

Joint Insolvency Examination Board

12 NOVEMBER 2024

3.5 HOURS

CORPORATE INSOLVENCY

Scotland

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 |

References to legislation are to that which was in force on 30 April 2024. 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 2018.

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

Important information

Please read this information carefully before you begin your exam.

Starting the exam

Click on the **right arrow** in the header to begin the exam. The exam timer will begin to count down.

Preparing your answers

Answer all questions.

Respond directly to the exam question requirements. Do not include any content of a personal nature, such as your name.

Only your answer in the word processing area will be marked. You must copy over any data for marking from the spreadsheet area to the word processing area.

Issues during the exam

If you encounter any issues during the exam you should tell the invigilator as they may be able to resolve the issue at the time. The invigilator cannot advise you on how to use the software.

Ending the exam

When the exam timer reaches zero, the exam will end. To end the exam earlier, go to the last question and click the right-hand arrow button, then click the **Submit** button to close the exam.

Question 1

You are an Authorised Insolvency Practitioner. You have been approached by an unsecured creditor of a company that was placed into Creditors' Voluntary Liquidation in June 2024. The Liquidator in office ("the Current Liquidator") is a partner in a local accountancy firm called PIN Accountancy LLP.

The creditor has some concerns over the conduct of the case. These concerns have been discussed with several other creditors and an informal group ("the Group") has been set up. The Group feels that the Current Liquidator is not investigating various matters that have been raised by the Group. The Group is prepared to fund a Liquidator to investigate to see if there are any recoveries that could be made for the benefit of creditors. The Group has sought from the Current Liquidator an indication of the costs that he would incur to carry out the investigations that the Group considers are necessary, but he has ignored this request. The Group represents approximately 80% by value of the company's creditors and together have claims of approximately £1 million.

Following an initial meeting, the Group has written to you to set out their concerns. They have raised issues and posed questions under five headings, as follows:

- (a) Is it possible to remove and replace a Liquidator? If yes, what is the procedure for us to follow? If possible, we would like to remove the Current Liquidator and replace him with someone from your firm.
- (b) We understand that the company in liquidation was an audit client of PIN Accountancy LLP. Is this acceptable?
- (c) Initially the creditors did not consider that a creditors' committee was required. Now that we have co-ordinated a group of seven creditors, which makes up most of the unsecured creditors in terms of value, we would consider forming a committee. Given that the Current Liquidator was appointed some months ago, have we lost the opportunity to form a committee? If we can form a committee, we would like to understand its functions and responsibilities and be given an overview of how one would now be formed.
- (d) We have concerns about the conduct of the Directors. We have advised the Current Liquidator of our concerns but not heard anything back. Does a Liquidator have a duty to issue some kind of report to an official body that may see them get struck off?
- (e) According to the statement of affairs and other information provided to creditors, there are no assets available. The information provided in relation to the company contains:
 - an overview of the financial statements at 30 September 2023 which detail a net asset position of c£300,000;
 - a summary of the statement of affairs showing a total estimated deficiency of c£300,000 to creditors; and
 - a deficiency statement showing an unexplained "trading loss" in the period from 1 October 2023 to the date of liquidation of c£550,000 and assets written down by £50,000.

On closer inspection of the company's accounts filed at Companies House there is a note detailing a debt due from a related company of £500,000. Our initial investigations into the related company show that it owns an unencumbered property of significant value. Its accounts also disclose the liability to the company in liquidation.

What are your thoughts on this and how you would investigate and potentially attack this transaction?

Requirement

Write a letter replying to the Group. Address separately each of the five headings (a) to (e), answering all of the questions raised and giving such further information and explanations that you consider necessary. Clearly set out any assumptions that you make.

Marks will be allocated as follows:

- (a) (5 marks)**
- (b) (3 marks)**
- (c) (4 marks)**
- (d) (4 marks)**
- (e) (4 marks)**

Total: 20 marks

Question 2

You are an Authorised Insolvency Practitioner. You have been approached by PGT Solicitors LLP (“the Solicitors”) who are acting for a client, Spaghetizza Limited (“the Company”) which operates a chain of restaurants.

The Company is in financial difficulties and has instructed the Solicitors to advise on the option of a Part 26A Restructuring Plan (“RP”). The Solicitors have engaged your firm to assist.

