JOINT INSOLVENCY EXAMINATION BOARD

Joint
Insolvency
Examination
Board

Joint Insolvency Examination (Scotland) 2020

10 November 2020

CORPORATE INSOLVENCY (3.5 hours)

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 Test** 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 2020. 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 (Scotland) Rules 1986.

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

Question 1

Due to a fellow case manager leaving your firm you, an insolvency manager, have taken on day to day responsibility for the case of Breton Products Limited ("the Company"), a company placed into creditors' voluntary liquidation on 12 March 2020. The handover notes provided by the previous manager have outlined two outstanding issues.

1.Review of bank statements and accounts

During a review of the Company's bank statements a number of payments to the Company's sole shareholder were identified in the lead up to the date of liquidation, as follows:

Date	Narrative	Amount
28 February 2019	Dividends	£10,000
31 March 2019	Dividends	£15,000
30 June 2019	Dividends	£30,000
30 September 2019	Dividends	£ 5,000
31 January 2020	Dividends	£10,000

The Company's balance sheets showed the following positions:

Year ended	Assets	Liabilities
28 February 2019	£150,000	£100,000
29 February 2020	£190,000	£260,000

The Company's accounting records suggest that profits and losses accrued evenly throughout the year.

The handover notes reveal that nothing has been done with the information gleaned from the review.

2. Unpaid fee note

A fee note for a partner in your firm acting as liquidator, amounting to £10,000 plus VAT, has been raised by your firm but is awaiting approval prior to being paid out of the liquidation estate.

You have reviewed the fee resolution and identified that a vote for one creditor, upon which the passing of the resolution depended, was based on the statement of affairs balance for that creditor. The creditor had not provided a proof of debt prior to the decision date and when their claim was received several weeks later the balance claimed was substantially less than the balance shown in the statement of affairs. If the amount subsequently claimed had been used for voting purposes rather than the statement of affairs balance the fee resolution would not have been passed.

An amount of £15,000 has already been paid in relation to liquidator's fees.

Requirements

Explain the steps that you would take to deal with:

(a) the information gleaned from the review of the bank statements and accounts. (10 marks)

(b) the situation as regards liquidator's fees. (10 marks)

Total: 20 marks

Question 2

You, an Authorised Insolvency Practitioner, have been contacted by Cleveland Bank Plc ("the Bank") in relation to one of its customers; Altai Retail Limited ("the Company"). The Bank has been concerned for some time as to the trading position of the Company and has suggested that the Company's directors ('the Directors") take professional advice from you.

The Company operates a number of high-quality clothing stores located in relatively close proximity to each other. Over the last few years the Company has expanded quickly and this has placed considerable pressure on the management team and the Company's infrastructure, in particular on its distribution centre.

You have met the Directors and they are keen to explore the possibility of using a CVA to help implement a turnaround strategy for the business.

The Directors have identified a number of key areas of restructuring that would improve the trading position and ensure that the Company has a viable future:

- The distribution centre is critical to the business but due to the recent store expansion programme has not had sufficient capacity to fulfil orders and deliver goods to the stores on time. As a consequence the Directors estimate that, if there was sufficient stock in store, sales would be 10% higher than historic levels. Having reviewed the options the Directors have established that in the short to medium term the only solution to this issue is to reduce the number of stores from 7 to 5.

- The reduction in number of stores would save £25,000 p.a. of agency staff costs within the distribution centre.
- Head office costs are too high and the Directors have identified cost savings of £50,000 p.a. in relation to general costs and £40,000 p.a. from the redundancy of 1 member of staff.

- A property expert engaged by the Company has established that the rent for a number of the properties is above market rates (see below). The Company therefore intends to propose as part of the CVA that rent is adjusted down to market value.

- The buying department has reviewed its contracts and discussed with its key suppliers the prices it pays for stock. It has established that it cannot improve on its gross margin, that amounts to on average 60%, but has agreed with its suppliers annual rebates totalling £50,000 payable to the Company monthly and commencing shortly.

- Due to the high-end nature of its products the Company has to continually invest in property improvements. The Directors estimate that a provision of £5,000 p.a. per store and a general provision of £10,000 p.a. to cover both the distribution centre and head office would be appropriate.

