



Chartered  
Institute  
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Management

# **Legal Proceedings and Insolvency Question Paper, Answers and Examiner's Comments**

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## **Legal Proceedings and Insolvency questions, answers and examiners' comments**

LEVEL 5 DIPLOMA IN CREDIT MANAGEMENT

**JUNE 2015**

*Instructions to candidates*

Answer **COMPULSORY** questions 1 and 2 and any **THREE** other questions

All questions carry equal marks.

Time allowed: 3 hours

**You are reminded that, where appropriate, your answers should contain references to statutes and to case law.**

*This syllabus relates to two major disciplines which impact upon most, if not all, credit managers at some point during their career. In that respect, it is appropriate for candidates who aspire to Graduate Membership of the Institute to acquire a sound understanding of these syllabus topics.*

*Comments made following previous examinations included the following advice:*

- *That developed responses are a strict requirement at Level 5*
- *That candidates show development by incorporating appropriate analysis, evaluation, reasoning and context where appropriate in addressing the tasks*
- *That appropriate law is referred to where relevant*
- *That responses address the actual tasks which have been set.*

*The above still holds good following this examination. It is important to stress particularly that offering straight-forward knowledge of material in the form of bullet-point lists or processes without application to set scenarios, or comprehensive 'by rote' recall of topical information which has only indirect or scant relevance to the tasks, are not techniques likely to be well-rewarded.*

**Questions start overleaf**

## COMPULSORY SECTION

Answer **both** questions in this section

1. Faith is a 34 year old hairdresser. She left home at the age of 28, but was unable to afford a deposit for a house so instead moved into unfurnished rented premises. She lives upstairs in the flat and has turned the downstairs into a hair and beauty salon.

When buying furnishings to make her flat cosy and in building up her business, Faith has financed her purchases on credit cards. She found these easy to obtain and they provided her with the flexibility to shop wherever she liked.

However, she has now realised that this was perhaps not such a good idea. Although she has been making the minimum monthly payments, the overall balance seems to be increasing rather than going down. Consequently, Faith is now finding it difficult to meet the monthly payments and is struggling with her business costs.

Her estimated total assets are £10,000 and she owes:

- Wages to part-time staff      £1,500
- Credit card bills                      £8,000
- Trade creditors                      £2,000
- Potential Trustee in Bankruptcy fees are estimated at £1,000.

### TASK

- a) Relating your answer to the above scenario, discuss what is meant by the expression 'trading out of insolvency', giving examples of those parties Faith might be able to contact for help in her current situation. (4 marks)
- b) What key factors should a trade creditor consider when deciding whether insolvency or court action should be used to recover the debts owed by Faith? (4 marks)
- c) Explain what is meant by the priority of creditors, illustrating your response with a detailed list. (10 marks)
- d) If Faith were to be made bankrupt, trade creditors would hope for a dividend from her trustee. Show a calculation to identify the likely surplus or deficit available to trade creditors. (2 marks)

Total 20 marks

### Question aims

To test the candidate on:

- trading out of insolvency
- choosing between insolvency or court action for debt recovery
- the priority of creditors
- ranking for/receiving dividends.

## Suggested answer

### a) Trading out of insolvency. Grounds of response might include:

If an individual becomes insolvent they will not necessarily go into liquidation

In cases of consumer debt, some financial institutions may recognise that it is uneconomic to take bankruptcy proceedings against an individual who has few or no assets or little income. An example might be someone who owes large sums to credit card companies. Some institutions also recognise that consumers are likely to have multiple debts, and so debt counselling and informal recovery procedures may be more beneficial. The Consumer Credit Counselling Service, a commercial organisation sponsored by a number of major creditors, helps to arrange repayment packages, charging a fee based on the payments it collects. Citizens' Advice Bureaux and Money Advice Centres can provide this service free of charge.

### b) Key factors which could be discussed included:

- the amount of the debt owed
- the holding of security or a guarantee
- the attitude of the creditor
- the potential reactions of other creditors (who may be larger and more able and willing to take action)
- the trustworthiness of the debtor.

### c) The priority of creditors

In any insolvency the creditors must be paid in a pre-determined order. Some creditors enjoy higher priority than others because of the type of debt they hold.

A list of creditors potentially relevant to the scenario in order of priority is as follows.

**Expenses of the insolvency** - This includes the costs of the petitioning creditor, the official receiver and the trustee in bankruptcy or liquidator.

**Preferential debts** - Wages or accrued holiday pay.

**Ordinary debts** - These form the vast majority of debts in an insolvency. Ordinary trade creditors fare rather badly in terms of creditor priority but often possess information that can reveal additional assets that can then be realised for the benefit of all creditors.

**Interest on preferential and ordinary debts.**

**Deferred debts plus interest thereon** - These are debts owed to 'associates' of the insolvent (such as family members) or 'connected persons' of the insolvent company (such as directors). By giving these debts the lowest priority outside creditors have a better chance of recovery.

d) **Calculation of dividend pool: [A narrative was not required by the task]**

Assets available per scenario	=	
£10,000		
• Less Trustee's Fees £1,000 (Insolvency Expenses)		£(1,000)
• Less Wages £1,500 (Preferential Creditor)		<u>£(1,500)</u>
So giving £7,500 for distribution 'pari passu'		<u>£</u>
<u>7,500</u>		
£7,500 divided by £10,000 (being Credit Cards £8,000 + Trade Creditors £2,000)	=	<u>£7,500</u> (£8,000 + £2,000) = 75%
• So unsecured creditors dividend pool	=	75% of available funds
• Trade Creditors' proportion: £2,000 x 75%		= £1,500

Trade creditors would therefore have £1,500 available for dividend.

