

JOINT INSOLVENCY EXAMINATION BOARD

*Joint
Insolvency
Examination
Board*

Joint Insolvency Examination (Scotland)

Monday 3 November 2014

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 2014. 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.

1. On 15 October 2014, you were appointed Liquidator of Goingbroke Plc (“the Company”) pursuant to Schedule B1, paragraph 83.

Previously, the Company entered into Administration on 2 May 2014, when an Authorised Insolvency Practitioner based in another firm was appointed Administrator pursuant to Schedule B1, paragraph 22. The Company’s undertaking and assets were sold by the Administrator on 6 May 2014. The Administrator paid the preferential creditors and the floating charge creditor in full. The floating charge was created on 22 July 2003.

On 15 October 2014, assets comprising cash at bank of £1.5 million and an uncollected debt of £2 million were transferred from the Administration to the Liquidation. The cash at bank is in a deposit account that earns gross interest of approximately £1,000 per month. The Administrator also advised you that unsecured creditors of £10 million had been admitted by him for voting purposes in accordance with Rule 2.26C. There was no Creditors’ Committee in the Administration, but there is a Liquidation Committee

You wish to declare an interim dividend but you are aware of the following matters:

- i. In July 2014 the Credit Controller of Mandible Limited, a creditor for £800,000 (included in the total of those admitted for voting by the Administrator), wrote to the Administrator, expressing concern about the conduct of the Administration. The Administrator responded in August 2014 but the Credit Controller was still not satisfied with the conduct of the Administration and especially with the fees charged by the Administrator. The Administrator has not responded to the Credit Controller’s latest correspondence. You are aware of several other creditors that have similar concerns.
- ii. The Administrator has submitted to you a final invoice for £100,000 in respect his fees. This invoice, which has not been paid, is in addition to Administrator’s fees of £400,000 that have previously been invoiced and drawn during the Administration.
- iii. You have not yet drawn any remuneration. The Credit Controller of Mandible Limited has intimated that she is unhappy about yet more fees being incurred.
- iv. Sternum Plc provided health and safety advice to the Company and has just submitted an invoice for £200,000, of which £30,000 was incurred during the Administration.
- v. Humerus Limited owed the Company £40,000 at the date of Administration. On 12 May 2014 Humerus Limited purchased and was assigned certain book debts of Pelvis Limited (paying 20% of their book value). These debts included a debt of £150,000 incurred by the Company with Pelvis Limited in 2013. The debt to Pelvis Limited was included in the Company’s books at the date of Administration.
- vi. Ron Dopey, a director of the Company, was owed £175,000 at the date of Administration. This comprises £100,000 in respect of a loan account and £75,000 for the cost of stationery purchased for the Company. These amounts were not included in the total admitted for voting purposes by the Administrator.
- vii. The Administrator had considered that only about 10% of the uncollected debt of £2 million was likely to be realisable because the debtor claimed that the work done by the Company was not satisfactory. The Administrator had not made any effort to collect the debt.
- viii. In 2004 the Company issued one million 7% cumulative £1 preference shares. The dividend is payable each year in arrears on 30 June and 31 December. At the date of Liquidation, the dividend payable in June 2014 was outstanding. This liability was not included in the total admitted for voting purposes by the Administrator.

- ix. One holder of preference shares has written to you claiming that he is owed £200,000, comprising £190,000 lent to the Company in 2012 and £10,000 in respect of his preference dividend. Neither of these amounts was included in the total admitted for voting purposes by the Administrator.
- x. At the date of Liquidation, there were ten ordinary shareholders each holding 10,000 £1 shares with 40 pence paid. One ordinary shareholder was listed in the Company's creditors' ledger at the date of Administration, for £6,000 for services it provided to the Company.

