



STATEMENT OF INSOLVENCY PRACTICE 3B (SCOTLAND)

COMPANY VOLUNTARY ARRANGEMENTS

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1 INTRODUCTION

- 1.1 This Statement of Insolvency Practice (SIP) is one of a series of guidance notes issued to licensed insolvency practitioners with a view to maintaining standards by setting out required practice and harmonising practitioners' approach to particular aspects of insolvency.

SIP 3 is issued under procedures agreed between the insolvency regulatory authorities acting through the Joint Insolvency Committee (JIC). It was commissioned by the JIC, produced by the Association of Business Recovery Professionals and has been approved by the JIC and adopted by each of the regulatory authorities listed below:

Recognised Professional Bodies:

- The Association of Chartered Certified Accountants
- The Insolvency Practitioners' Association
- The Institute of Chartered Accountants in England and Wales
- The Institute of Chartered Accountants in Ireland
- The Institute of Chartered Accountants of Scotland
- The Law Society
- The Law Society of Scotland

Competent Authority

- The Insolvency Service (for the Secretary of State for Trade and Industry)

The purpose of SIPs is to set out basic principles and essential procedures with which insolvency practitioners are required to comply. Departure from the standard(s) set out in the SIP(s) is a matter that may be considered by a practitioner's regulatory authority for the purposes of possible disciplinary or regulatory action.

SIPs should not be relied upon as definitive statements of the law. No liability attaches to any body or person involved in the preparation or promulgation of SIPs.

- 1.2 The Insolvency Act 1986 (IA 1986) and The Insolvency (Scotland) Rules 1986 (as amended) set out a procedure which enables the directors, the administrator or the liquidator of a company to make a proposal for a voluntary arrangement (CVA) with its creditors.

The arrangement must take the form of a composition in satisfaction of the company's debts or a scheme of arrangement of its affairs.

- 1.3 Members should refer to the relevant legislation which, for a CVA, is contained in sections 1 - 7B (inclusive) of the IA 1986 Schedule A1 to the IA 1986 and Rules 1.1 - 1.45 (inclusive) of the Rules, as amended.

Members should also refer to The EC Regulation on Insolvency Proceedings (Council Regulation [EC] No. 1346/2000) ("the EC Regulation").

The objective of this statement is to set out best practice in relation to the work carried out by members in connection with CVAs.

- 1.4 The statement has been prepared primarily to address the circumstances where a proposal for a CVA is made by the directors of a company but it

should also be applied as appropriate where the proposal is made by an administrator or liquidator.

- 1.5 In many cases the member's role will change during the conduct of the case, for example from adviser to nominee to supervisor. These roles will involve different responsibilities: for example, when acting as advisor the member's role will be to consider the best course of action for the company in the light of its particular circumstances; when he becomes nominee his duty will be to the creditors and the court; and when acting as supervisor his responsibilities will be governed by the terms of the arrangement. The member should be mindful of possible conflicts of duty arising from these changes of role. He should ensure that his case records distinguish between these functions and that his remuneration in respect of each function is separately identified.

2 BASIS OF THE ARRANGEMENT

- 2.1 The terms of the CVA will be contained in the proposal, with or without modifications which is approved by the creditors. A comprehensive and accurately drafted proposal is therefore fundamental to the arrangement. In view of the importance of the proposal the member should, where the circumstances are complex, consider whether it should be prepared or approved by a lawyer. The contents of the proposal are given further consideration in section 5 and the Appendix.
- 2.2 In dealing with a CVA the member should bear in mind his overriding duty to ensure a fair balance between the interests of the company, the creditors and any other parties involved. In considering whether to accept appointment as either nominee or supervisor the member should have regard to the ethical guidelines of his authorising body.