The main reason for the Company’s financial difficulties lies in its having operated a number of loss making sites. Recognising this, the decision was made to close 50 sites on 31 October 2024, with 700 staff being made redundant. All closure costs, including redundancy, were met from cashflow.

On 28 November 2024 the quarterly rent under the leases on all of the Company’s 150 sites will become due. To preserve cash, the Board has decided that the Company will make payments to the landlords of the 100 open sites but not to the landlords of the 50 recently closed sites.

Following a discrete marketing campaign, there are several interested parties that have expressed an interest in buying the business and assets out of an Administration.

Spaginvest Limited

The Company’s key stakeholder is Spaginvest Limited (“Spaginvest”), which owns 80% of the share capital and also holds a Secured Loan Note (“SLN”) of £10,000,000. The SLN, which attracts interest of 10% per annum (paid on a quarterly basis), was due for repayment on 31 October 2024 but the Company was not in a position to repay. Interest is paid up to date but will not be paid for the next 3 months.

The SLN is secured by a post Enterprise Act Bond and Floating Charge over the Company’s assets. Spaginvest is reserving its position on appointing Administrators. It considers that if an RP can be achieved, this will be less disruptive than a formal insolvency and its position, as major creditor and shareholder, will improve in the medium to long term future. As a result, it is prepared to provide additional funding to support the RP. If the RP does not go ahead, Spaginvest would want to buy the business and assets from an Administrator and considers it would be in a good position to do so as it is the sole secured creditor with the biggest financial interest and would therefore be in control of the process.

Financial information

The Company is unable to pay its debts as and when they fall due and is balance sheet insolvent.

The Company has not paid the June 2024 VAT return. A Time to Pay Arrangement (“TTP”) was agreed but has recently been breached leaving £250,000 due under the TTP. The VAT return to 30 September 2024 has been submitted showing a liability of £1,000,000 and has not been paid in line with the terms of the TTP. PAYE and NIC of £1,000,000 is owed to HMRC in relation to the October 2024 payroll.

The Company is within trading terms with its trade suppliers and owes approximately £7,500,000 to them, including £5,000,000 to two key suppliers. However, the Company is coming under pressure from many local authorities for outstanding business rates on the 50 closed sites with various Court hearings due in early 2025. It is estimated that the average annual rates liability on all sites is £10,000 per site.

Cashflow forecasts

The Company has produced cashflow forecasts that anticipate that no funding will be required in the estimated 3-month period required to explore the RP. The Company is expected to have cash available at the bank of £3,500,000 on 28 November 2024.

The average annual liability (encompassing rent and all other payments due to landlords) for the 100 open sites is £100,000 per site and for the 50 closed sites is £80,000 per site. The restructuring costs are estimated at £500,000 which is to be paid from the available cash at bank.

After restructuring costs and payments to landlords, cashflow from all other income and expenditure is expected to be neutral on the basis of pro-forma trading. The Directors have received advice from the Solicitors that the indebtedness to HMRC should remain at the current level during the consideration of the RP. The Directors are therefore intending to maintain HMRC indebtedness at the same level of liability from 30 November 2024 from cashflow.

Agent's Report

Your chosen specialist agent has provided you with their valuation advice on the matter as follows:

- The 50 closed sites would result in minimal, if any, net realisations in both a going concern and forced sale scenario. It is unlikely that the realisations made would be sufficient to meet the costs of collection and sale of the chattel assets at the closed sites.
- Of the 100 open sites, 50 are prime sites in city centre locations. For these sites it is estimated that each lease assignment would generate an average of £50,000 per site, if sold in a going concern type scenario. The other 50 open sites would attract an average of £10,000 per site in a going concern situation. None of the 100 open sites would realise anything in a forced sale scenario.
- Each open site typically holds unencumbered kitchen equipment and restaurant furniture which has an estimated value of £15,000 per site if sold as a going concern and £5,000 in a forced sale scenario.
- Each open site typically holds food and wet stock of £100,000 (at cost) which is supplied by the two key suppliers who are owed £5,000,000 between them and who, the Solicitors have advised, have strong retention of title terms and conditions.
- It is anticipated that the two key suppliers will actively claim and collect stock in an Administration scenario. Any other stock not subject to ROT would typically achieve 25p in the £ in a going concern sale and 5p in the £ in a forced sale scenario
- A value would be achievable for the intellectual property (brand and name) and the leasehold improvements at each site. It is estimated that £25,000 per open site would be realised but only in a going concern sale
- The estimated claim of landlords of each site for dilapidations, rent arrears and future rent is estimated at £100,000 per site.

