

**JOINT INSOLVENCY EXAMINATION BOARD
NOVEMBER 2010 EXAM (SCOTLAND)
EXAMINERS' REPORT AND MARKING PLANS**

GENERAL NOTE

Some candidates wasted time and lost marks by perpetuating bad habits to which attention has been drawn in the past. No marks are awarded for copying out extracts from the question. Time is wasted by candidates by not planning their answers: extra marks are not awarded for making the same point twice. The quality of handwriting remains an issue: if something cannot be read no marks can be awarded. Finally, some candidates waste time by underlining what they consider key points. Some of the underlining is so carelessly done that it comes perilously close to deleting the answer, therefore running the risk that marks are lost.

EXAMINATION MARKING PLANS

The marking plans are set out below after each examiner's report. Markers are encouraged to use discretion and to award partial marks where a point is either not explained fully or made by implication. The marking plan is also adapted to give credit for valid points made by candidates. Inclusion of extraneous material often causes candidates to lose time that should be spent addressing the questions that were asked, and may adversely affect the holistic score.

**ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS & RECEIVERSHIPS
DECEMBER 2010 (SCOTLAND)**

2010 EXAMINER'S REPORT

QUESTION 1

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

This question was designed to test candidate's knowledge of Schedule A1 to the Insolvency Act 1986, the Companies Act 2006 requirements to qualify as small company and the admissibility, or otherwise, of proxies for voting purposes.

The first part of the question was generally well answered from a process perspective and it was clear that most candidates had a good working knowledge of the Act. The second part of the first requirement was disappointingly answered, with a large number of candidates failing to differentiate between net and gross assets in respect of the balance sheet test or, of more concern, having little knowledge of the Companies Act provisions.

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

The assessment of the admissibility of creditors' claims for voting purposes was very poorly answered. The majority of candidates failed to appreciate the need to discount a debt payable in the future (Bayou Finance), to identify that Mr Brookes was a connected party (Adam Brooks) and adequately deal with an unliquidated claim (Loch Estates).

QUESTION 2

- (a) **For each supplier outline the matters to be considered when assessing the validity of the claim, whether you consider their reservation of title claim is valid and any practical suggestions for dealing with the claim. (12 marks)**

Question 2 required candidates to demonstrate their understanding of the legal and practical issues surrounding retention of title claims and the procedures should a creditor disagree with an administrator's decision. Overall, the question was very poorly answered with only one candidate in Scotland achieving more than half marks.

The vast majority of candidates in the first part of the question failed to reach a decision, or indeed attempt to reach a decision, but instead stated they would seek legal advice. Whilst good quality legal advice can be essential in a contentious dispute, an insolvency practitioner must be able to assess the facts, understand the implications and seek to reach a conclusion on matters relating to the estate he is administering. It was also disappointing the number of candidates who failed to state the basic facts (ie the type of clause involved) for which marks were available. The examiner is unable to award marks on the assumption that candidates know the basics even if he/she has dealt with the more complex areas of the question.

- (b) **Draft a note outlining what legal and practical steps suppliers may generally take should they disagree with any decision regarding the validity of their reservation of title claim. Explain how an Administrator should deal with this situation. (8 marks)**

In the second part of the question, most candidates were able to identify some of the practical steps that should be taken where there is a dispute, however, the majority failed to provide a discussion on the legal procedures should commercial negotiations fail. It was particularly concerning that one candidate gave a discourse on the merits, or otherwise, of physical violence in such a situation.

QUESTION 3

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

This question required candidates to demonstrate their understanding of the contents of an information memorandum, the ethical considerations to be addressed when accepting an appointment over a company in which the proposed IP has had previous dealings and, finally, the disclosure requirements for a "pre-pack" sale.

It was apparent in the first part of the question that those candidates who had prior, practical, experience of a sale of business process scored extremely well. Candidates should bear in mind that the JIEB examinations are a practical test as well as technical and are designed to ensure an individual has the requisite skills to hold an insolvency licence. The ethical section of the question was reasonably answered with most candidates having a fair knowledge of the fundamental principles and threats.

The final part of the question was exceptionally well answered. It was clear that candidates have been waiting for a question on SIP 16 and few missed the opportunity to exploit this to their full advantage with large numbers of candidates quoting the SIP verbatim. In their eagerness, however, a significant minority of candidates failed to address, or indeed mention, the requirements of SIP 13. The number of candidates who augmented their answer with reference to Dear IP 42 was also encouraging.

QUESTION 4

- (a) **Prepare a weekly cash flow forecast for the 4 week trading period, showing the expected weekly trading receipts, payments, bank balance and funding required from Pippin Bank plc. Show also the trading transactions that will fall outside the trading period and the total outcome. (20 marks)**

The final question in this year's examination asked candidates to prepare a trading cashflow and to consider the risks should an administrator trade a business, especially where this generated a loss.

In contrast to prior years, the numerical part of the question was almost universally inadequately answered. It was clear that the overwhelming majority of those sitting the examination did not understand the mechanics of invoice discounting. As asset-based lending is becoming an increasing feature of corporate banking facilities, IPs must show they have an understanding of the practicalities of this type of funding. There was a disappointing number of candidates who chose to haphazardly apply VAT to certain receipts and payments or, in a number of cases, ignore VAT altogether.

- (b) **Prepare a note for your principal outlining**
- (i) **The financial impact on the estate of continuing to trade the business during this period assuming that the costs of monitoring the ongoing trade will be £20,000 per week. (4 marks)**
 - (ii) **The potential personal risks that trading at a loss may have to an Administrator. (4 marks)**
 - (iii) **Steps that ought to be considered to minimise the risk to the Administrator associated with trading at a loss. (2 marks)**

The second part of the question was also poorly answered. Given the majority of the actions an administrator could be faced with are included within the Insolvency Act, it was surprising that few candidates adequately identified and discussed the correct provisions. Instead, a significant minority gave a full and detailed discourse on the administrator's liability to wrongful trading under section 214.

JIEB ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS and RECEIVERSHIPS

NOVEMBER 2010

EXAMINATION MARKING PLAN

QUESTION 1 - Lagune limited

- (a) Your principal asks you to prepare points for a letter to management outlining:
- (i) A brief summary of the steps that a company needs to take in order to obtain court protection through the Voluntary Arrangement Moratorium.

Directors submit to Nominee

Document setting out the terms of the proposed voluntary arrangement

Statement of affairs containing particulars of its creditors, debts, liabilities and its assets as may be prescribed and such other information as may be prescribed.

Any other information necessary to enable the Nominee to comply with the requirements to submit a statement to the directors under para 6(2) which the Nominee requests

The Nominee submits to the directors a statement in the prescribed form indicating in his opinion:

The VA has a reasonable prospect of being approved and implemented

The company is likely to have sufficient funds available to it during the proposed moratorium to enable it to carry on its business and

Meetings of the company and its creditors should be summoned to consider the proposed voluntary arrangement

Directors must file in court:

The CVA document

A Statement of Affairs

A Statement the company is eligible for a moratorium

A statement from the Nominee that he has given his consent to act

The Nominee's statement to the directors (above)

Court fee

Moratorium comes into force upon filing of the documents in court.

(ii) Relevant eligibility requirements for a CVA moratorium and how these would be applied in the above circumstances. For this purpose assume that the CVA was filed in court on 30 November 2010. (10 marks)

Company does not fall into any of the ineligible categories under Para 2(2)

Company would be ineligible if:

- In Administration
- Being wound up
- Receiver appointed
- A Voluntary Arrangement in effect
- Provisional liquidator appointed
- Moratorium in force for the company at any time during the period of 12 months ending with the day of filing and
 - No voluntary arrangement had effect at the time at which the moratorium came to an end or
 - A voluntary arrangement which had effect at any time in that period has come to an end prematurely
- An administrator appointed under paragraph 22 of Schedule B1 has held office in the period of 12 months ending with the date of filing
- A voluntary arrangement in relation to the company which had effect in pursuance of a proposal under section 1(3) has come to an end prematurely and, during the period of 12 months ending with the date of filing an order under Section 5(3)(a) has been made

Company does not fall into other exclusions

- Capital market arrangement
- Public private partnership
- Liability under an arrangement

Company is eligible if it meets the qualifying conditions

- In the year ending with the date of filing OR
- In the financial year of the company which ended last before that date

Qualifying conditions are met by a company if in that period it satisfies 2 or more of the requirements for being a small company specified in Section 382 Companies Act 2006

Qualification conditions:

- Turnover no greater than £6.5million
- Balance sheet total no greater than £3.26m
- No more than 50 employees

Balance sheet total is based upon total assets excluding liabilities

	Nov-10		Mar-10	
Turnover test <= £6.5m	7,900	No	5,550	Yes
Balance sheet total (total assets excluding liabilities) <=£3.26m	6,700	No	2,750	Yes
Employees <= 50	40	Yes	52	No
Eligible	No (1 of 3)		Yes (2 of 3)	

As company meets the requirements in the last financial year it will qualify under Section 3(1) and 3(2)

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

(i) Bayou Finance limited

Lombard North Central v Brook; Re Durham Counters Ltd

Proxy forms can be received up to the time of the meeting

Submission of written details of claim before or at meeting

As there is a termination clause, the insolvency in itself is not a breach of contract.

Should be permitted to vote for total amount falling due under the agreements less a standard discount for accelerated receipt.

No deduction for valuation of the asset

Allow to vote for £36,500 less standard discount

Standard discount calculated by reference to Paragraph 1(2) of Schedule 1 of the Bankruptcy (Scotland) Act 1985 as applied, ie at statutory interest rate of 8%:

Calculation of claim for voting:

Payment no	Payment	Reduction	Amount provable
1	10,000	1.08	9,259.26
2	10,000	1.1664	<u>8,573.39</u>
			17,832.65
Rent arrears			10,000.00
Termination charges			6,500.00
Total claim for voting			<u>34,332.65</u>

(ii) Adam Brookes

Submission of written details of claim before or at meeting
Votes calculated according to the amount of the creditor's debt as at the date of the meeting.
As an individual no requirement to submit proxy form
Section 249 states that a person is connected with a company if he is a director or shadow director of the company or an associate of such a director
Section 435 states a person is an associate of an individual if that person is the individual's husband or wife.
As Mr Brookes remains married to the director he is a connected party
Connected party votes excluded from simple majority required to vote in favour of the arrangement.
Admit to vote for £7,500.
Include £7,500 in the voting for the required excess of 75% but exclude from the 50% vote

(iii) Loch Estates Limited

Dilapidations unliquidated.
Rule 1.15A(3) debt valued at £1 unless Chairman agrees to put a higher value on it.
No evidence upon which chairman can conclude that a higher value should be placed on the dilapidations.
Chairman not obliged to speculate or investigate.
Service charge and insurance arrears liquidated.
Allow to vote for £5,001

QUESTION 2 – Coultard (UK) limited

(a) For each supplier outline the matters to be considered when assessing the validity of the claim, whether you consider their reservation of title claim is valid and any practical suggestions for dealing with the claim. (12 marks)

(i) **Massa Limited**

Invoice post contract
All monies clause
ROT clause incorporated into contract through prior course of dealing
Contract valid whether verbal or written
Sole supplier and therefore no doubt regarding supply
Amount of money owed is greater than the value of the stock
Goods can be easily removed without damage
600 units sold – no claim over these goods
Valid ROT claim over £14,000 of stock
Agree to pay for goods incorporated into the finished products
Seek discount for costs saved in having to remove stock from products

(ii) **Prost Limited**

Raw material

More than 1 supplier of same stock which is mixed
Chiltwood & Prost both owed more than goods cost
Doctrine of Commixion applies therefore cannot identify its goods and claim should be rejected

Commercially, due to low value of goods, consider allowing Prost to cover 1 tonne, ie two thirds, of the remaining stock
Will require agreement with Chiltwood

Moulded goods

Moulded items changed form
Goods would have to be damaged to recover the materials
No valid claim on WIP and finished goods

(iii) **Gubby Limited**

Simple clause
Incorporated into contract
Goods identifiable as having been supplied by Gubby Limited
Model 4565A - Necessary to identify items to unpaid invoices therefore reject claim over 300 units.
Models 3333B and 6667Q valid claim over 750 and 250 units respectively
Sold goods - no reservation of title claim as no concept of tracing in Scots law
Accept ROT claim for £6,500 and pay for the goods required as a cost of the administration

- (b) Draft a note outlining what legal and practical steps suppliers may generally take should they disagree with any decision regarding the validity of their reservation of title claim. Explain how an Administrator should deal with this situation. (8 marks)**

Suppliers to provide reasons why they disagree with decision
Administrator consider taking legal advice
Administrator should consider commercial negotiation
Administrator to provide reasons in writing
Under Paragraph 43 of the Act consent of Administrator or permission of court required to institute legal proceedings/Moratorium in place
When creditor applies to administrator for leave, administrator should act:
 Quickly
 Without using the moratorium as a bargaining position
 In the interests of the general body creditors
 Providing reasons for decisions

Court and administrator should consider Re Atlantic guidelines
 Balance interests of creditors as a whole against the interests of the applicant
 If significant loss would be caused to applicant by refusal leave normally granted
 If substantially greater loss would be caused to the general body of creditors out of all proportion to the loss of the applicant then leave may be refused

Onus on applicant for leave to make out case
Court will consider all relevant matters including conduct of parties
Application for permission will not adjudicate on disputes
Court has broad discretion
If permission granted then supplier able to take action specified by court
If permission not granted then supplier cannot take action until moratorium has ended.
Applicant may have the ability to appeal against the court's decision

QUESTION 3 - Carroll Limited

- (a) **Set out the main sections that should be included in a sales memorandum and list the main contents to be included within each section. (15 marks)**

