

JOINT INSOLVENCY EXAMINATION BOARD

*Joint
Insolvency
Examination
Board*

Joint Insolvency Examination (Scotland)

Tuesday 11 December 2007

ADMINISTRATIONS, COMPANY VOLUNTARY ARRANGEMENTS and RECEIVERSHIPS (3 hours)

ANSWER ALL FOUR QUESTIONS

**QUESTIONS 1 AND 2 CARRY TWENTY MARKS EACH
QUESTIONS 3 AND 4 CARRY THIRTY MARKS EACH**

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 2007. 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 Insolvency Act 1986 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. Your principal was appointed Administrator of Rodrigo Windows Ltd (“the Company”) on 16 January 2007. He asks you to review the case today to see when the Administration can be concluded. Your review reveals the following information.

The Company manufactured and installed uPVC windows as a specialist contractor primarily in the local authority sector. It got into financial difficulty during 2006 due to a disruptive and costly relocation coupled with quality problems following the installation of new complex manufacturing equipment.

The appointment was consented to by RHBC Bank plc (“the Bank”), which has a bond and floating charge dated 5 September 2002 over all the assets of the Company. The charge was duly registered. The Bank is owed £1.25 million through a combination of term loan and overdraft facilities.

The appointment was advertised in the Edinburgh Gazette and an appropriate newspaper on 30 January 2007 and a Notice of Appointment was also sent to the Registrar of Companies on that day.

A short period of Administration trading was essential to complete work in progress and maximise recoveries from book debts and retentions. Trading ceased on 9 February 2007 at which date all remaining employees were made redundant.

The Administrator’s proposals:

- Were sent to creditors and the Registrar of Companies on 16 March 2007;

- Stated that the purpose of the Administration was to achieve the objective set out at paragraph 3(1)(b) and/or 3(1)(c) of Schedule B1;

- Contained a statement pursuant to paragraph 52(1)(b) of Schedule B1;

- Proposed to implement the provisions of Paragraph 84 of Schedule B1 once the purpose of the Administration was fully achieved;

- Provided for Administrator’s fees on a time cost basis (subsequently approved by the secured and preferential creditors);

- Sought no other approvals from creditors.

An interim progress report sent to creditors and the Registrar of Companies on 6 September 2007 disclosed receipts and payments as follows:

	Receipts and Payments £ 000	Statement of Affairs £ 000
Assets not specifically pledged		
Book debts	450	650
Retentions	150	350
Work in progress	400	400
Stock	95	100
Plant, equipment & vehicles	80	120
Interest received	5	
	<hr/>	<hr/>
Total receipts	1,180	1,620
Payments		
Administrator's fees & expenses	70	
Other professional costs	30	
Direct labour	80	
Other trading costs	50	
Finance agreement settlements	25	
Distributions		
Preferential creditors - 100p/£ paid 22/06/07	25	
Floating chargeholder - 22/06/07	750	
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Funds in hand	150	
Total payments and funds in hand	1,180	

Agents' disposal costs of £20,000 were deducted from the proceeds of sale of plant, equipment and vehicles and only the net realisation of £80,000 remitted to the Administrator.

Subsequent to the period covered by the progress report, further transactions have taken place. Book debts and retentions have realised £150,000 and £100,000 respectively and bank interest of £10,000 has been received. Further Administrator's fees and other professional costs of £30,000 and £10,000 had been paid respectively.

Looking forward the only remaining outstanding matter is a final retention sum falling due for payment at the end of January 2008. By negotiation, you have obtained agreement with the third party concerned that this will be released in the sum of £50,000 on 28 January 2008.

You conclude from your review that appropriate steps should be taken in order to finalise the Administration on 29 February 2008 and that an extension to the period of Administration by consent be obtained pursuant to paragraph 76(2)(b) of Schedule B1 to the Act. Final Administrator's fees of £25,000 will be drawn at the conclusion of the case.

Requirements

- (a) Identify the compliance breaches that had occurred prior to your review. (3 marks)
- (b) List the statutory steps that will need to be taken to complete the Administration and to enable the Administrator to vacate office. (5 marks)
- (c) Prepare draft receipts and payments accounts to accompany the Administrator's progress reports for each of the periods required by statute up to and including the proposed conclusion of the Administration on 29 February 2008. (12 marks)

(20 marks)

NOTE: Ignore VAT and taxation.

2. The directors of Virtuous Plc (“the Company”) have prepared a proposal (“the Proposal”) for a Company Voluntary Arrangement (“CVA”) and have given written notice of the Proposal to your principal, the intended Nominee, who has agreed to act.