Other matters

Spaginvest Limited has agreed, if the RP proceeds, to introduce £5,000,000 by way of new funds, as equity, to allow the Company to trade under its restructured format and to offer creditors a distribution. It is proposed that the liability owed in relation to the SLN will remain and that interest will continue to be paid post the implementation of the RP.

It is proposed that HMRC will be paid £3,000,000, in satisfaction of their total indebtedness, from the new funds and that the remainder of the new funds will be used for working capital purposes.

For commercial reasons, payments to trade creditors and landlords of the open sites are to continue within existing terms.

No payment will be offered to landlords of the closed sites. Payments will not be made to Local Authorities for any arrears of rates on any site, but ongoing payments will be made in relation to the open sites.

Requirements

- (a) In advance of an initial planning meeting, draft a statement showing the estimated outcome for each class of creditor under a relevant alternative. Clearly set out your workings and state any assumptions that you make. (14 marks)
- (b) Explain your rationale for choosing the relevant alternative used by you in your answer to Requirement (a). (2 marks)
- (c) Set out your initial thoughts on the prospects of the proposed restructuring plan being successfully implemented. (4 marks)

Total: 20 marks

Question 3

You are an Authorised Insolvency Practitioner. You were appointed as Liquidator of Investment Crazy Limited (“the Company”) on 5 September 2024, following the making of a winding up order. The Company appears to have ceased trading around the end of June 2024, following the presentation of the winding up petition.

The Company offered high risk unregulated investments to members of the public offering rates of interest significantly higher than those generally available. The Company claimed to own sophisticated software and an algorithm that, it said, was “in a prime position to exploit opportunities in worldwide stock markets to generate significant returns from the trading of under-performing global shares and investments”.

You have held a meeting with a former employee of the Company who was employed to maintain the books and records and they have provided you with the log-in details for the Company’s cloud-based accounting package. You have also obtained bank statements and other limited books and records. Following a review of the accounts package you are satisfied that the books and records are largely reliable.

You have had many calls and letters from concerned individuals (“Investors”) who have invested significant sums of money in what they thought were safe investments. They have lost money and are claiming that fraud has been committed.

Your case manager has performed extensive investigations and has prepared a report on the following five matters that have been identified to date:

- (a) In June 2024 a “management charge” of £5,000,000 was charged to the Company by Investment Crazy Two Limited (“IC2”). Investigations have shown that the intercompany account between the two companies is made up of several cash advances by the Company to IC2 over the previous four years amounting to £4,500,000 and the management charge. As a result a balance is shown as owing to IC2 of £500,000.

The 31 October 2023 accounts at Companies House for IC2 suggest that it does not appear to have traded. IC2 has no employees and an application to strike it off the register has been made to Companies House.

- (b) In the Company’s most recent financial statements, motor vehicles with a net book value of £150,000 are included. This relates to one vehicle (a Rolls Royce) which was sold in May 2024. There is an invoice in the Company’s records showing that it was sold for £25,000 to a related company. The books and records do not indicate that any payment was received for the vehicle.

Payment has been requested from the related company. They have advised that they are not paying as they are a creditor and have been for a long time. An online search has revealed that the car is for sale on a popular car sales website for £100,000.

- (c) There is a sundry debtor of £350,000 made up of 10 bank transfers to the Company’s sole Director in the 12 months to June 2024.
- (d) Following a detailed review of the transactions of the Company, it is clear that diverse shares and investments were not acquired as promised to Investors and as set out within the “Investor Prospectus”. You have identified that most of the cash that was received from Investors has been used to pay interest and returns to some of the Investors (at 8%) and to acquire four large “investments”.