Requirements

- (a) **Set out how you would address each outstanding matter in order to reach the position where the interim dividend can be declared. Where appropriate calculate the amount which should be accepted by you, as Liquidator, as a claim in the Liquidation or set out the further information you will require in order to calculate that amount. State your reasons and assumptions; (20 marks)**
- (b) **Prepare an estimated distribution statement, stating your further reasonable assumptions. (5 marks)**

(25 marks)

NOTE: Ignore VAT

2a. You are an Authorised Insolvency Practitioner. You have carried out a review of three cases to which you have been appointed and have noted the following:

- Fibula Plc (“Fibula”) entered into Administration, pursuant to Schedule B1 paragraph 22, on 29 November 2013. You were appointed Administrator. Immediately following your appointment, fourteen out of the fifteen employees were made redundant. One employee remains, having assisted in the disposal of the assets, all of which have now been realised. After paying the costs of the Administration there are surplus funds available for unsecured creditors. Fibula entered into Creditors’ Voluntary Liquidation on 31 October 2014, following the filing of Form 2.25B (Scot) at Companies House. You are in office as Liquidator.
- Metatarsals Limited (“Metatarsals”) entered into a Company Voluntary Arrangement on 22 June 2012 and you were appointed as Supervisor. The Proposal provided for Metatarsals to restructure, including making six of the fifteen employees redundant, and to continue to trade whilst employing the remaining nine employees. Under the Proposal Metatarsals agreed to make contributions from profits every three months until 2017. The Proposal further provided that, in the event of a missed contribution, the Supervisor should advise the Directors to take steps to place Metatarsals into Creditors’ Voluntary Liquidation. Metatarsals missed its September 2014 contribution following a decline in turnover and went into Creditors’ Voluntary Liquidation on 30 October 2014. You are the Liquidator.
- A Receiver was appointed over the assets and undertaking of Phalages Limited (“Phalages”) on 13 June 2014. At that date twelve out of fifteen employees were made redundant with three employees remaining to assist the Receiver. The Court wound up Phalages on 24 September 2014, following a petition presented on 18 July 2014. You were appointed Liquidator on 30 October 2014.

Requirements

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

2b You, an Authorised Insolvency Practitioner, have received a telephone call from George, a manager at Village Bank Plc (“the Bank”). George is concerned that Scaphoid Limited (“the Company”), a customer of the Bank, may be placed into Liquidation, perhaps without the Bank’s knowledge. George wants to meet you to discuss the Bank’s options and has emailed to you the following information:

- The Company operates a construction business. It has one main contract, carrying out work for Pisiform Plc. Pisiform Limited went into Creditors’ Voluntary Liquidation on 2 October 2014. It is unlikely there will be a dividend for unsecured creditors.
- The Company has granted a standard security over its heritable property and a floating charge to the Bank over all of its assets and undertaking.
- The Company’s balance sheet at 30 September 2014 was:

	£’000		£’000
Assets		Liabilities	
Goodwill	20	Trade creditors	1,000
Land	300	Village Bank Plc loan	285
Stocks and work in progress	400	Capital and reserves	
Trade debtors	500	Share capital	5
Cash at Village Bank Plc	10	Profit and loss account	(60)
	<u>1,230</u>		<u>1,230</u>

The land comprises three development plots purchased in 2012. All stocks are held on-site and consist of consumables. All the work in progress is uncertified. Of the trade debtors, £450,000 is due from Pisiform Limited and £50,000 is due from another client under a completed contract.

Requirements

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

(25 marks)

3. You are a Senior Manager in a large practice of Authorised Insolvency Practitioners and have had a meeting with wife and husband, Cleo and Anthony, who are concerned about the group of companies (“the Group”) of which they are variously shareholders and/or directors as follows:

Company	Country in which registered	Directors	Shareholders
The Holding Company	Luxembourg	- Anthony - Cleo	Anthony (50%) Cleo (50%)
The Scottish Company	Scotland	- Anthony - The Holding Company (represented by Cleo)	The Holding Company (100%)
The Jersey Company	Jersey	- Anthony - Cleo	The Holding Company (100%)

Anthony has given you the following information about the Group’s structure and procedures:

