

13 November 2018

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## CORPORATE INSOLVENCY (3.5 hours)

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This exam consists of **four** questions (100 marks).

### Marks breakdown

Question 1	20 marks
Question 2	20 marks
Question 3	20 marks
Question 4	40 marks

1. Please read the instructions on this page carefully before you begin your exam. If you have any questions, raise your hand and speak with the invigilator before you begin.
2. Please alert the invigilator immediately if you encounter any issues during the delivery of the exam. The invigilator cannot advise you on how to use the software. If you believe that your performance has been affected by any issues which occurred, you must request and complete a candidate incident report form at the end of the exam; this form must be submitted as part of any subsequent special consideration application.
3. Click on the **Start Exam** button to begin the exam. The exam timer will begin to count down. A warning is given five minutes before the exam ends. When the exam timer reaches zero, the exam will end. To end the exam early, press the **Finish** button.
4. You may use a pen and paper for draft workings. Any information you write on paper will not be read or marked.
5. The Examiner will take account of the way material is presented. Candidates should answer the questions set: marks will not be awarded for extraneous material.
6. Ensure that all of your responses are visible on screen and are not hidden within cells. Your answers will be presented to the examiner exactly as they appear on screen.
7. References to legislation are to that which was in force on 30 April 2018. References to 'the Act' are to the Insolvency Act 1986 as amended.
8. References to Sections, Schedules and Rules are to Sections and Schedules of the Act and to Rules of the Insolvency (England and Wales) Rules 2016.
9. References to Sections and Rules of other Acts, Regulations and Orders will mention the Act, Regulation or Order.

## Question 1

You are an Authorised Insolvency Practitioner and have been contacted by the Directors of Dousard Limited (“the Company”), which operates eight fast food restaurants. The Company’s cash flow position has deteriorated over the last 12 months following a material increase in business rates and the impact of the national living wage.

The Directors have confirmed that the Company will be unable to pay this month’s wage bill and cannot see any opportunity to turn the business around. The Company therefore ceased trading yesterday and the Directors would like to place the Company into Creditors’ Voluntary Liquidation.

### Requirements

- (a) **Assuming there is no request for a physical meeting, set out the key practical and legal steps required to place the Company into Creditors’ Voluntary Liquidation (12 marks)**

Following your appointment as Liquidator to the Company by the shareholders and creditors of the Company, you have the following matters to deal with:

- A creditors’ committee, comprising four members, was formed shortly after your appointment. Three of the members are creditors and one is a contributory. One of the creditor committee members has failed to attend the last three committee meetings.
- You have identified that the Company’s shareholders have not paid the full value of their shares. Of the £100,000 total nominal share capital, £80,000 is unpaid. Together the shareholders are due £10,000 of unpaid dividends relating to the financial year ended 31 May 2018.

### Requirements

- (b) **Prepare a file note outlining how you would deal with the above two matters. (8 marks)**

**(Total: 20 marks)**

## Question 2

You are an Authorised Insolvency Practitioner and have been contacted by Robert and Ned, the Directors of Westerfall Limited (“the Company”).

The Company, which has been struggling for some time, supplied TV show merchandise to high street retailers. Over the last two years Robert has lent £275,000 to the Company to support its losses. However, due to the failure of a major customer, Cerslyn Limited (“Cerslyn”), the Company found itself in a critical position and unable to pay outstanding VAT due to HMRC.

The Company is now in compulsory liquidation following a winding up petition presented by HMRC on 11 September 2018 and a winding up order made on 23 October 2018. The total amount owing to the creditors of the Company is £500,000.

Robert and Ned have requested your advice on the following matters:

- Robert and Ned have set up a new company called Westerfall (2018) Limited and would like to acquire the assets of the Company from the Liquidator so they can continue in business.
- The Company received notification of the appointment of Administrators to Cerslyn in May 2018 and was advised that “dividend prospects for unsecured creditors at this time are unclear, with any dividend likely to be less than 5p/£”. Cerslyn owes the Company £75,000. From May 2018 the Company was unable to pay its trade suppliers and three creditors including HMRC obtained judgement against the Company. The Company ceased trading on 23 October 2018.
- Robert and Ned set up an Employee Benefit Trust six years ago. Money was paid to an offshore trustee from the Company’s profits and the trustee then administered a fund on behalf of Robert and Ned who were the trust’s beneficiaries. The money in the trust was then loaned to Robert and Ned and therefore not subject to income tax. These loans remain outstanding. The Company has received an accelerated payment notice from HMRC requesting payment on account of the tax owed following use of this tax avoidance scheme.
- Robert, in his personal capacity, provided consultancy services to the Company in relation to sourcing new customers and manufacturers, for which he received a 20% commission. He then invoiced the Company on a monthly basis. Over the last twelve months Robert issued valid invoices and received £125,000 from Company funds.
- For the past three years, the university tuition fees and living costs of Arla, Ned’s daughter, have been paid by the Company. These total £55,000. There was never any intention that his daughter would repay these monies to the Company.