A top-level summary of the cash movements suggests the following position:

| | £'000 |
|---|---------------|
| Cash received from Investors | <u>47,000</u> |
| Capital repaid to Investors | 10,000 |
| Monies paid to acquire four large investments (see below) | 19,100 |
| Monies paid to IC2 | 4,500 |
| Interest paid to Investors | 10,000 |
| Monies paid to the Director | 350 |
| Other cash movement, including wages and salaries | 2,300 |
| Solicitors' costs | 500 |
| Total cash out | <u>46,750</u> |
| Cash in the Company's bank account | <u>250</u> |

Interest was paid to Investors up until the advertisement of the winding up petition and the freezing of the Company's bank accounts.

The payments of £19.1 million were made to acquire the four large "investments" that have been identified. The monies have all been paid to related companies that have been dissolved, liquidated or have ceased trading. There appears to be no prospect of making a recovery from any of the four companies.

The "investments" are treated as debtors on the Company's balance sheet and are made up of the following debts due:

- AAAA Global Trading Facilities Limited - £3,900,000
- BBBB Sports Betting Limited (dissolved) - £1,200,000
- CCCC Share Trading Limited (in liquidation) - £5,000,000
- DDDD Property Investments Fund Limited - £9,000,000

The Company's Director is a director of all four companies. Members of his family also act as directors of the four companies.

- (e) The Company used one firm of solicitors to act on various matters. There are invoices paid by the Company (approximately £500,000) for their services in assisting with various matters including the four "investments".

Requirements

- (a) What are the obligations placed on a Liquidator to investigate the affairs of a company in liquidation?**

(6 marks)

- (b) For each of the five matters raised in the case manager's report identify, and if possible quantify, the recoveries that might be made for the benefit of creditors. In each case explain:**

- i. what further enquiries and investigations should be made;
- ii. what further information should be requested and from whom; and
- iii. what potential recovery actions could be taken by you.

(14 marks)

Total: 20 marks

Question 4

You are an Authorised Insolvency Practitioner. You were appointed as Administrator of LLBT Engineering Limited (“the Company”) on 9 October 2024. The Company was facing financial difficulties following the demise of its parent company, and major creditor, based in California. As a result, a winding up petition was issued by a supplier: this development concerned the Company’s bank and Qualifying Floating Chargeholder, Kingfisher Bank PLC, and they appointed you as Administrator to protect their position.

The Company operates as a highly specialist engineering business and typically works on short to medium term contracts lasting between three and six months. The Company is heavily reliant on one customer based in Edinburgh who over the years had accounted for approximately 85% of the Company’s overall business (“the Customer”).

Contracts with the Customer

Following your appointment, you quickly contacted the Customer to explain the position and to explore options. The Customer confirmed that they would not be willing to support any successor business created from a “pre-pack sale” to the current Directors or management. The Customer advised that, due to poor service levels and delays in completion of contracts, they had in any event been implementing contingency plans to move their business away from the Company in the short to medium term. They had already decided to cease the awarding of new contracts to the Company.

You also established that all the Company’s other customers had ceased to provide new orders to the Company and that work was only being carried out for the Customer.

You therefore quickly concluded that there was no real prospect of selling the business and assets of the Company as a going concern.

Following further discussions with the Customer, they explained that they would support you in allowing some contracts to be completed and some ongoing contracts to be novated to their new replacement supplier (“the New Supplier”).

Due to the lack of funding available to you, the Customer agreed to fund an element of trading by settling immediately the value of Work In Progress (“WIP”) on the contracts to be continued by you. The Customer also agreed to review all previously completed contracts within 4 weeks of your appointment and to pay all agreed debts due. Further, the Customer agreed to put forward a settlement proposal for all retention amounts outstanding, taking into account the fact that the Company would not be in a position to carry out any rectification works in the future.

You instructed a firm of Quantity Surveyors (“the QS”) to assist you in the case. The QS advised that if work was not completed or agreed to be novated, it would be unlikely that any value would be achieved from the contracts concerned. For such contracts the Customer would incur costs because of non-performance of the contract and would seek to claim against the Company for such costs and damages. It is likely that the claims relating to the ongoing contracts would exceed the current WIP values and erode the value of any debtors and retentions due for completed works.

