructuring in England.

[Hellas Telecommunications (Luxembourg) II [2011] EWHC 3176 (Ch)]

Note in this case the Holding Company is not likely to be restructured.

### **Jersey Company**

This is not in EC.

COMI probably in Jersey.

IA s426 applies

Assets in Scotland (and France and Germany).

(and may also be wound up as an unregistered company s221)

Appeal Court has ruled that UK courts have authority to grant assistance to a foreign court under s426 even where an insolvency proceeding has not been opened in the foreign court.

[HSBC Bank plc v Tambrook Jersey Limited [2013] EWCA Civ 576]

4(a) Prepare a statement of affairs and deficiency account for the Company at 31 October 2014, setting out any reasonable assumptions you make; (8 marks)

**Scary Hair Limited: Statement of Affairs at 31 October 2014**

Ref		BV £	ETR £	
	<b>Assets subject to charges</b>			
	Motor vehicle	5,000	1,000	
	Due to Dodgy Motor Finance Plc	(6,000)	(6,000)	
	Shortfall to Dodgy Motor Finance Plc c/d		(5,000)	
	<b>Assets not subject to charges</b>			
	Leasehold improvements	15,000	0	
	Rent bond held by Landlord's solicitor	30,000		
	Less rent arrears	(15,000)		
	Less dilapidations	0	15,000	
	Fixtures, fittings and equipment	10,000	1,000	
	Stock	3,000		
	Bubbly Shampoo Suppliers Limited ROT claim (assume valid)	(1,500)		
		1,500	150	
	Estimated assets available to preferential creditors			16,150
1	Wage arrears	(3,700)		(3,700)
	Assets available to unsecured creditors			12,450
	Prescribed part creditors	n/a		
	Trade creditors	(40,000)		
	Add back quarterly rent	15,000		
	Add back Bubbly Shampoo Suppliers Limited (ROT)	1,500		
	Dodgy Motor Finance Plc b/d	(5,000)		
	Mrs Robinson – increase in claim	(47,000)		
	HMRC - VAT	(18,000)		
	HMRC – PAYE/NI	(10,000)		
	Director's loan	(20,000)		
	Bank loan and overdraft	(42,000)		
1	Wage arrears	(3,300)		
2	Redundancy pay	(13,867)		
3	Pay in lieu of notice	(12,250)		
	Estimated deficiency to unsecured creditors			(182,467)
	Share capital		(2)	
	Estimated deficiency to shareholders			(182,469)



Notes to Statement of Affairs

1 Employee preferential creditors

Sch 6, para 9 wages owed for the whole or any part of the period in the 4 months before the relevant date of the insolvency. Subject to maximum of £800/employee (Insolvency Proceedings (Monetary Limits) Order 1986 SI1986/1996, art 4

4 employees are owed over £800 and one is owed less than £800:

$$4 \times £800 = £3,200 + £500 = £3,700$$

Remaining wages £7,000 – 3,700 = £3,300 are unsecured

No information given on holiday pay and so assume none or state assumption.

2 Redundancy pay

Each employee aged between 30 and 40 years is entitled to one week's pay for each year of service, subject of a maximum of £464 per week (Employment Rights Increase In Limits) Order 2014 (SI 2014 No382).

In this case each employee has worked for the Company for 7 years and all but one earn over the maximum of £464/week:

$$\text{i.e. } 464 \times 7 \text{ years} = £3,248 \text{ per employee.}$$

$$3,248 \times 4 \text{ employees} = £12,992$$

$$\text{Remaining employee earns } £500/\text{month (say } £125/\text{week): } 125 \times 7 \text{ years} = £875$$

$$£12,992 + £875 = £13,867$$

3 Notice pay: it is not stated in question whether or not notice of termination of employment has been given.

If assume there is no notice then employees would be entitled to one week's wages for each year employed (as all employed for < 12 years), say:

$$7/4 \times 7,000 = £12,250$$

and subject to mitigation if employee(s) is employed during the notice period.

For both redundancy and notice assumed no contractual obligations. Would need to ascertain this, especially whether or not Clare has a contract of employment with the Company. Alternatively need to state assumptions.

**Scary Limited: Estimated Deficiency Account at 31 October 2014**

Accumulated deficit per balance sheet		(110,002)
Reduction in value of leasehold improvements	(15,000)	
Rent bond less rent arrears (30,000 – 15,000)	15,000	
Reduction in value of stocks	(1,350)	
Reduction in value of fixtures, fittings and equipment	(9,000)	
Reduction in value of motor vehicle	(4,000)	
Change in stocks (ROT claim)	(1,500)	
Reduction in creditors – rent arrears	15,000	
Reduction in creditors – ROT claim	1,500	
Increase in Mrs Robinson's claim	(47,000)	
Redundancy pay and pay in lieu of notice	(26,117)	(72,467)
Deficiency per statement of affairs		(182,469)

**4(b) Taking into account the known specific circumstances of the Company, identify the issues that need to be dealt with when placing the Company into Creditors' Voluntary Liquidation, as well as the issues that may be anticipated to arise during the Liquidation. (12 marks)**

Issues that need to be addressed – placing company into CVL:

Money laundering/Identity checks/KYC

**Fees**

If assisting to place Company into CVL an IP will need to ascertain source of fees – there are no funds in Company:

- will Clare pay? Does she have the resources
- Will IP rely on being paid out of assets (risk that there may not be any assets – low realisable values and risk rent bond may not be forthcoming;
- Or Clare guarantees payment? (if she has resources)

Similar considerations on accepting appointment if no funds available for fees.

**Written instructions/ensure director aware of her responsibilities**

IP needs to obtain written instructions from Clare, as director, which clearly define the matters on which he/she advises (SIP 8, para 2)

**Conflict of interest/competent to provide advice**

Ensure no conflict of interest (SIP 8, para 2)

Ensure level of competence of IP to provide advice (SIP 8, para 2)

**Court winding up**

Need to talk to director of Bubbly re possibility of it petitioning for court winding up and to ascertain whether it is content with a CVL and whether court winding up would be better. Should discuss costs of doing so (although note ranking petitioning costs R4.67 .

Court will only override wishes of majority of creditors in special circumstances. Re JD Swain Ltd [1965] 2 AELR 761

-.

See also Re Tony Rowse NMC Ltd [1996] BCC196

Note timescale for petition which has not yet been made.

**Procedure to place Company into CVL**

Discussion of Act, Rules and SIPs should be in context of circumstances of question.

Check articles before advising on convening members' meeting

S84 – special resolution of members to wind up

S85 – notice in Gazette

S98 – 100 – convene and hold creditors' meeting

Also, R7.2 and 7.13

**SIP 8 para 3 venue and time of meeting**

Note para 4.7 re when to hold meetings of members and creditors, in the circumstances of the question it seems no reason to hold meetings on different dates.

SIP 8 para 4: notice of meeting;

SIP 8 para 5 – provision of information prior to creditors' meeting;

SIP 8, para 6, proxies and other representation. Also, SIP 10 Proxies

SIP 8, para 7 – claims;

SIP 8, para 8, Availability of proxies and claims for inspection;

SIP 8,, para 9, Attendance at meetings;

SIP 8, para 10, Information to be provided at meeting;

SIP 8, para 11, Conduct of meeting;

SIP 8, para 12, Provision of Information to Liquidator;

SIP 8 para 13, Report to creditors following meeting

Mrs Robinson's personal injury claim:

- need to consider how to treat claim for voting purposes;
- no legal action has yet been taken and so it cannot easily be quantified;

- the minimum amount seems to be £3,000 as both parties seemed to be nearing agreement, at least before Mrs Robinson's hair started to fall out;
- Was Clare, as a director, negligent in not renewing public liability insurance?

Voting for Liquidator at s98 meetings – R7.9-7.12

Ethical considerations re desire to be appointed Liquidator.

Retention of title

Consider valuation of claim for voting purposes.

Post liquidation:

Need to ascertain when clause agreed by Company and nature of clause. Whatever type of clause should identify goods to unpaid invoices (even in all monies clause)

- allowed by Sale of Goods Act 1979 for sale of specific goods;
- IA, s251: definition;
- must be incorporated into contract (standard terms of trading) at time of supply, and agreed before supply;
- incorporation of ROT clause may be by signature; "reasonable notice"; "course of dealing"; trade association terms; reference to another document;

Email terms and conditions with order? Emphasis of ROT clause on invoice – could argue course of dealing?

Q does not specify what the nature of the ROT clause is, e.g. simple, all monies.

If all monies clause – should ascertain when balance with Bubbly Shampoo Ltd was nil.

Consider whether Clare's conduct needs further investigation – consider whether any funds to recover (what are Clare's personal assets?)

General issues re all liquidations, including dealing with employees, landlord, insurance

**4(c) Set out the issues that a Liquidator of the Company needs to consider in response to Clare's plan. (5 marks)**

Liquidator is acting for Company and should advise Clare to take independent advice.

(Ethical Guidelines – including need to be independent, advocacy threat)

Also SIP 13, para 4

Consider SIP 13, Acquisition of Assets of Insolvency Companies by Directors: duty to act in best interests of company, its creditors and members (para 3)

Liquidator will need to consider issues in SIP 13, para 6

Discussion of issues re restriction on reuse of company name – s216.