**Total 20 marks**

*A compulsory question largely on insolvency issues, where the scenario discussed an individual whose small business was delivering a personal skill. This is a common situation today and the tasks required a developed response with that perspective in mind. General responses, or responses which clearly included or focussed upon the viewpoint of a company, did not therefore directly address the task/scenario.*

*Higher marks were available for directly explaining 'trading out of insolvency' in (a), going on to discuss why it might be sometimes be preferable to allow a party such as Faith to continue to trade and the external organisations who might support those in such a situation.*

*Discussion of the stated factors (or similar) introduced in (b) should suggest in a two-sided response (insolvency or litigation) the impact of those factors in maximising the chance of recovery. Candidates needed to look at both options and outline the expected outcomes for each so that a decision could be made on what action to take in order to get the best recovery of the debt.*

*Most candidates could offer a general statement as to the meaning of priority of creditors and a memorised textbook list of creditors in relation to (c), but few could justify what determines the priority, applied their list to the given scenario or tailored it to Faith's situation. The calculation of the potential unsecured trade creditor dividend pool in (d) should be a 'corner of the page' calculation for credit managers, but confused the candidates who offered a simple 'assets less liabilities' calculation which, by definition, ignored the priority of certain creditors.*

2. Stella is new to the legal collections team where you are team leader. She has successfully completed some claim forms using Money Claims Online. You have now been asked by your manager to continue her training by looking at 'defended' actions.

### TASK

- a) Stella shows you a 'bullet point help sheet' on the subject that she found from the internet, but because it contains no detail and 'just asks questions', it is no use to her.

Explain in detail to Stella **three** important issues concerning dealing with defended actions in the courts' system. (9 marks)

- b) You have received notice from the court that your customer MAA Ltd intends to defend your claim for the £3,200 they owe you. They say that the biscuit tins your company made for them were not as specified and that no-one has bothered to address this. However, your company's Quality Control Manager, Jim, has told you that this is not the case. He has shown you and Stella documentary evidence confirming that he has spoken with the Accounts Manager at MAA Ltd on several occasions, that all queries were answered and that it was agreed that there had been an error by the Buyer at MAA. Although you are now confident of your chances of success, Jim also tells you he is about to go on a year's sabbatical.

Show how this defended action should now proceed, referring to the scenario and adding any further detail or discussion you consider appropriate to your response. (6 marks)

- c) Explain what is meant by the term 'Affidavit' and the current relevance of this document. (5 marks)

Total 20 marks

### Question aims

To test the candidate on defended actions, case management and track allocation.

### Suggested answer

- a) **Important issues include:**

#### Case Management:

Where a claim is 'defended' (disputed) it will be referred to a judge who will 'manage' it. The judge will determine what needs to be done to bring the case to a conclusion by giving 'directions' and will fix timetables with which the parties must comply. Failure to comply may result in a claim by the claimant or a defence submitted by the defendant being 'struck out' (dismissed). The judge has power to strike out a defence that does not disclose a genuine dispute, or a claim that has little prospect of success.

#### Track Allocation:

Defended cases will be allocated to a defined 'track' primarily by the Claim Value, as shown in the table, although legal complexity is also taken into account:

Small claims track	Up to £10,000
Fast track	Between £10,000 and £25,000
Multi-track	Over £25,000

All claims up to £25,000 must be commenced in the County Court. As a result of the Civil Procedure Rules, there is an 'overlap' between Fast and Multi-track so that straightforward claims up to £25,000 can use Fast Track. Documents that set out the claimant's claim and the defendant's defence are known as 'pleadings'.

**Recovery of Fees and Costs:**

'Fees' are sums paid to the court for the issue of process and applications. 'Costs' are sums awarded to the successful party. Costs may either be 'fixed'—on a scale laid down by the Ministry of Justice, or 'assessed', where the Court will determine the award. There is no provision for the recovery of legal costs in a case dealt with in the Small Claims track, although reimbursement to any witnesses of loss of earnings or travel expenses may be ordered.

- b) Stella's company will need to be able to support your claim, conform to the principles of pre-action protocols and carry out any Directions from Court. If on presentation of the documents the Judge does not think the case has any prospect of success, it will be struck out (dismissed). Given that the company has all the documentary evidence that it needs, but Jim will not be available at the likely time the matter comes to Court, it needs to arrange for him to verify all that he knows with a Witness Statement and Statement of Truth. Unless MAA is able to show that there are real grounds for the sum not being due, this should be enough for the Judge to find for the company. Alternatively, the Judge may look at the documents and decide there is a case, in which situation it is likely to be allocated to the Small Claims Track primarily because of the value of the claim (<£10,000), which will adversely influence legal costs recovery. The Court may also order some form of Alternative Dispute Resolution (e.g. Mediation) to attempt settlement, especially if the Judge is not satisfied that has already happened.
- c) 'Affidavits' are sworn statements made by the parties to the action, their employees or solicitors. Although there is still provision for affidavit evidence, the Civil Justice Rules provide for them to be replaced, in many instances, by written Witness Statements verified by a 'Statement of Truth'. These statements are used in place of oral evidence on all hearings and applications except the trial of an action. In the small claims track, there is provision for the court, at the request of one of the parties, to decide the case on the written evidence lodged, and without the need for the parties to attend.