Contents page
Disclaimer <ul style="list-style-type: none">No liability for inaccuraciesAgent of companyConfidentialityContents of the document are the responsibility of managementAny relevant Financial Services Marketing Act (FSMA) disclosures and disclaimers
Terms of reference
Executive summary <ul style="list-style-type: none">Summary of the other sections within the memorandumKey points for interested parties - summary of the opportunity
Background information <ul style="list-style-type: none">Company historyNature of the business – its products or servicesLocationSummary of reasons for the financial positionActions taken to address the situationGroup structure
Market information <ul style="list-style-type: none">Relevant market statistics showing trendsPosition of the company within the marketRoute to market (distribution channels etc.)CustomersCompetitorsSWOT analysis
Financials <ul style="list-style-type: none">Historic financial results<ul style="list-style-type: none">Profit and loss account, balance sheet and Cash flowAnalysis of key areas where appropriateExplanation and commentaryForecasts<ul style="list-style-type: none">Summary of management forecastsKey assumptionsKey sensitivities and analysisProfit and loss account, balance sheet and Cash flowSummary of prospects for and improvements in the businessProfit bridge from historic financials to forecasts to show expected improvements and additional costs.Funding<ul style="list-style-type: none">Existing funding structurePosition of existing funders – willingness to supportAny additional funding identified that may be available

Assets

- Details of key assets
- Valuations obtained
- Information regarding any intellectual property
- Further investment requirements
- Property
 - Freehold v leasehold
 - Lease terms
 - Rent arrears
- Intellectual property

Suppliers/creditors

- Creditor positions
- ROT issues
- Key suppliers

Employees

- Organisational chart
- Management team CVs
- List of employees and their relevant TUPE information
- Any claims outstanding
- Pension scheme
 - Type of scheme in place
 - Terms of scheme

Next steps

- Timetable
- Contact names/numbers/email for further information
- Any further information available
- Process

Appendices – providing more detailed information than that contained in the body of the document

Other relevant points

- Warranties provided
- Any matters relevant to insurance
- Regulatory matters/permits
- Health and Safety history

(b) Following a period of marketing the business for sale you conclude that the offer from the incumbent management team would represent the best outcome to creditors.

(i) Outline and explain the main matters for consideration before you could accept the appointment as Administrator of the Company. (7 marks)

General penalty bond in place

Ensure qualified to act

IP should ensure that he is satisfied that the following matters have been considered:

- Obtaining knowledge and understanding of the entity, its owners, managers and those responsible for its governance and business activities.
- Acquiring an appropriate understanding of the nature of the entity's business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed.
- Acquiring knowledge of relevant industries or subject matters.
- Possessing or obtaining experience with relevant regulatory or reporting requirements.
- Assigning sufficient staff with the necessary competencies.
- Using experts where necessary.
- Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

Consider threats to fundamental principles

fundamental principles

Integrity

Objectivity

Professional competence and due care – IP should only accept an insolvency appointment when they have sufficient expertise

Confidentiality

Professional behaviour

Threats

Self-interest threat – financial or other interest in the entity

Self-review threats – reviewing previous judgements made by an individual within the practice needs to be re-evaluated by the IP

Self-review threats – review nature of advice and the client advised in relation to the pre-appointment work.

Advocacy threats - individual within the practice promotes a position or opinion to the point that subsequent objectivity may be compromised

Familiarity threats – close relationship with company

Intimidation threats – may occur when an Insolvency Practitioner may be deterred from acting objectively by threats, actual or perceived.

Consider any relevant safeguards to ensure fundamental principals not breached

Consideration should always be given to the perception of others when deciding whether to accept an insolvency appointment

Attitude of secured creditors

Attitude of unsecured creditors

Ability to pay fees

Identification of clients known (money laundering)

- (ii) **Outline the disclosure requirements of an Administrator following a disposal of the business to the directors under a 'pre-packaged' sale and list the key matters that should be disclosed to creditors following such a sale. (8 marks)**

Statement of Insolvency Practice 16 – Prepackaged sales in administration

- The source of the administrator's initial introduction
- The extent of the administrator's involvement prior to appointment
- Any marketing activities conducted by the company and/or the administrator
- Any valuations obtained of the business or the underlying assets
- The alternative courses of action that were considered by the administrator, with an explanation of possible financial outcomes
- Why it was not appropriate to trade the business, and offer it for sale as a going concern, during the administration
- Details of requests made to potential funders to fund working capital requirements
- Whether efforts were made to consult with major creditors
- The date of the transaction
- Details of the assets involved and the nature of the transaction
- The consideration for the transaction, terms of payment, and any condition of the contract that could materially affect the consideration
- If the sale is part of a wider transaction, a description of the other aspects of the transaction
- The identity of the purchaser
- Any connection between the purchaser and the directors, shareholders or secured creditors of the company
- The names of any directors, or former directors, of the company who are involved in the management or ownership of the purchaser, or of any other entity into which any of the assets are transferred
- Whether any directors had given guarantees for amounts due from the company to a prior financier, and whether that financier is financing the new business
- Any options, buy-back arrangements or similar conditions attached to the contract of sale

Statement of Insolvency Practice 13 – acquisition of assets of insolvent companies by directors

- Whether the purchaser and was independently advised
 - DUPLICATES OF SIP 16 (no additional marks if mentioned under other SIP)The date of the transaction
 - Details of the assets involved and the nature of the transaction
 - The consideration for the transaction and when it was paid
 - The name of the counterparty
 - The nature of the counterparty's connected party relationship with the vendor

QUESTION 4

Fastpharm Limited

- (a) Prepare a weekly cash flow forecast, for the 4 week trading period, showing the expected weekly trading receipts, payments, bank balance and funding required from Pippin Bank plc. Show also the trading transactions that will fall outside the trading period and the total outcome. (20 marks)

	1 Nov 10 £	Week commencing		22 Nov 10 £	Period after £	Totals £
		8 Nov 10 £	15 Nov 10 £			
RECEIPTS						
From invoice discounting	205,625	164,500	123,375	246,750		740,250
Balance					317,250	317,250
	<u>205,625</u>	<u>164,500</u>	<u>123,375</u>	<u>246,750</u>	<u>317,250</u>	<u>1,057,500</u>
PAYMENTS						
ROT suppliers	67,563	14,688	–	–	–	82,250
Non-ROT supplies	–	161,563	132,188	264,375	–	558,125
Overheads	29,375	29,375	29,375	29,375		117,500
VAT					44,625	44,625
Staff net wages PAYE/NI	12,000	12,000	12,000	12,000	24,000	48,000 24,000
	<u>108,938</u>	<u>217,625</u>	<u>173,563</u>	<u>305,750</u>	<u>68,625</u>	<u>874,500</u>
Net	<u>96,688</u>	<u>(53,125)</u>	<u>(50,188)</u>	<u>(59,000)</u>	<u>248,625</u>	<u>183,000</u>
Cumulative	<u>96,688</u>	<u>43,563</u>	<u>(6,625)</u>	<u>(65,625)</u>	<u>183,000</u>	
Funding requirement	<u>–</u>	<u>–</u>	<u>(6,625)</u>	<u>(65,625)</u>	<u>–</u>	

Question (a) Workings

		Week 1	Week 2	Week 3	Week 4	After	Total
Cash receipts							
Sales		250,000	200,000	150,000	300,000		900,000
VAT	17.5%	43,750	35,000	26,250	52,500		157,500
Total sales		<u>293,750</u>	<u>235,000</u>	<u>176,250</u>	<u>352,500</u>		<u>1,057,500</u>
Invoice discounting %	70%	<u>205,625</u>	<u>164,500</u>	<u>123,375</u>	<u>246,750</u>	<u>317,250</u>	<u>1,057,500</u>

Supplier purchases							
Stock required	75%	<u>187,500</u>	150,000	112,500	225,000		675,000
Existing stock	200,000						
Non-ROT %	65%	<u>130,000</u>					(130,000)
ROT Stock	70,000	(57,500)	(12,500)				(70,000)
Additional suppliers			– (137,500)	(112,500)	(225,000)	–	(475,000)
		<u>(187,500)</u>	<u>(150,000)</u>	<u>(112,500)</u>	<u>(225,000)</u>	<u>–</u>	<u>(675,000)</u>

VAT receivable							
VAT on additional suppliers		–	(24,063)	(19,688)	(39,375)	–	(83,125)
VAT on ROT stock		(10,063)	(2,188)	–	–		(12,250)
VAT on other costs		<u>(4,375)</u>	<u>(4,375)</u>	<u>(4,375)</u>	<u>(4,375)</u>		<u>(17,500)</u>
		<u>(14,438)</u>	<u>(30,625)</u>	<u>(24,063)</u>	<u>(43,750)</u>	<u>–</u>	<u>(112,875)</u>
VAT Payable		43,750	35,000	26,250	52,500	–	157,500
Cash payment						44,625	

(b) Prepare a note for your principal outlining

- (i) The financial impact on the estate of continuing to trade the business during this period assuming that the costs of monitoring the ongoing trade will be £20,000 per week. (4 marks)

PROFIT CALCULATION

Method 1		£	
Cash from trading		183,000	Taken from (a)
Monitoring costs		(80,000)	
Stock used		<u>(130,000)</u>	
		<u>(27,000)</u>	
Method 2		£	
Sales		900,000	
Cost of sales			
ROT	70,000		
Other stock used	130,000		
Other materials	<u>475,000</u>	<u>(675,000)</u>	
		225,000	25%
Wages and salaries		(72,000)	
Other costs		(100,000)	
Monitoring costs		<u>(80,000)</u>	
		<u>(27,000)</u>	

Other matters

Uplift in value of intellectual property of £950,000
Stock has an opportunity cost of use in administration trading
Carry back of administration trading tax loss
Reduction in employee claims
Protection of the book debts

(ii) The potential personal risks that trading at a loss may have to an Administrator. (4 marks)

Could be challenged under Paragraph 75 of Sch B1 Misfeasance (Section 212 does not apply)
Unlike s212 not required to be in liquidation
Application can be made by Administrator, Liquidator, Creditor or Contributory
Trading at a loss could be considered:
a breach of fiduciary duty, or
a misfeasance, or
misapplication of property of the company
Administrator may be required to:
Repay, restore or account for the money or property
Pay interest
Contribute a sum by way of compensation
Not appropriate to apply to court to review reasonable decisions
Risk to administrator in this case appears to be £27,000 (or loss calculated in (i))
Losses rank ahead of administrator's remuneration
Paragraph 74 Challenge to administrator's conduct of company

(iii) Steps that can be taken to minimise the risk to the Administrator associated with trading at a loss. (2 marks)

Indemnity from the bank/appointor
Cash backed underwriting loss by parties interested in acquiring the business
Underwriting of losses by customers or suppliers
Documenting trading decision and rationale
Consultation with key affected creditor classes
Professional advice regarding valuation of business/assets

LIQUIDATIONS (SCOTLAND) - NOVEMBER 2010

EXAMINERS' REPORT

GENERAL

17 Candidates sat the exam. Candidates need to read the question and try to address the issues raised. Some candidates appear to have time problems and generally this is caused by the writing of extensive narrative beyond what is being sought. Candidates need to ensure that they fully answer individual questions and whilst it is important that the thinking process behind the answers is demonstrated, the provision of extraneous material, particularly regurgitation of legislation, is unlikely to add to the marks obtained.

EXAMINATION MARKING PLANS

The marking plans are set out below after each examiner's report. Markers are encouraged to use discretion and to award partial marks where a point is either not explained fully or made by implication. The marking plan is also adapted to give credit for valid points made by candidates. Inclusion of extraneous material often causes candidates to lose time that should be spent addressing the questions that were asked, and may adversely affect the holistic score.

QUESTION 1

Using the information provided in the draft balance sheet and associated notes, and stating any assumptions:

- (a) **prepare a statement of affairs for the Company as at 31 October 2010, making and explaining estimates of any contingent or prospective liability at a level that you regard as commercially realistic. (12 marks)**

Question 1 was split into three distinct areas. The first dealt with the preparation of a statement of affairs which also required some commercial judgment comment. The thinking behind such judgment was sought as part of the answer. The majority of candidates answered the question well though some answers appeared to suggest that some candidates may not have had practical experience in this area.

- (b) **prepare a deficiency account for the Company as at 31 October 2010. (5 marks)**

The second part dealt with the preparation of a deficiency account. This is an area which is examined regularly and some candidates do not appear to understand the basics of producing this statement. As it is a requirement when reporting to creditors, all candidates should understand how to produce this document.

- (c) **suggest, with reasons, what options are available to the Company. (3 marks)**

The third part dealt with a discussion of the options which were open to the company. Marks ranged from full marks to no marks. As this was straightforward discussion on matters which had been presented in the earlier sections of the question, the lower end marks were disappointing. The question as a whole is very much part of the basic liquidation process at the commencement of a case and some candidates appeared to simply not be capable of working through this in a logical manner.

QUESTION 2

Question 2 required candidates to deal with a number of issues in a member's voluntary liquidation.

- (a) **Set out the steps that you should advise directors and members to take to procure a Statutory declaration of Solvency and a members' resolution for placing a company into Members' Voluntary Liquidation. (7 marks)**

The initial part of advising on how to deal with the Declaration of Solvency and the members' resolution was generally well dealt with.

- (b) **Set out the problems of an early distribution to members in a Members' Voluntary Liquidation. (3 marks)**

The second part which sought comment on the dangers of an early distribution was also well addressed.

- (c) **Assuming that this Company enters Members' Voluntary Liquidation set out the issues that the Liquidator will need to settle before making a distribution to members. (5 marks)**

The third part where candidates were asked to address issues which the Liquidator would require to deal with prior to distribution was dealt with competently by some and less so by others. It is suspected that lack of practical exposure may well be behind some of the poorer answers.