- The Holding Company’s only assets are the shares in the Jersey Company and the Scottish Company. It does not trade.
- The Scottish Company distributes industrial maintenance and repair products. It has five autonomous branches: two in Scotland, two in France and one in Germany.
- Each branch maintains its own accounts ledgers in the local currency and each sends its monthly results to the Scottish Company’s main accounting office and registered office, which is located in Edinburgh in premises rented from a third party. On receipt of the information from the branches, staff prepare the accounts for the Scottish Company. Each of the five branch managers reports directly to Anthony.
- The Scottish and French operations each accounted for 45% of the Scottish Company’s turnover in the year to September 2014 with the German branch accounting for the remaining 10%.
- The Scottish Company has bank accounts in Scotland, France and Germany. The French and German branches retain enough funds for their trading and transfer any surplus to the accounting office in Edinburgh. The Scottish Company has not granted any standard securities or floating charges.
- The Jersey Company does not trade. Its only assets are the five branch premises from which the Scottish Company trades in Scottish, France and Germany. The Scottish Company pays rent to the Jersey Company.
- Most board meetings for the Scottish Company are held in Edinburgh but they are occasionally held in Paris. Anthony and Cleo have homes in Edinburgh and Paris.
- The registered offices of the Holding Company and the Jersey Company are based at their lawyers’ offices in Luxembourg and Jersey respectively.
- The Scottish Company’s auditors are located in Edinburgh.

The Scottish Company is in financial difficulties, but Anthony believes that the Scottish Company has a strong brand name throughout Europe. If the Scottish Company has to be sold, Anthony believes that the maximum value would be achieved by selling it as a single entity.

Anthony explained to you the reasons for the financial difficulties and the present position, as follows:

- A customer that accounted for over half of the Scottish Company's turnover in Scotland went into insolvent Liquidation in August 2014 and there is no prospect of a dividend. In France three customers entered into insolvency procedures during the year to September 2014 and dividend prospects are small.
- The Scottish Company has total assets of £40 million: about 10% are located at the German branch with the remainder being divided equally between the Scottish and French branches.
- The Scottish Company has liabilities of £88 million, of which £30 million are inter-company debts. The inter-company debts comprise rent arrears of £4 million due to the Jersey Company and £26 million due to the Holding Company in respect of loan capital and interest. Anthony told you that in 2012 the Holding Company had raised funds from various financial institutions and lent these funds on to the Scottish Company. Included in the £58 million due to other creditors is an amount of £3 million due to a Scottish bank under a loan taken out in 2012. The loan is repayable in 2017.
- An analysis of the locations of the Scottish Company's creditors (excluding the inter-company debts) shows the following:

Location of creditors	Scottish branches	French branches	German branch
Scotland	40%	20%	20%
France	20%	45%	10%
Germany	25%	25%	60%
USA	15%	10%	10%
	<u>100%</u>	<u>100%</u>	<u>100%</u>

- Creditor pressure at all five branches is intense.
- In Scotland, HMRC are pressing for payment of £250,000 and have been granted an attachment order in respect of the plant, equipment and stocks at one of the Scottish branches.
- In France, a major French creditor is pressing for a French insolvency expert to take control of both French branches and a major German supplier has written to reclaim goods for which payment has not been received.
- In Germany, the employees' monthly wages for October 2014 were not paid and they have refused to carry out any further work. The German accounts staff have refused to send any further accounting information to the accounts department in Edinburgh until they have been paid.

As a result of the problems in the Scottish Company, the Holding Company and the Jersey Company are themselves in financial difficulties. Anthony has asked whether it is possible for any necessary insolvencies of these companies to be dealt with in Scotland.

Requirements

- (a) Set out the main legislative and other sources that you would consult when considering cross border insolvency; (4 marks)
- (b) Taking into account the specific circumstances of the Scottish Company, and making and stating any reasonable assumptions, set out, with reasons, where you consider the location of the Scottish Company's Centre of Main Interest to be; (5 marks)
- (c) Making and stating any reasonable assumptions, write a file note setting out, with reasons, the issues that may be encountered if the Scottish Company were to be placed into Creditors' Voluntary Liquidation in Scotland and explaining how these issues may be resolved; (10 marks)
- (d) Write a file note setting out, with reasons, how the Holding Company and the Jersey Company may each be wound up in Scotland. A detailed explanation of the procedures is not required. (6 marks)

(25 marks)

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4. Scary Hair Limited (“the Company”) was incorporated in 2007. Its sole Shareholder and Director throughout has been Clare Scary (“Clare”).

Shortly after its incorporation the Company purchased an established hairdressing business. The acquisition was financed by a £20,000 loan from Clare and a £30,000 loan from Town Bank Plc. Clare personally guaranteed Town Bank Plc’s loan.