**Total 20 marks**

*Majoring on legal proceedings, this compulsory question asked about (a) background understanding of issues which are generally exclusive features of defended actions, (b) conduct of a potential defended action, and (c) continuing development of the administrative system relating to the supply of evidence to court.*

*Two things were evident here: firstly, many candidates' understanding in this examination was based upon a rote recollection of reading, which meant that understanding of procedures and any topical insight was missing, and secondly, there was little technique supporting given responses. For instance, some candidates added extra responses or information that was neither asked for, nor relevant to the task or scenario, and part (a) required discussion of 3 issues only. Each could be addressed by explaining what it is, how it works and give an example/illustration to show understanding.*

## OPTIONAL SECTION

### Answer any three questions

3. You are credit controller at Oranges Consultancy firm which has a judgment against a Mr Sage for £11,349 in relation to services rendered to him personally. You know that Mr Sage is a Director at Onion & Sage Ltd because your firm has contacted him there whilst providing the consultancy service and when chasing payment of the outstanding debt.

So far, no payment or offer has been made and you are now looking at the enforcement options available to you.

### TASK

- a) Explain in detail these two types of enforcement options:
- i. Attachment of Earnings Order. (6 marks)
  - ii. Third Party Debt Order. (10 marks)
- b) Evaluate the above scenario and briefly explain the relevant merits of each of these two options in that situation. (4 marks)

Total 20 marks

### Question aims

To test the candidate on enforcement of judgments procedures.

### Suggested answer

- a) i) **Discussion of Attachment of Earnings orders might include:**

The **Attachment of Earnings Act 1971** gives the **County Court exclusive jurisdiction** to deal with applications for attachment of earnings.

Under the Act, a Court Order is made against the debtor's employers, and requires the employer to deduct a specific sum from the debtor's weekly or monthly wage (along with up to £1 which can be retained by the employer as an administration charge) and to pay that sum to the court until the judgment debt is discharged. The court then accounts for monies received to the judgment creditor. The actual sum to be deducted is determined by the court according to a fixed formula, and an allowance is made in respect of earnings which the law requires to be protected from deductions.

An Attachment of Earnings Order Application is made on a standard form N337 and must be made in the County Court covering the district in which the debtor resides. The court will serve an order on the debtor, requiring the debtor to give particulars of his employment, wages, overtime, deductions and liabilities. At that stage the debtor has an opportunity to make an offer to pay. The court has the power to require the employer to give the court a statement of the debtor's earnings.

The process only applies to employees, not to the self-employed, to partners in a firm, or to a non-executive director. Generally, therefore, it is a feature of consumer debt collection and attachment is not common in the case of commercial debt where many B2B debtors are either self-employed or not in permanent employment.

A debtor who fails to respond may be committed to prison for up to 14 days.

ii) **Discussion of Third Party Debt orders might include:**

**Part 72 Civil Rules and Practice Directions** govern the use of these orders.

This process enables a judgment creditor to obtain an order against any third party holding money for or owing money to the debtor. Its most obvious use is against banks or building societies where the debtor has an account. It can, however, be used in respect of any money payable to the debtor. For example, a customer of the debtor, who owes money to that debtor, can be subject to a third party debt order.

Application must be made, on a standard form – Form N349 – to the court in which the judgment was obtained. A debtor, who wishes to oppose the application, can ask for the matter to be transferred to his/her court. The application form is supported by an affidavit (in standard form) in which the creditor sets out the name and address of the third party who is believed to hold money for the debtor.

On receipt of the application, the court will serve an order on the debtor and on the named third party, fixing a date for a final hearing. The order will be served on the third party at least seven days before it is served on the debtor.

Service of the order 'freezes' the money in the hands of the third party, so it cannot be released to the debtor. However, a debtor has the right to apply to the court for a hardship payment order, which must be supported by evidence to show that as a result of the freezing of the money the debtor has no money for 'family needs'.

Such an application must be dealt with, by a judge, immediately. For example, if an order is made against a bank or building society, the judge may order that organisation to release a fixed sum immediately, or at regular intervals, until the matter is determined.

In respect of a bank or building society, the creditor may know the bank or building society concerned, but may not know the branch and account number. Application can still be made, and the order will be served on the head office of the bank or building society. That order requires the bank/building society to certify to the court all sums held in any account or accounts of the debtor in his/her sole name.

If the third party holds sufficient money, it can pay it to the court. That brings the matter to an end. If the third party ignores the order, the hearing will proceed. It will also proceed if the third party disputes the allegation that money is held or owed to the debtor.

b) As Mr Sage is a Director of Onion & Sage Ltd:

Re: **Attachment of Earnings:** There is merit in such an application if it can be shown he is an employee, either as an executive director, or as a 'Director of (something)'. If he is a Non-Executive Director without a contract of employment, he is not likely to be an employee, so an Attachment of Earnings Order is not appropriate as there are no earnings from Onion & Sage Ltd to attach it to.

Re: **Third Party Debt Order:** He may be entitled to other forms of remuneration from Onion & Sage Ltd connected with his directorship (e.g. a fee) even if he is not an employee. If so, such an Order is appropriate to capture these sums and to ask the court to order Onion & Sage Ltd to pay them to you rather than to Mr Sage.

