

# JOINT INSOLVENCY EXAMINATION BOARD

*Joint  
Insolvency  
Examination  
Board*

**Joint Insolvency Examination**

**Tuesday 4 November 2008**

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## **ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS and RECEIVERSHIPS (3.5 hours)**

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**ANSWER ALL FOUR QUESTIONS**

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

**SUBMIT ALL WORKINGS**

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

**The time allowance has increased to 3.5 hours to include half hour reading and compilation time, but candidates may write at any time during this period.**

**Note:** References to legislation are to that which was in force on 30 April 2008. References to 'the Act' are to the Insolvency Act 1986 as amended.

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

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

1. On 29 October 2008 Slack Foods Ltd ("the Company"), a manufacturer of TV dinners, was placed into Administrative Receivership. This followed a visit from Environmental Health Officers who served a closure notice on the Company after persistent and serious hygiene safety infringements. The Company is the sole occupant of individual, interconnected freehold properties at Units 2, 4 & 6 Hogarth Trading Estate, South West London. Trading has ceased and all employment contracts have been terminated.

The Administrative Receiver's appointor, Amethyst Bank Plc, holds fixed charges over Units 2 and 4 and a floating charge over all the assets and undertaking of the Company.

Burgundy Securities Plc, the holder of a fixed charge over Unit 6, has recently approached you to accept appointment as Law of Property Act ("LPA") Receiver.

Messrs Eddie Diamond & Partners, a firm of commercial property consultants, have undertaken some informal enquires on your behalf and have established that:

- (1) The Administrative Receiver has already given marketing instructions to Messrs RS Smart who will be acting on a 1.5% agency fee in respect of the properties. The three Units as a whole have an estimated value of around £1.8m and by reference to floor areas Unit 6 has a value in the region of around 30% of the whole. A third party has apparently already expressed an interest in acquiring all three Units as a whole. The internal access linking Units 4 and 6 is limited and could readily be closed but at an estimated cost of around £20,000.
- (2) Unit 6 is separately metered in respect of all mains services. The accounts of all suppliers of such services are in arrears.
- (3) As part of a programme of refurbishment works agreed with the local authority, painting contractors have completed the internal redecoration of Units 2 and 4 and are about half way through Unit 6. The agreed price for the job was £15,000 and no interim payments on account have been made by the Company.
- (4) There is a sophisticated fume extraction and air filtration system installed in Unit 6 but as this has not yet been inspected by Eddie Diamond & Partners, they are not able to comment about the extent to which the system is attached to the property. It is thought that the equipment would have an "in-situ" value of around £25,000 (in addition to the estimated values discussed at (1) above).

## Requirements

- (a) **List the matters that you would consider before accepting the appointment. (3 marks)**
- (b) **Set out a Receiver's statutory powers under the Law of Property Act 1925. List the principal additional powers that you would expect to be contained in the charge document under which it is proposed to appoint you. (5 marks)**
- (c) **Outline the extent of your duty of care should you accept the appointment. (4 marks)**
- (d) **Comment on the effect of the information obtained from Eddie Diamond & Partners upon your strategy for dealing with the charged property. (8 marks)**

**(20 marks)**

2. Logistica Consulting Ltd (“the Company”) is a logistics and supply-chain management consultancy which is in financial difficulty.

The Company’s difficulties stem first from a large bad debt that it sustained when a South American client defaulted due to bankruptcy and secondly because of significant management time that has been taken up defending a substantial professional negligence claim which was eventually settled without admission of liability and at no significant financial cost to the Company.

The two director-shareholders have already invested heavily in the Company and are unable to inject additional funding. Approaches have been made to third parties for funding without success and the Company is coming under increasing creditor pressure.

With assistance from the Company’s accountants, the directors have drafted a proposal for a Company Voluntary Arrangement (“the Proposal”), written notice of which together with a copy of the Proposal has been served on you as the proposed Nominee. It proposes quarterly contributions of £50,000 from continued trading over a period of 3 years resulting in an estimated return to unsecured creditors of around 70p in the £. Supporting profit and loss and cash flow forecasts for the next three years indicate that this level of commitment to the creditors appears feasible. You note, however, that the proposal makes no reference to the possibility of the Company being in breach of its terms and the consequences thereof.

The Proposal compares with an estimated return of less than 10p in the £ if the Company were to be wound up. You signify your agreement to act as Nominee in accordance with the Rules.