The Company traded profitably until two years ago when one of the Company’s hairdressers together with its only beautician left to set up a rival business. Turnover declined and the Company stopped trading on 30 September 2014 when its overdraft limit was exceeded and the September wages were not paid.

Last week Clare asked your firm for assistance. Your firm is a partnership of Authorised Insolvency Practitioners and you are the Senior Manager.

The Company’s balance sheet at 30 September 2014 was:

	Notes	£	£
Fixed assets			
Leasehold improvements	i	15,000	
Fixtures, fittings and equipment	ii	10,000	
Motor vehicle	iii	5,000	
Current assets			
Stock	ii	3,000	
			33,000
Creditors – amounts due in less than one year			
Trade creditors	iv	(40,000)	
Dodgy Motor Finance Plc	iii	(6,000)	
Arrears of gross wages	v	(7,000)	
HMRC - VAT	vi	(18,000)	
HMRC - PAYE/NI	vii	(10,000)	
Director’s loan		(20,000)	
Town Bank Plc overdraft	viii	(12,000)	(113,000)
Creditors – amounts due in more than one year			
Town Bank Plc loan	viii		(30,000)
			<u>(110,000)</u>
Share capital and reserves			
£1 ordinary shares			2
Profit and loss account			(110,002)
			<u><u>(110,000)</u></u>

Notes:

- i There is no realisable value in the leasehold improvements. The leasehold premises are in good order and the landlord’s solicitors hold a rent bond of £30,000.
- ii The fixtures, fittings and equipment and the stock are unlikely to realise more than 10% of their book value. 50% of the book value of the stock comprises products supplied by Bubbly Shampoo Suppliers Limited (“Bubbly”).
- iii The motor vehicle is used by Clare. It was purchased using hire purchase funding from Dodgy Motor Finance Plc and is unlikely to realise more than 20% of its book value.

iv Trade creditors comprises:

	£
Quarterly rent due 29 September 2014	15,000
Bubbly	4,000
Mrs Robinson	3,000
85 other creditors	<u>18,000</u>
	<u>40,000</u>

Bubbly has supplied the Company with hairdressing products since 2007. Clare has explained that she used to email the Company's order to Bubbly and Bubbly sent a confirmation email to Clare stating when the order would be delivered. Bubbly's terms and conditions were included as an attachment to its email. You have ascertained that Bubbly's terms and conditions are also printed on the back of its invoices and its retention of title clause is highlighted in bold. Bubbly's Sales Director has written to Clare demanding return of all the stock of Bubbly products.

Bubbly's Sales Director is also concerned that Clare has a lavish lifestyle despite the declining fortunes of the Company. He has indicated that he proposes to instruct solicitors to petition for the winding up of the Company.

Mrs Robinson was a regular customer but during her last visit to the salon in April 2014, Clare inadvertently applied purple dye to her hair. Despite Clare's best efforts to remedy the situation, Mrs Robinson's hair colour remained purple for several weeks. Clare considered that Mrs Robinson would accept £3,000 compensation. However, since the preparation of the balance sheet the Company has received a letter from Mrs Robinson's solicitor stating that Mrs Robinson's hair is falling out and she is now claiming £50,000. Clare believes that the amount now claimed is excessive. All the Company's liability insurances expired on 31 March 2014 and were not renewed. You are aware that Mrs Robinson's solicitor usually advises clients with debt recovery problems to take the advice of ABC Insolvency Practitioners, another firm of Authorised Insolvency Practitioners.

v The arrears of gross wages comprises:

	£
Clare	2,500
Hairdresser A	1,500
Hairdresser B	1,500
Hairdresser C (part time)	1,000
Receptionist (part time)	<u>500</u>
	<u>7,000</u>

The employees had all worked for the Company since 2007 and are all aged between 30 and 40 years.

- vi The amount owed to HMRC in respect of VAT follows an investigation by HMRC into the underpayment of VAT. The amount claimed includes penalties and interest.
- vii The amount due to HMRC in respect of PAYE and National Insurance does not include that owed for the September payroll.
- viii The Company has not granted any charges to Town Bank Plc.

Clare is concerned that she has no income and wants to re-establish a hairdressing company called Scary Hair as soon as possible. A friend has told her that she can pay a Liquidator a nominal sum for the Company's stock, fixtures and fittings and she will soon be back in business.

Requirements

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

(25 marks)