- (d) **Set out the amounts that should be paid to each of the members, distinguishing the types of payment. (5 marks)**

The final part which dealt with the quantification of the distribution to each member showed a similar marking pattern to the preceding section.

QUESTION 3

Question 3 asked candidates to address employee issues following liquidation.

Set out:

- (a) **the issues that the liquidator should address with respect to the employees and the types of employee related claims and expenses that will arise in the Liquidation. (20 marks)**

The first part dealing with the types of claims which could arise was generally well answered with four candidates scoring over 70%.

- (b) **what points the Liquidator should include in the letter dismissing employees. (6 marks)**

The second part of the question sought candidates knowledge of what should be put into the letter making the employees redundant. As with the first part, this section of the question was well answered.

- (c) **with reasons, what employee related issues that may affect the sale price of the business. (4 marks)**

The final part sought candidate's views on the effect of the sales price which could be caused by employee issues. The answers were variable but all candidates provided a basic answer.

QUESTION 4

Question 4 was divided into two distinct parts.

- (i) **If a liquidator is appointed to a company subject to a winding up order, set out the Liquidator's reporting requirements in relation to the company and the directors. (3 marks).**

The first part asked candidates to look at issues from the perspective of a creditor and to provide reasoned proposals as to how to proceed. All candidates picked up on the main issues though some failed to expand their reasoning adequately. The final part was divided into two parts. The first was a basic question asking candidates to address the Liquidator's reporting requirements as regards the company and its directors. All candidates gave good basic answers with some developing their answers in a logical progression.

- (ii) **Set out the issues that the Liquidator has to consider in relation to each of the properties and set out the steps that you recommend the Liquidator should take to preserve the value of the estate for the creditors. (21 marks)**

The last part of the question, where the bulk of the marks were available, dealt with two properties and how the Liquidator could protect value for creditors. The candidates who scored best dealt with each property separately, as both had differing issues, and where candidates failed to do so, the differentiation between what they were proposing was not always clear.

LIQUIDATIONS (SCOTLAND)

NOVEMBER 2010

EXAMINATION MARKING PLAN

QUESTION 1

Using the information provided in the draft balance sheet and associated notes, and stating any assumptions:

- (a) prepare a statement of affairs for the Company as at 31 October 2010, making and explaining estimates of any contingent or prospective liability at a level that you regard as commercially realistic. (12 marks)

Statement of Affairs as at 31 October 2010			
	Book value £'000	Book value £'000	Estimated to realise £'000
Assets specifically pledged			
Assets subject to fixed charge			
Investment in subsidiary	300	0	
Freehold land and buildings	2,000	1,500	
Less due to Towncity Bank Plc (2,500 + 700)	(3,200)	(3,200)	
Deficit to Towncity Bank on fixed charge c/d	<u>(900)</u>	<u>(1,700)</u>	
Production line	800	480	
Less due to Zog Finance Ltd	(800)	(800)	
Deficit to Zog Finance Ltd c/d	<u>0</u>	<u>(320)</u>	
Assets subject to floating charge			
Other machinery and equipment			
Subject to hire purchase	550	220	
Less due to hire purchase company	(500)	(500)	
Surplus (shortfall) to hire purchase company c/d	<u>50</u>	<u>(280)</u>	
Not subject to hire purchase (2,000 – 550)	1,450		
Less subject to retention of title claim	(400)		
	<u>1,050</u>	420	420
Office fixtures and fittings	600	10	10
Motor vehicles	100	30	
Less subject to hire purchase	(100)	(100)	
(Shortfall) to hire purchase company c/d	<u>0</u>	<u>(70)</u>	
Inventories			
Inventories – raw materials ((2,200 – 1,760) x 50%)	2,200	220	220
- work in progress ((100 – 90) x 50%)	100	5	5
- finished goods and goods for resale ((800 – 720) x 50%)	800	40	40
Receivables			
Trade debtors (3,500 – 2,900 – 400) x 70%, say	3,500	140	140
Due from subsidiary	1,100	0	
Prepayments	200	0	
Deferred tax asset	400	0	
Cash at bank	200	200	200

Estimated total assets available for preferential creditors	10,050		1,035
Preferential creditors – unpaid wages (included in other creditors in accounts)	(180)	(180)	(180)
Estimated surplus as regards preferential creditors	9,670		855
Estimated prescribed part of net property available to unsecured creditors and excluding shortfall to floating charge holder <i>50% of £10,000 = £5,000</i> <i>20% of £855,000 less £10,000 = £171,000</i> <i>Total prescribed part = £176,000</i> (Note this does not exceed maximum of £600,000) (This calculation has excluded estimated costs of realisation and liquidation)			<u>176</u>
Estimated total assets available for floating charge holder (855 – 176)			679
Debts secured by floating charge b/d			(1,700)
Surplus/ (Deficit) to floating charge creditor			<u>(1,021)</u>
Estimated prescribed part of net property where applicable (brought down)			176
Deficit to Zog Finance Ltd b/d	(320)		
Deficit to hire purchase creditor on machinery & equipment b/d	(280)		
Deficit to HP creditor on cars b/d	(70)		
Trade creditors	(8,000)		
Add back ROT creditor	400		
Adjustment for Euro Exchange rate:	5		
In September (45,000) and on Friday (40,000) = 10,000			
Other taxes and social security	(400)		
Other creditors (200 less 180 preferential)	(20)		
Warranty claims:	(2,000)		
one years' sales claims are £500,000 x 4 = 2,000,000 (of which <i>already provided 200,000</i>)			
Other accruals (200 less 200)	0		
Pension deficit	(500)		<u>(11,185)</u>
Deficit to unsecured creditors entitled to participate in prescribed part of net property			<u>(11,009)</u>
Surplus/(Shortfall) to floating charge holder b/d			<u>(1,021)</u>
Deficit to unsecured creditors			<u>(12,030)</u>
Issued and called up share capital		(100)	
Share premium		(100)	
Revaluation reserve		(300)	<u>(500)</u>
Estimated deficiency as regards members			<u>(12,530)</u>

(b) prepare a deficiency account for the Company as at 31 October 2010. (5 marks).

1 (b) Deficiency Account as at 31 October 2010		
Reserves at 31 10 10		(300)
Decrease in value of:		
Investment in subsidiary	(300)	
Land and buildings	(500)	
Production line	(320)	
Plant & machinery subject to HP	(330)	
Plant & machinery not subject to HP and not subject to ROT	(630)	
Motor vehicles	(70)	
Office fixtures & fittings	(590)	
Raw materials	(1,980)	
WIP	(95)	
Finished goods	(760)	
Goods subject to ROT	(400)	
Trade debtors	(3,360)	
Due from subsidiary	(1,100)	
Prepayments	(200)	
Deferred tax	(400)	(11,035)
Adjustments to creditors		
ROT creditor	400	
Adjustment re Euro exchange rate	5	
Adjustment re warranty claims	(1,800)	
Accruals and deferred income	200	(1,195)
Deficiency per statement of affairs		(12,530)

(c) suggest, with reasons, what options are available to the Company. (3 marks)

Company is insolvent as defined by s123 (both on a cash flow and balance sheet basis)
 It is not feasible for the Company to continue to trade as its major customer is insolvent
 Options – the directors can take steps to place the Company into CVL, s98
 - CVL, takes at least 14 days to put into place and, if creditors are pressing may need to place the Company into CVL more quickly using s166 (Centrebind)
 - the directors/shareholders/creditor(s) can petition the Court for the Company to be wound up but this is likely to be more expensive than CVL
 - note that the floating charge holder will need to be notified of the shareholders' resolution to wind up (5 days' notice) and may object.
 - floating charge holder may prefer administration
 - as there is likely to be a distribution of the prescribed part, sanction of the court will be necessary in administration or the exit route could be CVL so the distribution of the prescribed part can take place.

QUESTION 2

- (a) **Set out the steps that you should advise directors and members to take to procure a Statutory Declaration of Solvency and a members' resolution for placing a company into Members' Voluntary Liquidation. (7 marks)**

a. Declaration of solvency

Ensure that the directors are aware of the consequences of signing a declaration of solvency. As it is an oath a false statement is perjury.

The directors have to declare that they have made a full enquiry into the Company's affairs and, having done so, have formed the opinion that the Company can pay its debts in full, together with interest (see s189) within such period, not exceeding 12 months, from the passing of the resolution, as may be stated in the statutory declaration. S89(4)

The declaration of solvency has to be accompanied by a statement of assets and liabilities s89(2)

It is important to ensure that proper enquiry/due diligence into the statement of assets and liabilities is carried out.

If possible, and especially if the Company has been recently trading, the statement of assets and liabilities should be based on audited accounts (balance sheet).

Consider arranging an audit of the Company's accounts.

If this is not possible, carry out a detailed reconciliation of the latest management accounts (balance sheet and profit and loss account) with the last audited accounts.

The directors have to be confident of the values placed on the assets. Discuss with the directors whether or not formal valuations are necessary.

The directors have to be confident that all liabilities: present, future and contingent (and including those in tort) are included in the statement of assets and liabilities.

Review

- minutes of Company and board meetings
- memorandum and articles
- correspondence with Company solicitors
- correspondence with Company's insurers/brokers
- records of meetings/correspondence with trade unions/employee reps/employees
- accident book
- correspondence and risk assessments with Health and Safety executives (retain these files)
- the Asbestos Register for each non-domestic property (includes the common parts of blocks of flats) and retain. (If there is no register for every property, instruct an agent to produce for the properties with no register either a Register or a statement that the duty to maintain the Register rests with an identified party).

to assess whether there are any contingent or other liabilities.

Consider the type of industry(ies) that the Company has operated in since incorporation.

Has the Company entered into any lease or taken an assignment of any lease of property or guaranteed the performance by another party of the covenants contained in the lease?

Write to lease companies or third parties for details if necessary.

Has the Company given any product guarantees? (If so consider taking out run-off product insurance).

Has the Company given any cross guarantees in respect of group liability (including VAT group registration)?

Has any other group Company given any indemnity for the Company's liabilities?

Are there any current or pending legal actions?

- Arrange with the directors, the date, time and place of the meeting of the board of directors for the purpose of making a Declaration of Solvency and convening a meeting of members.
- Discuss with the directors the date, time and place of the members' meeting. This must be held within 5 weeks of the swearing of the Declaration of Solvency. S89(2)
- Where necessary, book the venues for the meetings by telephone and confirm in writing.
- Form 4.25 (Scot)

Review articles to ascertain the quorum for board and Company meetings. Make a file note.

Obtain from the directors a complete list of the names and addresses/email addresses of all current registered members of the Company.

Any communications under the IA 1986 should be in writing and any Companies Act 2006 notifications should be sent by post as well.

Consider whether the Companies Act notices should additionally be sent electronically
The Companies Act 1985 (Electronic Communications) Order 2000

CA 2006 s308, 309, 333, 1143, 1148

Sch 4, 5

CA 2006 s333(2)

The resolutions to be placed before the members will need to be prepared for the Board meeting to consider:

- Special resolution to place Company into liquidation
- Ordinary resolution to appoint a liquidator
- Ordinary resolution to approve liquidators' remuneration (Where an agreement to limit fees has been reached, this needs to be expressed in the resolution ie that the basis of remuneration is on time costs basis, however where such time costs exceed the figure agreed, the liquidators will not seek to recover any sum in excess of the limit. The effect of this resolution is that where the time costs are less than the agreed limit, it is only possible to recover the time recorded and NOT the limit agreed).
- Special resolution sanction of liquidators' powers under Sch 4 Part 1 IA 1986
- If there is to be a s110 scheme - special resolution to enable the liquidators to exercise any powers necessary to achieve this.
If required, special/extraordinary resolution for distribution in specie (check that the articles allow this)
- S165
- Consider whether the Company should change its name (this may be necessary if a group Company and the group may wish to retain the name) (check articles).

Confirm with client who is to be the chairman of the Board meeting.

Arrange for the following to be completed and signed by the directors:

- Minutes of Board meeting

A1 Notice to members of resolutions to wind up and to appoint a liquidator (and any other resolutions).

A2 IA 89(3)

A3

At the Board meeting the directors should swear the Declaration of Solvency before a justice of the peace or commissioner for oaths or practising solicitor. Form 4.25 (Scot)

Deliver Statutory Declaration and Declaration of Solvency to Registrar within 15 days of Resolution to wind up.

S84(2A) does not apply as there is no floating charge

If Company is an authorised (or former authorised) deposit taker send notice to shareholders to the FSA and to scheme manager established under s212(1) of the FSMA 2000.

At the same time, send to each registered member at least 14 clear days (but check articles to ensure that 21 days notice is not required) before the date of the general meeting: S84CA 2006 s291

- notice of general meeting
- proxy 4.29 (Scot)
- covering letter

Check articles to ensure requirements for voting, notice, etc are satisfied. Make a file note. CA 2006 S307(5)

Ensure that there is a file note on the reasons for convening general meeting at short notice

Send to each registered member:

- notice of general meeting
- form of agreement of members to short notice of general meeting
- All members can sign one agreement or each can sign a separate form)
- Where shares are held jointly, all holders should sign
- Proxy Form 4.29 (Scot)
- covering letter
- Ensure that the consent of a majority in number of the members who hold shares giving them the right to attend and vote at the general meeting and who together hold at least 95% (for a public Company) or 90% if a private Company – but check articles which may be based on CA 1985 or 1948 and may still be 95%) of such shares is obtained to the convening of the meeting at short notice.

Send notice of general meeting to any of the Company's personnel whom you consider should be told of, or be present at, the meeting. This should be sent to all directors including those who are not registered members.

