

JOINT INSOLVENCY EXAMINATION BOARD

*Joint
Insolvency
Examination
Board*

Joint Insolvency Examination

Monday 10 December 2007

LIQUIDATIONS

(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 Rules 1986 as amended.

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

1. You are the only insolvency practitioner in a small firm of chartered accountants and have returned from holiday today. On your return, you have the following issues (a to d) to deal with:
- (1a) Rainy Ltd ("the Company"), a wholly owned subsidiary of Downpour Ltd, went into Members' Voluntary Liquidation on 19 July 2007. The Declaration of Solvency was signed on the same date. You were appointed Liquidator. The statement of assets and liabilities forming part of the Declaration of Solvency showed that there were assets of £2 million and liabilities of £1.8 million. Two days ago you received an apparently valid claim, for £500,000, which on investigation you find was not reflected in the statement of assets and liabilities. If the claim is found to be admissible there will be insufficient funds in the Liquidation to pay all of the creditors in full.

Requirements

Set out the immediate practical steps, and, if those steps do not result in a resolution of the problem, the legal and procedural steps that you, as Liquidator, should take. Set out the consequences for the Liquidator. (4 marks)

- (1b) Windy Ltd ("the Company") went into Creditors' Voluntary Liquidation, following resolutions of members and creditors, on 30 May 2007 and you were appointed Liquidator. The directors were Bob and Bill.

According to the directors' statement of affairs, the Company's liabilities totalled £1,500,000, including £170,000 owed to Towncity Bank Plc ("the Bank"). All of the liabilities are unsecured. The Company's assets comprise a book debt, of £100,000, and sundry fixed assets valued at £10,000.

The Bank has submitted a proof of debt for £170,000. It is recorded on the proof that it has the benefit of a guarantee from Bob and the benefit of security of three of Bob's properties.

You have received a letter from Bob's solicitors:

Dear Liquidator

My client, Bob, has received a demand from Towncity Bank that he pay it £170,000 under the terms of his guarantee. If he does not do this within the next 10 days, the Bank has threatened to take legal action against him. This means that he is subrogated as guarantor of the Company's liability and is a creditor of the Company for £170,000. I enclose a proof debt for £170,000.

Yours sincerely

*A Solicitor
Hue and Cry Solicitors*

Requirements

Reply to the solicitor's letter explaining, with reasons, whether or not the solicitor's proposition is correct. (4 marks)

- (1c) Carrot Ltd (“the Company”) went into Creditors’ Voluntary Liquidation, following meetings of members and creditors on 28 November 2007. The only asset is a debt of £21,000 due from Turnip Ltd (“Turnip”) representing the outstanding part of the total cash consideration of £25,000 for the business and assets (excluding the leasehold business premises referred to below) of the Company which Turnip had purchased on 12 November 2007. Turnip paid certain of the Company’s creditors in compliance with the sale agreement. The outstanding creditors shown in the statement of affairs are:

HM Revenue & Customs in respect of outstanding corporation tax	£65,000
Landlordship Plc in respect of arrears of rent of the Company’s leasehold business premises	£92,400

After costs of the Liquidation, it is unlikely that there will be a dividend to creditors. There are no secured creditors.

Requirements

Set out the issues to be considered by, and the remedies available to, the Liquidator. (4 marks)

- (1d) Mistier Ltd (“Mistier”), a national windows and doors replacement business, operated from twenty locations. In March 2007, Mistier entered into an agreement with Smog Plc (“Smog”), a major supplier and creditor, for Mistier’s financial restructuring. Under that agreement Smog advanced £50,000 to Mistier repayable by Mistier, with interest, by monthly instalments of £5,000 from September 2007. No such repayments have been received by Smog, despite letters of demand.

Earlier today, Hubert, Smog’s managing director, telephoned you for advice. He is concerned that Mistier’s assets are disappearing. Hubert has learnt that Mistier’s two directors have left for a long holiday in Spain and that Foggiest Ltd, a wholesaler, has been removing substantial raw material stocks from several of Mistier’s sites.

The total amount owed to Smog by Mistier is £170,000, including the amount of the advance and interest on it. Smog does not hold any security for any part of that debt.

Requirements

Advise Hubert on the immediate actions that Smog can take to prevent Mistier’s assets from further dissipation and on the procedures involved. Explain any risks to Smog of taking immediate action. (8 marks)

(20 marks)

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- 2a. Jones & Smith is a two partner insolvency practice. Most insolvency appointments are in joint names, Fred Jones ("Fred") and Joe Smith ("Joe"). Support staff comprise a manager and four case administrators but none of them has worked for the firm for very long. The manager allocates the work to the case administrators as it occurs.

In cases of joint appointment, the lead partner in a particular case is the one who introduced the case to the firm, the other partner taking little interest in the case apart from participating in formal paperwork.