What is a prohibited name: s216(2)

What is the restriction: s216(3)

Application to court for permission to use name, s216(3)

What are penalties: s216(4), s430, Sch10

Personal liability for debts following contravention – s217

## JOINT INSOLVENCY EXAMINATION BOARD

### ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS AND RECEIVERSHIPS (SCOTLAND)

#### EXAMINER'S REPORT AND MARKING PLAN FOR THE 2014 SITTING

This was the first JIEB exam sitting subject to computer based marking ("e-marking") and as such candidates were presented with a different booklet format to other papers and previous sittings. In this respect candidates received a single booklet divided into 4 sections; one for each question. If additional paper was required supplementary booklets were available on request. All candidates provided their answer to the relevant question in the correct location.

Overall there remain a significant number of candidates who fail to answer the specific requirements of the question or to demonstrate an ability to apply matters to the scenario in the question. Candidates have a tendency to write everything they know on a subject area thereby wasting time by including information irrelevant to the question set.

Candidates generally presented answers appropriately although as in previous years a lack of workings or logical setting out of the approach adopted tended to result in marks not being awarded as it was unclear how candidates arrived at conclusions or answers.

#### Question 1

This was a predominantly numerical question testing candidate's ability to identify the appropriate level of contributions to a CVA and preparing an associated comparison of outcome.

**(a) Based on the information provided, set out the level of monthly contributions to a CVA you would consider appropriate to be put forward to creditors. (5 marks)**

Candidates were required to recommend a level of contributions based upon the company's expectations as to profit improvement. The majority of candidates were able to make a good attempt of these calculations although many of the candidates were unable to set out a coherent and logical approach in arriving at their answer. The better candidates recognised that a proportion of the profit would normally be proposed as contributions (rather than its entire profit). Few candidates identified that the proposed remuneration of the directors was likely to be acceptable to creditors.

**(b) Stating appropriate assumptions, prepare a Comparative Estimated Outcome Statement for inclusion in a CVA proposal. (15 marks)**

This part of the question was generally well answered by candidates. There was some confusion within the candidate group as to what the CVA outcome should be compared against, with variations including comparisons to Administration as well as liquidation. The majority of candidates were, however able to present their answers in an appropriate columnar format.

The majority of candidates correctly identified that, due to the date of floating charge, the Prescribed Part would not apply.

The employee liability calculations were disappointing with few candidates able to calculate what was a relatively simple redundancy and notice pay calculation of 4 employees.

A proportion of responses failed to include details of the assumptions or calculation they had applied and therefore lost out on marks. In the case of an assumption, this should be stated clearly to obtain marks and workings for calculated figures should be included so that it is clear that the candidate is applying the appropriate methodology.

**(c) Without listing the requirements under the Rules and Statements of Insolvency Practice, set out the key matters in these particular circumstances that you would disclose to creditors within your Nominee's report. (5 marks)**

This part of the question was poorly answered. Despite the requirements specifying that answers were to be relevant to the circumstances, a large proportion of candidates presented a long list of general items that would be included within a Nominees Report. Several candidates also set out detailed legislative and SIP requirements when the question specifically excluded these. As a result candidates wasted valuable time writing pages of information that was not relevant in the context of the question.

The intention was for candidates to identify key matters specific to the case that a Nominee would wish to bring to the attention of creditors— in this case the company’s directors projecting a marked turnaround of the profitability of the Company. Candidates generally did not highlight the risks associated with management’s plans, although many did identify some of the antecedent transactions that would also be reported. Generally it appeared that candidates thought that the role of the Nominee was purely administrative; to provide general statutory information rather than adding value to the creditors’ decision as to whether they should accept the proposal - Section 2 of the Act makes it clear that opinions of the Nominee are required.

## Question 2

Generally candidates achieved a reasonable mark on this question however again many went off topic and wasted time listing points that were not required perhaps leading to time pressure on other questions.

- (a) Prepare a note for the Directors outlining the conditions under which an Administrator can be appointed to the Company. Include within your note an explanation as to the meaning of insolvency and how it may apply to these circumstances. (10 marks)**

This part of the question was generally poorly answered. Candidates were required to outline the circumstances under which an Administrator can be appointed. Many candidates provided significantly long answers outlining the full process of placing the company into administration including consideration of ethics, documents filed, notifications, small company moratoriums, etc. Often buried within several pages of extraneous information was mention of achieving a ‘purpose’ however candidates rarely gave it more than a casual short comment.

We would remind candidates that their answers should be focused on the specific question being asked and a ‘scatter gun’ approach is likely to result in increased time pressure on other questions with few marks awarded.

- (b) Set out alternative, non-insolvency options the Company could consider for dealing with the loan from Dechy. (5 marks)**

The majority of candidates were able to identify a number of restructuring options with the better candidates being able to apply these to dealing with the loan from Dechy. The less able candidates tended to list general restructuring options without consideration of whether these were relevant to the bank loan position.

- (c) Summarise the responsibilities of the Directors in the period leading up to the appointment of an Administrator. (10 marks)**

Most candidates were able to list matters that directors should be aware of but in the main they failed to properly explain their answer. Examples include “Avoid making a preference” and “ensure stock is not dissipated” without any explanation as to what they mean.

In the main candidates were able to identify core and mainstream responsibilities but few were able to demonstrate a knowledge beyond that.

Overall candidates generally did not perform well on this part of the question, which is concerning as an IP should be expected to be able to provide specific advice to directors of companies into the lead up to Administration (or liquidation).

## Question 3

This question was split between technical and aspects of a receiver’s appointment and the practical considerations in relation to completion of a property development. Overall this was the best and most consistently answered question on the paper from the cohort of candidates.

- (a) Set out the steps required to appoint a Receiver to the Company. (10 marks)**

Generally candidates were comfortable with the appointment process with the better candidates not only making mention of the statutory requirements but also the IP’s internal processes and practical and commercial considerations. Responses that scored highest set out their answers logically in chronological order, those that did not tended to miss out key stages of the process.

**(b) Explain the role of a Receiver and outline their duties. (5 marks)**

Generally candidates were able to demonstrate an understanding of the role of a receiver and their duties.

**(c) Outline the matters you would review and the information you would require in order to establish whether or not to complete the Project. (10 marks)**

This was the more practical aspect of the question and marks were awarded for any reasonable and appropriate points made. Disappointingly, this part of the question was the least well answered again emphasising that candidates struggle to demonstrate commercial awareness and an ability to demonstrate sector specific knowledge.

**Question 4**

Candidates were presented with a situation where a floating charge had been granted to a bank shortly prior to the appointment of an Administrator. The company concerned had continued to trade after the granting of the floating charge with funds being received into and paid out of a secured overdraft.

Overall the presentation of answers was good however candidates generally were unable to apply the principle being tested and as a result this question was the poorest answered in the paper.

**(a) In these circumstances, explain the effect of the legislation which may affect the Bank's security position. (3 marks)**

Whilst most candidates were able to identify the relevant aspect of the Insolvency Act (Section 245) very few were able to copy out the relevant points, explain it or apply it to the circumstances of the case.

**(b) Ignoring any claims that the LLP may have against its Partners, prepare a Statement of Affairs as at 31 October 2014 showing clearly how the Bank's claim would rank for dividend purposes. (14 marks)**

Generally the Statement of Affairs format presented by candidates was good. Most candidates correctly calculated the prescribed part.

Whilst many candidates had identified in part (a) that the provisions of section 245 were relevant in this case, very few attempted to calculate the extent of its validity and many made the assumption within their answer that the charge was entirely invalid. A number of candidates presented a comparative statement of an entirely valid or entirely invalid floating charge.

**(c) Calculate the amount for which the Partners may be liable under their personal guarantees to the Bank and outline other potential liabilities arising from the failure of the LLP for which they may also be responsible. (8 marks)**

Very few candidates successfully demonstrated how they calculated the extent of the partners' liability under their personal guarantee. Generally candidates struggled to identify other possible liabilities with most candidates focusing on general misfeasance in relation to reporting the claim to the insurers. A few candidates mentioned s214A.

**ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS AND RECEIVERSHIPS (SCOTLAND)**

**EXAMINER'S MARKING PLAN FOR THE NOVEMBER 2014 SITTING**

**Question 1**

- (a) Based on the information provided, set out the level of monthly contributions to a CVA you would consider appropriate to be put forward to creditors. (5 marks)

	IF ON ANNUAL BASIS		IF ON 9M BASIS		ON A MONTHLY BASIS
	£'000	£'000	£'000	£'000	£'000
Loss for the 9 months		(990)		(990)	(110)
Estimated loss for the 12 months		(1,320)			
Salary savings from redundancies		400		300	33.33
Robert pay cut					
Current gross pay	25		25		
For the period	300		225		
Saving	25%	75	25%	56.25	6.25
Other staff					
9 month pay	1,350		1,350		
Gross up	1,800		1,350	n/a	
Less Robert	(300)	From above	(225)	From above	
Less redundancies	(400)	From above	(300)	From above	
Remaining salaries	1,100		825		
Saving	10%	110	10%	82.5	9.17
Improvement in margin					
Current margin %	20.00%		20.00%		
Protected margin %	30.00%		30.00%		
Improvement	10.00%		10.00%		
Sales	6,300		6,300		
Grossed up	8,400		6,300		
Profit improvement		840		630	70.00
Motor vehicle costs					
Current cost	120		120		
Grossed up	160		120		
Saving	50%	80	50%	60	6.67
Rent reduction					
Current cost	225		225		
Grossed up	300		225		
Saving	25%	75	25%	56	6.25
Utilities savings					
Current cost	75		75		
Grossed up	100		75		
Saving	20%	20	20%	15	1.67
Other costs (leased printer)		40	for consistency necessary to annualise	30	3.33
Add back loss on disposal (one off)					
For period		67		50	5.56
Mr Austin cost (dividends not included in net loss)		(100)		(75)	(8.33)
Estimated CVA profit		<u>287</u>		<u>215</u>	<u>23.89</u>