## Requirements

**Write a file note in preparation for your meeting with the Directors, advising them of the key points to consider in relation to the above five matters. (20 marks)**

### Question 3

You were appointed Administrator of Shutlingsloe Products Limited (“the Company”) on 4 October 2018. On 25 October 2018 you uploaded your Administrator’s proposals to your firm’s creditor portal together with your fee proposal, with the intention of approving these matters through a Qualifying Decision Procedure.

On 29 October 2018 you received four letters in relation to the case all requesting a physical meeting be held.

#### Silverhill Law LLP (“Silverhill”)

Silverhill is a firm of solicitors representing 3 former employees of the Company who were made redundant following your appointment. In their letter the solicitor has outlined the employee claims as follows:

	Mr Potts	Mr Jones	Miss Sinclair
Weekly pay	£1,000	£500	£450
Arrears of pay			
Weeks	2	1	1
Total £	£2,000	£500	£450
Redundancy			
Weeks	4.5	6	8
Total £	£4,500	£3,000	£3,600
Notice pay			
Period (weeks)	26	6	8
Pay £	£26,000	£3,000	£3,600
Total claim £	£32,500	£6,500	£7,650

#### Mr Gorvin

Mr Gorvin is the sole Director and Shareholder of the Company and has requested a formal meeting as he considers your proposed fees to be excessive. The Company’s records indicate that Mr Gorvin owes £50,000 to the Company.

#### Landlord

The former landlord has submitted a written claim comprising £500,000 for future rent to the end of the lease (5 years remaining), £30,000 for rent arrears and a dilapidations claim of £1m. Your agents have indicated that the dilapidations claim is spurious and that from their inspection of the property the rectification costs would be £50,000. The statement of affairs signed by the Director included a total debt due to the landlord of £130,000.

#### Whatborough Limited (“Whatborough”)

Whatborough was a supplier to the Company and along with its letter has sent you a proof of debt showing an amount of £35,000 as being outstanding to it. The statement of affairs includes this creditor with an outstanding balance of £20,000.

The statement of affairs lists 200 unsecured creditors with a total debt of £5m.

## Requirements

- (a) Summarise the circumstances when an Insolvency Practitioner is required to convene a physical meeting of creditors and set out the steps required to convene a meeting in these circumstances. (5 marks)
- (b) Outline how the claims received by you would be treated and, where you consider it necessary, what additional supporting information/documentation you would request in relation to;
- (i) the request to convene a physical meeting to consider your proposals and fees;
  - (ii) the voting at any physical meeting that is held; and
  - (iii) the distribution by way of dividend of funds to the creditors.

(15 marks)

(Total: 20 marks)

## Question 4

Wheeler Turbines Limited ("the Company") has approached you for advice regarding its current financial situation. You have established the following information relevant to the Company's position.

### Background

The Company manufactures components used in the wind turbine industry and it trades out of leasehold premises on the outskirts of Reading. The Company employs 150 members of staff including the 3 Directors.

On 1 October 2018, due to two VAT quarters and four months' payroll taxes being overdue, HMRC presented a winding up petition at Court. Whilst the Company then attempted to negotiate a time to pay arrangement with HMRC, this was unsuccessful and this morning (13 November 2018) the winding up petition was advertised in the London Gazette. At 9.00am today the Company received a call from its bank confirming that the account had been frozen. Following this call the Company's Directors contacted you, an Authorised Insolvency Practitioner, for advice and provided you with the following information.

The Court hearing in relation to the petition is scheduled for 27 November 2018.

### Trading performance

The Company's most recent management accounts available are summarised below together with related notes from your discussion with management.

#### Accounts for the 4 weeks to 30 September 2018

	Period ending: Number of weeks:	30-Sep 4	Year to Date 39
	Notes	£'000	£'000
Income	1	1,200	14,000
Materials	2	(660)	(8,400)
Labour	3	(300)	(3,500)
Gross profit		<u>240</u>	<u>2,100</u>
Overheads			
Administrative staff	3	(75)	(675)
Rent	4	(20)	(180)
Rates	5	(10)	(97)
Utilities	6	(8)	(78)
Depreciation		(70)	(630)
Sundry costs	6	(10)	(90)
Total overheads		<u>(193)</u>	<u>(1,750)</u>
Net profit before interest	7	<u>47</u>	<u>350</u>

#### Notes

1. The Directors expect sales to continue at the same weekly level as for the 4 weeks to 30 September 2018 for the foreseeable future. The Company's customers pay extremely promptly with 25% of the week's invoicing paid in that week and the remainder the following week.
2. The material cost for September was unusually low and management believe that the cumulative to date figure is a fairer representation of future costs. Whilst in the past the

Company obtained trade credit for material purchases, given the situation in the future it will have to pay these costs on a pro-forma basis. Each week the Company will have to purchase 80% of that week's requirements and existing stock can be used for the remaining 20%.

