

SIP 14 Draft

An office holder's responsibility to Preferential Creditors

INTRODUCTION

1. Preferential creditors are defined by statute and divided into primary and secondary classes with rights which are different both from each other and from non-preferential creditors.
2. The particular nature of an insolvency office holder's position renders transparency and fairness of primary importance in all their dealings. Creditors whose debts are preferential should be confident that proper consideration is being given to their rights and they are being treated fairly.
3. In order to ascertain what assets are subject to the statutory rights of preferential creditors, it is necessary to distinguish, on a proper interpretation of the charging document(s), which assets are subject to a fixed charge and which are subject to a floating charge. In this statement this process is referred to as 'categorisation'.
4. The statement is divided into the following sections:
 - Principles
 - Key compliance standards
 - Provisions of general application
 - Provisions of specific application
 - The categorisation of assets and allocation of proceeds as between fixed and floating charges
 - The apportionment of costs
 - Remuneration and expenses
 - The determination of claims for preferential debts
 - Disclosure of information to preferential creditors

PRINCIPLES

5. The office holder has a duty to identify assets and allocate costs appropriately, but that allocation will involve the exercise of professional judgement undertaken with a full appreciation that it must be made in accordance with the fundamental principles of objectivity and integrity as set out in the Code of Ethics.

KEY COMPLIANCE STANDARDS

6. It should be noted that:
 - it is the type of charge at the time of its creation which determines whether the assets are available to meet preferential debts. Crystallisation of a floating charge

into a fixed charge prior to or upon the appointment of an office holder does not affect the rights of creditors with preferential debts to be paid out of assets subject to a crystallised floating charge;

- the conversion, during an insolvency, of assets subject at the date of appointment of a liquidator to a floating charge (for example, stock), into assets subject to a fixed charge (for example, book debts payable into a blocked designated account), will not remove them from the pool of assets which is available to pay primary and secondary preferential debts.
7. The preferential creditors in any insolvency appointment should be identified by the office holder at an early stage and treated in accordance with their preferential status.
 8. In relation to corporate insolvency appointments where assets are found to be subject to fixed or floating charges¹ the office holder should ensure the respective costs of dealing with the different classes of assets are properly attributed to them.
 9. The office holder should assist preferential creditors with quantifying their claims where reasonably practical to do so. Creditors should be advised how they may access suitable information setting out their rights within the first communication with them.

PROVISIONS OF GENERAL APPLICATION

10. It is the duty of an office holder to determine the appropriate categorisation. It is not of itself sufficient for the charging document to state that an asset is subject to a fixed charge for it to be subject to such a charge. Legal advice may be taken in cases of doubt. Where there is doubt regarding the correct categorisation, it may be possible to consult the charge-holder and reach agreement with them. If, however, this is not possible, and after taking into account the interests of other creditors the office holder cannot determine the correct categorisation, it may be necessary to apply to the court for directions.

PROVISIONS OF SPECIFIC APPLICATION

CATEGORISATION OF ASSETS AND ALLOCATION OF PROCEEDS

11. The insolvency legislation requires that the preferential debts shall be paid out of the floating charge assets coming into the hands of the office holder in priority to the prescribed part creditors and to the debenture holder (bond and floating charge holder in Scotland). Where any action which the office holder proposes to take could result in a diminution in the amount available to meet primary or secondary preferential debts the office holder should assess the risk of any impact on primary

¹ Following enquiry by, and to the satisfaction of, the office holder, having obtained legal advice if necessary.

and secondary preferential creditors and consider and document their reasons for action or forbearance.

12. Office holders should ensure that the allocation of the sale proceeds and associated costs between fixed and floating charge assets properly reflects the financial interests of the different classes of creditor in the individual assets or classes of assets. This allocation may be different from any apportionment of sale consideration suggested by the purchaser.