	IF ON ANNUAL BASIS		IF ON 9M BASIS		ON A MONTHLY BASIS
	£'000	£'000	£'000	£'000	£'000
Annualised		287		287	286.67
Adjustments for high costs					
Mrs Austin		40			
Robert Austin		165			
		<u>492</u>			
Contribution rate		80%			
Contributions		<u>393</u>			
Contribution		<u>33</u>			



**(b) Stating appropriate assumptions, prepare a Comparative Estimated Outcome Statement for inclusion in a CVA proposal. (15 marks)**

	Book Value £'000	CVA £'000	Liquidation £'000	
Assets subject to a fixed charge	1,010	-	1,010	Any reasonable assumption but less than or equal to BV
Tangible assets	(1,000)	-	(1,000)	
Due to finance companies	10	-	10	
Assets subject to a floating charge				
Stock	2,200	-	550	Any reasonable assumption
Trade debtors	1,600	-	1,280	Any reasonable assumption – here 80%
Other debtors	25	-	-	Any reasonable assumption if there is one from above
Surplus from fixed assets	10	-	10	
Preference	-	-	100	Any reasonable assumption
Transaction at undervalue (vehicle)	-	-	50	Any reasonable assumption
Illegal dividends	-	-	-	Any reasonable assumption
Contributions	-	1,967	-	Assumed years x profit contribution in (a)
	<u>3,835</u>	<u>1,967</u>	<u>1,990</u>	
Costs				
Liquidator costs		-	(50)	Any reasonable assumption
Nominee Costs		(7)	-	Any reasonable assumption
Supervisor costs		(25)	-	Any reasonable assumption
Other costs (agents, legals etc.)		(5)	(25)	Any reasonable assumption
Available for preferential creditors		<u>1,930</u>	<u>1,915</u>	
Preferential creditors				Assumed £800 per employee – 4 in CVA, 50 in liquidation(45+4+Robert) Calc in Liquidation = 1350/50
Employee arrears of pay		(3)	(40)	
Employee holiday pay		(3)	(14)	
Available after preferential creditors		<u>1,923</u>	<u>1,861</u>	
Prescribed part		n/a	-	Pre-enterprise Act charge
Available for floating chargeholders		<u>1,923</u>	<u>1,861</u>	
Floating chargeholder – Stubbs		n/a	(1,330)	Reasonable assumption for IF termination charges
Available after floating chargeholder		<u>1,923</u>	<u>531</u>	
Prescribed part		n/a	-	
Available for unsecured		<u>1,923</u>	<u>531</u>	
Unsecured creditors				
Shortfall to Bartoli Finance Limited		-	-	If there is one from above
Shortfall to Stubbs Commercial Finance Limited		-	-	If there is one from above
Trade creditors	(2,100)	(2,100)	(2,100)	
HMRC	(400)	(400)	(400)	
Director loan	(50)	(50)	(150)	Depends on assumption over preference repayment above – if

Leased asset obligation	-	(90)	(90)	repaid debt would increase £30k p.a. x 3
Employees	-	(23)	(104)	
Other creditors		(345)	(345)	Any reasonable assumption for liquidation, calc for CVA. See workings below
Shortfall to unsecured creditors		(1,085)	(2,658)	
Dividend to unsecured creditors p in £		0.64	0.58	

#### Assumptions

- Bartoli Finance Limited has a consolidation clause
- Assumed 80% of debts recoverable - any reasonable assumption
- Other debtors not recoverable
- Dividends not recoverable
- 5 year CVA
- No arrears of pay or a calculation or any reasonable assumption based on ee numbers (CVA illustration assumes 4 redundant ees owed full £800, liq assumes 50 ees owed full £800)
- No holiday pay outstanding or any reasonable assumption based on employee numbers (CVA (4 employees) and Liq (50 employees) illustration assumes 2 days each)
- Director repays preference
- Director repays Transaction at an undervalue
- Director participates in CVA - alternative is that he may defer until after CVA

#### Employee workings

Role	Age	Service	Weekly pay	Notice pay	Redundancy weeks	Redundancy pay
Sales Director	36	2	2,885	5,769	2.0	928
Sales Coordinator	32	1	1,827	1,827	-	-
Quality control manager	40	3	1,538	4,615	3.0	1,392
Marketing director	55	4	1,442	5,769	6.0	2,784
				17,981		5,104
Total employee liability				23,085	Statutory	464

If liability is reflective of entire workforce then total employee claims are:

Salary for 4 as % of total Payroll	400	/	1,800	22%
Applied to cost			(£1,350k/9*12)	103,881

- Assumes full statutory notice (no mitigation) and redundancy (any reasonable assumption over notice periods, mitigation and contractual redundancy)

**(c) Without listing the requirements under the Rules and Statements of Insolvency Practice, set out the key matters in these particular circumstances that you would disclose to creditors within your Nominee's report. (5 marks)**

Matters to highlight in Nominee report

- Loss of sales staff may impact on ability to generate sales
- Loss of Quality control manager may also impact on deliverability of projections
- Improvements to gross profit may be difficult within a CVA
- Improvement to margin significantly higher than achieved in 2013
- May be difficult to change utility supplier if debt outstanding
- Creditors unlikely to accept that Robert gets paid £225,000 per year.
- Offences to report to creditors
  - Possible illegal dividends – shareholder receiving in good faith?
  - Preference in relation to payment of director loan account

- Transaction at an undervalue in relation to company car

## Question 2

(a) **Prepare a note for the Directors outlining the conditions under which an Administrator can be appointed to the Company. Include within your note an explanation as to the meaning of insolvency and how it may apply to these circumstances. (10 marks)**

- Company is or is likely to become unable to pay its debts (s123)
- distinction should be given between considerations of cash flow, and considerations of assets and liabilities (Eurosail)

### Balance sheet test (s123(2))

- Focus on the debts which were due or would fall due in the reasonably near future
- Subsidiary investment likely to be impaired reducing net assets by £7m
- Contingent liability of £1m from subsidiary guarantee should be included
- Other parent guarantees could increase liabilities
- Loan not due – repayable over long period; arguable that the £8m long term liabilities does not 'count' for the test
- Breach of covenant may result in the loan becoming immediately due

	£
Net assets	3,400,000
Impair investment	(7,000,000)
Subsidiary guarantee	(1,000,000)
Impair interco debtor	(3,000,000)
Revised net liabilities	(7,600,000)

### Cash flow test s123(1)(e)

- Audit fee overdue
- Net Current assets of £3.4m
  - Includes £3m of intercompany unlikely to be recoverable
- Other creditors in arrears? HMRC?
- £100,000 losses per month; Company likely to become insolvent.
- Unable to support Graf suggests that cash flow limited

### Legal action test s123(1)

- (a) Statutory demand left unpaid or secured or compounded amounting to over £750. No indication of such an issue
- (b)-(d) depending on location; no indication of charge for payment or enforcement action

The administration order is reasonably likely to achieve the purpose of administration

- Rescuing the Company as a going concern; or (if this is not possible)
- Achieving a better result for the Company's creditors as a whole than would be likely if the Company were wound up (without first being in administration); or (if this is not possible)
- Realising property in order to make a distribution to one or more secured or preferential creditors

Circumstances where administrator cannot be appointed

- Not in liquidation para 8(1)
- Effects or carries out contracts of insurance subject to para 9(3)
- Has a liability in respect of deposit but not authorised deposit taker para 9(1)
- Directors out of court; no winding up petition outstanding

**(b) Set out alternative, non-insolvency options the Company could consider for dealing with the loan from Dechy. (5 marks)**

- Compromise of debt – bank may agree a reduction in its debt in the Company;
- Compromise of debt – bank may accept full and final settlement from third party
- Debt for equity swap – bank may accept a reduction in its debt in return for a share (or all) of the equity
- Debt rescheduling – the repayment profile could be extended
- Interest forgiveness – the company could ask the bank to suspend payment of interest
- Refinance – unlikely due to losses and security position
- Security – the above may be supported by additional external security/Personal guarantees
- Shareholder/director/external investor finance
- Asset based lending; potentially part of a solution
- Options require losses to be addressed; interest from the above could be substantially reduced but may be insufficient in itself to bring the company to profitability.