Ensure that the following are prepared at least one working day before the general meeting:

- proposed liquidators' consents to act
- draft minutes of the general meeting (including the resolutions to be taken)
- copy of the special and ordinary resolutions to be considered at the meeting and for eventual filing with the Registrar

- copy of the special and ordinary resolutions to be considered at the meeting and for eventual filing in the Gazette
- Forms 600 & 600A for filing
- attendance register
- certificate of appointment made out in the names of the proposed liquidators

(Ensure the certificate of appointment specifies whether the joint liquidators act jointly or severally. The members' meeting must determine to what extent acts that they are required or authorised to do by statute are to be done by one or more or all of them. This may be done either as part of the resolution of appointment or by way of a separate resolution.)

S231

Form 4.8 (Scot)

- copy of the Declaration of Solvency Form 4.25 (Scot)
- copy of the directors' report on the affairs of the Company (if required)
- summary of proxies given by the members of the Company – to be completed by the close of business on the last day prescribed for members' proxies.
 - check articles to ensure that a proxy attending the meeting has the same voting rights as the member
 - CA 2006 s285

1. form of indemnity

2.

Ensure chairman has been provided with the proposed liquidators' consents to act.

Ensure that every person attending the meeting is provided with:

- a copy of the Declaration of Solvency which must have been sworn before the members' meeting
- a copy of the directors' report on the affairs of the Company (if required)

When votes are taken ensure that there are sufficient majorities (special resolution – 75% and ordinary resolution – 50% of those members entitled to vote at the meeting, either personally or by proxy) CA 2006 S282, 283

Obtain signature of the chairman of the meeting on the following documents:

- attendance register
- summary of proxies
- minutes of general meeting
- copy of the special and ordinary resolutions passed by the meeting and for filing with the Registrar
- copy of the special and ordinary resolutions passed by the meeting and for publication in the Gazette

Arrange for a copy of the special and ordinary resolutions for publication in the Gazette be attested at the meeting by a chartered or certified accountant or by a solicitor or chartered secretary.

The Chairman of the meeting should certify the appointment of the liquidator. The certificate should be sent to the liquidator and kept as part of the liquidation records.

Form 4.8 (Scot)

The winding up is deemed to have commenced at the time of the passing of the resolution for voluntary winding up. S86

On the appointment of the liquidator all the powers of the directors cease, except so far as the company in general meeting or the liquidator sanctions their continuance S91(2)

(b) Set out the problems of an early distribution to members in a Members' Voluntary Liquidation. (3 marks)

main issue is whether the liquidator is sure that he has identified and reserved for all liabilities
liquidator also needs to be sure that he has identified and reserved for all expenses of the liquidation
liquidator needs to obtain indemnity from shareholders who may be reluctant to give and/or may not have the resources to back an indemnity in which case the liquidator may require a third party to provide an indemnity

(c) Assuming that this Company enters Members' Voluntary Liquidation set out the issues that the Liquidator will need to settle before making a distribution to members. (5 marks)

- ascertain all liabilities - present, future and contingent
The lease has one year to run:

Calculate liability, Debt payable at a future time: Sch 1 B'Cy (Scot) Act 1985:
(The following follows the English Rules)(No specific rules exist for Scotland but good practice would suggest that the English position be followed.)

2 payments of £25,000 due on 25 December 2010, 25 March 2011

Assume date of liquidation = 3 November

For each £25,000 the admitted proof shall be reduced by $1/(1.05)^n$

$$25 \text{ Dec } 10 = 25,000 \times 1/(1.05)^0.167 \\ = 25,000 \times 1/1.008 = 24,801$$

$$25 \text{ Mar } 11 = 25,000 \times 1/(1.05)^0.46 = 25,000 \times 1/1.022 = £24,461$$

Total admitted proof = £49,262

- distinguish between claims of members, as members and as creditors

Dividend on preference shares:

Total preference shares = 600,000 of £1

Dividend not paid = $5\% \times 600,000 = £30,000$

(d) Set out the amounts that should be paid to each of the members, distinguishing the types of payment. (5 marks)

	£'000	£'000	
Proceeds from sale of pharmacies		3,000	
Cars at valuation (less belonging to Mr Mill)		120	
Less:			
Liabilities			
Trade payables	(200)		
Adjustment for directors' loan accounts (which must be paid to the liquidator as creditors):			
Mrs Kant	(20)		
Mr Kant	(10)		
Mr Hume	(30)		
Mr Mill (payment for car)	10		
Leasehold premises	(49)		
Other current provisions (assume all payable)	(30)		
Corporation tax	(50)		
Receivables			
Due from Mrs Hume	10	(369)	
		2,751	
Preference share dividend		(30)	
Available for distribution to preference and ordinary shareholders (in cash and in specie)		2,721	
Repayment of preference shares at par (200 + 100 + 200 + 100)		(600)	
Available for distribution to ordinary shareholders		2,121	
Dividend per share = 2,121,000/400 = £5,302.50			
Each shareholder has 100 shares, value of distribution = £530,250			
Mr Kant receives:			
Preference share dividend	10,000		
Preference share capital at par	200,000		
Cash distribution (530,250 – 40,000)	490,250		
Car – distribution in specie*	40,000		740,250
Mrs Kant receives:			
Preference share dividend	5,000		
Preference share capital at par	100,000		
Cash distribution (530,250 – 20,000)	510,250		
Car distribution in specie*	20,000		635,240
Mr Hume receives:			
Preference share dividend	10,000		
Preference share capital at par	200,000		
Cash distribution (530,250 – 50,000)	480,250		
Car distribution in specie*	50,000		740,250
Mrs Hume receives:			
Preference share dividend	5,000		
Preference share capital at par	100,000		
Cash distribution (530,250 – 10,000)	520,250		
Car distribution in specie*	10,000		644,250
* The cars have been shown as a distribution in specie but it is acceptable to show the directors paying for their cars pre-liquidation provided that the additional cash (40,000 + 20,000 + 50,000 + 10,000 = 120,000) is included in the amount to be distributed amongst the shareholders.			

QUESTION 3

Set out:

- (a) **the issues that the Liquidator should address with respect to the employees and the types of employee related claims and expenses that will arise in the Liquidation. (20 marks)**

Issues

Need to contact/email JobCentre Plus re possible redundancies

Consultation generally re redundancy for 20 or more employees

If > 100 employees – at least 90 days

If < 100 employees – at least 30 days

Trade Union and Labour Relations (Consolidation) Act 1992

- duty to consult appropriate representative of the employees with a view to reaching agreement
- to avoid/reduce the number, mitigate consequences of the dismissals
- specific consultation re redundancy of selected employees (regardless of location) .
- consultation is in respect of “establishment”

Employer disclosure requirements

- reasons for proposals
- how many/which employees to go
- total number of employees of that description
- how employees will be selected for redundancy
- proposed procedure including time period
- how redundancy payments to be calculated

Discussion of practicalities

Failure to consult – trade union or employee rep can complain to Employment Tribunal and can be awarded up to 90 days pay as protective award. If not paid individual employee can enforce by complaining to Employment Tribunal

- need to minimise protective awards

Haine v Sec of State [2009] EWCA Civ 626:

- protective award provable in liquidation
- obligation to consult pre dates liquidation and so protective award claims provable even if not yet heard by Employment Tribunal (see also Unite v Nortel Networks UK Ltd [2010] EWHC 826)
- insolvency per se is not special circumstances

- consider whether trade union or need to elect employee reps

- calculation of amounts owed (detailed calculations not required), but issues to consider include: whether employees paid minimum wage in which case the shortfall will fall part of their claim for arrears of wages (see below)

- consider position of directors and/or shareholders as employees

Sec of State v Neufield [2009] EWCA Civ 280:

- a controlling director/shareholder can be an employee as long as company is not a sham
- need to look at contract with company and whether he did it and whether what he agreed to do points to a contract of employment

If no written contract: need to decide whether there was a contract and the terms and the conduct of the director and/or shareholder.

- consider whether the directors are personally liability for unpaid NI

Claims

Need to distinguish the types of claims the employees may have

There are two main types of employee claims to consider:

- preferential and
- unsecured

In addition certain debts are guarantee by Sec of State.

Preferential claims – see IA 1986, s 386 and Sch 6 Category 5

Unsecured claims – include claims for wrongful or unfair dismissal or redundancy pay (but in practice will be able to recover these from the Sec of State)

Also consider whether employees have other claims eg arrears of expenses, which will be unsecured

Guaranteed debts - Of these claims some will be guaranteed by virtue of the Employment Rights Act 1996 s 182 – 189.

ERA 1996 s183(3) provides – an employee of an insolvent employer whose employment is terminated may have a right to claim from the Sec of State certain debts due to him from his employer.

Note that the employee's claim is subrogated to the Sec of State to the extent of the payment made.

- any arrears of pay in respect of one or more (but not more than eight) weeks;
- any amount which the employer is liable to pay the employee for the period of notice required by ERA 1996 s86(1) or (2) for any failure of the employer to give the period of notice required by ERA 1996 s86(1) any holiday pay in respect of a period or periods of holiday not exceeding six weeks in all; and to which the employee became entitled during the 12 months ending with the appropriate date;
- any basic or compensatory award of compensation for unfair dismissal (or any award made under a designated dismissal procedures agreement (not exceeding the basic award for unfair dismissal to which the employee would be entitled but for the agreement));
- any reasonable sum (as defined by ERA 1996 s 184(4)) by way of reimbursement of the whole or part of any fee or premium paid by an apprentice or articulated clerk (ERA 1996 s184 as amended)

'arrears of pay' include –

- a guarantee payment;
- any payment for time off under ERA 1996 Part VI, or the Trade Union and Labour Relations (Consolidation) Act 1992 s169 (payment for time off for carrying out trade union duties etc);
- remuneration on suspension on medical grounds under ERA 1996 s64 and remuneration on suspension on maternity grounds under s 68; and
- remuneration under a protective award made under the Trade Union and Labour Relations (Consolidation) Act 1992 s189 (ERA 1996 s184(2)(d))

'holiday pay' is defined by ERA 1996 s184(3)

"holiday pay" – need to consider Working Time Regs as to how much holiday can carry forward and also consider any contractual obligations.

The debt in question must be due at the 'relevant date':

- in relation to arrears of pay (not being remuneration under a protective award made under the TULRA 1992 s189 and to holiday pay, the date on which the employer became insolvent;
- in relation to such an award and to a basic award of compensation for unfair dismissal, whichever is the latest of:
 - the date on which the employer became insolvent;
 - the date of the termination of the employee's employment; and
 - the date on which the award was made;
- in relation to any other debt to which the section applies, whichever is the later of the dates mentioned in sub-para (i) and (ii) of para (b) (ERA 1996, s185)

ERA 1996 s 166 also provides that the employee may be able to recover from the Sec of State certain other payments which cannot be recovered from the company.

Also the employee will have a right to have pension contributions made up (Pensions Schemes Act 1993, s24)

Expenses

Consider whether the liquidator may need to pay arrears of those keeping on as expense of liquidation

Consider whether the liquidator has the funds to pay on-going wages as expenses of the liquidation

If employees were paid less than the minimum wage – the liquidator will have to pay at least the minimum wage

Practical issues, including

- obtain copy of contracts; meet workforce; obtain payroll details, including all information required for PPF.
- Arrange for P45s to be issued to staff.

(b) what points the Liquidator should include in the letter dismissing employees. (6 marks)

- employees should register with JobCentre Plus asap
- reason for dismissal is redundancy because the Company is unable to pay its debts
- make it clear that Company (and not liquidator) is dismissing them
- complete RP1s asap and send to liquidator for checking (good practice)
- explain what the employee can claim for: arrears, redundancy, pay in lieu of notice (mitigated by anything earned during notice period) – see 3a above (but no double marks for explanation if given in 3a)
- explain that if employee has claims, other than arrears of wages and those associated with redundancy – eg expense claims – explain that these claims are treated different and request details of claim in writing (or enclose proof of debt)
- specify date of dismissal
- request return of all company property

(c) with reasons, what employee related issues that may affect the sale price of the business. (4 marks)

- no TUPE under EC rules and so may increase sale price
- an existing (and skilled) workforce may be important to a buyer (a prospective purchaser may wish to ascertain whether workers with key skills are available)
- existence of protective awards, prospective employer will not be liable for these
- although prospective employer is not liable to pay pre-insolvency debts of employees, if he wishes to retain the workforce he may wish to
- workforce may be disgruntled

QUESTION 4

- (a) **State the options that are available to Risky Finance Plc and state, with reasons, what Immediate action(s) you recommend. (6 marks)**

Concern that the assets may be at risk and you do not know whether or not company is insolvent:

[You are acting for finance company] advise:

- issue petition for winding up
 - apply to court for provisional liquidator to be appointed
 - possibly apply to court for administration [but if wrongdoing administration is probably not appropriate and may take too long to put in place, also you do not know at this stage whether or not the Company is insolvent.
 - if suspect fraud/money laundering report this to SOCA (regardless of whether appointed or not)
- other options – CVA and CVL – would require the co-operation of the directors (in any case CVA would take too long) and you do not know at this stage whether or not the Company is insolvent

Given the urgency of the situation taking steps, such as talking to the directors, is unlikely to assist the creditor that you are advising (and may be tipping off)

- (b) (i) **If a Liquidator is appointed to a company subject to a winding up order, set out the Liquidator's reporting requirements in relation to the company and the directors. (3 marks).**

Requirement to report under CDDA (D forms) in court winding up.

- no requirement to investigate criminal conduct but if it comes to liquidator's attention that criminal offence may have occurred he should report to Lord Advocate (IA s218(2)).

Liquidator should also report to SOCA under Money Laundering Regs (or through MLRO).

- Liquidator must send a report to creditors on the S138 meeting and then send 6 monthly progress reports.