**Total 20 marks**

*A straight-forward knowledge of procedure and law-based question which required candidates to then review the two options and comment on the merits of each in relation to the scenario.*

*Higher marks were available for details regarding law, procedure and relative usefulness, with few marks available for details of the application process and little understanding of the place of these actions in the enforcement armoury.*

*Part (b) did not ask for a one-sided justification of one or the other as offered by some candidates.*

4. In relation to Insolvency Proceedings, explain the following areas, identifying where appropriate, any differences between the treatment of individuals and companies:
- a) Jurisdiction of the courts in such proceedings. (10 marks)
  - b) Office-holders in such proceedings, explaining their required qualifications for the role. (10 marks)

Total 20 marks

### **Question aims**

To test the candidate on the different roles for the courts in corporate and individual insolvency.

### **Suggested answer**

#### **a) Comments regarding the jurisdiction of the courts in insolvency proceedings might include:**

Insolvency Proceedings is the term that covers any proceedings under the Insolvency Act 1986 or the Insolvency Rules 186/2003. Insolvency proceedings have two separate terms to differentiate between matters concerning individuals and companies. For individuals, personal insolvency is known as 'bankruptcy', whereas for companies, it is referred to as corporate insolvency and the term used is 'liquidation'. Corporate and personal insolvency developed for many years along completely different paths, but the 1986 legislation and later Rules brought these paths much closer. Consequently, there are now a number of similarities in the processes.

In both situations, the High Court is the usual forum with some matters dealt with locally by selected County Courts. Therefore, for individual debtors resident in the London Insolvency District, the Bankruptcy Court is within the High Court's Chancery Division and outside of London, certain County Courts are charged with responsibilities for running the local Bankruptcy Courts.

In corporate insolvency, the High Court has jurisdiction to wind up any company registered in England and Wales and, again, limited jurisdiction is delegated to some County Courts to wind up local companies in their area, as long as their share capital does not exceed £120,000.

Courts are not only involved in the 'terminal' issues of liquidation and bankruptcy. Other proceedings considered for individuals are deeds of arrangement and individual voluntary arrangements (IVA); company proceedings include receiverships and corporate voluntary arrangements (CVA)

#### **b) Discussions of Office-Holders and their qualifications might include:**

Insolvency proceedings are 'overseen' by officers. In some circumstances these officers must be licensed Insolvency Practitioners (IPs) as defined by the Insolvency Practitioner Regulations (various dates); in others, office-holders may be individuals who are suitably authorised, but are not necessarily IPs.

Authorised persons will belong to bodies recognised by the Secretary of State for Business, Innovation and Skills for the purpose of conducting Corporate or Individual Voluntary Arrangements. They have undertaken adequate training and are adequately bonded in order to act in that capacity.

Under the Insolvency Act 2000, proposals for Voluntary Arrangements for individuals or companies may include, as nominee or supervisor, an "authorised person" not otherwise licensed as an insolvency practitioner. Using authorised persons enables a greater number of eligible people to be able to undertake these tasks. However, Trustees in Bankruptcy and in Deeds of Arrangement for individuals must be licensed Insolvency Practitioners, as must Administrative Receivers, Liquidators and Administrators in corporate insolvency matters.

Under the Law of Property Act 1925, receivers in corporate insolvency do not have to be qualified under the Insolvency Regulations, but they are usually specialists in their own field, such as Chartered Surveyors.

Prior to the Insolvency Practitioner Regulations 1986, there was little attempt to regulate the appointment of liquidators, trustees in bankruptcy and other officers involved in insolvency proceedings. These tables summarise (so therefore, in themselves, do not 'explain') the roles that are the sole province of IPs, and those which can be held by licensed insolvency practitioners and other authorised individuals:

<b>Offices that can <u>only</u> be held by licensed insolvency practitioners</b>	
<b>In respect of individuals:</b>	<b>In respect of companies:</b>
Trustee in Bankruptcy	Liquidator
Trustee of a Deed of Arrangement	Administrative Receiver
	Administrator

<b>Offices that can be held by licensed IPs or authorised individuals</b>	
<b>In respect of individuals:</b>	<b>In respect of companies:</b>
Nominee of an IVA	Nominee of a CVA
Supervisor of an IVA	Supervisor of a CVA

**Total 20 marks**

*Although this question related to insolvency, some candidates offered responses which clearly related to debt recovery through the courts, and which therefore missed the point of the set tasks.*

*It is important in any question for candidates to note and address the 'task requirement' when responding, so a simple list of office holders was not an indication that a candidate could distinguish between the different office holders and, in any event, was not the 'explanation' requested.*

5. Mark is a building surveyor who looks for prime building sites as they become available and draws up projects for their development. His friend Harvey is a builder with his own business, H Ltd, which obtains finance for the building projects and carries out the build. The two have worked closely together for many years and have been very successful up until now. However Harvey has just had a very bad experience. He was not paid the balance (the final stage payment) for a supermarket complex which took more than 13 years between borrowing the money for the land purchase to the completion of the actual build. Because he could not then repay the loan to the debenture-holding bank, H Ltd is now in Administrative Receivership. However, Harvey has promised Mark that no matter what, he is sure he will be able to pay Mark's bills soon.

### **TASK**

- a) Contrast an 'Administrative Receiver' with other types of Receiver, referring in your response to the definition enshrined in Section 29 of the Insolvency Act 1986. (6 marks)
- b) Explain the nature of a debenture and the effect upon the subject company of an Administrative Receiver's appointment by a debenture holder. In the light of your response, briefly evaluate the promise Harvey has made to Mark regarding payment of his bills. (5 marks)
- c) Explain the three usual purposes of an Administrative Receivership. (9 marks)

Total 20 marks

### **Question aims**

To test the candidate on the appointment of an Administrative Receiver and conduct of Administrative Receiverships.