The QS agreed with the Customer the following information regarding the live contracts:

| Contract number | Contract value - net of VAT (£) | % complete | Amount already billed and paid by the Customer – net of VAT (£) |
|-----------------|---------------------------------|------------|---|
| 1 | 500,000 | 25 | 75,000 |
| 2 | 1,000,000 | 80 | 650,000 |
| 3 | 200,000 | 75 | 100,000 |
| 4 | 750,000 | 10 | - |
| 5 | 100,000 | 70 | 20,000 |
| 6 | 400,000 | 15 | 10,000 |

Following negotiations with the Customer, the following terms were agreed:

- **Contracts less than half complete**
 - to be novated to the New Supplier;
 - 50% of the total work in progress value to be paid to you by the New Supplier; and
 - ongoing, the New Supplier to be paid by the Customer.
- **Contracts more than half complete**
 - all such contracts to be completed within a month;
 - all contracts that have not been novated are to be completed;
 - the Customer will immediately pay the agreed outstanding WIP;
 - the Customer will pay for the remainder of the work to be completed subject to the work being signed off as satisfactory by an independent QS;
 - the independent QS costs are to be paid for by the Customer but ultimately this cost is to be shared equally. The independent QS costs are estimated at £10,000 plus VAT; and
 - a 25% discount is to be applied to the work completed by you due to the loss of retention and to reflect the risk associated with settling the WIP early.

Strategy adopted

A decision was made to embark on the strategy to novate certain contracts and complete others. You considered that this strategy would allow you to achieve a better result for the Company's creditors as a whole than would be likely if the Company were wound up. As part of the strategy, the majority of the workforce was made redundant, but a small team was retained to complete the works and assist in the accounts and HR function. The Customer made payment for the WIP as promised to allow you to fund trading costs.

The present position

Late last week, you received an update from the QS. All contracts have now been completed and signed off by the Customer's independent QS with the exception of Contract 3. On Contract 3, there was some additional work requested by the Customer and a variation to the contract was agreed resulting in a further amount of £25,000 to be paid by the Customer (with no discount being applied to this element of the work). The Customer has sent you an invoice for your share of external QS costs for £5,000 plus VAT.

The Customer has made contact with you today and advised that they are satisfied with all the work that has been performed during the period of the Administration. They have asked you to provide a schedule of the amounts that you consider are due for payment for work performed in the Administration period. On receipt of this, they will review the schedule and, if it is agreed, will arrange a payment within 7 days.

Requirement

- (a) Prepare the schedule to be sent to the Customer. Clearly set out your workings and state any assumptions that you make. (4 marks)

Note: assume VAT at 20%.

Mindful of the need to prepare the Administrator's Proposals ("your Proposals"), you have requested updates from your appointed agents ("the Agents"). They have provided you with the following report:

Freehold property - Factory

The property has now been marketed extensively and several offers have been received supported by proof of funding. We recommend the offer from a reputable local property investor of £1,250,000 which is above our initial valuation and is the best offer. They have available funds, and they wish to move fast and are willing to pay a non-refundable 10% deposit on exchange of contracts with completion within 3 months.

Plant and machinery

We have achieved sales to date of £223,500 by informal tender. We have arranged for an on-site auction to take place in January 2025 for the remainder of the plant and machinery. The remaining items originally cost approximately £200,000 and we estimate that these will be realised at about 25p in the £.

Stock

We have now assisted your team with the return of all retention of title ("ROT") stock claims. The initial stock inventories that were provided by the Company's finance department indicated that there was stock, at cost, of £1,274,872. This schedule was reviewed and minor shortfalls were identified amounting to approximately 10% of cost.

Valid ROT claims of £634,932 have been identified by claimants. Some of this stock was used by the Administrators and paid for and the remainder has been collected by suppliers and credit notes requested.

Approximately 50% of the remaining stock had been bought for specific contracts that ended because of the Company ceasing to trade. The New Supplier has offered to acquire the stock at 50p in the £. We recommend this offer is accepted as it will achieve a better result than auction.

We propose to sell the remainder of the stock in auction, and we estimate that this will realise approximately 10p in the £.

Motor vehicles

The Company's fleet of vans and cars are all subject to hire purchase agreements with Patchwork Finance. There are 23 vans each with an average estimated realisable value of £10,000 and 15 fleet cars each with an average estimated realisable value of £15,000.