- Liquidator is required to hold annual meetings of creditors (Rule 4.13(1)) to include

- a progress report to cover the period of one year commencing on the date on which the liquidator is appointed, and every subsequent period of one year.

The report should include:

- the company name, address, number and registered office;
- details of the office holder's name, address, date of appointment and any changes of office holder;
- details of any remuneration for which approval is sought. Either as set by the court or Liquidation committee, with rights of appeal.

the basis fixed for the remuneration of the office holder (or if not fixed at the date of the report, the steps

- a statement of the expenses incurred by the office holder during the period of the report;
- details of the progress during the period of the report including a receipts and payments account;
- the receipts and payments account be in the form of an abstract showing receipts and payments for the period of the report and where the liquidator ceased to act, a statement of the prescribed part paid under section 176A;
- details of any assets that remain to be realised;
- a statement of the creditors' or members' rights to request further information and their right to challenge the office holder's remuneration and expenses.
- any other relevant information for the creditors;

In addition to the above the Liquidator will file Forms 4.5 (Scot) and 4.6 (Scot) in relation to the first 12 months of the winding up and for each succeeding 6 months with the Accountant in Bankruptcy within 30 days of the end of the accounting period.

- convene and report for final meeting (final progress report) sent to creditors giving 28 days notice of the meeting. (S146 IA 1986)

(ii) Set out the issues that the Liquidator has to consider in relation to each of the properties and set out the steps that you recommend the Liquidator should take to preserve the value of the estate for the creditors. (21 marks)

Liquidator will need to ascertain whether there is a value in each of the properties (and other assets)
Consider debtors - Downturn Ltd
Consider whether future income (and therefore value). What are the implications of collecting rent?
Consider whether there is any rent deposit
Liquidator will need to ensure that the value of assets (properties) is preserved and so will need to consider:

- insurance
- health & safety
- fire risk (consider who is responsible)
- security of site
- environmental issues/contaminated land

Liquidator will need to consider expenses of the liquidation

- are there sufficient funds?
- will the costs of preserving the value of the assets be covered by the realisations?
- related to this – timescale – how quickly will the liquidator be able to realise the assets and what costs are being incurred?
- will costs be incurred regardless of timescale (eg in respect of contaminated land)
- consider eligibility for empty property rates:

Property has to be completely empty. The law states 100% relief for 3 months then 50% charge applies. However individual local authorities have discretion to continue 100% relief. In practical cases 3 months should be adequate to deal with leasehold property.

In a liquidation if the property is retained or the liquidator makes use of the property for the benefit of the liquidation, the rent is an expense of the liquidation:

Liquidator will need to ascertain the liabilities at the relevant date (date of petition)

- valuing claims

Owned factory – Potentially major problem for Liquidator.
Appoint environmental agents to advise re contamination

- environmental issues likely to be very expensive and so likely that liquidator would wish to protect his position as far as possible.

Contaminated land is likely to expose the liquidator to criminal liability under Health & Safety legislation
Consider appointing solicitor to advise.

- write to council re- empty property
- Obtain lease and ascertain whether the lease can be assigned for value
- Take no steps which could be construed as personal adoption of the lease
- appoint agent to advise
- actively market stock in order that orderly withdrawal can be made
- discuss position with landlord/landlord's agents
- review terms of sub lease

Tenant: collect rent/implications of collecting rent. Legal action?
Take steps to sell the leasehold interest

PERSONAL INSOLVENCY (SCOTLAND)

NOVEMBER 2010

EXAMINERS' REPORT

EXAMINATION MARKING PLANS

The marking plans are set out below after each examiner's report. Markers are encouraged to use discretion and to award partial marks where a point is either not explained fully or made by implication. The marking plan is also adapted to give credit for valid points made by candidates. Inclusion of extraneous material often causes candidates to lose time that should be spent addressing the questions that were asked, and may adversely affect the holistic score.

QUESTION 1

Identify the debtor's potential assets and explain the steps you would take to maximise realisations, noting any issues that might be encountered when dealing with the realisation process and how you might address them. (20 marks)

Candidates were provided with background information regarding a self-employed debtor and asked to identify assets and offer suggestions to maximise realisations.

It was hoped that the question would produce creative thought and practical response to the issues raised in the question and whilst this was apparent from some candidates, many answers tended to display a narrow focus and poor grasp of legislation. Several candidates sought to apply trust deed procedures to the question when it was clear that a sequestration was being handled, and although the debtor's wife's consent would be helpful in terms of selling the buy-to-let properties, far too many candidates explored section 40 of the Bankruptcy (Scotland) Act 1985, which is incorrect because such section refers exclusively to a family home. There was confusion as to whether or not rent can be collected by a trustee after repossession has occurred (the trustee cannot do so) and a number of candidates seemed happy to instruct court action without taking the time to clarify the various issues with the debtor, auctioneer, pension provider etc.

Some of the more straightforward aspects of the question were overlooked such as obtaining the debtor's accounting records and checking invoices, delivery notes etc, and clarifying the auction position with Scotfree Auctioneers before jumping to conclusions eg, assuming monies had been stolen and instigating legal action. Candidates seemed aware of the difference between approved and unapproved pension schemes although few thought that it might be worth determining the reasons for the increase from the insurer eg investment performance or a transfer from another pension fund, but when it came to dealing with excessive pension contributions this aspect was handled well. Virtually all candidates dealt with the issue of a contribution from the debtor in a satisfactory manner, including the aspect, of an Income Payment Agreement and an Income Payment Order.

Many scripts proved difficult to read and the layout was poor, making the task of awarding marks a challenge.

QUESTION 2

The question concerned a deceased debtor whose estate was insolvent. Candidates were asked to list the steps required to secure appointment as trustee and to explain how each point noted in the question would be dealt with for the benefit of the sequestrated estate.

Set out the steps required to secure your appointment as trustee over the deceased debtor's estate. (2 marks)

The first part was answered well and most candidates were aware that the petition should be submitted to court rather than the accountant in bankruptcy. Several candidates sought to offer advice to the executors and quote extensively from section 5 of the Bankruptcy (Scotland) Act 1985, but the relatively few marks should have been a clue that only the main steps were required in order to attract marks.

Based upon the information provided, explain how you would deal with each point noted above for the benefit of the sequestrated estate. (18 marks)

The second part of the question was designed to determine the application of knowledge to the relevant legislation. It was anticipated that answers would include ideas and suggestions for dealing with issues together with factual comments. Virtually all candidates were aware that funeral expenses would be paid from the sequestrated estate as an expense but, particularly when dealing with the various properties, candidates seemed reluctant to consult with either the AiB or the commissioner (the question did not say if a commissioner had been appointed). Further, many answers provided a definitive response, either positive or negative, to various issues without explaining the basis of such response. A number of candidates seemed to assume that the debtor's mistress was a spouse and sought to apply the provisions of section 40 of the Bankruptcy (Scotland) Act 1985. Few candidates mentioned moveable assets in the properties eg furnishings, or queried either the date of creation or validity of the trust fund. Every candidate assumed that the BMW was subject to hire purchase but the question did not say what type of finance was in place eg it could have been an unsecured loan.

The insurance policy and pension policy aspects were dealt with in a satisfactory manner but it was surprising how many candidates mentioned the trustee's requirement to deal with heritable property within 3 years, failing which it would revert to the debtor when the question concerned a deceased debtor.

The mark plan was designed in a suitably flexible manner such that candidates would benefit from providing a cogent and clear answer.

Question 3

- (a) **Prepare a letter to the club steward and outline the options available. (12 marks)**
- (b) **Set out the steps you would take to ensure that you can act for the club if appointed as trustee. (3 marks)**

The club is sequestrated and you have taken office.

- (c) **List the potential assets that are available and set out the steps that you would you take in order that you can realise them, noting any particular difficulties that you anticipate. (7 marks)**
- (d) **List the key issues that require to be addressed in the first few days and set out how you would deal with each one. (8 marks)**

The question required the preparation of a letter to explain the options available to a social club which was experiencing financial difficulty. Thereafter candidates were invited to detail the main assets available for realisation and note the key issues that will require to be addressed in the first few days following appointment of a trustee.

Whilst candidates knew how to commence an advice letter, and many took the time to summarise the position in order to expand logically as the letter progressed, it seemed that many scripts contained a list of points without either explanatory notes or definition which rendered such letter of little benefit. The first part of the question was designed for candidates to offer suggestions regarding continued trading/restructuring, doing nothing, and comparing trust deed and sequestration as formal insolvency options. Curiously, some candidates considered the club to be an individual and referred to the debt administration scheme as an option and some scripts simply suggested that the club should speak to a citizens advice bureau, which rather defeated the purpose of being able to display knowledge of the potential options.

When dealing with the club after appointment as trustee it was clear that the points noted in the question did not deter some candidates from taking steps to continue trading. Some candidates wanted to meet all 600 members as quickly as possible, without explaining why, and there was clear evidence that many candidates did not understand the landlord's security position. For example, suggesting that one can remove assets after appointment to thwart any landlord's claim is incorrect. There was confusion about appointing a trustee. Many candidates ignored the expired charge for payment and spent considerable time discussing how to obtain a concurring creditor. When looking at potential assets valuable time was spent on the lease which was unnecessary given the fact that the question said rent was nominal, it had not been paid for five years and one would not anticipate a local council assigning the existing lease ie the question made it fairly clear that there was no value in the lease.

In many scripts, the spelling and grammar left much to be desired but at least the majority of answers demonstrated practical application of knowledge.

QUESTION 4

- (a) **Prepare a receipts and payments account of the trust deed as at today's date stating any reasonable assumptions you consider necessary. (15 marks)**
- (b) **Write a memorandum to describe the issues that should be considered and the steps that require to be taken to progress the trust deed. The memorandum should include financial illustrations where applicable. (15 marks)**

This question provided various items of financial information and required candidates to prepare a receipts and payments account followed by a memorandum which dealt with progressing the trust deed process.

The receipts and payments account was requested as at the date of the exam and it is unclear why many candidates sought to produce a forecast until the end of the trust deed. Nevertheless, where assumptions were provided which appeared logical they were accepted, otherwise no marks were awarded.

The debtor was stated to have assumed the business of Wheezo and hence, it was inappropriate to include profits from Wheezo as trust deed income. Also, such trading profits were the basis from which the debtor was able to pay a contribution. Many candidates included the second year's fee for the trustee in the account but the second year of the trust deed had not yet concluded and thus, the fee had not been approved by creditors. Although a heading was included on most of the receipts and payments accounts offered, no candidate sought to sign/date the document.

When describing the main issues and how to progress the trust deed, a memorandum is easier to mark when headings are provided together with logical narrative. Simply writing everything that one can think of on a particular subject does little to assist the accumulation of marks. Some candidates thought that the trustee had locus over the new business, which was not the case because the question noted that it had been transferred to the debtor, and when a candidate uses a term such as "explain the consequences" without detailing what these are, the marker cannot determine if the candidate knows what such consequences are. The main issues to identify were highlighted by the majority of candidates: family home, Hambleton House, continued trading and debtor contributions. Surprisingly few thought that the trustee's fee level might have to increase and hence, considered the effect of SIP3A, clause 8.8. Only one or two noted that capital gains tax would be an outlay if Hambleton House was realised during the course of the trust deed process.

The question was designed to allow candidates freedom of thought rather than being overly prescriptive. There were numerous marks available but it seemed that candidates tried to spot matters of high technical merit rather than stating the obvious on many occasions. The continued use of colloquialisms and poor handwriting did little to generate enthusiasm.

PERSONAL INSOLVENCY (SCOTLAND)

NOVEMBER 2010

EXAMINATION MARKING PLAN

QUESTION 1

Identify the debtor's potential assets and explain the steps you would take to maximise realisations, noting any issues that might be encountered when dealing with the realisation process and how you might address them. (20 marks)

The debtor's assets identified and the realisation steps considered appropriate are noted below by type.

1. Sale of moveable assets

The balance of the net sale proceeds in respect of the sale of the debtor's plant, machinery and stock by Scotfree Auctioneers "Scotfree" on 13 March 2010, and believed to be due to the sequestrated estate is calculated as follows:

	£	£
Sale price		18,000
VAT @ 17½%		<u>3,150</u>
		21,150
Less: costs of sale	(2,000)	
VAT @ 17½%	<u>(350)</u>	
		<u>(2,350)</u>
Net sale proceeds		18,800
Received to date		<u>(11,000)</u>
		<u>£7,800</u>

Notification of the trustee's appointment should be intimated to Scotfree, a copy of the award provided, and payment of the outstanding balance requested. Details of the sequestration bank account can be provided in order to expedite payment. There appears to have been a delay in sending the monies to the debtor and clarification should be sought. For example, what instructions were given to Scotfree in terms of settling other debts and were there items on finance which had to be cleared? Perhaps Scotfree consider themselves to be a creditor? The trustee will want to know that fair value has been obtained ie the sale was at an open auction and to enquire if Scotfree still hold any unsold assets. If so, a plan will be required to deal with them.

In order to verify that all assets were passed to Scotfree in the first place by reviewing the debtor's accounting records.

If legal action is required, consult with AiB/commissioner beforehand and consider cost-effectiveness.

2. Book debts

The information provided by the debtor's accounts assistant shows that book debts appear to comprise the following:

Customer A	£
Total sum due	60,000
Less: paid to date	<u>(15,000)</u>
Sum outstanding	<u>£45,000</u>

The first step will be to check that there are copy sales invoices and evidence of service delivery eg architect's valuation to support the debt. Also, check that depending upon what has been done for the customer, there are signed terms of trade and that retention of title can be utilised if necessary. Thereafter, a letter should be sent to customer A intimating the trustee's appointment and requesting payment. The letter would ask why only part payment has been made eg is there a creditor set-off being applied or is the balance in dispute. The trustee would advise the customer that if payment is not received within seven days or valid reason(s) provided for non payment, formal recovery action will be undertaken by the trustee and any costs involved recharged to the customer. Details of the sequestration bank account should be provided in order to expedite payment.