The Directors have provided the following summary of the Company's financial performance:

Store Number	Turnover (p.a.)	Rent (p.a.)	Market rent (p.a.)	Current profit contribution (p.a.)
1	£500,000	£125,000	£125,000	£75,000
2	£450,000	£85,000	£65,000	£40,000
3	£750,000	£175,000	£125,000	£(15,000)
4	£600,000	£140,000	£150,000	£50,000
5	£400,000	£95,000	£75,000	£30,000
6	£400,000	£100,000	£90,000	£100,000
7	£250,000	£60,000	£50,000	£20,000
Total	£3,350,000	£780,000	£680,000	£300,000
Distribution centre		£100,000	£100,000	£(175,000)
Head office costs		£50,000	£50,000	£(300,000)
Total net (loss)				£(175,000)

The Directors have explored the possibility of third-party investment into the Company and have received an offer to provide, subject to the approval of a CVA, sufficient working capital for the Company. This will allow 75% of the available cash from operations for the next 3 years to be made available for creditors.

Requirements

(a) Assuming that the Directors' proposal and turnaround plan is implemented, estimate the amount that would be available for creditors of the CVA. Clearly state any assumptions made. (7 marks)

(b) Summarise the key information that may be required by landlord creditors as set out in the British Property Federation CVA guidance. (7 marks)

(c) In relation to closed sites, summarise the key elements of each landlord's claim within the CVA and what information you would require to establish its validity. (6 marks)

Total: 20 marks

Question 3

You have been approached by Mr Oldenburg, a high net worth individual, in relation to one of his personal investments; Campeiro Limited ("Campeiro").

During 2016 Mr Oldenburg invested £3 million in Campeiro to provide it with sufficient funding to acquire a freehold property ("the Property") and the entire share capital of Garrano Limited ("Garrano" and "the Shares"). The majority of this investment (£2.5 million) was in the form of debt, secured by a standard security over the Property and a share pledge over the shares in Garrano. In addition, Mr Oldenburg obtained a guarantee and a Floating Charge from Garrano in relation to this debt. The remaining £500,000 investment was provided in return for a 20% share of the equity of Campeiro.

Campeiro's balance sheet comprises the Property, the investment in the Shares and Mr Oldenburg's loan. There are no further liabilities within Campeiro other than those relating to the employment of its board of directors ("the Directors").

Campeiro's income comprises the rent from the Property, management charges levied to Garrano and dividends from Garrano. Campeiro's expenditure is limited to the payment of the Directors' salaries and repayment of Mr Oldenburg's loan.

Garrano is profitable and has a relatively healthy balance sheet with net assets of £1.5m, including trade debtors of £2 million. It operates in a highly specialised and regulated sector servicing customers under supply agreements. These contracts include strict service level obligations due to the criticality of its services and the potential high financial impact on customers of any supply problems.

Mr Oldenburg is highly critical of the Directors, who have little involvement in Garrano and draw high salaries. As a result of these costs, Campeiro has been unable to make loan repayments to Mr Oldenburg for the last 4 months. In order to resolve the situation Mr Oldenburg has held several meetings with the Directors who refuse to reduce their salaries or leave the employment of Campeiro without payment of their significant contractual termination payments. Mr Oldenburg has reached the conclusion that a consensual agreement cannot be reached and that the Directors, who also own the remaining 80% of share capital in Campeiro, will not co-operate with any process. The Directors have stated that are not willing to buy Mr Oldenburg's shares or debt.

Mr Oldenburg has therefore approached you for advice as to how to deal with the situation. He does not wish to have any future involvement with Campeiro and his objective is to recover as much of his investment as possible.

Requirements

Prepare a briefing note for Mr Oldenburg. Briefly summarise the insolvency options available to him in these circumstances. Set out the key relative advantages or disadvantages of each option and provide a reasoned recommendation as to what action he should take.

Total: 20 marks

Question 4

You, an authorised insolvency practitioner, have recently met the directors ("the Directors") of Appaloosa Technology plc ("the Company"), a company quoted on the Alternative Investment Market.

The Company operates within the technology sector having developed a product that monitors the driving efficiency of haulage fleets. Whilst initially the product was ground-breaking and generated high profits, its competitors introduced competing products and subsequent generations of the Company's product have been viewed by customers as inferior. Whilst the Company has continued to operate profitably, it has continued to invest heavily in product development and build stock levels, leading to a highly negative cash flow position.

As a result, the Company has built up significant HMRC and supplier liabilities and in September 2020 the Directors identified that, based on current levels of cash outflows, it would exhaust its working capital facilities within 6 months. Following discussions between the Directors, key shareholders and the Company's advisors it became clear that further equity investment via a rights issue or share placement would not raise sufficient capital to secure the Company's long-term future. As a result, the Directors instructed a corporate finance boutique to explore the possibility of a sale of the business and assets.