### **Suggested answer**

- a) Section 29 Insolvency Act 1986 defines an 'Administrative Receiver' (AR) as:
- a receiver or manager of the whole or substantially the whole of a company's property who has been appointed by or on behalf of debenture holders holding security which includes a floating charge, or
  - a person who would be such a receiver or manager but for the appointment of some other person as receiver of part of the company's property

**Discussions to contrast may include:** An administrative receiver must always be a licensed insolvency practitioner, whereas other receivers need not be. Consequently, the nature of the licencing procedure maintains professional standards of IPs.

ARs differ from other receivers because the party making an AR appointment is a debenture holder with a 'qualifying floating charge'. This is a charge which is dated prior to September 2003 and is a charge on assets which are likely to change or be replaced over time (for example, stock, equipment etc.). Typically, floating charges will include all the undertakings of the company and will therefore qualify under the Section 29 definition.

All this contrasts with the broader definition of a Receiver appointed in other circumstances, either under a fixed charge over specific named assets, or under the Law of Property Act 1925 (in the case of land only), and attaches to the charged asset only. These relevant individuals need not possess any particular qualifications, however, companies or other corporate bodies, undischarged bankrupts, or those individuals subject to an order under the Company Directors Disqualification Act 1986 can not be appointed.

- b) A Debenture is a document which gives security for a loan to a company by transferring various powers or rights to the lender in the event of default, and it has been usual for a bank or other lender to seek security for significant corporate loans in this way. In the past, a debenture giving rights over current assets (that is, those that constantly change in value in the normal course of business) has been specified as a Floating Charge. If the company defaults on the terms for repayment of the loan, or if another event specified within the terms of the debenture occurs, this could result in the 'crystallisation' of the charge and the power of the lender to appoint an Administrative Receiver (AR).

The effect of the appointment of the Administrative Receiver on the company is that it can no longer deal freely with its assets, and control of the organisation now vests with the AR, who supplants the power of the current management. In light of this, it would be difficult for Harvey to fulfil his promise to Mark regarding payment as he would no longer have control over the finances of his company. Mark would therefore be reliant on the Administrative Receiver or subsequent office-holder for his payment, not Harvey.

- c) The purposes of administrative receivership are:
- i) To continue running the business as a going concern with a view to returning to profitability or disposing of the business. If unpaid creditors refuse to supply further goods it is not seen as an abuse of their dominant position (Art 86, Treaty of Rome)
  - ii) To continue part of the business which is (or could be) profitable with the winding down and disposal of other parts of the business. For example, a company which has diversified over time may have become unprofitable because of inappropriate acquisitions yet may still have a profitable core business
  - iii) To wind the business down by completing outstanding orders so as to maximise income and then dispose of the company's assets on a piecemeal basis. This option will apply where it is perceived that there will be no ready purchaser for the business and there is little if any value in the goodwill of the business. Wherever possible the receiver will try to sell the business as a going concern in order to get a higher price, and may therefore adopt option i) above for a short time before falling back on this iii) option.

**Total 20 marks**

*Candidates are reminded that it is not just the very central or most popular syllabus issues in both legal proceedings and insolvency which are examined and because candidates come from a wide background, opportunities will be given for candidates of different experiences to be able to respond to option section tasks. Even then, the starting point for this question is the Insolvency Act 1986, surely one of the staple 'reference points' for this syllabus?*

6. Dhruv was renovating his bathroom and had bought a bathroom suite from Bally's Bathrooms Ltd. He set about installing the suite, but when it came to the shower screen, it did not fit the shower tray. He called Bally's who, although very apologetic, did not have a shower screen in the right size. They did promise Dhruv a refund though, after they had collected the incorrect screen. The shower screen was collected and the driver signed the returns note.

However, six weeks later and after several phone calls to Bally, the promised refund had still not been made. Since Dhruv had purchased a new shower screen elsewhere, he is out of pocket and wants his money back.

### **TASK**

- a) Advise Dhruv of the detailed action he should now take to facilitate the refund using the courts' process, concentrating on those matters before court action and prior to judgment. (14 marks)
- b) Dhruv has followed your advice, but has now received a letter stating that Bally's are in liquidation and his claim will be dealt with 'pari passu'. Explain to Dhruv what both 'liquidation' and the 'pari passu' principle means. (6 marks)

Total 20 marks

### **Question aims**

To test the candidate upon the preparation of a legal claim in the courts up to judgment and the basis of the distribution of dividend.

### **Suggested answer**

- a) A general discussion to respond to this task might have included discussions such as:

In order to seek a refund using the courts process, Dhruv must gather together all the information he has regarding the order and refund, including any written order, delivery note, the signed returns note for the shower screen, notes of the telephone calls made, copies of letters/emails requesting the refund and importantly any copy of the promise of the refund from the supplier. This bundle will, if necessary, be able to be provided to the court, firstly to support Dhruv's claim, and secondly, as evidence that he has complied with what is known as a Pre-Action Protocol.