If payment is not received within the specified timescale, the trustee could consider serving a Statutory Demand for Payment of Debt (prescribed Form 1) and if payment was not made within 21 days and the debt was not denied, further consideration could be given as to whether or not to progress formal insolvency proceedings against customer A. Other options comprise trying to negotiate a repayment programme, raising a payment action or progressing diligence such as attachment or arrestment.

Customer B

The customer appears to have made payment of the debt in full, but to one of the debtor's creditors to whom the debt had been assigned on 16 May 2010. The trustee would need to confirm that what the customer says is true ie by speaking to the creditor. A copy of the assignment would need to be obtained in order to check validity and that it had been properly intimated/accepted. Perhaps the debtor was in the habit of assigning book debts eg is this typical of the industry, and are there others that need to be reviewed? As the assignment occurred within six months of the date of sequestration it could be considered to be an unfair preference and be challenged by the trustee with a view to seeking restitution of the funds to the sequestrated estate.

An unfair preference is detailed in section 36 of the Bankruptcy (Scotland) Act 1985. Defences to a challenge by the trustee would be:

- (i) that the transaction was in the ordinary course of trade or business [is this a standard business practice that the debtor adopted?]
- (ii) that payment was in cash for a debt which when it was paid had become payable unless the transaction was collusive with the purpose of prejudicing the general body of creditors [thus, check to determine if there is a relationship between the debtor and creditor that is more than arms' length commercial]
- (iii) that the transaction whereby the parties thereto undertook reciprocal obligations, whether the performance by the parties whereof their respective obligations occurs at the same time or at different times, unless the transaction was collusive [thus, check what documentation is available and clarify the basis of the arrangement by speaking with the debtor], or
- (iv) that the granting of a mandate by the debtor authorising an arrestee to pay over the arrested funds or payment thereof to the arrestor where (a) there has been a decree for payment of a warrant for diligence and (b) the decree for warrant has been preceded by an arrestment on the dependence of the action or followed by an arrestment in execution [unlikely to apply in this situation given the information provided but the document review will clarify matters].

If the trustee seeks to raise a challenge and the court find in his favour, the court shall grant decree of reduction or for such restoration of property to the debtor's estate or other redress as may be appropriate.

Customer C

Customer C appears to be claiming set-off for £40,000 against the debt due to the debtor of £120,000, thus leaving a net sum receivable by the sequestrated estate of £80,000.

The essential features of set-off are:

- (i) Both debts must be liquid or capable of immediate liquidation. A debt is liquid when it is actually due and the amount ascertained. A disputed debt is illiquid whilst admission of a debt makes it liquid.
- (ii) The debts must be due at the same time. A debt which is presently due cannot be set-off against a future or contingent debt.
- (iii) Each debt must be debtor and creditor in the same capacity which means that a sum due to the debtor's business may not be set-off against a debt due to him personally.
- (iv) Set-off must be pled before decree is granted for a debt and sustained by judgement before it has effect, unless there is an agreement to set-off.
- (v) The debts must be of the same nature. For example, a money debt can be set against a money debt, a demand for delivery of goods may be set against a claim for similar goods, but a money debt cannot be set against a claim for delivery of goods.

With regard to customer C, both debts are liquid, they are both due, they both appear to relate to the same business and of the same nature. Steps are required to ascertain if written/verbal agreement to set-off was in place. This can be achieved by discussion with the debtor and reviewing the business records. It may be that this type of arrangement was custom and practice or that the customer is simply trying to avoid payment. As part of the exercise the trustee will need to ascertain that the creditor's claim is correctly stated and valid.

Remaining customers

The book debt recovery steps outlined for customer A above should be followed for the remaining customers who have not yet provided a response or paid. Similar considerations exist in terms of ensuring that the book debt can be supported by the debtor's accounting records lest a dispute arises. In all cases, if legal action is considered, the trustee needs to consider the cost-effectiveness of his actions and consult with AiB/commissioner.

3. Value of the debtor's pension fund

The first step is to determine why the value has increased ie is it due to investment performance? It may be because the debtor had another pension arrangement and was simply consolidating his pension arrangements or he could have paid substantial contributions in an attempt to place funds out with the reach of his creditors. The trustee should determine with the debtor if there are/were any other pension arrangements.

The trustee will wish to contact the insurer and obtain details of the fund movements since December 2008.

The position regarding personal or private pensions is governed by the provisions of the Welfare Reform and Pensions Act 1999. Personal and private pension schemes do not vest in the trustee in respect of sequestrations commencing after 29 May 2000.

If it transpires that the fund increased because of cash inflows, the trustee will need to determine the source of such monies ie was it from the debtor's resources or a gift from a relative (perhaps made on the condition that the monies were paid into the fund). The trustee may then consider challenging excessive contributions to an approved scheme.

Section 16 of the Welfare Reform and Pensions Act 1999 allows the trustee to seek a court order to recover excessive contributions. Contributions are excessive if they were made for the purpose of placing assets beyond the reach of creditors.

The debtor is 55 and might care to consider taking a lump sum from the pension scheme to lodge with the sequestrated estate in order to help settle creditor claims.

If it is the case that the debtor made excessive contributions, the trustee can consider asking the AiB to apply for a Bankruptcy Restriction Order.

4. Debtor's income

Although not a tangible asset, payment of a contribution should be available from the debtor's ongoing earnings. In this regard the debtor should be requested to complete a current income and expenditure schedule in order to calculate his disposable income and the level of affordable contribution to his estate. Current figures suggest that the trustee might seek a monthly contribution from the debtor of about £1,000.

Once the contribution has been determined, the debtor can be requested to complete/sign an Income Payment Agreement. A copy thereof should be filed with the accountant in bankruptcy. If the debtor refuses to comply/sign then an Income Payment Order could be sought from the sheriff. If such action is taken, the trustee should consult with the AiB/commissioner.

5. Potential equity in the four flats owned jointly by the debtor and his spouse

It appears that properties 1 and 3 are subject to repossession proceedings by the secured lender. It is noted that intimation of the appointment has been made to the secured lender. The following steps should be undertaken:

- (a) Organise an independent valuation.
- (b) Undertake a title search in order to confirm the debtor's title and percentage thereof
- (c) Obtain details of the secured indebtedness and redemption figure, providing a copy of the award of sequestration in order to evidence authority to request, such information from each lender. In this regard, it may be appropriate to consider making good any mortgage arrears if the trustee determines that there is substantial equity and a better sale price would be obtained by selling in a more controlled manner.
- (d) Ascertain if adequate insurance cover is in place for the building and contents should it transpire that there is equity. If there is no equity, advise the secured lender(s) so that they may make their own arrangements.
- (e) Determine if caution requires to be amended.

If enquiries reveal that there is substantial equity and the secured lender has unduly delayed the realisation of the property, the trustee can take steps to sell the property in accordance with section 39(4)(c) of the Bankruptcy (Scotland) Act 1985.

If, however, all documentation is appropriate and the repossession proceeds, a state for settlement should be requested from the secured lender in due course.

With regard to property 4, the trustee should write to the tenant to advise that repossession proceedings are underway but meantime, all rentals should be paid to the trustee pending formal repossession of the property. The trustee should account to the joint owner for one half of the net monthly rentals.

The risk in continuing to accept rentals is that the trustee might be held liable for any repairs that are required during the tenant's occupation of the property. If any payments are required, they should be made from the accumulated rentals, with half being paid by the joint owner.

It is noted that there has been no communication from the secured lender for properties 2 and 4. Property 2 is meantime vacant and thus the trustee should endeavour in his attempts to contact the secured lender in order to obtain information noted at points (a) to (c) above. If it transpires that there is no equity in the position, the trustee should write to the secured lender in accordance with advising that he does not wish to sell the property and if appropriate, formally abandon his interest.

The trustee should intimate his appointment to the tenant of property 4 and continue to collect the rent until the position is clarified.

QUESTION 2

Set out the steps required to secure your appointment as trustee over the deceased debtor's estate. (2 marks)

The sequestration of the estate of a deceased debtor is dealt with in section 5(3) of the Bankruptcy (Scotland) Act 1985, as amended, "the Act" and is on the petition of:

- (a) an executor, or person entitled to be appointed executor, of the estate;
- (b) a qualified creditor, or creditors, using Form 1 contained within the Act of Sederunt (Sheriff Court Bankruptcy) Rules 2008 "the Rules". A qualified creditor(s) is one is solely or jointly owed not less than £1,500 as at the date of presentation of the petition. The petition can be presented at any time where apparent insolvency has been constituted within 4 months of death. In any other case, the creditor(s) must wait until at least 6 months after the debtor's death;
- (c) a temporary administrator using Form 2 in the Rules;
- (d) a member state liquidator appointed in main proceedings, also using Form 2 in the Rules, or
- (e) a trustee acting under a trust deed using Form 3 in the Rules.

A copy of the Will should be obtained and reviewed to ascertain who has been appointed executor(s).

Once this has been determined, the executor(s) can present a petition to the local sheriff court by using a law agent, and a copy of such petition will be sent to the AiB.

On the basis of no conflict of interest, a letter of consent will be provided by the trustee elect, which will be attached to the petition together with an estimated statement of affairs (such statement being signed by whoever is presenting the petition).

(b) Based upon the information provided, explain how you would deal with each point noted above for the benefit of the sequestrated estate. (18 marks)

- 1) In accordance with section 51 of the Act, funeral expenses are payable after payment of the remuneration and outlays of the trustee but prior to payment of any petitioning expenses and dividend distributions to creditors in accordance with their legal ranking. The debtor's family can be invited to settle the funeral costs and submit details thereof to the trustee seeking reimbursement.

The AiB guidance notes provide that upon application to the trustee by a person who is responsible for, or has paid, funeral costs, consideration can be given by the trustee to release reasonable funds at an early stage from the sequestrated estate eg monies received from any life assurance policy, to meet such costs.

- 2) If the debtor had a standard life assurance policy, it will vest in the trustee as will the resultant proceeds. The original policy documents should be obtained (copies if the originals cannot be found) and reviewed to confirm the beneficiaries. The trustee's interest should be recorded with the insurer(s) and a certified copy of the death certificate provided.

Check when written into trust by looking at the trust document. Ascertain if it was written into trust within the last five years. If it was, determine when and if debtor was solvent at the time. For example, the debtor may have paid a large premium shortly before death knowing he was about to die but in an attempt to transfer value to his wife. Accordingly, if policy was written into trust within the last five years, check that the trust documents was part of the initial process and there is no obvious sign of a gratuitous alienation. If an alienation has occurred and the trustee considers it cost-beneficial to raise a challenge, seek advice/agreement from the commissioner/AiB before acting.

If there are no issues, the benefit arising from the policy that is written in trust would be paid to the debtor's spouse. The trustee will be required to complete the relevant documentation in order to obtain the death benefit from the other policy. Consider if caution level is sufficient.

- 3) Determine if an unapproved pension arrangement (funds will vest in estate) or an approved pension arrangement (more usual type and funds will not vest in estate). Thus, the pension documentation will be obtained and reviewed to confirm the beneficiaries. As noted in 2 above, determine when monies were paid into the scheme lest a gratuitous alienation has occurred. If it has, legal advice will be required in terms of challenging the premium payments with a view to returning value to the sequestrated estate. If the beneficiaries are as noted and the trustee determines that there is no challenge, the monies will vest in the beneficiaries. Consider if caution level is sufficient.

- 4) Obtain the lease and review it in order to ascertain if it shows the debtor as sole tenant, or him and his wife as joint tenants. If the debtor is the only named tenant, any arrears of rent as at date of sequestration will rank as an ordinary claim subject to any rent deposit that the landlord may hold. If the lease reflects the debtor and his spouse as joint tenants, any arrears would be jointly and severally due by both parties and thus, whilst the landlord would be invited to submit a claim in the sequestration, he may also choose to pursue the debtor's spouse. If she pays it all, she will be entitled to lodge a claim in the sequestrated estate for one half of such arrears. The trustee cannot use sequestrated monies to pay any rent after date of the debtor's death.

- 5) The loan and credit card liabilities would rank as ordinary claims in the sequestration for amounts up to date of death. Creditor correspondence/statements should be uplifted from the executor/the debtor's family. Each creditor will be advised of the trustee's appointment and invited to submit a claim (Form 4) with supporting documentation in order that the trustee can determine the overall position.
- 6) Check the title position of the Jedburgh property in order to determine legal ownership. Instruct an independent valuation, confirm the level of secured borrowings from the mortgage provider and ask if there are any arrears. Determine from the secured lender if steps are being taken to repossess the property. Calculate the potential equity and hence, the debtor's share thereof. Advise cautioner and consider if specific insurance cover is required.

Obtain a copy of the disposition in order to determine when it was brought and where funds came from to effect the purchase eg any cash from debtor that might be construed as an alienation of his assets. A view will be required regarding whether or not there is economic benefit to the sequestrated estate in seeking return of such monies ie from the ultimate sale proceeds of the property. The trustee will consider whether to lodge notice of title in order to protect the estate's interest but, in doing so, must exercise caution in case there is a problem with the property that might cause a claim to fall upon the estate.

Enquiries should be made in order to clarify if there was an insurance policy in place to cover the secured borrowings in the event of death. If a policy was in place and assigned to the secured lender, the debtor's potential equity will increase and benefit the sequestrated estate. If a policy exists but was not assigned, take steps to obtain the policy proceeds for the benefit of the estate.

Determine who owns the contents because they are unlikely to fall within the scope of essential household assets and may be capable of being sold.