Only 2 weeks into this process, due to covenant breaches, the Company's debt funder withdrew its facilities creating an urgent cash flow issue. As a consequence, the Directors sought advice from you and you have indicated that the appointment of an administrator may be appropriate in these circumstances. The Company has engaged you to consider an appropriate strategy and to liaise with relevant stakeholders.

Limited marketing of the business has already been undertaken. One party, Esperia Investments Limited ("Esperia"), has expressed a significant level of interest and has formulated an offer, subject to contract and further due diligence. You have spoken to Esperia and explained the situation, and they are keen to progress with a purchase and are willing to buy the business and assets from an administrator. They would ideally like 5 weeks to conduct further due diligence and satisfy themselves in relation to certain critical aspects of the business but could undertake a pre-packaged sale within 1 week at a risk-adjusted price. An extract from Esperia's offer letter is set out below:

Esperia Investments Limited's offer for the business and assets of Appaloosa Technology plc
Esperia 2020 Limited, a dormant and newly formed subsidiary of Esperia Investments Limited, is willing, subject to contract, to acquire the following assets of Appaloosa Technology plc.

	Pre-pack sale	**Sale in 5 weeks**
	£'000	**£'000**
Intellectual property	750	1,500
Fixed Assets	250	450
Debtors	Excluded	Excluded
Stock	60p in £	90p in £

The employees of Appaloosa Technology plc will all be transferred under TUPE to Esperia 2020 Limited.

On completion Esperia 2020 Limited will pay 50% of the agreed consideration with the remainder being paid 3 months later.

Your agents have indicated that the values within the offer for the tangible assets are consistent with their restricted marketing and in-situ valuations respectively and that stock could be sold separately for 50% of its normal sales value.

Your assessment of the book debts is that they would be fully collected if there was continuity of supply but that if the business had to close, any outstanding debts would realise only 75p in the £.

It is expected that it will take 1 week for the Company to be placed into administration and you will therefore be appointed on 1 December 2020.

You have held discussions with the Directors about the draft accounts drawn up for the Company's last comparable 4-week trading period and what is likely to happen going forward. Your notes of these discussions include the following:

	Historic 4-week period £'000	**Notes**
Sales	6,000	The Directors expect sales to decline by 20% due to the uncertainty created by the administration. In addition, a lack of product warranty would reduce prices by 10%. Sales accrue evenly over the 4-week period. The debtor book at the start of the 4-week period will be £10,800,000 and customers receive at least 4 week's credit. The debtor balance is expected to be received; week 1: 15%, week 2: 10%, week 3: 15% and week 4: 35%, week 5:15%, week 6: 10%.
Cost of sales (stock)	(2,500)	Current stock levels are £10 million. The only purchase required is for £1.8m relating to a shipment of goods from China that is due to arrive in port on 4 December 2020. There is no duty payable on these items but VAT must be paid at the point of import.
Gross profit	3,500	
Overhead costs		
Directors' remuneration	(100)	Includes non-executive directors; could be reduced by 50% without any adverse impact. Net pay was £60,000.
Wages and salaries	(2,000)	Staff would have to be retained in order to preserve value. Net pay was £1.5 million. Normal payroll date for December would be 23rd.
Rent	(450)	Rent is paid quarterly in advance on normal quarter days and is paid up to date. The amount is the equivalent of £15,000 per day.
Rates	(200)	Annual rates liability is £2.6m and paid over 10 months; £200,000 is the amount accrued for the 4-week period.
Heat, light and power	(150)	Payable by direct debit on 15th of each month. Subject to VAT at 5%.
Other costs	(100)	Expected to be paid in the week to which they relate. Subject to VAT.
Depreciation	(400)	Relates to equipment and capitalised costs associated with development.
Net profit	100	

The Company's funder has stated that they would be willing to fund an administration trading period provided it is likely to result in a better outcome.

Requirements

(a) Set out the weekly cash flow of the Company assuming that it trades in administration for a 4-week period. Include an extra column for receipts and payments that would be received or paid after that period. (13 marks)

(b) Compare the total realisations in the administration under (i) a pre-packaged sale, (ii) a sale following 4 weeks of trading and (iii) trading followed by closure.
(7 marks)

(c) Outline the approach which you would take in relation to identifying other potential interested parties. (8 marks)

(d) In the event that a sale to Esperia were to proceed, summarise what protection could be put in place in relation to the deferred consideration and what would you do to satisfy yourself that the risk of selling the assets on such terms would be acceptable. (6 marks)

(e) Explain generally how the value of intellectual property could be determined in insolvency situations. (6 marks)

Total: 40 marks

State clearly any assumptions that you make
Unless otherwise stated, assume VAT at 20%