He now needs to draft a letter to the supplier, Bally's – this is known as the Letter of Claim (Letter Before Action) and must include the following information [*note: a simple list of contents here would not attract many of the available marks. Higher marks would be achieved by stating the indicative content and going on to link with scenario facts, translate into particular advice for Dhruv, and justifying comments given.*]:-

- The amount outstanding to Dhruv, what it is for, and when it should have been paid
- The time within which a response from Bally's is required – as the supplier is a company, Dhruv should allow 7 days to pay the total sum due
- The action that Dhruv will take if payment is not made within that period (namely, complete and serve a County Court claim)
- Whether Dhruv intends to claim for interest and on what basis, citing relevant law and detail where appropriate

- Whether Dhruv intends to claim for the court fees and recoverable costs he will be put to
- An address and telephone number for Dhruv to facilitate any response to the letter.

A copy of this letter should be added to the bundle of evidence discussed above.

If, after the 7 days have elapsed, Dhruv has still not received the refund, he may complete a County Court Claim Form (N1) for the value of the refund, the interest he wants to claim and any costs he may be entitled to, and submit it to the local County Court with the relevant fee. From that point, Dhruv is known as the Claimant and Bally's (the Supplier) is known as the Defendant. The Claim form is served on the Defendant together with a Response Pack created by the Court.

Upon receipt of the claim, the Defendant usually has a number of options [*note: consistent with giving advice to Dhruv, whilst he is at the point of considering a letter of claim, these matters are only of interest and 'advance information', so a 'by rote' detailed account here of what avenues a claimant has does not form a substantive response to the task*], including:

- To pay the amount due including any fees, interest and costs
- To dispute (defend) the claim in total
- To admit part of the claim and dispute the remainder
- To make a claim against the Claimant (in this case, counterclaiming against Dhruv)
- To make an offer to pay at a future date (including by instalments).

The Defendant may also try to ignore the claim, or may raise a fictional dispute to delay matters further.

**b) Typical areas of discussion included:**

Liquidation of a company is the orderly process of closing a company down. This may happen if the company is solvent (able to pay its debts on closure) or insolvent (unable to pay all its debts from available assets). The final action of a solvent liquidation is that surplus wealth after all debts are paid in full is distributed among shareholders and the cause may be for a number of reasons. Insolvent liquidations occur when the company is unable to pay its debts as they fall due or when their Balance Sheet suggests that their liabilities (what they owe) exceed than their assets (what they own). There may also have been another insolvency process prior to the liquidation itself (perhaps an unsuccessful CVA proposal). A liquidator (a licensed Insolvency Practitioner) will be appointed to wind up (close down) the company's affairs; liquidation is the process of converting any assets into cash and distributing that cash to whom it is owed.

However, in an insolvent liquidation (which is likely to be the situation regarding Bally's), there will be insufficient cash to pay all classes of creditor in full. Therefore, there is a procedure known as 'ranking' which effectively benchmarks creditors within different 'classes', each with its own priority in a 'pecking order'. Creditors within each benchmark will be treated 'pari passu'. The pari passu principle states that creditors are paid equally within their creditor class (priority level) or equally in proportion to their debts if there are insufficient assets to meet all the debts in that particular class.

In this way, ordinary creditors (such as Dhruv) receive nothing until after the preferential debts (such as unpaid workers' salaries) have been satisfied in full. Each layer in the pecking order is satisfied in full until there are insufficient funds to wholly repay a creditor class, whereupon that class will be paid 'pro rata' – at so many pence in the pound.

Where there are no funds available for a particular credit class, then no distribution can be made. Dhruv will have to hope that there may be sufficient funds to receive some proportion of what he is owed by Bally's.

**Total 20 marks**

*This question involved a common situation of an individual dealing with a company on an unfulfilled internet sale, and was strictly legal proceedings-based in application. The task requires giving advice to Dhruv and the expectation was that there should be strong linkage with the scenario detail. Higher marks were available for tailoring the response in (a) to Dhruv's situation. After all, unlike Dhruv, candidates should be able to show an understanding of pre-action and early action using the courts' process.*

*Disappointingly, in (a), many wrote bullet-point lists of generic letter of claim contents and copious details of 'what the claimant can do' without direct reference to the scenario. Some discussed 'enforcement', which was not required by the task (...prior to judgment...') and therefore received no reward sadly.*

*However, where there was linkage by candidates with scenario facts, e.g. relating the advice to the Small Claims Track since it was unlikely a shower screen would breach the upper financial limit. This was entirely consistent with this level of paper and was rewarded accordingly.*

7. a) Evaluate the extent to which a Bankruptcy Order has an effect upon the following:
- i) The bankrupt debtor; (6 marks)
  - ii) The bankrupt's creditors. (8 marks)
- b) Discuss the nature of Bankruptcy Restriction Orders and Undertakings, referring to the difference between the two and the reasoning behind why they are granted. (6 marks)

Total 20 marks

### Question aims

To test the candidate on the effects of granting Bankruptcy Orders and Bankruptcy Restriction Orders and Undertakings.

### Suggested answer

- a) i) **Grounds for discussion includes:** The Bankruptcy begins on the day the Order was made and it lasts until the Order is discharged, so the effect on the bankrupt is immediate, as defined by Section 278, Insolvency Act 1986. The bankrupt immediately loses control of their estate upon the appointment of their Trustee in Bankruptcy. The bankrupt may not dispose of property without consent of the Court and transactions for the disposal or transfer of property after issue of the Order are void and of no effect.

The Official Receiver (OR) becomes the receiver and manager of the bankrupt's estate and empowered to sell assets as necessary, as well as being obliged to take all steps as required to protect the estate. The debtor will receive a copy of the Order from the Official Receiver along with an instruction to the bankrupt to provide whatever details are needed by the OR in order to complete a Statement of Affairs.