**(c) Summarise the responsibilities of the Directors in the period leading up to the appointment of an Administrator. (10 marks)**

- Responsibility for conduct of the Company's affairs remains with its directors until the formal appointment of an insolvency practitioner
- Companies Act 2006 duties continue to apply but overriding responsibility to creditors
- Company should only make such payments as are necessary to preserve its assets and continue the Company's trade
  - directors must *either* (a) be satisfied that the Company is trading profitably and that it will be able to meet all further debts incurred, *or* (b) honestly and reasonably believe that continuing to trade will result in a more beneficial realisation of the assets than immediate cessation
  - Existing creditors are only paid when this must be done to ensure the continuation of essential supplies that cannot be sourced elsewhere
- Wrongful trading risk - directors who know, or ought to realise, that there is no reasonable prospect of avoiding insolvent liquidation may be personally liable for wrongful trading unless they can demonstrate that they have taken every step to minimise the potential loss to creditors.
- No further credit should be incurred and any goods or services required must be specifically paid for immediately and before the date of any proposed insolvency procedure;
- Delivery of all further goods or services previously ordered, 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 whether or not they are entitled to claim a set-off on any grounds;
- No disposal of the Company's assets should take place. This does not include stocks that are sold in the ordinary course of business for full value;
- Credit / charge cards issued to directors / senior personnel should no longer be used;
- All assets of the Company should be properly insured and all liability insurances such as for employees, products, property, owners and public liability should be maintained. The appropriate premiums should be paid;
- Bank account
  - If the Company's bank account is overdrawn and that overdraft liability is not secured against the Company's assets, no further funds should be paid into the overdrawn account
  - If there are guarantees on an overdraft may be appropriate to ring fence funds to be paid in.
  - If the Company has granted security to the bank legal advice on nature of charge and entitlement to funds
- No creditor claiming Retention of Title (ROT) to goods previously supplied should be permitted to remove any goods pending the appointment of an Insolvency Practitioner to the Company.
- No goods of the Company should be despatched or deposited with carriers, hauliers or warehousemen who are owed money by the Company;
- No redundancy or collective employment scheme should be undertaken or implemented by the Company without prior consultation with employees as required by law and after discussion with proposed administrators.
- Keep records of and rationale behind decisions.
- Keep records and file returns as required by Companies Act
- Deposits should not be accepted if there is a risk of non-completion or such funds should be placed on trust.

### Question 3

**(a) Set out the steps required to appoint a Receiver over Company. (10 marks)**

#### Pre appointment

- Agree term of indemnity with the appointor
- Consider any ethical issues
- Ensure have the skills and expertise required
- Establish if company in liquidation as this will impact on agency of the receiver
- Establish if the Company is in administration as if it is then consent of administrator or permission of the court required.
- Agree basis of fees
- Provide consent to act

#### Process

- Establish if there are any other charge holders
- Consider impact of any ranking agreement
- Legal review facility and security documentation to establish
  - Charge filed at Companies House and land registry
  - If loan repayable on demand or whether other event of default has arisen
  - Powers conferred by the documentation on the receiver
  - Joint appointment – check powers can be exercised individually
- In accordance with facility documentation serve letter of demand requiring immediate payment of all sums due.
- Consider whether debtor will invite the appointment of a receiver
- If debt not repaid then a receiver can be appointed but
  - Debtor must have opportunity to implement the mechanics of payment
- Document of appointment sent to proposed receiver:
  - Appointment must be accepted by the end of the business day following the day of receipt
  - Appointment effective from time of signature of receiver
- Appointment can be accepted orally.
- Instrument of appointment returned to charge holder
- Could be appointed by court order
  - Petition lodged in court
  - Interlocutor obtained
- Notice of appointment to Companies House and Accountant in Bankruptcy within 7 days
- Notify the Company of appointment. Contact directors and explain situation.
- Obtain legal advice on validity of appointment

**(b) Explain the role of a Receiver and outline their duties. (5 marks)**

#### Role:

- Recover money due to the lender and/or
- Protect the position of the lender by taking control of assets attached by floating charge
- Not necessarily terminal
- Independence; Receiver must act independently of bank or may be deemed agent of the bank
- Receiver is an agent of the company and officer of the court

#### Duties:

- Principle duty to lender
- Also duty to:
  - Debtor/borrower,
  - Other charge holders
  - Guarantors.
  - Other interested parties
  - Preferential creditors
- Request Statement of Affairs from directors
- Report to meeting of creditors

- Must act in good faith, take reasonable precautions and exercise good faith in sale process and due diligence in the management of the charged asset
- Duty to sell the charged property at best reasonable price
  - does not extend to taking steps or incurring costs to enhance the prospects of sale.
  - does not extend so far as to require a sale to be delayed.
- Notice of appointment to Companies House and Accountant in Bankruptcy within 7 days
- File Receipts and Payments accounts within 2 months of the anniversary of appointment and subsequently period of 12 months with the Accountant in Bankruptcy, FC holder, members of creditors committee and the company (or liquidator if company in liquidation).
- Account for taxes such as VAT and CIS

**(c) Outline the matters you would review and the information you would require in order to establish whether or not to complete the Project. (10 marks)**

- Establish level of funding required
  - Obtain a copy of build plan and costs
  - Obtain a full review of the build status
  - Review assumptions contained in build plan
  - Consult appropriate professionals (eg surveyor)
  - Establish revised build plan and funding requirements
  - Establish if funding will be provided by bank (or guarantors or other parties)
  - Indemnity from bank for costs/liabilities
- Review financial benefit of completion
  - Value of property in current position compared to value of completed units
  - Establish how issues regarding snagging and post-sale warranties will be dealt with
- Discuss with insurers and ensure proper insurance in place
- Establish New home warranty position
- Establish if any warranties have obtained to date from sub-contractor work undertaken
- Establish if subsidence issues have been resolved or addressed
- Environmental issues
  - Establish the previous use for the site; brownfield
  - Obtain any reports obtained pre-build
  - Consult appropriate professionals if necessary
- Health and safety
  - Establish what procedures and policies are in place and if deficient put processes in place
  - Consider security arrangements
  - Appoint appropriate professionals if necessary
- Establish the employee position
  - Number
  - Status - arrears of pay
  - Roles of staff members
  - Employment contracts - personally liable for contracts adopted. Adoption after 14 days.
  - Consider appointment of main contractor
- Planning permission
  - Obtain copy of planning permission
  - Establish whether work undertaken to date complies with planning
  - Establish if any other matters apply such as tree preservation orders etc.
- Legal title
  - Establish whether freehold or leasehold
  - Review title documents for any restrictive covenants
- Existing contractor
  - Establish level of creditor arrears
  - Establish whether co-operation of contractor required for completion; e.g. certificates relating to groundwork rectification.
  - If necessary discuss with contractor the situation to establish a mutually agreeable way forward.
- Developer contributions
  - Establish if any Section 75 obligations exist
  - Establish if road adoption agreements in place
  - Establish if any performance bonds have been provided to secure obligations
- Charge holders
  - Establish if other charge holders exist and discuss strategy with them and seek their opinion
  - Discuss strategy and benefit/cost with appointor and seek their opinion

- Establish view of other interested parties such as guarantors

#### Question 4

**(a) In these circumstances, explain the effect of the legislation which may affect the Bank's security position. (3 marks)**

- Section 245 Avoidance of certain floating charges.
- Floating charge created at a relevant time is invalid except to the extent of the aggregate of new monies provided to the company.
- Company traded post creation of the charge and funds received and paid.
- The relevant time is 2 years for a connected party and 12 months for unconnected .
  - Bank appears to be unconnected.
  - Charge was created during the relevant period.
- It is also only a relevant time if the LLP was unable to pay its debts within the meaning of s123 or unable to as a consequence. Due to the existence of the insurance claim it is likely that at the date the charge was created the LLP was insolvent.

- (b) Ignoring any claims that the LLP may have against its Partners, prepare a Statement of Affairs as at 31 October 2014 showing clearly how the Bank's claim would rank for dividend purposes. (14 marks)

**Statement of Affairs of Zardo Architectural design LLP**

	Book value £'000		Estimated to realise £'000
Assets not sepcifically secured			
Goodwill	nil		10
Work in progress	6,000	10%	600
Debtors	4,500	25%	1,125
Office equipment	unknown		15
Available for preferential creditors			<u>1,750</u>
Preferential creditors			-
			<u>1,750</u>
Prescribed part			(353)
Available for floating chargeholder			<u>1,397</u>
Floating chargeholder			(1,250) (from calculation)
Surplus to floating chargeholders			<u>147</u>
Prescribed part			353
<b>Unsecured non-preferential creditors</b>			
HMRC			(200)
Trade creditors			(50)
Insurance claim			(3,500)
Unsecured claim (floating chargeholder)			(1,100)
Shortfall to creditors			<u>(4,350)</u>
<b>Members</b>			??
Deficit to members			
<ul style="list-style-type: none"> <li>Assumed that assets stay at same level as per question</li> </ul>			



**Bank position calculation**

		£'000
Bank b/f		(2,500)
Receipts from debtors		
Debtors	4,500 from Q	
Days	90 from q	
Per day	50 4500/90	
trading period	28 from Q	1,400
Payments out		
Partners	(150)	Assuming continued
Salaries	(400)	£600k - £200k
Purchases	(50)	Tr cr amount
PAYE/NI	(200)	Assumed September paid during Oct
VAT	(450)	(1,250) from Q
Debt due to bank as at 31/10/13		<u>(2,350)</u>

**(c) Calculate the amount for which the Partners may be liable under their personal guarantees to the Bank and outline other potential liabilities arising from the failure of the LLP for which they may also be responsible. (8 marks)**

- Tax liabilities - LLP tax transparent and therefore any tax payable on profits is a personal liability. Conversely partners may be able to claim losses.
- Personal guarantees – if the partners have provided any personal guarantees to suppliers, landlord, lease companies etc.
- Partners' drawings (s214A) in last 2 years - if partner had reasonable grounds for believing the LLP was unable to pay its debts as they fall due at the time of withdrawal or if there was no reasonable prospect of avoiding insolvent liquidation. Applicable if the LLP enters liquidation.
- Common law
  - Even if acting on LLP business partner could be liable to client for own negligent acts.
  - Could be liable to LLP if partners' negligence causes the insolvency.
- Negligence/breach of duty for failure to adhere to the terms of insurance resulting in an uninsured loss.
- Bank PG (limited to £50,000 per person) as follows:

Debt	(2,350)	
Paid under floating charge	<u>1,250</u>	
Paid under unsecured	(1,100)	

Unsecured debts (exc bank)	(3,750)
Paid under prescribed part	<u>353</u>
Debt	(3,397)
Bank unsecured claim	(1,100)
Bank unsecured claim as % of total	24%

Floating charge surplus	147	From (b)
-------------------------	-----	----------

Dividend to bank	36	36
------------------	----	----

Total shortfall to bank	<u>(1,064)</u>
-------------------------	----------------

Partners	20
----------	----

Liability each	<u>(53)</u>
----------------	-------------

Restricted to	<u>(50)</u>
---------------	-------------

## JOINT INSOLVENCY EXAMINATION BOARD

### PERSONAL INSOLVENCY (SCOTLAND)

#### EXAMINER'S REPORT AND MARKING PLAN FOR THE NOVEMBER 2014 SITTING

##### General comments

This paper examined topics which should be core for anyone working in personal insolvency.

