

JOINT INSOLVENCY EXAMINATION BOARD

*Joint
Insolvency
Examination
Board*

Joint Insolvency Examination (Scotland)

Monday 7 November 2016

LIQUIDATIONS (3.5 hours)

ANSWER ALL FOUR QUESTIONS

EACH QUESTION CARRIES TWENTY-FIVE MARKS

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.

Note: References to legislation are to that which was in force on 30 April 2016. 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 Act and to Rules of the Insolvency (Scotland) Rules 1986 as amended.

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

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1. Skiiz Limited ("the Company") is a ski wear manufacturing company with a leasehold head office and factory in Aviemore. The Company also owns a distribution centre in Grenoble, France. The Company manufactures own brand ski wear as well as ski wear under a licence agreement granted by a third party. Following a period of poor product reviews of its own brand products in skiing magazines and on-line, the Company's sales fell dramatically causing severe cash flow problems, leading to the Company's insolvency.

You were appointed Joint Liquidator of the Company on 27 October 2016 following meetings of members and creditors on that date. Immediately following your appointment the Company ceased trading.

You have identified the following issues:

- You have just been informed by the accountancy software supplier that they will be disconnecting this service tomorrow morning due to non-payment of invoices. You have outstanding orders to process and do not yet have an accurate view of the debtors' ledger.
- Mallera Inc, an American supplier of ski helmets to the Aviemore factory, has contacted your office stating that they still own the helmets as the Company hasn't paid the last two outstanding invoices. They do not wish to attend a stock take as they are based in Baltimore, USA and have arranged for a courier to collect their stock tomorrow morning. You have been informed that there were two helmet suppliers as the Directors were concerned that Mallera Inc may be in financial difficulty and wouldn't be able to guarantee supply.
- The Company has received a deposit of £5,000 for ski wear from a charity which provides ski holidays for disadvantaged children. The deposit was paid into the Company's main bank account five days before your appointment. The Company will be unable to supply the ski wear the charity has ordered.
- Following a review of a health and safety report you commissioned, you find out that the Company has been storing contaminated waste on the Aviemore site which is leaking into the ground and will cost £20,000 to clean up.
- The licence agreement is not determinable on the insolvency of the licensee. Licence payments of £10,000 per quarter are payable and the most recent payment is now overdue. The licensor is threatening to terminate the agreement and is demanding delivery of the goods. The licensee must also run a marketing campaign twice a year to promote the licensor's products. In order to meet this marketing obligation the Company was running a ski holiday competition with a closing date for entries of 30 October 2016.
- A creditors' committee comprising 3 members was formed at the creditors' meeting. All appointment formalities have been completed and you now wish to draw remuneration on a time costs basis and disbursements.
- Due to unexpected ill health, your Joint Liquidator has decided to retire from this, his last case, with immediate effect, following which he will cease to be an Authorised Insolvency Practitioner.

Requirements

- (a) Write a file note of the practical and legal steps you need to consider in the Liquidation to resolve the issues you have identified. You should make reference to relevant legislation and case law. (21 marks)
- (b) Set out the issues arising from the EC Regulation on Insolvency Proceedings that you may encounter when dealing with the French distribution centre. (4 marks)

Total: (25 marks)

2. Dixiemusic Ltd ("the Company"), which operated a nightclub, was placed into Creditors Voluntary Liquidation on 10 October 2016, following meetings of members and creditors on that date, when the Authorised Insolvency Practitioner for whom you work was appointed Liquidator. The Company ceased trading upon her appointment.

The Confirmation Statement and Register of People with Significant Control ("the PSC Register") discloses that the Company is a 100% subsidiary of Dixienotes Ltd ("Dixienotes") which is registered in Gibraltar.

The Company has the following Directors:

Name	Position	Shareholding in Dixienotes
Wanda	Managing Director of both the Company and Dixienotes. Disclosed in the PSC Register. Wife of Earl	56%
Earl	Financial Controller and Company Secretary of the Company. Disclosed in the PSC Register. Husband of Wanda	34%
Hank	Non-executive Director of the Company. Son of Earl and Wanda	10%

Further investigation has identified the following additional information:

