

GUILDHALL CHAMBERS CASE STUDY

SIP 16

1. An insolvency practitioner ("IP") is approached informally in June 2008 by X & Y directors of ABC Limited. They have been given his name by a mutual friend. ABC runs a retail business with several outlets including a new flagship store, in Cabal Circus, which has recently been fitted out at a very high cost. The business is seasonal and the most profitable trading periods are the summer and Christmas periods.
2. They meet in a local pub. At this first meeting, only draft management accounts are available, but IP gives general advice as to the relevant insolvency processes. Looking at the figures provided by X & Y, IP advises that it appeared to be satisfactory for ABC to continue trading, but that they needed to keep a careful eye on the figures. He told them that, based on what he had seen, it was a close call and that he would need more information before he could reach a final view. He also advised them that ABC should try to reach agreement with its landlords to pay rent monthly to ease cashflow.
 - *To what extent will it be necessary under SIP 16 to disclose this initial meeting?*
 - *If the meeting should be disclosed, to what extent should the advice given be disclosed?*
 - *Would the position be different if the advice had been that it was necessary to consider a formal insolvency procedure at this stage?*
3. On 5 January 2009, IP receives a telephone call from ABL, the provider of funding to ABC:-
 - 3.1. X & Y have contacted them with a view to extending ABC's credit facilities. ABL is concerned that ABC may not be as financially strong as X & Y tell them.
 - 3.2. ABL asks IP, as a member of its panel, to contact ABC and carry out a business review.
 - 3.3. IP arranges an immediate meeting with X & Y to discuss the situation.
 - 3.4. X & Y have given personal guarantees to ABL.
 - *Who is IP advising?*
 - *Who is IP acting for?*
 - *In any subsequent report prepared to comply with SIP 16 what will it be necessary to disclose?*
 - *Is it necessary to disclose panel membership?*
 - *What would be the position if the introduction had come from ABC's solicitor?*
 - *If there was a reciprocation agreement in place (formal or informal) between ABL and ABC's solicitors, would it be necessary to disclose this?*
4. Trading over the Christmas period has not been as good as predicted; ABC's sales fell off a cliff in October and only recovered in December because of substantial discounting. IP meets with X & Y. ABC is in clear financial difficulty. IP believes that the underlying business has value, but it is cashflow insolvent.

5. ABC has successfully negotiated the payment of rent on a monthly basis in respect of some shops but not others. Rent is mostly up to date, but there are two shops where the December 2008 quarter rent has not been paid. The Cabal Circus shop has a one year rent-free period. Where rent is due on a monthly basis by 31 January 2009, there are insufficient funds to pay it. In addition, there are outstanding VAT, PAYE and NIC liabilities of £325,000 making HMRC the major creditor. The remaining unsecured creditors amount to £250,000 and ABL is owed £200,000.
6. X and Y have read about pre-packs in the press and think that they sound like a really good idea. They want to buy parts of the business back and in anticipation have obtained a valuation of the business at £275,000. They tell IP that they have also been approached by a competitor which has expressed an interest in merging the two businesses with a view to reducing costs. X & Y would lose overall control but believe that the competitor may be willing to make an offer to purchase the business, subject to due diligence and arranging finance (it has no spare cash to fund any purchase).
 - *What should IP make clear to X & Y?*
 - *What should IP consider?*
7. Having reviewed the latest management accounts IP considers that a pre-pack is a possible route, but is also of the view that if sufficient funds could be obtained to continue trading, that might achieve a better return for unsecured creditors.
 - *What should IP do?*
 - *Approaches to funders – who?*
 - *What records should he maintain to justify his actions?*
8. ABL and the directors make it clear that they are not prepared to fund continued trading and, having reviewed figures prepared by ABC, IP decides that, in reality, continued trading without such funding (i.e. a trading administration) is not a viable option. IP therefore obtains a valuation of the assets from a firm of specialist insolvency valuers which he has used for years. They value the business at £250,000.
 - *Should IP consult anyone else?*
 - *If so what about?*
 - *What is the position in respect of legal advice?*
 - *On what basis should the business be valued?*
 - *How many valuations should be obtained?*
9. HMRC have served a statutory demand on ABC over a month before IP is consulted but have not yet issued a winding up petition. As the majority creditor, HMRC is concerned that ABC has a bad track record in paying its taxes when due and have informed IP that they object to the sale of the business back to the existing management, whom they consider responsible for the failure of ABC.
 - *What should IP do?*
 - *Are there any other courses he could/should adopt?*
10. IP decides to proceed with a sale to a new company, Newco, incorporated by X & Y specifically for the purpose of purchasing some of the assets of ABC. Newco does not

want to buy two of the most loss-making shops. IP instructs a specialist firm of insolvency solicitors to act on his behalf, who draw up the necessary sale documents. A company search shows that the formation agents are still registered as the company officers.

- *What should IP tell the directors?*
- *What should he do if X & Y refuse to take independent legal advice?*

11. Just before the sale documents are finalised, Y decides that he does not want to become a registered director of Newco, but his married daughter has agreed to do so, although IP knows that she works elsewhere and will be a director in name only. Further Y will continue to be involved in the day to day management of Newco but has decided that the shares will be registered in the name of a pre-existing family trust.

- *What are the disclosure requirements under SIP 16?*

12. Newco cannot raise the purchase price all in one go. It is agreed that Newco will pay 50% on completion of the sale and the balance by 12 equal monthly instalments. X has offered a personal guarantee in respect of the outstanding balance of the purchase price. The contract contains a retention of title clause, but it is recognised that this may be of little benefit as stock changes frequently and the leases are valueless. ABL is funding the new business and Y is giving a personal guarantee to ABL.

IP is then appointed on 19 January 2009 and the sale is completed on the same day for £275,000, with £137,500 payable immediately and the balance over the following twelve months. It is a further term of the agreement that if the lease of ABC's flagship store is not assigned within 6 months there will be a £50,000 reduction in the sale price. This term was only inserted at the last minute when it became clear that the landlord may not accept a personal guarantee from Y alone in respect of the rent. X has indicated that he may be willing to give a personal guarantee but is undecided. At the completion meeting, IP also felt obliged to agree that this last issue would be kept confidential for 2 months to enable it to be resolved more easily. Immediately following his appointment,

13. IP is instructed by ABL to collect the book debts on its behalf. IP will receive commission of 15% of collected book debts.

- *What should IP send to creditors?*
- *On what date(s) should he send it?*
- *What specific matters should he disclose?*
- *What about fees?*
- *On what date should the initial creditors' meeting be held?*