As with recent papers, scoring good marks depended on candidates' ability to demonstrate practical knowledge and to apply this to the facts. Such skills are key for any insolvency practitioner but were often not shown by candidates sitting this paper.

It was disappointing that, as in some prior years, a number of candidates showed a lack of personal insolvency awareness by using terminology which has no place in personal insolvency. Inappropriate references to Directors, Companies House and Registrar of Companies appeared far too often. Such references can prevent candidates from being awarded higher holistic marks.

##### Question 1

**Draft the memorandum. Set out the steps that you would take to deal with the seven claims. In each case explain the legal and/or other principles which you will need to apply and set out any further information which you will require. (25 marks)**

This question presented candidates with the scenario of a sequestration in which the assets had all been realised and the Trustee wished to pay a dividend. Candidates were required to comment on the steps to be taken in order to deal with seven proofs of debt, each of which tested different aspects of creditors' claims and the final claim also touched upon ethical principles.

The information in the question indicated that the dividend was sizeable, and that the seven claims were the most significant. Therefore, the adjudication of these larger claims would have a significant impact upon the overall dividend rate and thus the ultimate return to all creditors. Unfortunately no candidates identified this important practical implication of the facts in the question.

Candidates adopted a well-structured approach dealing with each claim in turn. A few did waste considerable time at the outset copying out what the Act says generally about adjudication on claims. The relevant points could have been summarised in a sentence.

Answers generally dealt well with the claims of both HMRC and the Landlord.

A worrying number of candidates completely failed to identify the ethical issue in dealing with Dunstan's claim and no candidate provided a sensible solution to address it.

A number of candidates also recommended admitting some of the claims as contingent claims with no reference to the valuation thereof, this implied that they were unable to distinguish between allowing claims for voting purposes and formally adjudicating on claims for dividend purposes.

##### Question 2

**Write a letter to Mr. Jones. In your letter you should:**

- (a) (i) **explain the role of a Trustee under a Trust Deed, his responsibilities prior to and within the first ten weeks of the trust deed being signed and the purpose of his initial circular to creditors. A listing of the contents of a circular is not required; (15 marks) and**
- (ii) **set out your suggestions as to the steps that Mr. Jones might himself take to be satisfied that he should not object to the Trust Deed signed by Miss Wilding (Kate) becoming protected. (5 marks)**

- (b) Set out the information that Mr. Jones should expect to receive regarding the Trust Deed (assuming it becomes protected) on an ongoing basis, and the options available to him if he is not satisfied with the information provided. (5 marks)**

This question outlined a scenario where a Customer of a business was considering signing a Trust Deed. The question asked candidates to prepare a letter essentially explaining what a Trust Deed is, what the Trustee's responsibilities are, what the creditor should do to determine if they were prepared to accede to it becoming protected and the ongoing information that they should expect to receive. This question, in general, was not answered particularly well.

Without exception, the candidates recognised that they needed to answer in a letter format. Some candidates maintained the letter style throughout with good use of structure, headings and bullet points.

The key to answering this question was for candidates to put themselves in the position of Mr Jones and explain what a Trust Deed is and the important things that he needed to be aware of about a Trust Deed from his perspective as a creditor. Very few candidates took into account the practical implications of the fact that Mr Jones was a key supplier of Ms Wilding, who in turn was a key customer of Mr Jones and therefore the practical assessments that would require to be made by Mr Jones prior to considering whether to object to the protection of the Trust Deed.

Only one third of candidates recognised that the level of Mr Jones' debt was sufficient to prevent the TD becoming protected if he objected which possibly shows a lack of practical experience.

Some candidates failed to take a step back and explain what a Trust Deed is instead focussing on the Trust Deed process and Regulations about which they provided large amounts of detail and copied out the Regulations (even though the question specifically said not to). In reality large sections of legislation are not interesting or helpful to Mr Jones. As candidates should be aware, limited marks are available for this. Similarly to Question 4 (below) some candidates provided long lists of things that the Trustee should do, for example, open a sederunt book and time code. In the context of the question, there was no relevance to these comments and therefore no marks were awarded.

### **Question 3**

- (a) Prepare a cash flow forecast on a monthly basis for the Business for the year ending 31 October 2015. Set out your supporting calculations and state clearly any assumptions which you have made. (12 marks)**

This question provided information about a small sole trader's business and asked the candidates to prepare a monthly cash flow and Profit and loss account and Balance Sheet for the year for the purposes of establishing whether the business was sufficiently viable to fund the payments to a DPP.

Cash flows were generally well prepared with most candidates demonstrating a good understanding of what it was they were trying to show ie the Receipts, payments and cash inflow/outflow of the business. The only point which caused any real difficulty in the cash flow was the need to make an assumption about what happened to the opening debtors and trade creditors. Approximately half of candidates did not realise this was an issue.

- (b) Prepare a profit and loss account for the Business for the year ending 31 October 2015 and a balance sheet as at that date. Set out your supporting calculations and state early any assumptions which you have made. (8 marks)**

Not all candidates were able to effectively produce a profit and loss account or Balance Sheet and few were able to produce a Balance Sheet that "squared" or balanced. A few candidates failed to produce either profit and loss or a balance sheet.

- (c) Giving your reasons, comment on whether it would be viable for George to continue to trade the business to fund a payment to a DPP and outline the risks and practical difficulties of doing so. (5 marks)**

The underlying business was not profitable, whilst the one off Contract was, and the business had a funding requirement. Due to a number of incorrect calculations a limited number of candidates had a cashflow which showed this.

Marks were given in this section for sensible comments about the viability of trading to fund payments to the DPP made based on the candidates' workings. Candidates did not answer this well. A few resorted to writing everything that they knew about the DAS which was simply wasting time.

#### **Question 4**

- (a) What factors would you take into account in making the decision on whether or not to continue to trade? (5 marks)**
- (b) Assuming you decide not to continue to trade, identify the issues to be dealt with and the actions that you and the Agent will need to take in the next week. In relation to each issue, state clearly the relevant law and any assumptions which you have made. (20 marks)**

This question provided an example scenario that an Insolvency Practitioner could be faced with immediately following their appointment. It required candidates to demonstrate the approach that they would take to determine whether to continue trading and if they decided to close the business the steps they would take immediately thereafter.

Part (a) was generally answered well candidates being able to identify a number of factors which should be considered. A number of candidates failed to identify that there needs to be a benefit to creditors in allowing trading to continue for example, a sale as a going concern, improved realisation of WIP or generating a trading profit. The best answers stated this at the beginning. Those that did not identify why you would trade scored less well because they were simply a list of reasons why the Trustee would not trade. A number of candidates failed to identify whether the Trustee had automatic powers to trade in terms of the legislation or that projections/cashflows are required to back up a decision to trade.

Part (b) was also generally well answered. There was a lot of information available in the question, candidates, who scored well, had clearly read the question and then structured their answer to deal with an issue at a time. Those with a more scattergun approach missed marks by not thoroughly exploring each issue and duplicating points they had previously made.

As this was a trading business, and the question provided a number of issues which needed to be urgently addressed, marks were weighted towards dealing with these specific issues. Some candidates fell back on a long list of points or issues which would be dealt with in every case, (similarities in the lists would suggest that they were regurgitating a set of notes), for example, opening a sederunt book, creating accounts of intromissions and opening a time code and case file. While there were a small number of general marks available, candidates should have recognised that their priority was to address the relevant key issues and not waste time on peripheral points until this was done. A number of candidates failed to adequately address how employees should be dealt with in this type of situation, which demonstrated a lack of practical experience dealing with employees.

## PERSONAL INSOLVENCY (SCOTLAND)

### EXAMINER'S MARKING PLAN FOR THE NOVEMBER 2014 SITTING

#### Question 1

**Draft the memorandum. Set out the steps that you would take to deal with the seven claims. In each case explain the legal and/or other principles which you will need to apply and set out any further information which you will require. (25 marks)**

#### General remarks

- The dividend is substantial - in the region of 50p in the £ including the 7 claims still to be considered.
- The adjudication of the few larger claims will have a significant impact upon the overall dividend rate and thus the returns to all creditors.
- The remaining claims (29 of them) are relatively small (c£22,000), and thus adjudication of the larger claims needs to be robust whilst the remaining claims need not be subjected to the same degree of rigour.
- Admit/reject claims in accordance with s49/Schedule 1 of the Act.
- Creditors should be advised in writing of the Trustee's adjudication on their claim and that if they disagree with the adjudication they have 14 days to appeal to the Sheriff Court.
- In practice these letters will not be issued until you have resolved the issues below.
- The debtor and creditors should all receive a copy of the final adjudication on claims.