The Company has used its funding to design and build a prototype of a range of high performance digital entertainment systems incorporating the latest technology. It was scheduled to launch its first products in September 2006. However, the first production units were subject to several technical and manufacturing shortcomings, rendering them unsuitable for sale. Original estimates suggested that redesign and re-engineering work would only take a few months. However, as each problem was solved new difficulties were discovered which called for further remedial work. The Company now expects to receive its first sales revenue in September 2008.

The largest investor is Plasma Investment Trust Ltd (“PIT”) which has invested £1million in shares and an unsecured £200,000 loan. In September 2007 PIT conducted a review of its investment strategy and in early October informed the Company that it would be making no further investments in the Company. The Directors immediately sought alternative sources of funding but were ultimately unsuccessful.

The Company’s assets and liabilities according to the Statement of Affairs as at 30 November 2007 comprise:

	Book value £ 000	Estimated to realise £ 000
Assets not specifically pledged		
Investment in subsidiary	500	0
Office equipment	40	5
Stock	90	15
R&D tax reclaim		260
		<u>280</u>
Preferential creditors - wages and holiday pay		<u>(70)</u>
		210
Unsecured creditors		
Trade and expense creditors	(400)	
PIT loan (advance for wages & essential services)	(200)	
Group creditor (Robust Technologies Ltd)	<u>(600)</u>	
		<u>(1,200)</u>
Shortfall to unsecured creditors		(990)
Share capital & share premium		<u>(2,200)</u>
Estimated shortfall to members		<u><u>(3,190)</u></u>

The Company owns the entire share capital of Robust Technologies Ltd (“Robust”) and owes Robust £600,000. Taking account of the irrecoverability of the debt due from its parent (Virtuous Plc) and of the fact that the future viability of Robust is inextricably linked to the survival of its parent, it is clear that in the context of a cessation of trade, Virtuous Plc’s investment in Robust has no realisable value.

The “estimated to realise” figures for stock and office equipment assume the discontinuance of trading.

The Company may be due a tax refund in respect of its research & development expenditure in the year to 30 April 2007.

The Directors propose that, rather than being wound up, the Company enters into a CVA under which the Company would continue to trade, its survival to be secured by a combination of debt forgiveness by creditors under the CVA and a commitment from PIT to provide an adequate level of funding for its ongoing operations.

Creditors will have the same priority for the repayment of their debts as they would if the Company were wound up.

Continuing to trade in a CVA will require around 70% of the workforce with a consequential reduction in employee preferential claims of £50,000 compared to a closure of the business. On this basis it is proposed that the preferential creditors will receive repayment of their debts in full.

The prospects for the unsecured creditors will depend on the amount received by way of a tax refund in respect of its research & development expenditure in the year to 30 April 2007. The Company's tax advisers have estimated that, in a best-case scenario, if the claim is upheld fully this will result in a refund of £260,000. If the tax refund claim is upheld fully then PIT will make a third party contribution sufficient to pay a dividend of 25p in the £ to ordinary unsecured creditors of the Company.

On the other hand, in the worst-case scenario, it is possible that HM Inspector of Taxes could reject the claim in full. If the refund claim is rejected in full, PIT will make a third party contribution sufficient to pay a dividend of 5p in the £ to ordinary unsecured creditors.

No other assets are to be included in the CVA.

Robust's claim of £600,000 will rank for dividend in the CVA equally alongside third party unsecured creditors. However as a condition of the CVA, PIT has agreed it will convert all of its unsecured debt into share capital in the Company.

The Supervisor's fees and disbursements are fixed at £30,000. It is assumed that the costs of a liquidation would be identical to those in the CVA.

The proposed term of the CVA is six months, or such period, which in the opinion of the Supervisor, is required to effect the Proposal.

Your principal seeks your assistance in connection with the Nominee's report and comments on the Proposal.

Requirements

- (a) List the matters required to be included in Nominees' comments on CVA proposals. (6 marks)**

- (b) Draft a comparative outcome statement, showing the estimated outcome of the proposed CVA on both a "best-case" and "worst-case" basis and also showing the estimated outcome of liquidation on both a "best-case" and "worst-case" basis. (14 marks)**

(20 marks)

3. Schematic Distributions Ltd (“the Company”) operates as a distributor in the high fashion sports clothing and footwear sector. The Company’s business involves the importation of goods largely from Chinese manufacturers operating under licence from US based suppliers. The Company has exclusive agreements with the US based suppliers in the UK market. Shipments of goods have been financed by letters of credit accepted by the Company’s banker, Parochial Bank Plc (“the Bank”).

According to the directors the Company sustained significant losses in the last two years of trading due to shifting market conditions that could not be foreseen. Despite substantial equity injections during the periods in question, the Company is now insolvent on both a balance sheet and a cash flow basis.