### **Requirements**

- (a) List the main issues that you would cover in your letter of engagement to the directors dealing with your respective duties and obligations. (5 marks)**
- (b) Draft appropriate amendments to the Proposal for discussion with the directors dealing with any breach of the arrangement by the Company and the consequences of such breach. (5 marks)**
- (c) Assuming that your Nominee’s report to the Court on the Proposal is favourable, list the steps for summoning the meetings to consider the Proposal. (5 marks)**
- (d) Briefly state how you would deal with each of the following claims for the purposes of voting on the Proposal. (5 marks)**
  - (i) Twelve special proxies voting in favour of the Proposal from employees with claims for accrued holiday pay totalling £20,000;**
  - (ii) Eight general proxies for the chairman from trade creditors and suppliers totalling some £80,000;**
  - (iii) A special proxy from a landlord voting against the Proposal claiming the cost of unspecified dilapidations amounting to £30,000;**
  - (iv) A special proxy from a supplier voting against the Proposal for an outstanding debt of £25,000. The supplier is validly claiming retention of title in respect of goods with an estimated re-sale value of £15,000; and**
  - (v) A special proxy from Indigo Bank Plc for £160,000 being the outstanding balance of a loan granted under the Small Firms Loan Guarantee Scheme, which provides a government guarantee to the lender covering 75 per cent of the loan. The Company has provided no security for this loan. The proxy is in favour of the Proposal.**

**(20 marks)**

3. Arrowstorm (Tyres) Ltd (“the Company”) operated as a tyre supplier and vehicle repairer from five locations within this jurisdiction.

Six weeks ago HM Revenue & Customs (“HMRC”) distrained and obtained a walking possession agreement attaching to the majority of the Company’s chattel assets situated at its smallest depot. HMRC made it clear that if the outstanding PAYE/NIC taxes were not paid within the following three weeks, those assets would be removed. During this intervening period additional funding was sought but none was obtained. Consequently when the three-week period expired the directors sought protection for the Company by filing a Notice of intention to appoint an Administrator in the Court on 13 October 2008. You were appointed Administrator on 20 October.

Following your appointment you instructed agents to provide you with an inventory and valuation of the chattel assets, and valuation and disposal advice in relation to the Company’s freehold and leasehold properties. You concluded that there was a reasonable prospect of selling the business and assets as a going concern thereby significantly enhancing realisations compared to a break-up sale. You therefore prepared a short term trading plan and cash flow forecast which indicated the feasibility of a short period of continued trading, albeit at a small loss, whilst a purchaser for the business and assets was sought.

A sale was concluded on 30 October. Realisations were £420,000 for freehold and leasehold properties, £325,000 for plant and equipment and £33,000 for stock and work-in-progress. A payment of £47,500 was also achieved for goodwill. As a consequence of the sale, 24 employees transferred to the purchaser.

The sale proceeds attributable to the assets subject to the walking possession agreement were £23,000.

You calculate and accrue for a corporation tax liability of £12,500 arising from chargeable gains as a result of the sale.

Whilst you have not yet finalised your trading account you estimate that a loss of £15,000 will be incurred. However this has been more than offset by the enhanced realisations as a result of the going concern sale and you intend to apportion the loss between the fixed and floating charges in proportion to the gross realisations coming into your hands.

Immediately following your appointment you vacated one of the leasehold properties. Your offer to surrender the lease to the landlord was refused. The rateable value is £18,750 and the rate payable is 40p in the £.

Magenta Bank Plc (“the Bank”) holds a debenture incorporating fixed charges over freehold and leasehold property, goodwill and book debts and a floating charge over all of the assets and undertaking of the Company. At the date of your appointment the Bank was owed £700,000 in respect of loans advanced but there was £30,000 standing to the credit of the Company’s current account with the Bank. Analysis of that account shows that some £26,000 was paid in respect of wages in the week preceding your appointment of which £12,000 was above the preferential limit.

The trade debtors have been assigned to Magenta Invoice Financing (“the Factor”) under a factoring agreement. On your appointment the Factor was owed £335,500 in total in respect of advances and charges against a ledger expected to realise £360,000.

Your solicitors have confirmed the validity both of the Bank’s security, which was created on 8 April 2004, and of the factoring agreement.

From a review of the costs incurred to date, you assess that your own costs and expenses together with those of your legal and professional advisors are likely to be in the region of 10 per cent of the gross realisations achieved. You intend to apportion those costs and expenses between the fixed and floating charges in proportion to the gross realisations coming into your hands.

The Company has operated a group personal pension scheme but because of a clerical error, employers' contributions for April this year amounting to £3,000 were not paid over to the scheme.