#### HMRC Claim

- A claim based upon assessments is valid unless and until returns are submitted which supersede the assessments.
- Therefore, from a practical perspective, it would be appropriate to review the books and records in your possession in an attempt to submit returns which may reduce the size of the HMRC claim.
- You should try to ascertain from the records if the debtor used an accountant and if so, contact them to see when the last returns were submitted.
- Establish if they are prepared to prepare and submit the outstanding returns.
- Although such actions are likely to delay any dividend, and incur a modest further cost, it is likely that it will result in a significant reduction in the HMRC claim.
- Check with HMRC that they are prepared to accept late returns and will amend the claim upon receipt.
- It is perfectly acceptable for interest and penalties to be included provided that they are properly calculated and that interest is only included up to the date of the warrant to cite. Review amounts and periods.
- The Crown is entitled to offset the VAT refund against the income tax liability.

#### Landlord's claim

- Any arrears of rent outstanding at the date of sequestration will be a debt.
- Obtain a copy of the lease
- Review to ensure claim for current and future rent is calculated in accordance with the terms of the lease.
- Landlord has a common law duty to mitigate loss, if property is re-let then any rental income will be deducted from the sums claimed.
- It may appear that the rent for the rest of the lease is a "future" debt and therefore subject to discounting. In this case, the amount of the claim is calculated as if the debt were due on the relevant date, but interest between the relevant date and the due date is deducted at the prescribed rate (8%) If, in terms of the lease the future rent is due on termination then it is a current debt, but subject to the common law of mitigation.
- You should discuss with your surveyor how long it is likely to take to relet the property and therefore the extent to which you would expect the claim to be mitigated.
- Dilapidations – lease must provide for payment of dilapidations by the debtor.
- Round sum figure suggests that this may not be an itemised list.

- Landlord must provide itemised list of dilapidations, with quotations, or better still, invoices to support each material item. It may be beneficial to instruct an independent valuation of the dilapidations claim if this appears excessive.
- Landlord has a right of hypothec over the goods on the premises at the date of appointment in respect of sums due for pre appointment rent. This would entitle him to the proceeds of sale of these goods, less the costs of sale in priority to the other unsecured creditors. The £2,000 pre appointment rent is recoverable from the sale of the goods on the premises.
- The position regarding the post appointment rents is untested and it is recommended that legal advice is obtained as to whether the landlord's right to hypothec extends to the full £20,000 recovered from the sale of stock. Remembering that £18,000 represents c 5p in the £1 and the associated legal cost that may be involved.

#### Binwell

- There is clearly a dispute between the debtor and Binwells. But more information is needed in order to adjudicate on the claim.
- It appears that the debtor may have previously instructed a lawyer therefore it is important to obtain the file from the lawyer and establish what actions, if any, were taken and what further steps are available.
- Review the boxes of records to identify any correspondence with Binwells which may evidence the counterclaim.
- Similarly, identify any correspondence from dissatisfied customers.
- Are there any claims for poor quality products within the other, smaller proofs, which may provide evidence in support? – Binwells claim should be reduced by the cost (rather than sale value) of any such items.
- Ask Mrs Dixon for her comments on the dispute.
- Advise Mrs Dixon that the right to pursue the claim vests in the Trustee.
- Seek legal advice on the merits of any claim against Binwells.
- Right of action for consequential losses vests in the Trustee, who must decide whether there is any merit in the claim.
- Trustee must be mindful of commercial considerations ie cost and likely success of the action, and not dilute the dividend unnecessarily.
- With the information you have gathered and assuming that legal action is not cost effective seek to negotiate a reduction in Binwell's claim.

#### Mrs Stephens

- Mrs S would appear to have a valid claim in the sequestration provided she can evidence the cost of repairs
- However, if the debtor had taken out appropriate insurance, Mrs S would have a claim under the Third Parties (Rights Against Insurers) Act 2010.
- If successful, this will have the effect of reducing the level of claims and thus enhancing the dividend for creditors
- Review boxes of records to identify any reference to insurance of vehicles.
- Claim value is small so consider how cost effective it is to investigate or challenge the claim further.

#### Customer's claim for legal costs

- Court order imposing liability on debtor for payment of the customer's legal costs was pre-sequestration.
- Although the assessment of costs took place after sequestration, this simply quantifies a previously unquantified claim and is therefore provable.
- Interest is payable provided that it is included in the terms of the court order
- Obtain a copy of the Court Order
- And will be calculated from the date of the court order in September 2012 to the date of the warrant to cite (sequestration). The current calculation is incorrect and needs to be worked out correctly.
- Trustee will need to inform the creditor of the incorrect application of the interest calculation,
- And seek the creditor's agreement to amend the claim accordingly in order to avoid the need to partially reject

#### Mr Dixon

- Mr Dixon is jointly and severally liable for the debts due to each of the banks.
- Their separation has no effect on this position and as there has been no divorce, there will be no orders which might affect his liability
- It is important to establish how much has been paid to each bank, and the extent to which the payments made by Mr Dixon to the banks have repaid the liability to the banks.
- You should check that these repayments are also reflected in any claim admitted for the Banks.
- Where there is a co-obligant with the debtor and the co-obligant repays the sums due, the co-obligant is sub-rogated to the creditor's claim. Mr Dixon, may obtain, at his own expense an assignation of the debt and thereafter may submit a claim.
- If the banks have not been fully paid, they remain as the Primary creditor, and are thus entitled to claim in the sequestration in their own right. In this circumstance, Mr Dixon is only able to claim the amount that has been repaid.
- Any such claim will not be postponed pursuant to s51 3(b) BA 85 (discuss) because it is not a loan between husband and wife but rather a loan from the Bank(s) for which both parties are jointly liable

#### Dunstan

- Check your file to identify what was returned, to whom, and when and the circumstances presumably if anything was returned this was following a claim for ROT.
- Cross reference this information with the invoices in support of the claim from Dunstan. Ensure that the claim has been reduced for the value of the items that were returned to Dunstan.
- Upon establishing that Dunstan is an audit client, you should refer to the Ethical Guidelines issued by the trustees RPB regarding the potential conflict.
- Although the claim is material, the fact that the creditor is an audit client of the firm is unlikely to be sufficiently material to amount to a conflict of interest such that the Trustee would need to resign.
- Practically, it would be appropriate to instruct an independent third party to adjudicate on the claim
- such as another Insolvency Practitioner not connected to the firm,
- or a solicitor with relevant experience
- Reference should be made in the next progress report or the final report to creditors of how this potential conflict has been dealt with.



## Question 2

### Requirements

Write a letter to Mr Jones. In your letter you should:

- (a) (i) explain the role of a Trustee under a Trust Deed, his responsibilities prior to and within the first ten weeks of the trust deed being signed and the purpose of his initial circular to creditors. A listing of the contents of a circular is not required; (15 marks)

### The Role of the Trustee and duties within first ten weeks

The Role of the Trustee:

- The role of the Trustee is to establish the extent of the assets, surplus income and ultimately realise these. Distributing available funds to the unsecured creditors.
- The Trustee is appointed by the Trust Deed document and his role will be defined by the Trust Deed document itself.
- The Trustee must act in the interests of creditors though he has a duty of care to the debtor and should try and balance these interests.
- Must comply with the PTD Regs 2013 and SIP 3(A) (now SIP 3.3).
- In order to become a PTD, the TD must convey the same assets to the Trustee as would be conveyed in a sequestration.

Prior to appointment the Trustee should:

- Carry out checks to ensure there are no conflicts which would prevent you accepting the appointment.
- Meet with the debtor to discuss their position.
- In this case as there is a trading business, the IP should consider whether to visit the business premises.
- The IP should be satisfied that the debtor is insolvent.
- Must also be satisfied that the debtor cannot pay his debts in full within 4 years (DAS).
- The IP should ensure that the debtor is aware of and has considered all available options.
- The IP should ensure that the debtor has enough time to think
- They should advise the debtor in writing of the implications of signing a TD Regulation 7(3)(a) and
- Ensure that the debtor is provided with a copy of debt advice and information package – Reg (7) (3) (b)
- Prior to the TD being signed, the Trustee must discuss and agree the position with the family home with the debtor (ie excluded or not) and if not to be excluded, reach an agreement re how the equity will be realised.
- Assess value of assets in this case business, goodwill, stock
- Obligation on Trustee to verify key information provided by the debtor, including, obtaining valuations of any assets, particularly heritage, obtaining redemption statement from secured creditors.
- In this specific case, if trading is to continue then the Trustee would need to ensure appropriate controls were in place to secure the income and monitor the expenditure which is presumably going to drive the return to creditors.
- The Trustee would be expected to prepare or at least check the accuracy of the P&L, cashflow projections on which the estimated contribution is based and verify the source of any other income.
- The Trustee should verify key items of Expenditure which are allowed when calculating the Contribution to be paid to the TD.
- The Trustee should verify the balances due to creditors.
- Using this information, the Trustee should draw up a statement of assets and liabilities and quantify the return to creditors.
- Once appointed, the Trustee must immediately notify the AIB of their appointment by sending Form 1 to the AIB via the ASTRA system. The AIB will arrange for notice to be placed on the ROI (no longer Edinburgh Gazette).
- The Trustee must write to all known creditors within 7 days of the notice in the ROI to advise them of his appointment and give them a period of 5 weeks to lodge objections to the TD becoming protected.