- Company staff have suggested you speak to Mary, Wanda's best friend, who negotiated with all the Company's suppliers. Companies House records show that Mary resigned as a Director of the Company on 30 January 2015. You understand that she resigned following a conviction for a VAT fraud perpetrated when acting as a director of an unrelated company, and a consequent disqualification from acting as a director.
- On 22 September 2016 Dixienotes directed that the majority of the Company's bank balance of £34,500 should be transferred to Dixienotes' Gibraltar bank account, leaving only enough funds to pay the monthly management salaries for September. Earl has explained that Dixienotes was due money for outstanding dividends.
- A review of the Company's bank statements shows that on 22 December 2015, Loretta (Hank's ex-wife whom he divorced in 2014) paid £25,000 for the Company's flat above the nightclub. Loretta had been living in this flat with Hank. Loretta sold the flat on 3 October 2016 for £225,000.
- It appears that during the last year some of the Company's cash receipts have been paid directly into Wanda and Earl's personal bank account. Earl has explained that this was to repay a loan he and Wanda made to the Company a few years back.
- Mary has made two loans to the Company. The first loan for £110,000 was received by the Company on 30 June 2014, and was secured by a floating charge over the Company's assets created on the same day. This loan was repaid in full on 19 December 2014 and the floating charge satisfied. A second loan of £255,000 was received by the Company on 5 January 2015 and was secured by a floating charge created on 19 February 2015. This loan remains outstanding. Loan documents show that both loans are subject to a 100% annual interest rate.
- Company management accounts show that the Company was able to pay its suppliers within their trading terms until 1 July 2016, as a result of the loan made to the Company by Mary and by withholding the June quarter VAT payment to HMRC. The Company's trade creditors increased significantly from £25,000 to £275,000 between 1 July 2016 and the date of the Liquidator's appointment. Earl has explained that November was normally the Company's busiest month as there were some great country music promotions lined up.

- A local customer who regularly hired the nightclub for social events and whom you thought owed the Company £22,000, has advised he has settled all amounts due in full. Upon further investigation you have found an email from Earl telling Wanda to assign this book debt to herself.
- The Company's solicitors are reluctant to hand over the statutory books and records and other legal contracts they hold, saying it will cost them £2,500 to comply with your request.
- Wanda has left the country and you believe she is staying at her Spanish holiday home. She has failed to respond to any of your requests for information.
- In this morning's post you received a letter from Mary complaining about the Liquidator's "unprofessional behaviour".

Requirements

Write a file note for the Liquidator setting out:

- (a) the duties and powers the Liquidator has to investigate the affairs of the Company. (5 marks)**
- (b) the actions the Liquidator could take to recover assets for the creditors. (11 marks)**
- (c) who should be included in the Director Conduct Report and on what basis. (4 marks)**
- (d) the steps the Liquidator should take to deal with the letter received this morning from Mary. (5 marks)**

Total: (25 marks)

3. You have been called to a meeting with a firm of local solicitors and their client Pierre, a Director of Furnichere Ltd ("the Company"). The Company is a high end furniture retailer which trades from two leasehold stores in Edinburgh and Glasgow and an owned store in Stirling. The Company has ten employees. A winding up petition was presented against the Company on 31 October 2016 and served at the Company's registered office on 1 November 2016. The petition will be heard on 16 December 2016.

Pierre has also brought the following matters to your attention:

- The winding up petition was presented following an expired statutory demand which had been received from a supplier which claims to be owed £20,000 in relation to unpaid invoices. The Company disputes that any monies are due to the petitioner.
- On 28 October 2016, the landlord of the Glasgow store issued an Irritancy Notice for non-payment of rent which was served on the Company and Pierre is worried that the landlord of the Edinburgh store may do the same. Pierre who has given personal guarantees to both landlords has been personally served with a statutory demand by the Glasgow landlord for £15,000 which he cannot afford to pay.
- The Company has received a threat of calling up from the secured lender in respect of the Stirling store and is considering selling the property to an unrelated property investor, and then leasing it back.
- Other than the mortgage over the Stirling store, the Company has granted no floating charges.
- Following a challenging trading period, the Company's furniture was recently featured in a magazine shoot and endorsed by a celebrity customer. Orders have quadrupled in the last two weeks. Pierre would like to continue trading the business as he believes his new range of furniture and strong order book will change the Company's fortunes.

Requirements

Draft a letter to Pierre setting out:

- (a) the consequences on the above matters of the winding up petition being presented and how these can be managed. Make reference to relevant legislation and case law. (12 marks)**
- (b) the other options which are available to the Company to enable it to continue trading, and how these would be achieved given the outstanding winding up petition. State which option you would recommend and why. (9 marks)**
- (c) the options available to Pierre for dealing with the statutory demand served on him personally. Explain how each option could affect his directorship of the Company. State which option you would recommend and why. (4 marks)**

Total: (25 marks)

4. Blake and Miranda are the directors and shareholders of Hornbeam Sawmill Ltd ("the Company") which has ceased trading. Blake owns 60% and Miranda 40% of the Company's shares. They are in the process of emigrating and would like to realise their investment in the Company. They have asked you, an Authorised Insolvency Practitioner, to meet them tomorrow.

You have been given the following information about the Company.