3. Direct labour is paid weekly and administrative staff are paid on the 26<sup>th</sup> for the entire month. Payroll deductions including tax, national insurance and pension deductions typically account for one third of the total cost.
4. Rent is due on the normal quarter dates.
5. The Company pays its non- domestic rates bill by direct debit on the 15<sup>th</sup> of the month.
6. Other costs are paid weekly.
7. Without prejudice to the terms of their facilities, the bank and hire purchase company have agreed that they will not seek payment of interest or any capital payments until the Company has entered into an insolvency process.

### Balance sheet

Management has prepared an estimate of the balance sheet as at 12 November 2018 as follows:

<b>Assets</b>	<i>Notes</i>	£'000
Plant and Equipment	1,2	4,500
Cash at bank	3	65
Debtors	4	250
Stock	5	500
<b>Total assets</b>		<b>5,315</b>
<b>Liabilities</b>		
Trade creditors	2	(2,000)
Taxes		(3,500)
Hire purchase	1	(750)
Bank loan	6	(250)
<b>Total liabilities</b>		<b>(6,500)</b>

Notes:

1. The plant and equipment was subject to a valuation in September 2018 as follows:

	<b>Book value</b>	<b>In situ</b>	<b>Ex situ</b>
	<b>£'000</b>	<b>£'000</b>	<b>£'000</b>
Encumbered	1,500	1,200	750
Unencumbered	3,000	1,500	750
<b>Total</b>	<b>4,500</b>	<b>2,700</b>	<b>1,500</b>

The ex-situ valuations are based upon the special assumption as to the period of time the agent would have to market the assets for sale and is stated after the deduction of related holding costs. The encumbered assets are subject to a hire purchase agreement.

2. The Company has been experiencing significant creditor pressure and recently its landlord commenced enforcement action. On 17 October 2018 the Company entered into a Controlled Goods Agreement securing unpaid rent of £60,000 against its grinding machine. Since that date the Company has made two payments of £10,000 to the landlord in relation to this debt.

3. On 4 October 2018 a payment of £125,000 was made to one of the Directors and the reason for this is not clear. Other than this payment, all other recent payments have been in the normal course of business.
4. Management estimates that if there is continuity of supply 90% of the debts will be collectable. If the Company ceases trading, they anticipate that 25% of customers will refuse to pay.
5. The stock could be sold quickly, and it is estimated that it would realise, after costs, 60% of its value. None of the stock is subject to reservation of title claims.
6. The bank provides an unsecured loan. There are no charges registered against the Company.

### **Prospects for the business**

Due to cash flow issues, in August 2018 management instructed a firm of accountants to market the business for sale. Following a thorough marketing process several offers were received from unconnected parties.

The best offer is from Penrose Components Limited, who have been made aware of the situation and have confirmed that their offer still stands. It is however conditional on it being completed as a sale as a going concern by an Administrator. If the Company enters liquidation their offer is to be considered withdrawn. The offer, assuming completion on 27 November 2018, is as follows:

- Unencumbered plant and machinery - £1,100,000
- Encumbered plant and machinery - £100,000 for the equity in the machines
- Stock - £350,000
- Debtors - excluded
- Employees - transferred over together with their preferential claims of £75,000 and non-preferential claims of £450,000.

Of the total consideration £500,000 would be paid on completion and the remainder over 6 months.

### **Advice**

The Directors are keen to avoid a closure of the business and the associated job losses. Therefore, they wish to pursue a sale of the business as a going concern and are seeking your assistance to place the Company into Administration.

### **Requirements**

- (a) **List the key areas of information that a Court would require for it to consider granting a Validation Order. (4 marks)**
- (b) **Prepare a weekly cash flow forecast for the two-week period commencing 13 November 2018, together with notes, in a format that could be included with an application for a Validation Order. (12 marks)**
- (c) **Assuming that a Validation Order, covering transactions undertaken in the normal course of business, is approved, and clearly stating all other assumptions, prepare an estimated outcome statement comparing Administration to Compulsory Liquidation as at the date of the hearing. (20 marks)**
- (d) **In these circumstances set out the options as to how an Administrator may be appointed. (4 marks)**

**(Total: 40 marks)**

**Assumptions:**

**VAT at 20%**