### **Purpose of the initial circular**

- The purpose of the initial circular to creditors is to provide sufficient information to creditors to consider whether they wish to object to the trust deed becoming protected. The detailed requirements for the contents of the circular are set out in Regulation 10 of the PTD Regs 2013.
  - The circular should set out the likely return to creditors. The circular should provide a statement of affairs including a statement of the debtor's assets and the steps intended to take to realise these. The Trustee should advise creditors if any assets have been excluded. It should also show the debtor's income and expenditure and the level of regular contribution that has been agreed with the Trustee. A list of liabilities should be provided together with an estimate of the costs of realisation and dividend that will be paid to creditors. The Trustee should comment on the steps they have taken to verify the above.
  - Creditors should be invited to submit a claim.
  - Creditors should be advised how and when they can object.
  - Trustee should document any/all objections received and report outcome to AIB within 4 weeks of the expiry of the five week period and provide the documentation required by Reg 11 to ensure that the TD is registered as protected.
- (ii) **set out your suggestions as to the steps that Mr Jones might himself take to be satisfied that he should not object to the Trust Deed signed by Miss Wilding (Kate) becoming protected. (5 marks)**

### **Steps to be taken by Mr Jones**

- His claim of £52,000 out of total indebtedness of £140,000 is over 1/3 in value and he therefore has the voting power to prevent the TD becoming protected.
  - Mr Jones has five weeks from the date of advertisement of the TD to consider whether he wishes to object.
  - Mr Jones should review the circular and check that his own claim is accurately stated
  - If not, there may be other mistakes/issues which might affect the potential success of the TD
  - Use his experience of the market and any current issues within the industry to assess whether the dividend outlined is reasonable and achievable.
  - He should also consider the assets which are to be realised in conjunction with what he know about Kate's financial position and any information she has provided him previously to support the credit that she has been provided.
  - Establish extent of overall indebtedness and
  - and identify major creditors
  - Contact them for their views, and whether they will support her proposal
  - Establish the estimated level of dividend and therefore how much of a return he should expect in due course.
  - Ultimately, his decision whether or not to support the TD depends upon the overall impact upon his business compared to the alternative, which is most likely to be sequestration.
  - Given her position as a major customer, accounting for 10% of Malham's turnover, how would losing her business and writing off £52k affect his business?
  -
- (b) **Set out the information that Mr Jones should expect to receive regarding the Trust Deed (assuming it becomes protected) on an ongoing basis, and the options available to him if he is not satisfied with the information provided. (5 marks)**

### **Ongoing Information to be provided**

- The Trustee must provide a report to the debtor, creditors and AIB in the format required by the Regs Form 4. These must be no more than 12 months apart and should be provided no later than 6 weeks after the anniversary date.
- These reports will provide Mr Jones with an update on progress and in particular whether the estimated dividend has changed.
- Mr Jones is entitled to request that the AIB examine the administration of the case following receipt of the Form 4 (or at any time).
- Mr Jones should expect to be provided with details of the fees being requested by the Trustee. Mr Jones has the opportunity to object to the fees and request that they are audited by the AIB. In particular, under Reg 23 Mr Jones would expect to be asked to approve any increase in the Trustee's fixed fee.
- Mr Jones should expect to be invited to submit a formal claim and then should receive a formal adjudication on his claim. He is entitled to appeal to the Sheriff Court if he disagrees with the adjudication.
- In line with the 2013 Regs, Mr Jones should be expecting to receive dividends 6 monthly from 24 months onwards, assuming funds are available. Mr Jones should receive notification of these dividends.

- Mr Jones should expect to be advised if the debtor misses more than 3 contribution payments.
- Mr Jones should expect to receive notification that the debtor is being provided with her discharge and be given the opportunity to object to that.
- At the conclusion of the case, following the final distribution, Mr Jones will receive notification that the Trustee has applied for their discharge and is entitled to object to this.
- If Mr Jones is not happy with the information he receives, in the first instance he should raise this with the IP. In addition to the formal rights of appeal outlined above, if he is not satisfied with the IP's response, he could raise this with the IP's Regulatory Body or the AIB.

### Question 3

- (a) Prepare a cash flow forecast on a monthly basis for the Business for the year ending 31 October 2015. Set out your supporting calculations and state clearly any assumptions which you have made. (12 marks)

### WORKINGS

Opening balance sheet 1 November 2014				Closing balance sheet 31 October 2015			
<b>Debtors</b>				<b>Debtors</b>			
Monthly sales £20,000				Monthly sales £25,000			
Sales to non-public each month are 40%				Sales to non-public each month are 40%			
Monthly non-public sales are £8,000				Monthly non-public sales are £10,000			
Non-public customers pay in second month following sale				Non-public customers pay in second month following sale			
Sales for Sept and Oct 14 not yet paid				Sales for Sept and Oct 15 not yet paid			
These will be received in Nov and Dec				These will be received in Nov and Dec			
<b>£8,000 + £8,000 = £16,000</b>				<b>£10,000 + £10,000 = £20,000</b>			
<b>Creditors for supplies</b>				<b>Creditors for supplies</b>			
Supplies are acquired in month of sale				Supplies are acquired in month of sale			
Supplies are paid for in month following sale				Supplies are paid for in month following sale			
GP% is 50% on public sales and 40% on non-public sales				GP% is 50% on public sales and 40% on non-public sales			
Public sales are 60% of all sales and non-public 40%				Public sales are 60% of all sales and non-public 40%			
Monthly:	Total	Public	Non-public	Monthly:	Total	Public	Non-public
Sales	20,000	12,000	8,000	Sales	25,000	15,000	10,000
GP	9,200	6,000	3,200	GP	11,500	7,500	4,000
COS	<u>10,800</u>	<u>6,000</u>	<u>4,800</u>	COS	<u>13,500</u>	<u>7,500</u>	<u>6,000</u>
Supplies unpaid for Oct only: £10,800				Supplies unpaid for Oct only: £13,500			

## Cash Flow

	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sept	Oct	Total
<b>Receipts</b>													
Opening debtors	8,000	8,000											16,000
Sales to the public (60% x £20,000)	12,000	12,000	12,000	12,000	12,000	12,000							72,000
Sales to the public (60% x £25,000)							15,000	15,000	15,000	15,000	15,000	15,000	90,000
Sales to hotels etc (40% x £20,000)			8,000	8,000	8,000	8,000	8,000	8,000					48,000
Sales to hotels etc (40% x £25,000)									10,000	10,000	10,000	10,000	40,000
													0
One off sale made in Mar paid in May							60,000						60,000
	20,000	20,000	20,000	20,000	20,000	20,000	83,000	23,000	25,000	25,000	25,000	25,000	326,000
<b>Payments</b>													
Creditors	10,800												10,800
Supplies (paid one month after sale) (50% x 12,000) + 60% x 8000)		10,800	10,800	10,800	10,800	10,800	10,800						64,800
Supplies (paid one month after sale) (50% x 15000) + (60% x 10000)								13,500	13,500	13,500	13,500	13,500	67,500
One off sale: COS = 60% paid for in month of sale as supplies received a month early 60% x £60,000						36,000							36,000
Overheads	7,500	7,500	7,500	7,500	7,500	7,500	9,500	9,500	9,500	9,500	9,500	9,500	102,000
Drawings	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	2,500	30,000
Additional re IVA	500	500	500	500	500	500	500	500	500	500	500	500	6,000
	21,300	21,300	21,300	21,300	57,300	21,300	23,300	26,000	26,000	26,000	26,000	26,000	317,100
Net receipts	-1,300	-1,300	-1,300	-1,300	-37,300	-1,300	59,700	-3,000	-1,000	-1,000	-1,000	-1,000	8,900
Opening bank balance	7,000	5,700	4,400	3,100	1,800	-35,500	-36,800	22,900	19,900	18,900	17,900	16,900	7,000
Closing bank balance	5,700	4,400	3,100	1,800	-35,500	-36,800	22,900	19,900	18,900	17,900	16,900	15,900	15,900

Candidates may assume that the opening creditor figure of £10,800 is a claim in the IVA, and thus not include it as a payment in the cash flow. Either treatment is allowable provided the assumption is stated. If candidates exclude it as a payment, the closing bank balance each month should be increased (or overdraft reduced in March and April) and the closing balance at the year end will be increased by £10,800 in both the cash flow and the balance sheet

- (b) Prepare a profit and loss account for the Business for the year ending 31 October 2015 and a balance sheet as at that date. Set out your supporting calculations and state early any assumptions which you have made. (8 marks)