There are certain penalties and restrictions placed on the bankrupt following the order. These include being unable to act as a director, or be directly involved in the management, of a company. There are also various professional capacities, including insolvency practitioner or solicitor, that the bankrupt is barred from undertaking, even if qualified to do so.

- ii) Section 285, Insolvency Act 1986 provides that, once a Bankruptcy Order is made, creditors have no remedy against the bankrupt other than to prove for their debt in the bankruptcy. Consequently, creditors are no longer able to commence proceedings, seek judgment, or enforce a judgment by way of execution. Thus, where a creditor has obtained judgment, but the enforcement of the judgment has yet to take place (for example, where the HCEO [High Court Enforcement Officer/Sheriff] has yet to visit the debtor's premises to seize assets) that action is stayed (indefinitely suspended). An example of this is shown where an HCEO, acting under a Writ of Control (FiFa), enters the debtor's premises and seizes assets, but the execution is not complete unless:

- the asset realisation satisfies the debt fully, and
- the HCEO has retained the seized property for the statutory 14 days.

Additionally:

- an unsatisfied judgment grants the creditor no change to their priority in the resulting insolvency

- secured creditors are still entitled to enforce their security irrespective of a bankruptcy order
- any creditor receiving property or money from the debtor after the issue of the petition is now protected as bankruptcy petitions are no longer advertised, but the creditor will need to show that it was received in good faith, for value, as a consequence of legitimate collection activity and without notice of the petition.
- For some creditors, simply not collecting the debt may have ramifications for business survival and growth, and for individuals, an impact upon their own personal solvency.

**b) Bankruptcy Restriction Orders (BRO) and Undertakings (BRU)**

**Discussions might include:** There has been a movement over time to change the way that bankrupts have been perceived in society. From once certain imprisonment, the fostering of an enterprise culture means that whilst some bankruptcy is inevitable, so long as there is no attempt to pervert the system, most bankruptcies can be concluded within a reasonably short period.

However, whilst the Insolvency Act 1986 generally regularised bankruptcy as a consequence of taking risk and opportunity, some bankrupts were seen to manipulate events. The Enterprise Act 2002 introduced the concept of harsher restrictions in bankruptcy for these more “culpable” bankrupts. Therefore, debtors who have acted fraudulently, have concealed assets, have failed to keep proper books and records, and who have been generally reckless, etc. with theirs and other’s finances can be prevented from benefitting from seamless and short bankruptcies.

Schedule 4A to the Insolvency Act 1986 (inserted by the Enterprise Act 2002) provides the specific grounds under which a Bankruptcy Restriction Order/Undertaking may be sought. The court will also take into consideration the conduct of the bankrupt during the bankruptcy and whether the bankrupt has been an undischarged bankrupt during the previous six years.

Whilst all undischarged bankrupts suffer restricted activities, these generally disappear upon discharge or annulment. However, Court-ordered BROs or the more informal BRUs agreed between the bankrupt and the Secretary of State (BIS) can extend restrictions for “culpable” bankrupts for between a further two to fifteen years.

Although holding public office is no longer restricted for the majority of bankrupts a BRO or BRU can re-establish the old prohibitions of service as a Member of Parliament or Justice of the Peace. Whilst most bankruptcies will be discharged after 12 months, a BRO/BRU can extend restrictions beyond this and extend the scope of criminal offences under the Insolvency Act after discharge.

**Total 20 marks**

*This non-scenario question called for a review of (a) the impact of bankruptcy orders and (b) the treatment of those who are bankrupt but do not wholesomely participate in the laid-down procedures. With no scenario to engage with, it makes reference to the law, and general insight and understanding, more important routes to higher marks.*

*The task in (a) required candidates to not only discuss, but evaluate the extent of the impact of bankruptcy orders upon the debtor and their creditors – in other words, to cover not just what practical differences the adjudication makes, but how pervasive, controlling, and restricting it can be for the bankrupt and how detrimental it is for those they are in debt to. Consequently, whilst definitions are always welcome, neither they, nor bullet-point lists of what the restrictions are, do not address the set task.*

*In (b), it proved unexpectedly difficult for candidates to distinguish between the BR Undertaking – an agreement to comply with certain conditions – and a BR Order – a matter of compulsion by order of the court. Some candidates could not distinguish between the two and others confused them. Whilst reference to culpability was a necessary part of the task, and an illustration of a culpable event would show understanding, the task was not to specifically discuss culpability in isolation. Lists of culpable events did not centrally address the task, although was given nominal credit as a culpability example.*

8. a) Ronny, Kez and Bhav have been trading together under a partnership agreement for several years. They are all now married with families and feel they need to do something to protect their personal assets. Someone at a corporate event suggested an LLP to them, but they have no idea what that is.

Evaluate in detail, from the viewpoint of being a party to legal proceedings, the differences between a trading partnership and a 'limited liability partnership' (LLP). (8 marks)

- b) As a keen runner and active member of a local running club, you are interested in joining their management committee, but you have heard rumours of financial problems. From the viewpoint of being a party to legal proceedings, explain the situation you would be in, if you were a committee member. (4 marks)
- c) Discuss the usefulness of a Fast Track Voluntary Arrangement (FTVA) as an insolvency procedure and the role of the Official Receiver in their conduct. (8 marks)

Total 20 marks

### Question aims

To test the candidate upon the characteristics of types of debtor as parties to proceedings and upon Fast Track Voluntary Arrangements.