Patchwork Finance is owed £349,763 over various agreements and has a clause within their agreements which allows them to charge a termination fee of 7.5% of their indebtedness in the event of insolvency to defray their costs and damages. Patchwork Finance insisted that

their own agents collect and sell the vehicles and have advised that their likely agent's costs will be 5% of realisations.

Costs

We anticipate our total costs and disbursements for dealing with the floating charge assets including tender sale, auction and marketing will be £25,000.

Other updates

The case manager has advised that a full reconciliation of previously completed contracts has been carried out between the Company and the Customer and a settlement proposal has been made by the Customer for all debts due including retentions of £200,000. The QS has reviewed the proposal and has recommended that the settlement amount is agreed.

Review of liabilities

You are satisfied that the Company's books and records are generally in a good state. Based on the books and records and claims received to date from creditors, the liability position is as follows:

- **Kingfisher Bank PLC ("the Bank")**

The Bank holds a floating charge over the assets of the Company together with a Standard Security over the factory. As at the date of Administration, the Bank had the following amounts outstanding:

Term Loan - £742,500

Overdraft - £127,500

Covid support bounceback loan - £18,963

As you, the Agents and your solicitors are all on the Bank's panel, you have agreed to limit the costs of dealing with the Factory to 7.5%.

- **HMRC**

HMRC has submitted a claim for PAYE and NIC of £50,000 and VAT of £60,000. Both claims represent 3 months' liability. On closer inspection of HMRC's claim, it is noted that the final VAT return covering the final 2 month period is not included as it has not been prepared and submitted.

- **Other creditors**

A report generated from the Company's accounts system details that trade creditors amount to £2,713,976. This report was generated a couple of weeks ago and does not reflect any amendments in relation to the return of stock subject to ROT or the stock used by you in completing WIP.

The biggest creditor is LLBT Group Incorporated, the US parent company who have supported losses over the previous years. They are owed £5,000,000.

There were redundancies made immediately on your appointment of 73 staff. The HR department has generated a report which estimates the following entitlement per employee at the date of your appointment:

| | |
|----------------|--------|
| Redundancy | £9,000 |
| Arrears of pay | £2,000 |
| Holiday pay | £2,000 |

Although the notice pay provision has not been calculated, as the workforce is highly skilled it is expected that the majority of staff would have taken up employment immediately with other local engineering firms. The Company was well known in the industry for being “low payers” so it is expected that staff will attract higher salaries due to demand in the market place.

A further 15 members of staff agreed to continue to work post administration to complete the contracts and assist with finance and HR requirements and they have all now been made redundant by the Administrators and no staff remain.

Administrator’s trading costs

The costs associated with the fulfilment of the contracts and retention of staff to assist you has been as follows:

| | |
|---|----------------|
| | £ |
| Stock used subject to valid ROT | 50,000 |
| Wages and salary costs (including post appointment holiday pay) | 40,000 |
| Bonuses for staff retention | 15,000 |
| Insurance | 5,000 |
| Total QS costs (including the share of the Customer’s independent QS) | 15,000 |
| Arrears of wages for retained staff | 30,000 |
| Depreciation of plant and machinery | 15,000 |
| Total | <u>170,000</u> |

Statement of affairs

Despite several requests, the Directors have not provided a statement of affairs.

Requirements

- (b) Prepare an estimated outcome statement for the Administration showing the likely outcome for each class of creditor. Clearly set out your workings and state any assumptions that you make. (25 marks)
- (c) Based on the estimated financial outcome, draft an outline of the section of your Proposals that deals with how it is proposed that the Administration will end, including any further requirements associated with the proposed exit route. (4 marks)
- (d) On the assumption that you can achieve the statutory purpose in paragraph 3(1)(b), explain how you would seek authority for the payment of your remuneration. You are not required to explain the different bases on which the remuneration of an Administrator may be calculated. (4 marks)
- (e) In a matter where you have concluded that the statutory purpose in paragraph 3(1)(c) only can be achieved, explain how the consideration of the Administrator’s proposals and seeking authority for the payment of the Administrator’s remuneration would be different. (3 marks)

Total: 40 marks