**Profit & Loss Account**

**Profit and loss - y/e 31 October 2015**

		£	£
<b>Sales</b>			
Public	(6x12000) + (6x15000)	162,000	
Non-public	(6x8000) + (6x10000)	108,000	
One off		60,000	
		<hr/>	330,000
<b>Cost of sales</b>			
Public	50% x 162,000	(81,000)	
Non -public	60% x 108,000	(64,800)	
One off	60% x 60000	(36,000)	
			<hr/>
			(181,800)
<b>Gross profit</b>			<hr/>
			148,200
<b>Costs</b>			
Overheads	6 x 7,500 + 6 x 9,500	(102,000)	
Depreciation	25% x £22,000	(5,500)	
		<hr/>	(107,500)
<b>Net profit</b>			<hr/>
			40,700
<b>Drawings</b>			
	Living 12x2,500	(30,000)	
	IVA 12x500	(6,000)	
		<hr/>	(36,000)
<b>Net profit after drawings</b>			<hr/>
			4,700

Balance sheet	31-Oct-15	
	£	£
Fixed assets (£22,000 – 5,500)		16,500
Debtors (2x£10,000)		20,000
Bank account		15,900
		52,400
Creditors (1x£13,500)		(13,500)
Proprietor's funds		38,900
Funds b/f		34,200
Profit for the year	40,700	
Drawings (12x2500)	(30,000)	
IVA drawings (12x500)	(6,000)	
		4,700
Proprietor's funds		38,900

- (c) **Giving your reasons, comment on whether it would be viable for George to continue to trade the business to fund a payment to a DPP and outline the risks and practical difficulties of doing so. (5 marks)**

#### **Viable/ Practical difficulties and risks**

##### **Viability**

The underlying business is not profitable, and were it not for the one off contract, (which makes a profit of £24,000) there would be a loss after drawings meaning that payments into the DPP would not be made. If the cashflow is projected for another 12 months there aren't sufficient reserves or profits to pay the contributions. Payments exceed Receipts by c £1,000 per month. This needs to be addressed by securing more one off contracts and/or addressing the profitability of the core business.

##### **Practical Difficulties**

- The crucial practical difficulty is that the cash flow projection indicates that the bank account will become overdrawn in March and April.
- The bank has indicated that it will not permit the account to become overdrawn.
- Any lender/potential funder has to be made aware of the position with the DAS. The Debt Arrangement Scheme (Scotland) Regulations 2011 – Regulation 33
- Any anticipated borrowing requirement should be included in the original DAS proposal as a discretionary condition.
- This overdraft arises as a result of the need to pay for the supplies for the one-off contract.
- Alternative short term funding may need to be secured to enable trading to continue during this time; again if this is borrowing then the Lender has to be made aware of the DAS
- Or George will need to try to renegotiate either the payment terms to suppliers or from the hotel chain for this one off contract.
- Or alternatively the payments into the DPP could be staggered to reflect the cashflow in this period. Payment holiday up to 6 months is permitted.

- George should carry out a sensitivity analysis on his projections to assess the impact of changes to his assumptions.
- If an IP is appointed to the DAS and not a free Money Advisor then a fee will be charged (market rate c10% of the monthly payments), this will reduce the sums available to fund the business cashflow. (The IP has to advise George that he is able to obtain free advice and provide details of local Money Advisors )

#### Risks – Other

- No element of contingency in either business or personal I&E.
- Sustainability of the plan over the 5 year period – consider George's age.
- Suppliers – terms can he assume these are as before and will he get credit at all?
- Customers – will they still be prepared to pay upfront
- Book debts will they continue to be recoverable.

#### Question 4

- (a) **What factors would you take into account in making the decision on whether or not to continue to trade? (5 marks)**
- (b) **Assuming you decide not to continue to trade, identify the issues to be dealt with and the actions that you and the Agent will need to take in the next week. In relation to each issue, state clearly the relevant law and any assumptions which you have made. (20 marks)**

#### To trade or not to trade - Strategy

- Determine whether it is necessary and practicable for the garage to continue to trade remembering that trading should only be carried out if there is a benefit to the estate.
- The Trustee has the power to trade on under the provisions of s 3 of the Act.
- The lack of routine business (only two services booked) suggests that carrying on the business will not be profitable.
- Identify whether there are any special reasons to continue to trade: for example would it be worthwhile completing any of the restoration projects in progress.
- Is there any value to the business as a going concern ?
- If trading in some form is desirable, prepare projections (P&L and cashflow) to determine whether to do so would be practicable and establish the need for and availability of any funding requirement.
- Rent will need to be paid and the landlord will need to agree to your occupation – especially if the lease is terminated on sequestration.
- Will it be necessary to retain any employees and if so, are they willing to work for you and how will they be paid
- Can you continue to use the premises and are there environmental or Health & Safety issues that might prevent or inhibit trade
- It will be necessary to get insurance to cover the continued trade which may be difficult or restricted
- To what extent do you need the co-operation of the debtor and how co-operative has he been to date.
- Do you need any special licences to continue to trade?

If trading ceases, cancel the two booked services. (Give this mark either here or under MV but not both)

#### The premises

- Obtain a copy of the lease
- Undertake a valuation of the lease although given that only 2 years out of 25 remain, that rent is in arrears and a large dilapidations claim is likely, the lease is probably of little or no value and given the ongoing liabilities, onerous.
- Consider to what extent you will need to use or to have access to the premises, e.g. for removal of assets and/or continued trading.
- Mr Whitely has a right to hypothec to goods on the premises (not 3<sup>rd</sup> party goods) in respect of unpaid rent. Need to establish the amount of unpaid rent and also the value of the contents of the premises (see below)
- Whatever strategy is adopted there will be a need to negotiate with Mr Whitely and agree terms of use/access.
- Solicitors should be instructed to reply to the letter from Mr Whitely's solicitors and the suggestion that you are personally liable as claimed must be refuted.
- The arrangement with the hotel about the 1<sup>st</sup> floor accommodation should be ended immediately

- to avoid any liability issues arising
- The current occupants should be allowed to remove any personal belongings.
- The Hotel has an unsecured claim if they have paid any cash in advance

### **Motor vehicles**

- Establish the ownership of each vehicle.
- Secure the vehicle documentation
- If any of the four cars in the property is owned by third parties, find out whether the Garage has been paid for works carried out and collect any sums outstanding.
- If necessary, consider if a repairer's lien can be exercised.
- If thought appropriate, negotiate the terms (payment and otherwise) for any future work.
- Once payment issues resolved, return vehicles owned by third parties to them.
- Undertake valuation of all vehicles owned by the Garage.
- This should include an HPI check to establish whether any finance is outstanding.
- Consider the best way of realising the vehicles owned by the Garage – take agent's advice as it may be appropriate for disposals to take place through private treaty or specialist sales, rather than through, for example, a general auction.
- Also consider, depending on the status of your discussions/negotiations with the landlord whether you should take steps to immediately remove them from the premises.

### **Parts**

- Check for Retention of Title issues, as there appear to be outstanding creditors, although if the parts derive from breaking cars there is unlikely to be a material problem.
- Review piles of post for statements and invoices for evidence of further ROT claims from suppliers
- Take a broad inventory of the parts and undertake a valuation.
- Consider possible methods of disposal, for example through a specialist auction or trade/enthusiast internet websites
- Consider contacting marque owners' clubs or similar.

### **Health and safety issues**

- Consider the risks of:
  - General state of the premises, including the yard
  - The rusty barrels in the shipping container
  - Access (authorised or otherwise) to the premises.
  - The large quantity of paint
- Specialist advice may be required as may specialist waste removal services.
- Costs/risk dictate timescales for being on site

### **Olive Beauvoisin**

- Advise Bank of appointment freezing any credit balance in account and redirecting to Trustee's account;
- Trace the proceeds of the sale into the Garage's bank account.
- If the bank account is in credit, take advice on the possibility of OB being able to trace the proceeds
- She is less likely to have a claim if the account is overdrawn.
- but that may not be the whole story as the arrangement with OB and the sale all occurred after the warrant to cite.
- Inform OB that she should take her own legal advice/give her a claim form.
- Consider Debtor's conduct – possible BRO in due course.

### **Employees**

- Establish the position as regards the receptionist and any other people working at the Garage.
- Are any of them employees? Seqn appt does not terminate this automatically
- Do you need to retain any staff to organise the close down?
- Meet with employees and issue relevant ERA claim forms and discuss their entitlements. Provide them written confirmation of Trustee's appointment and that Trustee does not require their services – unless trading on where letter should confirm payment made for services but not adopting contracts.
- Establish extent of any arrears of wages;
- Arrange for payroll records to be brought up to date;
- Do pension search and s.120 intimation if there is a pension fund



## General issues

- Insurance – obtain open cover insurance over premises and assets pending full inventory and valuation of assets
- Site visit by insurer may be necessary given the specialist nature of the vehicles and the Health & Safety issues identified
- Consider whether premises are otherwise secure. However, carefully consider position with landlord and whether any agreement has been reached and on what basis the locks could be changed.
- Is there the need for physical security pending full valuations etc
- Is there an alarm? If so, contact alarm company to advise of appointment, change contact details and change alarm code
- Are there any book debts owed to debtor which should be pursued;
- Any leased equipment on site?
- Open redirected mail (any cheques?). Upload creditors' details for initial circular.
- Redirect mail in due course;
- Petty cash/cheques on premises, secure and Bank
- VAT 769
- Statutory duties – give debtor notification of appointment/Form 3, Start preparing SofA and circular to creditors;
- Books and records?
- Utility meter readings, close to date of appointment.
- Notify Council re rates.
- Document any issues that arise re the debtor's conduct for example, has his neglect of affairs (unopened mail) contributed to the insolvency – for future BRO