Fred has just gone on holiday to Australia for six months, leaving Joe to look after the current cases in which Fred has been the lead partner. Joe has found that he has to address the following, among other, matters in those cases:

- Platus Ltd went into Creditors' Voluntary Liquidation in July 2006.
 - The main asset, a property, was realised in the first month of the Liquidation.
 - There was some attempt to realise a patent which seemed to drag on for a further year when Bert, the junior case administrator who has now left, decided that there was no value in it.
 - Platus Ltd had not created any fixed or floating charge or other security interest in favour of any party.
 - Five months ago a dividend of 100 pence in the £ was paid to preferential creditors comprising the Redundancy Payments Service and a few employees. Two of the employees have not cashed their cheques.
 - Fred has left a note requesting that Joe pays a first and final dividend to the unsecured creditors and then closes the case.
 - The unsecured creditors' claims have been agreed.
- A further ten Compulsory Liquidations and fifteen Creditors' Voluntary Liquidations which commenced more than five years ago seem to have had very little work done on them, apart from the holding of annual meetings and filing of annual receipts and payments accounts in the Creditors' Voluntary Liquidation cases.

Requirements

(i) State the problems that are caused by the backlog of insolvency cases, using the above scenarios as mere general examples. In relation to delegation and control of cases handled by the insolvency practitioner firm, state the main points that are recommended to be addressed in the published guidance. (6 marks)

(ii) Set out the practical, legal and regulatory steps that need to be taken to close Platus Ltd. (11 marks)

- 2b. Joe has received an email from the property agent on another case. The agent has found substantial presence of asbestos in a factory, which he, as Liquidator, sold a few weeks ago. Although there have been no claims in respect of any personal injury attributable to past exposure to asbestos, he cannot rule out the possibility of such claims arising in the future.

Set out the issues Joe should consider on the basis of this information. (3 marks)

(20 marks)

3. Purpot Ltd (“the Company”) manufactured plastic mouldings. On a creditor’s petition presented to the Court on 22 August 2007, a winding up Order was made against the Company on 18 October 2007. You were appointed Liquidator by the Secretary of State, on 5 November 2007 under section 137.

The statement of affairs indicates that there are substantial tangible and intangible assets.

Requirements

For each of the following issues, (a) to (g), which have arisen after your appointment, state the legal and practical steps that you, as Liquidator, could take. If there is more than one possible course of action, explain the advantages and disadvantages of each option and state, with reasons, which option you prefer:

- (a) The Company had developed a process for the manufacture of a unique plastic material for flexible packaging of liquids. The process was registered as a UK patent in April 2007. The Company had spent several years developing the patent. Most of its book value, shown at £2.5 million in the statement of affairs, represents the research and development costs. To make the most economic use of the process, in the absence of sufficient funds to further develop it, the Company granted an exclusive licence over it to Stripey Ltd (“Stripey”) in return for Stripey’s obligation to pay the Company licence fees to be calculated by reference to Stripey’s sales of the material. The directors estimate the realisable value of the patent, with the benefit of the licence agreement, to be at least £250,000 based on the historic and projected income streams attributable to it. In July 2007 Stripey wrote to the Company stating that several customers had complained that the packaging was disintegrating and causing damage. Under the terms of the licence agreement the Company is liable to indemnify Stripey in respect of any loss or damage caused by the product due to any inherent defect in the process. Stripey is refusing to pay the licence fees and has stated that it intends to claim a substantial amount in damages from the Company. The Company’s research chemist confirms that in his opinion the product is unstable and liable to disintegrate a few months after coming into contact with certain liquids. He thinks that the problem may be rectified but this would entail several months of further research and testing at a substantial cost. **(6 marks)**
- (b) Before the winding up Order the Company had generally ceased making payments to creditors. It had, however, made two payments by cheque to a key supplier, Spotty Ltd: £15,000 on 24 September 2007 and £1,000 on 19 October 2007 in respect of goods supplied on 25 September and 17 October 2007 respectively. The Company’s bank account was in credit during the whole of September but was overdrawn throughout the period of 1 October 2007 to 18 October 2007. **(5 marks)**
- (c) You need to use a small number of staff who have not been paid their salaries for any part of October 2007. **(4 marks)**
- (d) Linear Ltd (“Linear”) supplied a chemical to the Company. The Company ordered the quantity it required each Friday and Linear supplied it on the following Tuesday. Linear invoiced the Company each month for the supplies. In the six months to the date of the Liquidation, the Company had paid £2,000 per week to Linear on account of the amount it owed. The Company’s accounts indicate that it owes Linear £23,000. Linear is claiming that the stock held by the Company is owned by it but has not explained the basis for that claim. **(5 marks)**