### Suggested answer

a) **Discussion/evaluation of the differences might include:**

A trading partnership, typically governed by a mixture of any bespoke partnership agreement and the provisions of the Partnership Act 1890, offers no protection to the individual partners' personal assets as they are all jointly (as a collective) and severally (individually) liable for the business debts of the partnership to the total extent of their personal wealth. Therefore in relation to legal proceedings, an unpaid creditor has the option of issuing proceedings:

- against the partnership in the partnership name
- against one or all of the individual named partners
- jointly against the partnership and the individual partners.

This means that if a creditor knows one of the partners has personal funds or assets, but the others do not, they can sue that partner for the full amount owed. However, once proceedings are issued, the creditor's election of defendant is irreversible.

A limited liability partnership (LLP), formed pursuant to the Limited Liability Partnership Act 2000, affords some protection to the individual partners as the partnership becomes a corporate body in its own right with a legal personality separate to that of the individual partners. Consequently, it can sue or be sued independently from its members. Any two or more persons can incorporate as an LLP by filing an 'incorporation document' with the Registrar of Companies and nominating the address of a Registered Office, situated in England or Wales. An LLP combines the organisational flexibility of a partnership with limited personal liability for its members. There does not have to be a partnership agreement between the partners.

- b) **Responses regarding legal responsibility of unincorporated associations might include:** Clubs, societies, trade unions and associations are not recognised as independent legal 'persons' in law. They must therefore sue and be sued in the names of the individual members or their representatives (typically members of the club committee or the trustees of the club or association). Some clubs and organisations are registered under particular statutes and specific rules apply to them.

Generally, where goods have been ordered by an individual on behalf of a club, the usual procedure is to sue that individual both in their own name and as a representative of the club. Provided that the individual who orders the goods or services on behalf of the club does so in accordance with the rules of the club, then any judgment obtained will bind all the members of the club. The committee would tend to be liable in the event that rules have not been followed. Therefore careful consideration should be given before joining a committee as any action will be binding on all members of the committee.

c) **Fast Track Voluntary Arrangements (FTVA)**

**Discussions regarding FTAs and the OR's role may include:**

Individual Voluntary Arrangements (IVAs) have proven popular in insolvency cases involving professionals and small business traders where assets and/or future income are likely to be available. However, consumer debtors who were no longer in control of their own financial affairs began to apply for IVAs as an alternative, but the intensive IVA procedure was not suitable for more straightforward situations often present in typical consumer debt positions. The FTVA, introduced on 1st April 2004 by the Enterprise Act 2002, offers a streamlined version of the IVA procedure potentially more suitable for use by consumer debtors, but with sufficient safeguards to avoid general abuse.

The Official Receiver (OR) has a pivotal role in the conduct of an FTVA and the following must be the case:

- the debtor is an undischarged bankrupt
- the OR is specified in the proposal as Nominee
- no application has been made for an interim order under s253 Insolvency Act 1986.

The bankrupt debtor's suitability for an FTVA is judged by the OR following their application. FTVA proposals follow a pro-forma with the bankrupt completing relevant details. Clearly, where fraud or suspected criminal activity is alleged an FTVA would not be appropriate, and complex or "trading" VAs are most likely to be referred to an IP for consideration of a full IVA.

The bankrupt has 14 days to complete the proposal and to send the registration fee and nominee fee to the OR, who reviews the proposal ensuring that:

- the bankrupt is eligible for the FTVA
- the projected income for creditors is better than an Income Payments Order in bankruptcy is likely to provide
- creditors are likely to agree to the FTVA.

Within 28 days of receiving the proposal, the OR decides whether or not to act as nominee and notifies the bankrupt accordingly. If the Official Receiver declines to act as nominee the bankruptcy continues and an Income Payments Order is applied for in due course.

If acceptable, the OR invites creditors to vote by post on the proposal (no meeting is held). No modifications are accepted as creditors are offered the proposal on a "take it or leave it" basis. A date is given for receipt of votes (within 21 days) and, as with the full IVA, a 75% majority of creditors voting is required to accept the FTVA and make it binding on all creditors, whether voting/consenting, or not. Following 28 days to allow for lodgement of any appeals against the vote, the FTVA is implemented and the bankruptcy annulled. Standard OR supervisor costs for FTVAs is set at 15% of assets realised.

**Total 20 marks**

*This question is not restricted to just one area of the syllabus and, in fact, it is fairer on occasion for the balance of the paper to include a question which contains separate tasks on both legal proceedings and insolvency, as this one does.*

*This question is a reminder that there are not necessarily hard and fast lines at the edge of the syllabus and that, in (a) for instance, from the perspective of legal responsibility for business debts of a partnership, candidates will significantly improve their own understanding of on-syllabus issues if they had some understanding of the law or the practical situation underpinning that legal responsibility. In most cases, that might simply mean revising previous learning from other CICM units. It is difficult to imagine how partnership insolvency issues can be effectively understood in isolation without that previous learning in mind. Responding to (b) follows the same learning theory.*

*In (c), whilst the suggested areas of response above may suggest a 'list of processes' at first sight, it is important to recognise the task is to show the usefulness of FTVAs, and the role of the Official Receiver in the conduct of an FTVA. Rather than an unfocussed list learnt by rote, the two parts of the task should be directly addressed.*

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