### **Requirements**

- (a) Set out the main points you would have included in your initial letter to all employees explaining the effect of your appointment on their employment. (5 marks)**
- (b) Outline the potential consequences for the Company of a failure to consult adequately about a prospective business transfer. (3 marks)**
- (c) State your statutory obligations in relation to the pension scheme. (2 marks)**
- (d) Estimate the amount of the net property and prescribed part for the purposes of the Administrator's proposals to creditors. (10 marks)**
- (e) Draft provisions for inclusion in the Administrator's proposals dealing with how the Administration shall end and also how the Administrator shall be released from office. (10 marks)**

**(30 marks)**

4. Yesterday you received a telephone call from solicitors acting for Advanced Bio Power Ltd (“the Company”), a company in financial difficulty. The Company operates a waste-to-energy processing plant converting municipal waste into electricity which it sells to the wholesale market. The highly advanced technology has been in development over the last eight years but has only recently begun to demonstrate its commercial viability. The directors have already concluded that the Company cannot continue to service its extensive debts incurred to fund the on-going development costs and resulting operating losses. Nevertheless they are convinced that, stripped of its liabilities, the business can enjoy a profitable future.

This morning you received a follow up email with further background information, the latest management accounts to the end of September 2008 and an emergency cash flow forecast for the next six weeks. You carry out a search of Companies House and obtain audited accounts for the year ended 31 December 2007, a schedule of registered charges, and the latest annual return.

Apart from £2.5m share capital, the major funding has come from a £6.5m term loan repayable over 12 years, provided in January 2001 by Banco Verde Esmeralda (“BVE”), an offshore lender sympathetic to the Company’s vision at a time when UK lenders were somewhat sceptical about greenhouse-gas emission reduction. BVE appears to have a valid fixed charge over leasehold property and intellectual property rights (“IPR”) and there is also a floating charge over all of the assets and undertaking of the Company but which you note was only subsequently created and registered during 2002. The balance of the BVE loan outstanding is £2.2m. There are other unsecured loans totalling £1.65m, including a bank overdraft and trade creditors amounting to £230,000. There are PAYE and NIC arrears amounting to £90,000 and also VAT arrears of £80,000, and HM Revenue & Customs have confirmed that the matter has now been passed to their enforcement office.

An urgent board meeting has been summoned for tomorrow and you have been asked to attend to give professional advice alongside the Company’s solicitors. The email to you concludes: “The Board is particularly interested to explore the possibility of a phoenix-style pre-pack”.

The directors are apparently contemplating the transfer of the business and assets, excluding the trade debtors, to a newly formed company (“Newco”) and for that purpose have assessed the open market value of the tangible assets to be transferred as follows:

	<b>30 September 2008 net book value £’000</b>	<b>Estimated open market value £’000</b>
Leasehold property	300	300
Plant & Machinery	822	800
Office fixtures, fittings & furniture	38	30
Stocks of consumables	81	70

Additionally they assess the IPR, which is not on the balance sheet, to be worth £1m.

Factored book debts amount to £750,000 with a corresponding liability to the factor of £690,000 (including estimated interest, termination penalties and management charges). There are also non-factored debts of £40,000 and an agreed R&D tax credit due of £50,000. The debtor book is clean and is considered fully collectible.

Your initial assessment of the likely professional costs associated with such a transfer in the context of an appointment of an Administrator is pre-appointment fees of £40,000, Administrator’s fees of £100,000, legal and professional costs of £50,000 and disbursements of £10,000. In each case these costs should be apportioned 50/50 as between fixed and floating charges.

## Requirements

- (a) Draft a briefing note for your meeting with the directors outlining:
- (i) the nature of a “pre-pack” sale;
  - (ii) the advantages and disadvantages of such sale in achieving realisations compared with alternative strategies;
  - (iii) any insolvency law or required practice provisions which moderate or control the conduct of such transactions by insolvency office holders; and
  - (iv) the matters to be addressed by the prospective Administrator in discussion with the directors to establish the suitability of the “pre-pack” sale presently envisaged by the board. (15 marks)
- (b) Prepare an estimated outcome statement assuming that the “pre-pack” sale envisaged is completed promptly following your appointment as Administrator. (12 marks)
- (c) Calculate the estimated recovery for BVE if, by having registered its floating charge at the time of granting the loan, BVE were able to appoint an Administrative Receiver to conclude the “pre-pack” sale to Newco. (3 marks)

(30 marks)

**NOTE:** Assume a Corporation Tax rate of 30 per cent.