In this context and following the departure of the founder and managing director in the last four months, the Bank withdrew its trade finance facilities. The Company therefore sought alternative facilities but has ultimately failed to secure them. Without international trade finance facilities, the Company is unable to trade.

At the Bank’s suggestion, the directors have approached your firm for advice.

The Bank is owed around £600,000 and has the benefit of a standard security over the leasehold property and a bond and floating charge over all other assets. The security was granted during 2002.

The Company occupies leasehold premises on a 25-year lease granted in 1988 (“the Lease”). The rent is payable quarterly in advance on the usual quarter days. There are currently no arrears of rent. The Company has recently entered into an option with a property developer under which the developer may require the Company to assign or surrender its Lease for land and buildings in return for a payment of £750,000 (“the Option”). The Option period is 12 months and is extendable by a further 6 months. An Option fee of £25,000 has already been paid to the Company in October. Inspection of the Lease reveals the following condition:

“if the rent herein stipulated or any part thereof shall at any time be in arrear for twenty one days after the same shall have become due (whether legally demanded or not) and shall remain unpaid for a further period of ten days after demand by the Landlord under threat of irritancy, or if there shall be a breach of any of the obligations undertaken by the Tenant under the Lease which shall not be remedied by the Tenant within such reasonable period as shall be allowed by the Landlord in a notice requesting the remedy of such breach under threat of irritancy, or if the Tenant shall become apparently insolvent or shall make any arrangement with creditors or being a company shall go into liquidation whether voluntary or compulsory (otherwise than a voluntary liquidation of a solvent company for the purpose of amalgamation or reconstruction) or being a firm shall be sequestrated, then and in any such case it shall be lawful for the Landlord by notice to the Tenant to bring the Lease to an end forthwith and to repossess the Premises as if the Lease had not been granted but without prejudice to any right of action or remedy of the Landlord in respect of any previous breach of any of the obligations undertaken by the Tenant under the Lease”

Trade debts amount to around £500,000 and there is stock with a cost value of around £250,000 in the warehouse.

Within the last few days, a supplier owed some £120,000 was allowed to collect stock with a cost value of £80,000. You await full details as to the circumstances.

There are 14 employees including the three executive directors. Including the directors the average length of continuous service is 9 years.

It is clear that the morale of the directors is low following the departure of the former managing director and subsequent withdrawal by the Bank of trade finance facilities. They are presently undecided about their futures. Two of the directors are the Company’s key sales personnel.

A search shows that a winding up petition has recently been issued against the Company.

Requirements

- (a) Outline the factors that the Bank would take into consideration when deciding whether to appoint, or to concur with the appointment of, an Administrator or to appoint a Receiver to the Company. (10 marks)**

- (b) Outline the steps that the board of directors should take to protect the interests of creditors generally, pending the appointment of an insolvency office-holder. Indicate the consequences that the directors may face if they do not take those steps. (10 marks)**

- (c) Set out the procedural steps required to effect the appointment of an Administrator by the directors in the present circumstances. (10 marks)**

(30 marks)

4. Yesterday, 10 December 2007, you were appointed Receiver of Dynamic Printing Ltd (“the Company”). In the three months prior to the appointment, your firm had been monitoring management information at the request of a floating chargeholder that was concerned about the level of its financial exposure.

The Company was originally formed in the early 1980s by former employees of Tayside Print Services Ltd, a typesetter, printer and binder of academic books and journals. Turnover grew steadily and in 1993 it was subject to a takeover by a larger local competitor. In 2004 the management team concluded a management buy out, acquiring the entire share capital.

In 2006 the Company lost two significant customers to competitors and whilst replacement customers were secured, the level of orders did not fully compensate for the lost customers. The adverse effect on turnover translated through into cash flow difficulties culminating in an inability to pay current creditors.

Your own research shows that the sector is currently experiencing over-supply with around 70% of printers reporting that they work below capacity. This has led to pressure on pricing and a consequent margin squeeze with average pre-tax profit margins falling below 5%.

The Company recently invested in a 5-colour computerised printing system. The Company has 17 employees including its two directors and trades from leasehold premises in Dundee.

Requirements

- (a) Set out the factors that you should take into account when deciding whether or not to allow the Company to continue trading. (10 marks)**
- (b) Outline the practical measures and controls that you should implement in order to manage post-appointment trading. (10 marks)**
- (c) Outline the steps that you should take to market the business and assets for sale. (5 marks)**
- (d) When instructing lawyers to prepare the contract for the sale of the business and assets, outline and explain the particular terms that you would expect them to incorporate into the contract, recognising this is a sale by a Receiver as opposed to a sale by a solvent company. (5 marks)**

(30 marks)