If there is equity, the trustee will need to determine if the debtor's mistress has any occupancy rights. The property is unlikely to be deemed the matrimonial home and thus, the provisions of section 40 will not apply. If legal advice dictates that she has, determine the effect of ability to obtain value for the property.

Once the equity has been determined and the trustee is satisfied that the property can be sold, the debtor's mistress can be invited to purchase the debtor's share of the equity of about £15,000, on the basis that this may yield maximum value [saves having to evict etc. if that proves necessary]. She should be advised to seek independent legal advice. If the mistress acquires the debtor's interest, the title deeds will require to be amended once a price has been agreed and monies received.

If the debtor's mistress is not in a position to purchase the debtor's net reversionary interest, her agreement to place the property on the open market should be sought. If such agreement is not forthcoming, court proceedings for an action of division and sale should be instructed. The trustee must always keep in mind the cost effectiveness of all actions and consult with the commissioner/AiB as matters progress.

The title deeds will have identified if the property is subject to a special destination clause. Even if one exist, the AiB guidance notes advise that the debtor's share vests in the trustee and may be realised by the trustee, for the benefit of the sequestrated estate.

- 7) The brother's loan will rank as an ordinary claim in the sequestration. The trustee should obtain an independent valuation of the watch and check that it is not subject to finance, such as HP, and thereafter ask the brother to deliver the watch to the trustee under section 31 of the Act. If the brother elects to exercise a right of lien he will be requested to provide documentary evidence of the basis upon which he received the watch from the debtor.

The provision of the car to the debtor's mistress may be a gratuitous alienation in terms of section 34 of the Act on the basis that the car was not provided for adequate consideration, the transaction occurred on a relevant date, and the debtor may have been insolvent at the time of the transaction. The relevant date is within 2 years (she is not an associate) of the date of sequestration. The trustee will consider challenging the transfer of the car with a view to it being returned to the debtor's estate, or seeking financial recompense from the mistress for the value of the car if she wishes to retain it. The trustee will need to be alert to the defences available to the mistress under section 34 of the Act and consider their validity in terms of the transaction. For example, the trustee will be required to determine if the debtor was in the habit of making regular gifts and at what level, and if the gift might be deemed reasonable in all the circumstances.

- 8) An independent valuation of the BMW mini should be obtained. The trustee will need to determine if the finance is a general bank/car loan or HP ie specific to the car and hence secured. Confirmation of the outstanding finance will be obtained. If the loan is secured over the car, confirm if there are any arrears, if the finance company is considering taking steps to repossess the vehicle and assess the potential surplus/shortfall. If the loan is secured and the level is greater than the car's value, the trustee will have no further interest in the vehicle. The finance company can be invited to uplift the vehicle and lodge a claim or liaise with the daughter regarding assumption of the finance obligation. If the daughter assumes HP, it will benefit estate by removing a creditor's claim.

If the car is not subject to a secured loan, ensure that insurance cover is in place. The debtor's daughter can be approached in order to determine if she wishes to purchase the car. If she declines, for whatever reason, the car can be uplifted and sold for the benefit of the sequestrated estate.

- 9) If a title check confirms the ownership position of the property in Barcelona, an independent valuation should be instructed. Insurance cover should be arranged if required and the level of caution reviewed. Confirmation of the secured borrowings will be obtained from the mortgage provider in order to confirm if there are any arrears, if the secured lender is taking steps to repossess the property and to determine the potential equity/shortfall. The trustee can then calculate the debtor's share thereof.

The trustee should try to determine why the value appears to have decreased to significantly eg did debtor overpay or is there another asset in Spain?

If the property has negative equity, the debtor's spouse can be invited to provide a nominal sum in order for the trustee to formally abandon his interest in the property eg £500.

If equity appears to be available, a similar approach to that outlined in note 6 above should be adopted.

- 10) The gifting of the flat in Leith may be a gratuitous alienation under section 34 of the Act. The trustee will determine when the flat was bought, what was the net equity position six months before death, who has been paying the mortgage after the transfer and what was the debtor's overall financial position at the time. If a challenge is to be made, the trustee will need to advise the daughter of his proposed action, recommend that she seek independent legal advice and calculate what value has been removed from the debtor's estate. The daughter may be in a position to settle the calculated sum or will defend any legal action raised by the trustee.

Consider if the level of caution remains correct and consult with the commissioner/AiB before embarking up on legal action such that the cost effectiveness is borne in mind.

The trustee will be aware that if the daughter lodges the defence that the gift was for her

21st birthday, he will have to demonstrate that it was an unreasonable gift.

- 11) Determine when the birthday was ie is it within the period for challenge under section 34 of the Act? Obtain the trust document and check if it is a properly designated fund or simply a separate bank account with money that the debtor was holding. If the latter, the trustee will take steps to uplift he monies for the benefit of the sequestrated estate.

The lender will be invited to submit a claim which will be granted an ordinary ranking.

QUESTION 3

(a) Prepare a letter to the club steward and outline the options available. (12 marks)

I M A Practitioner
Anytown

3 November 2010

Social Club address
Anytown

Dear Club Steward

The Social Club's Financial Position and Options to Consider

I refer to the recent meeting with the local councillor and thank you for the information and documentation that you provided to me. I have reviewed such information and note below the principle options available to the club as follows:

Continue trading

The club can write to HMRC to advise that although it is minded to cease trading, it wishes to continue for say, 6 months with a view to improving trading fortunes. Matters that might be considered are:

- Any assets that are not essential for ongoing trading will be sold and the sale proceeds used to pay HMRC. However, the information held suggests that there may not be much value in the assets and thus, limited benefit would be obtained.
- Members could be asked to provide funding/loans to keep the club open and allow time for the club to improve trading. However, in view of their recent reaction to increased subscriptions and food/drink prices, this might not be met favourably. Another option might be to ask the brewer for a loan but again, the current brewer's stance suggests this may be unlikely.
- The main trade union could be approached to provide an injection of capital to the club for the benefit of members.
- An extraordinary general meeting of members could be convened in order to table a proposal that subscriptions are increased in order to assist cashflow and keep the club open.
- An advertising campaign could be undertaken in order to seek new members in order to increase funds. This process would take time and needs to be viewed in such light ie the urgency of attracting more funds/members.
- The club's opening hours could be reviewed in order to ascertain what areas are profitable – lunches, evening meals, snooker group, functions, the bar. Once identified, the profitable areas could continue and consideration given to ceasing non profitable areas. This may entail amending the club's opening hours to say Thursday to Saturday in order to save on utility costs etc.
- The club could approach other local social clubs, who may also be experiencing similar problems, with a view to merging with another club who would move to the club's existing premises. This would take time and may not be a high priority.

If HMRC agree, the club officials will need to be satisfied that the club's activities are likely to generate profit and cash because there is a risk that the officials could be accused by creditors and members of acting out with their capacity, ultra vires, and thereby risking personal liability if new liabilities are assumed that cannot be paid.

If HMRC do not agree to hold recovery action in abeyance, this option is unlikely to prove fruitful.

Do nothing

If no positive action is taken by the club, HMRC, who now hold an expired charge for payment can be expected to take further steps to recovery the outstanding debt. Such action may include effecting diligence. Diligence is the name given to the process of executing and enforcing civil court orders and is normally in the form of an attachment. Attachment allows a creditor to seize moveable property eg wet/dry stock and other assets, as a means of recovering money owed.

If it becomes apparent that there are no assets with high value, HMRC may present a sequestration petition against the club and make it bankrupt.

Formal insolvency

Sequestration is the Scottish term for bankruptcy and it is possible for an incorporated body, like the club, to take early court action and submit a sequestration application to the accountant in bankruptcy "AiB". The AiB is a government official, based in Ayrshire, who oversees all sequestration in Scotland. The club would require to prove apparent insolvency ie inability to pay its debts as they fall due (certain conditions that must be met before applying for bankruptcy) or arrange for a qualified creditor(s) one due at least £1,500 (2 or more creditors can act together) to concur to the application.

In the club's case, apparently insolvency is evidenced by the expired charge for payment that has been served by HMRC.

The sequestration application provides for nomination of an insolvency practitioner to act as trustee. If a trustee is not nominated, the AiB is appointed. Sequestration lasts for one year and if creditors have not been paid as a result of the assets within the sequestrated estate, any unpaid balance is written off.

Sequestration introduces certainty and allows the trustee to take control, thus alleviating you from all financial and administrative matters. Given the trading position it is almost certain that a trustee would cease all trading activities resulting in a loss of venue for members and the redundancy of all staff.

One would anticipate that the members could be consulted by convening an EGM, but if creditor pressure is intense and time of the essence, a club official could sign the application immediately. There is a £100 filing fee and the process of obtaining a trustee takes about 5 to 7 days.

Whilst it is possible that a trust deed could be considered, a slightly lesser form of insolvency, the protection offered to club officials is not so clear and there is no reason to risk creditor disagreement to any proposals, or create further losses by continuing to trade. Also, a trust deed process contemplates a financial return to creditors and meantime, that is by no means guaranteed.

Conclusion

Given the information reviewed sequestration proceedings appear to be the only viable option. Please contact me in order to discuss the procedure in more detail.

Yours sincerely

I M A Practitioner

Enclosure: debt advice and information brochure

(b) Set out the steps you would take to ensure that you can act for the club if appointed as trustee. (3 marks)

In order to act, the prospective trustee will ensure that the following steps are undertaken:

1. Obtain a copy of the club's constitution to verify that due process has been followed for progressing formal insolvency proceedings against the club and to ensure that the correct procedure has been undertaken in passing the resolution at the meeting of members.
2. Undertake client verification proceedings for the club steward and any other senior club representative(s).
3. Ensure that the nominated insolvency practitioner and none of the other partners in his firm have not had a personal relationship with the club or a connected person in the 3 years prior to appointment, which might be seen to impair objectivity.
4. Confirm that acceptance of the appointment will not give rise to a conflict with any other current insolvency.
5. Ensure the proposed type of proceedings is the most appropriate procedure in all the circumstances.
6. Ensure the trustee and his staff have sufficient time/knowledge to handle the appointment with due care and attention.

The club is sequestrated and you have taken office.

(c) List the potential assets that are available and set out the steps that you would you take in order that you can realise them, noting any particular difficulties that you anticipate. (7 marks)

The potential assets available are:

1. Moveable assets:

An independent valuation of the moveable assets (both owned and financed) should be instructed.

Consideration should be given to whether any assets are considered fixtures ie part of the fabric of the building by future of their installation and being permanently fixed or installed/plumbed in, etc. (cookers, fridge/freezer). Also the removal of some assets might be physically impossible eg if the snooker table is in a room with insufficient door space or if it is too costly to remove due to the size, weight, etc. Some assets such as kitchen appliances might not conform with current health and safety regulations.

(a) Owned assets

If owned assets are moveable and it is cost effective to do so, they should be uplifted and sold at public auction.

Whilst it is recognised that the landlord might exercise his right of security over the assets in view of the arrears of rent, steps should be taken to approach the landlord with a view to negotiating payment for the assets in order that they can remain in situ for use by a future tenant.

(b) Financed assets

Settlement figures should be obtained for each agreement and compared with the valuation in order to determine if there is any equity in any asset. Enquiry should also be made with the finance company to confirm if any agreements are consolidated.

If equity exists and the agreements are not consolidated, the relevant agreements could be settled and the asset(s) sold in order that the equity is made available for the general body of creditors.

If there is negative equity or agreements are consolidated such that an overall negative equity position arises, the finance company(ies) should be invited to uplift the assets.

Steps should be taken to identify if the oil painting was taken on the basis of a valid set-off. Meantime, the treasurer should be asked to return the oil painting to the club.

2. Wet and dry stock

An independent valuation should be instructed of the wet and dry stock. On the basis that the club will cease trading, consideration should be given as to whether the stock can be sold eg to another licensed trade entity. Discussions with the club steward may help identify potential interested parties.

If a sale of stock is not possible, it might be that former member of staff or club members will be willing to volunteer to host a members' night in the club whereby all drinks would be charged at say, £1 in order to dispose of the stock and generate funds. Consideration of potential damage to the club and the insurance costs of hosting the event would be required such that the exercise is deemed to be cost-effective.

3. Outstanding subscriptions

It may be that there are some outstanding subscriptions due by those members that pay on a monthly basis by cheque/cash. Steps can be taken to collect any outstanding subscriptions ie up to date of closure, it is anticipated that this could be met with opposition in view of the situation.

4. Liquor licence

If the liquor licence is held by the club and trading ceases, there may be scope to seek value from a future tenant in order to ensure a smooth transfer of the licence. If it is deemed that the premises will be attractive for use as a licensed premises, it may be worthwhile for the trustee to consider a transfer the licence into his name meantime.

5. Continue club's operating activities

Whilst it is noted that the club has been trading at a loss in recent months, consideration could be given to whether or not, the trustee can trade on a restricted basis to obtain any surplus funds generated at the functions that have been booked for the forthcoming Fridays and Saturdays. A cashflow forecast should be prepared in order to provide an overview of the position, with the presumption being that restricted trading will not occur. Potential issues to consider are:

- (a) Funding: It is not anticipated that the club's bank would agree to assist in funding ongoing trading and thus, unless there have been sufficient takings in recent days, which have not been banked, ongoing trading may not be possible – no funds for food and drink deliveries or to pay for wages.
- (b) Staffing. Staff may decide that they do not wish to work under the supervision of a trustee.
- (c) Liquor licence: If the premises license is held by the landlord and the manager decides not to continue working for the trustee, it will not be possible to open the premises until an amended manager's licence is obtained from the licensing board.
- (d) Insurance: It may be costly for the trustee to obtain insurance for a licensed premises.
- (e) Suppliers: Suppliers may decide that, in view of outstanding accounts due by the club, they do not wish to trade with the trustee.
- (f) Utilities: The trustee would require to provide an undertaking for ongoing utility supplies during the period of trade.