Hornbeam Sawmill Ltd
Balance Sheet as at 31 October 2016

	Note	£'000	£'000
<i>Fixed assets</i>			
Land and buildings	1	355	
Fixtures and fittings	2	30	
Plant and machinery	3	200	
Intangible assets	4	<u>20</u>	605
<i>Current assets</i>			
Stock	2	50	
Work in progress	5	75	
Trade debtors	6	200	
Other debtors	6	40	
Cash at bank and in hand		<u>15</u>	
		<u>380</u>	
<i>Current liabilities</i>			
Trade creditors		(58)	
Hire Purchase creditor		(10)	
Other taxes and social security	7	(25)	
Directors' loans	8	<u>(79)</u>	
		<u>(172)</u>	
<i>Net current assets</i>			208
Bank overdraft	9		<u>(50)</u>
<i>Net assets</i>			<u><u>763</u></u>
<i>Capital and reserves</i>			
Called up ordinary share capital			200
Share premium account			75
Profit and loss account			403
Revaluation reserve			<u>85</u>
<i>Equity shareholders' funds</i>			<u><u>763</u></u>

Notes

1. Land and buildings consist of the following:

Sawmill and offices	£270,000
Manager's cottage	£ 85,000

The properties were last revalued for accounts purposes 5 years ago, and a recent valuation has valued the sawmill and offices at £335,000 and the manager's cottage at £115,000. It has been agreed that Miranda can have the manager's cottage at market value as a distribution in specie.

2. It is the intention of the directors to sell the fixtures and fittings and stock at a general auction. The auctioneer has estimated the net proceeds will be:

Fixtures and fittings	£9,000
Stock	90% of book value

3. The plant and machinery includes £15,000 of hire purchase ("HP") assets. The HP company is due £10,000. The Company has a buyer lined up for the HP assets who has agreed to pay book value and the HP company has consented to the sale.

All the rest of the plant and machinery will be sold in a specialist auction and has generated great interest in the trade due to the high quality and excellent condition of the machines. The auctioneer is confident she will be able to achieve a premium over and above the book value, and has suggested a reserve of £280,000. The auctioneer charges commission and selling costs of 10%.

4. Blake holds a registered patent for a full-sized portable sawmill he designed whilst working at the Company. Blake believes the patent may be of interest to a Canadian competitor and is worth around £25,000.
5. The work in progress relates to an incomplete order for a customer who has gone into liquidation. The directors consider that, if sold to a fencing supplier, they could get £35,000 for the wood.
6. The directors are confident they will achieve an overall 80% recovery of trade and other debtors.
7. Other taxes and social security comprise £15,000 in respect of PAYE and NI for the last two weeks and £10,000 in respect of VAT due since the last VAT return was submitted for period end 30 September 2016.
8. Miranda and Blake have both provided the Company with unsecured loans. Miranda has loaned £50,000 and Blake has loaned the balance.
9. The bank overdraft is secured by fixed and floating charges over the Company's assets.
10. All wages have been settled by the Company until 31 October 2016 when all staff were made redundant. The ten ex-employees are still owed redundancy pay of £105,500 and employee and employer occupational pension contributions of £14,500 are overdue. All notice and holiday pay has been settled in full.
11. The Company has entered into a supply agreement until 31 December 2016 with a local forestry estate to purchase 1,200 felled trees per annum. By 31 October 2016 the Company had purchased 968 felled trees. The contract states that should the Company fail to purchase the 1,200 trees to which it has committed, it has to pay damages of £125 for each tree it fails to purchase.
12. The Company is party to a Climate Change Agreement for the sawmill facility. Therefore if the Company meets the agreed energy efficiency targets at the end of each annual reporting period, it is eligible for a 35% discount on the Climate Change Levy it pays on gas and 10% discount on electricity. The Company has already received this discount for the year based on estimated consumption, however it did not meet its targets during the last annual reporting period and now needs to report this to HMRC and repay the discount. The Company spent £175,000 on electricity and £50,000 on gas (prior to any discount being applied), in the year to 31 October 2016.

Requirements

In preparation for tomorrow's meeting:

- (a) prepare a statement of affairs for the Company as at 31 October 2016, stating any reasonable assumptions that you make. (11 marks)
- (b) prepare a distribution statement for each shareholder, stating any reasonable assumptions that you make. (3 marks)
- (c) write a file note explaining:
 - (i) the purpose of the statement of affairs. (3 marks)
 - (ii) the practical steps a Liquidator should take if Blake and Miranda request an early distribution. (3 marks)
- (d) state what matters you should consider before accepting an appointment as Members' Voluntary Liquidator to the Company. (5 marks)

Total: (25 marks)

Note: Ignore Corporation Tax