APPORTIONMENT OF COSTS

13. The amount available to meet preferential debts is the funds realised from the disposal of assets subject to a floating charge net of the properly allocated costs. It is dependent, therefore, not only on the correct categorisation of the assets but also on the appropriate allocation of costs.
14. In order to enable an office holder to allocate costs on an appropriate basis, contemporaneous records of the dominant reasons for incurring costs should be maintained. These will also assist them in providing explanations as to how they arrived at what they consider to be an appropriate allocation of costs and provide evidence should that allocation be challenged by any of the relevant stakeholders including their regulatory bodies.
15. Where costs are clearly identifiable as having been incurred in the realisation or collecting in of fixed or floating charge assets they should be recorded as such in the office holder's records so that they can be deducted from the corresponding realisation proceeds in ascertaining the amount available for each class of creditors.
16. Where costs are less easily identifiable, for example when trading is continued, it may be difficult to arrive at an appropriate allocation of costs. It is therefore important that the office holder engages with the charge holder at an early stage to agree a framework for a contribution to costs from them in respect of both fixed and floating charge assets.
17. In allocating costs an office holder should have regard to:
 - the objectives for which costs were incurred, it being recognised that certain types of costs may, properly, be allocated to the fixed charge assets in one case and to the floating charge assets in another². In another case such costs may enhance realisations in both categories.
 - the benefits actually obtained for those financially interested in one or other category of asset in terms of protection of those assets or their value and any augmentation of that value.

² For example the payment of rent on a leasehold property may be to preserve the value of the lease or to enable manufacturing to continue and work in progress to be completed.

- whether the benefits to those interested in assets subject to a fixed charge have been enhanced by action which proves to be detrimental to those interested in floating charge assets (for example where trading losses are incurred to protect or enhance the value of property or other assets subject to a fixed charge).
- whether the realisation of the undertaking and assets by means of a going concern sale has resulted in a reduction in the quantum of debts which are preferential due to the transfer of employment contracts.
- the maintenance of a proper balance between the classes of creditors with whose interests they are required to deal in the light of their legal rights.

18. In apportioning the costs of fulfilling their statutory duties and in the absence of any guidance from the courts, office holders should have regard to the principle referred to in paragraph 17 above of maintaining a proper balance.

REMUNERATION AND EXPENSES

19. The allocation of an office holder's remuneration and expenses should be undertaken adopting the same principles as those applicable to costs. Office holders should ensure that they maintain contemporaneous records which will enable them to evidence an appropriate division of their remuneration and expenses between the different categories of assets and to provide an explanation of that division if required.

DETERMINATION OF PREFERENTIAL DEBTS

20. An office holder should assess whether there are likely to be sufficient floating charge realisations to pay a distribution to preferential creditors. Where no payment will be made, it is not necessary to agree preferential claims.
21. Where there will be a distribution to preferential creditors, it may be that such creditors are not able to quantify their claims without information from the insolvent person or entity; accordingly, the office holder should assist them, where reasonably practical, by providing adequate information to enable them to calculate their claims. With the exception of employees, the office holder may assume primary and secondary preferential creditors have full knowledge of their legal entitlements under the Insolvency Act and, unless they advise to the contrary, should invite them to submit their claims. The office holder should then check those claims and accept or reject them as appropriate.

Employee preferential claims

22. In determining the preferential claims of individual employees, and of any other preferential creditor who has so advised, the office holder is not entitled to regard them as having full knowledge of their rights and entitlements. Accordingly, the office holder should obtain information from the insolvent entity's records or from the

employee, or other preferential creditor, before calculating their claim (other than one which is payable to the Secretary of State by way of subrogation³). The employee, or other preferential creditor, should be provided with details of the calculation of their claim and any further explanation that they may reasonably require.

23. When an employee's preferential debt has been paid out of the National Insurance Fund (NIF) of the relevant jurisdiction, the NIF is entitled to the benefit of the employee's preferential debt, in priority to any residual claim of the employee in their own right. An office holder is not, however, obliged to accept the NIF's preferential claim without being satisfied that it is correct. If an office holder is not able to accept the NIF's claim they should contact the Redundancy Payments Service to explain why and attempt to reach agreement on the amount to be admitted. Ultimately it is for the office holder to formally reject the claim if agreement is not reached, and for the RPS to appeal if they do not accept the office holder's adjudication.

DISCLOSURE TO CREDITORS WITH PREFERENTIAL DEBTS

24. When the funds realised from assets subject to a floating charge are inadequate to pay the preferential debts in full, the office holder should include this information in their next progress report to creditors and is not obliged to notify the preferential creditors separately and in advance of that report.
25. Any further information which a creditor with a preferential debt reasonably requires should be provided promptly.

EFFECTIVE DATE

This SIP comes into effect on

³ Anyone who has advanced money for the purpose of paying wages, salaries or accrued holiday remuneration of any employee is a preferential creditor (subject to the applicable statutory limit) to the extent that the preferential claim of the employee is reduced by such advance. Such a claim may be described as a 'subrogated claim'.