- (e) Wavier Ltd, a supplier, is claiming that unpaid stocks of a chemical it supplied are owned by it, in accordance with its terms and conditions as printed on the reverse of its invoices as rendered to the Company. Some of this stock has been mixed with other chemical compounds purchased by the Company from other sources. Wavier Ltd is insisting that it also has a proprietary interest in the admixed product. **(4 marks)**
- (f) Parallelogram Ltd (“Parallelogram”) supplied to the Company cardboard boxes on credit. The agreed terms of supply (which you have seen) provided that:
- so long as any money remained owing by the Company to the supplier on account of any of the supplies whatsoever, the legal and beneficial ownership in all the boxes supplied would remain in the supplier
 - the Company would hold such boxes in a fiduciary capacity, and
 - the Company could however sell or otherwise dispose of the boxes in the ordinary course of its business but all book debts as they arose which were generated from such sale or disposal would belong and be deemed to be assigned to the supplier.

The Company used the cardboard boxes for packing the plastic mouldings sold to its customers and a charge for the packaging was added in its invoices to the price of its goods. The invoices have not yet been paid. On the date of liquidation Parallelogram was owed £35,000 by the Company but there were no boxes in stock. The Company had factored some of its debts, including the debts represented by the above unpaid customer invoices. **(3 marks)**

- (g) In accordance with the usual court practice, the winding up order contained an order that the costs of the petition be paid to the petitioning creditor out of the Company’s assets. The petitioning creditor’s solicitor has sent you an invoice for £14,000 in respect of such costs. You consider that this amount is very high. **(3 marks)**

(30 marks)

4. Primrose Cars Plc ("the Parent") operated a national car rental business. In February 2005 it purchased 100% of the shares in Violet Hire Plc ("the Subsidiary") which specialised in a nationwide business of providing vehicles and drivers for special events. The Parent intended that the Subsidiary would remain under separate management, paying to the Parent dividends on the shares acquired by it. No dividends were paid.

A winding up Order was made against the Subsidiary on 6 October 2006. The event came as a surprise to the directors of the Parent, which had substantial guarantee liabilities to the Subsidiary's vehicle leasing creditors. The Parent's last audited accounts at 30 September 2006 showed net assets of £4,500,000, including the value of its investment in the Subsidiary.

You were appointed Joint Liquidator of the Parent on 8 August 2007 following meetings of members and creditors. The directors did not prepare a statement of affairs.

Tom, Dick, Harry and Dave were the only directors of the Parent for several years. Dave was the only non-executive director. Tom and Dick, who live in the Isle of Man, resigned as directors in January 2007.

The directors explained that the cause of the Parent's financial problems was the calling in of the guarantee for a substantial amount which the Parent had given to the Subsidiary's vehicle leasing creditors. This does not account for all of the deficiency of £3,400,000 which you have estimated. None of the directors is responding to your letters requesting a fuller explanation of the deficiency.

The following information has come to light since your appointment:

- (i) There is some evidence that substantial sales by the Parent, totalling £2,310,000, to an Isle of Man based company, had not been included in the audited accounts. You have found a letter indicating that a contract between the Parent and the Isle of Man company was signed by Dick, on behalf of the Parent, but you have not found the contract with the Isle of Man company. You understand that Freda, Dave's former wife, and her business associate Graham, may have information about the contract. During your several telephone conversations with Freda and Graham they both have been evasive.
- (ii) According to the Parent's books of account, the Subsidiary owes the Parent £1,500,000 representing certain payments made by the Parent to the Subsidiary. Tom had authorised all the payments made to the Subsidiary, and the accounts staff have been unable to explain the reasons for the cash transfers to the Subsidiary.
- (iii) A debt for £150,000 is shown in the Parent's books to be due by the Parent to Heureux Ltd, another Isle of Man registered company. During the year to the date of Liquidation, a total of over £2,000,000 was paid by the Parent to this company for car hire, when the directors claimed that other vehicles were not available. You understand, from conversations with company staff, that there has never been a time when leased cars were not available. You understand that Heureux Ltd's shareholders are Tom and Harry.

Requirements

- (a) State the main purposes of a Creditors' Voluntary Liquidation. Set out what factors should be considered when deciding whether to commence an investigation into the affairs of a company in Creditors' Voluntary Liquidation. (5 marks)
- (b) Taking into account the circumstances of the Parent's Liquidation and the information that has come to light since your appointment, set out the practical and legal steps that you, as Liquidator, may take to investigate the Parent in order to achieve the main purpose of the Creditors' Voluntary Liquidation. (15 marks)
- (c) State the matters that the Liquidator is required to report about the directors, apart from the matters listed in Schedule 1 of the Company Directors' Disqualification Act 1986. Explain the issues that may hinder any reporting. (10 marks)

(30 marks)