(d) List the key issues that require to be addressed in the first few days and set out how you would deal with each one. (8 marks)

Keys issues to address in the first few days of being appointed trustee include:

Club information

Meet with club steward/key personnel.

Collect books and records. If not up to date, either arrange for club personnel to do so or organise in-house.

Staff

If applicable, speak with Union representative to advise of intended cessation of trade.

Meet staff and advise of the situation and that contracts of employment will be terminated with immediate effect. Provide the relevant booklet detailing how they can claim for unpaid entitlements. The booklet also contains form RP1 which staff require to complete and is thereafter submitted to the Redundancy Payments Office for processing.

Establish employees' unpaid entitlements and prepare forms p45s for submission to HMRC and employees.

Landlord

Contact should be made with the landlord and a copy of the lease requested. Notification that the trustee does not wish to adopt the lease should be intimated.

Determine how much rent is in arrears and consider payment if cost effective to do so eg to allow sale of assets with greater value than the arrears.

Insurance/health and safety

Contact trustee's insurer and arrange open cover insurance pending the provision of further information about the assets. Consideration should be given to whether or not to arrange for continuation of the club's insurance eg for assets and public liability.

Consider any health and safety issues in terms of all those required to visit/enter the building.

Creditors

As the charge for payment has now expired, contact should be made with HMRC in order to avoid HMRC incurring costs in progressing diligence against the club.

Contact should be made with the club's bank in order to cancel all direct debits/standing orders.

Organise creditor list for mailing purposes in order to advise all creditors of cessation of trading.

Identify and consider any retention of title claims/issues.

Meter readings should be taken.

Assets

An independent valuation of the moveable assets (both owned and financed) should be instructed.

Copy finance agreements should be obtained in order that contact can be made with the finance companies. Determine which assets have equity and if any consolidated claims are likely to arise from a finance company.

Security

Identify any risks to the building and assets.

Any alarm codes should be noted for future access to the premises. Emergency call outs should also be considered and the relevant person identified and notified to the police.

Change locks if appropriate and consider boarding up ground floor windows (in conjunction with advice from insurer).

Licences

A copy of the premises and manager's liquor licences should be obtained and reviewed. Advise local licensing board of cessation of trading.

Members

Organise preparation of member address list in order to include them in all mailings.

Other matters

Telephone contact should be made with each individual/group who have booked a function in order to advise that the club has closed. The snooker group should also be advised.

Open a new bank account in the trustee's name in trust for the club.

Write to existing bank to freeze the account and obtain details of balance, standing orders and direct debits.

Advise cautioner and advise of initial sum required.

Request completion of statement of assets and liabilities from appropriate club representative.

QUESTION 4

- (a) Prepare a receipts and payments account of the trust deed as at today's date stating any reasonable assumptions you consider necessary. (15 marks)

NOTES/ASSUMPTIONS SUPPORTING THE TRUSTEE'S RECEIPTS AND PAYMENTS ACCOUNT

1. The monthly contribution paid by debtor is £3,000 and commenced on 1 November 2008 in accordance with the proposals submitted to all known creditors.

Assuming no arrears, 13 contributions were received between 1 November 2008 and 1 November 2009 (13 x £3,000 = £39,000). From 1 December 2009 to 1 July 2010 (the last date of receipt) there were 8 contributions totalling £24,000.

The trustee has not yet been able to ascertain the reason for missed payments and, in accordance with the provisions of section 8.6 of SIP 3A (Scotland) 2009, steps are being taken to collect the arrears from the debtor and ensure ongoing payment at the agreed monthly level.

2. It is assumed that Tipple & Co pay rent on a timely basis and the start of each year falls within the period under review. The whole rent is applied to the trust deed.
3. No bank interest was received on the monies held in the trust deed account.
4. It is assumed that the trustee intimated his proposed fee to the debtor and known creditors at the end of the first year of the trust deed at the level agreed in the original proposals. Such fee is also assumed to have been approved and settled after expiry of the statutory 14 day appeal period.

The second anniversary of the trust deed does not occur until 4 November 2010 and thus the account is not due until such date. The trustee cannot yet claim his proposed fee in respect of the second year of the process.

5. The trust deed expenses are as follows:

	£
Specific bond of caution	60
Statutory advertising	75
Register of inhibitions	15
Registration of protected trust deed	34
AiB supervision fee	<u>200</u>
	<u>£384</u>

6. a) The dividend paid to creditors at the end of the first anniversary was calculated as follows:

	£	£
Funds held by trustee as at 4 November 2009		45,616.00
Less: balance of funds to be retained by trustee at all times	2,000.00	
Income tax payable on 31 January 2010	2,000.00	
Trustee's proposed fee : year 2	1,000.00	
Trustee's proposed fee : to close	<u>2,500.00</u>	
		<u>(7,500.00)</u>
Available for distribution to creditors		<u>£38,116.00</u>

b) Creditors who participated in the dividend distribution were:

	Amount
	£
HMRC: VAT	60,000.00
HMRC: PAYE/NIC	15,000.00
HMRC: income tax	66,000.00
Trade creditors	<u>25,000.00</u>
	<u>£166,000.00</u>

The employees did not receive a dividend because their contracts of employment have continued [TUPE applies] and the terms of the trust deed specify that the debtor's uncle's claim is excluded until all other claims had been settled in full.

c) The dividend paid was 22.96p in the £ ($£38,116 \div £166,000$).

7. The trust deed became protected in December 2008.
8. In accordance with the provision of SIP 7, section 6.5, all receipts and payments are recorded exclusive of VAT because the debtor is VAT registered. Thus, VAT is recoverable from HMRC and the sum recoverable is part of the net surplus.
9. It is assumed that expenses of £2,000 arose relating to the collection of the rent and landlord's costs.

After application of a personal allowance, a tax payment was made in January 2010 in respect of the tax year ended 5 April 2009 of £2,000 [based upon £15,000 rent, less pro-rata expenses of collection and trust deed administration, less personal allowance, and applying a tax rate of 20%].

10. Independent valuations were instructed by the trustee upon appointment.

- (b) Write a memorandum to describe the issues that should be considered and the steps that require to be taken to progress the trust deed. The memorandum should include financial illustrations where applicable. (15 marks)

INTER-OFFICE MEMORANDUM

To: Trustee

From: Manager

Date: 3 November 2010

Subject: Protected trust deed for Crawford Mackay : review of case files and way forward

I have undertaken a review of the case files and draw your attention to the following matters which may help to progress the trust deed:

1. Background

The trust deed was signed in November 2008. At the time of writing the initial letter to creditors the position was estimated to provide the possibility of a full dividend to all creditors, with the debtor's uncle being a postponed creditor.

Assets: share of Portree house	£20,000
share of Hambleton House, less capital gains tax	£10,000
value of business and assets	£80,000
total contributions by debtor (4 years)	£144,000
rental income, less tax and expenses	£24,000

This provides potential assets of £278,000 from which require to be deducted the trustee's fee estimate of £11,000 and various trust deed costs of £1,000, leaving £266,000 available for dividend purposes. HMR&C and trade creditors total £166,000 and, if one ignores statutory interest, such claims can be expected to be repaid in full based on the above figures. The debtor continued to trade and assumed the responsibility for employee claims and thus, as long as the debtor's new business is in a position to pay the above value for the assets and trading connections that are now being used in the new entity, the only shortfall will be in respect of the debtor's uncle. It seems that the trust deed will last for the full four year period and the debtor's uncle will not receive full payment of his debt.

2. Matrimonial home: Portree

The debtor's share of the equity in the home, which he owns jointly with his wife, has not been sold within the first 18 months of the trust deed becoming protected ie in accordance with the original terms of the trust deed.

The independent valuation obtained for the property at the outset of trust deed proceedings indicated a figure of £380,000. Secured borrowings approximate £360,000 and the potential equity in the property is £20,000, one half of which would revert to the trust deed estate.

It is understood that the debtor and his wife separated recently and it is assumed that it may be fairly acrimonious because she intimated to the trustee recently that she will not cooperate with any refinancing exercise. The trust deed does not provide any powers of vesting in the trustee and the trustee cannot commence legal proceedings for an order to progress the sale of the home by means of an action of division and sale.

The preferred route is to try to negotiate a settlement position with the debtor's spouse and this may be possible if she has separated from the debtor and would like her share of the equity for alternative accommodation. Clearly, the trustee will be required to advise the debtor's spouse that she should seek independent legal advice.

Should a negotiated settlement not prove possible, either by selling the home or obtaining fair value for the debtor's interest therein, the alternative is for the trustee to petition for the debtor's sequestration. This will allow the trustee to commence an action of division and sale. However, in view of the potential costs that this option will create and the level of equity estimated to be available, consideration should perhaps be given to other potential assets that might be realised for the benefit of creditors. Indeed, it may be that the debtor's uncle, as the likely loser in terms of dividend prospects can be consulted for his view because he might agree to the trustee abandoning this asset in order to save cost, speculative legal action and stress on the debtor/debtor's spouse.

3. VAT liability

HMRC have written to advise that the VAT return for the quarter ended 30 September 2010 has not been submitted. This may be an oversight by the debtor and the position requires to be checked quickly. Any VAT liability incurred by the debtor after signing the trust deed does not fall to be settled from the trust deed estate because the business started anew under the debtor's control. In this regard it should be noted that, to date, the debtor's new business has not yet paid for the business and related assets. If they considered appropriate, HMRC could sequester the debtor in respect of this debt once they had undergone the relevant debt collection proceedings and that would not assist the trust deed administration in terms of asset recoveries and ongoing debtor contributions. Early engagement with the debtor is advised in order to clarify matters. For example, the debtor can be requested to provide accounts for the accounting period (s) since signing the trust deed together with a cash flow forecast to demonstrate liquidity.

4. Hambleton House

The forecast outcome is that there will be a shortfall to the debtor's uncle. This suggests that steps should be taken to realise value for the debtor's interest in Hambleton House which may involve the debtor's sequestration. The trust deed provided for realisation of the debtor's share if creditors' principal claims are not settled in full by 5 November 2011 but it is not clear if the debtor's brother (joint title-holder of Hambleton House) has agreed to this in writing. Check what signed agreement/documentation exists and then meet with the brother to discuss the options. The estimated capital gains tax liability arising if the house is sold for the independent valuation figure of £500,000 suggests that a negotiated settlement is preferred because the estimated return to the trust deed may be no more than £10,000.

If the brother refuses to meet/negotiate, care will need to be taken before steps are taken to try and realise the debtor's equity interest. For example, the trustee may wish to consult with the general body of creditors and/or the debtor's uncle (for the same reason noted above).

Another point to consider, which can also be applied to dealing with the matrimonial home, is to defer the debtor's discharge such that, after the four year trust deed period has expired contributions continue for a period long enough to obtain value for the debtor's equity interest in the property. If this applies to both properties then the trust deed process would need to continue for a period of 10 months assuming no change to the contribution level.

The business is based here but it may be possible to relocate, thus uncoupling the link between the business and the property in order to ease the sale of either.

5. Business and related assets

A major asset recovery for dividend purposes is the business of Wheezo. Depending upon the results of the enquiries noted above, the trustee might consider asking the debtor to pay for the business and related assets immediately. Currently, it is assumed that either the debtor will be able to pay for these from ongoing trading, or by instalments once the four year trust deed period concludes. However, if the view is taken that the debtor is losing business control and there is a realistic possibility of the assets being sold to a third party for full value (or more depending upon sale negotiations) with due regard to the contingent transfer liability of the employees, steps should be considered to maintain the realisable value for the trust deed estate.

The business has been transferred to the debtor and thus, the trustee is not in control of a sale process, but can force the debtor to consider a sale if value is not passed to the trust deed estate along the lines of the figure reflected in the original trust deed proposals.

6. Debtor/creditor communication

The debtor and creditors require to be provided with an annual update (SIP 3A section 8.1) and such updates are likely to include statements of estimated outcome should be provided. Creditors' views can be sought regarding the appropriate way forward because dividend prospects will be affected by how the trustee proceeds.

An annual status report will be sent to the debtor shortly in order to determine his ongoing income/expenditure pattern, and due regard will be made to the result of the enquiries noted above regarding the ongoing trading of Wheezo. A meeting with the debtor might also prove helpful in terms of discussing the heritable property positions.

7. Fee considerations

When such annual updates are sent, the trustee will wish to consider his fee position. The evolutionary aspects of this trust deed indicate that more time than originally anticipated will be required and hence the level of the fee. SIP3A, section 8.8, requires a trustee to advise the debtor and creditors when it is anticipated that the fee will be more than 25% of the level originally advised, and good practice means that full reasons should be provided. Depending upon how the trustee wishes to proceed with the issues identified in this memorandum, the circular that requires to be sent for the year ended 5 November 2010 can address this aspect of the trust deed process. Whilst it may not be possible to provide an accurate fee estimate, it is respectfully submitted that the debtor and creditors should be made aware of the likely fee situation as soon as possible.

8. Contributions

The file review did not clarify whether or not the debtor signed an Income Payment Agreement to evidence cooperation with the trust deed process. The debtor requires to explain why contributions ceased on July 2010 and to be asked for proposals to settle the arrears and reinstate the monthly £3,000 payment. One option might be to consider extending the trust deed to allow the agreed total contribution figure to be met over a longer period. This is the largest source of recovery for creditors and requires appropriate attention. A trust deed requires the debtor's cooperation to achieve maximum benefit for creditors which is why continued contributions are important in this trust deed and are in accordance with the debtor's ability to pay. The trustee will be required to comment on this matter in his forthcoming annual report to creditors.