3 INITIAL CONTACT WITH THE DIRECTORS

- 3.1 At the initial interview the member should explain to the directors the different roles he will perform during the conduct of the case and the different duties and responsibilities that they entail. He should point out to the directors the need for the nominee and supervisor to maintain independence.
- 3.2 The member should explain his role as nominee in relation to the directors' proposal and of his duty to perform an independent, objective review and assessment of the proposal for the purposes of reporting his opinion to the court and generally balancing the interests of the company and the creditors. This duty of independence and objectivity arises irrespective of the extent of the member's involvement in drafting the directors' proposals. The member should make it clear to the directors that his duties as nominee cannot be fettered by any instructions of the directors or any third party.
- 3.3 Where consideration is being given to obtaining a moratorium under section 1A IA 1986 the member should explain to the directors the additional duties which fall on the nominee and the responsibilities which fall on the directors during the moratorium.
- 3.4 The member should keep a contemporaneous and full file note of all matters discussed with the directors, including the matters referred to in paragraphs 3.1 to 3.3. A copy of the file note should be sent or reproduced in full in a letter to the directors.

- 3.5 The member should also send a letter of engagement to the directors setting out in writing their respective duties and responsibilities in relation to the proposal in order to minimise the scope for misunderstandings.
- 3.6 The member should give consideration to the most appropriate entry route into a CVA having regard to the degree of protection which may be required in the circumstances of the case.

4 STATEMENT OF AFFAIRS AND OBTAINING ADDITIONAL INFORMATION

- 4.1 The statement of affairs should detail the nature and amount of all the company's assets and liabilities, including the liabilities set out in paragraph 4.2(a)(i) - (vii) below. A misstatement of the amount of the assets and liabilities can constitute a 'material irregularity' (within the meaning of section 6, and paragraph 38 of Schedule A1, IA 1986) being a ground on which an approved CVA may be challenged by an aggrieved creditor, the nominee, the administrator or the liquidator. In addition, a director commits an offence if he makes any false representations or commits any other fraud for the purpose of obtaining the approval of the creditors to the proposed arrangement. The directors should be informed of these dangers.
- 4.2 The member's approach should, *inter alia*, cover the points listed below:

a) Creditors

The member should require the directors to provide details of all known or possible liabilities including:

- i) claims which are fully or partly secured: the status of the accounts and the existence of any arrears should be established;
- ii) preferential claims;
- iii) guarantee liabilities;
- iv) claims for breach of contract, including claims in respect of faulty and incomplete work and hire purchase and leasing agreements;
- v) creditors who are persons connected with the company ('connected persons') (as defined in section 249 IA 1986);
- vi) guarantors of the company's debts, including connected persons;
- vii) debts for an unliquidated amount or any debt whose value is unascertained, including particularly:
 - contingent liabilities;
 - the potential for liabilities arising under property leases (of both present and past tenancies);

He should also:

- viii) identify any creditors who have commenced diligence or any other legal process;

- ix) identify any creditors with special rights which may require special consideration in the proposal (for example insured claims)
- x) consider the possibility of early informal discussions with the key creditors, including government departments, to establish their views;
- xi) obtain independent confirmation from any bank or other financial institution of their intention to continue to provide financial support to the company where this is necessary for the purpose of the arrangement;
- xii) establish whether connected persons may consider withdrawing or deferring their claims.

b) Assets

The member should take steps to satisfy himself that the value of the assets is appropriately reflected in the statement of affairs. Where the value of an asset is material to the outcome of the arrangement consideration should be given to obtaining corroborative evidence as to its value. The member should also ensure that a comprehensive schedule of non-trading assets in which the company has an interest has been prepared together with explanatory notes. If there is a business, the member should consider, in conjunction with the directors, the manner in which that business is to be dealt with.

If the business is to be continued by the company, a 'business plan' should be produced to justify this decision stating the assumptions on which it is based, and in appropriate detail having regard to the circumstances and size of the undertaking. The member should satisfy himself that the plan has a reasonable chance of success.

c) Antecedent Transactions

The member should enquire as to:

- i) possible gratuitous alienations (section 242 IA 1986 or common law);
- ii) payments which may be unfair preferences (section 243 IA1986) or fraudulent preferences at common law;
- iii) floating charges which would be invalid in the event of administration or liquidation (section 245 IA 1986);
- iv) charges which would be void against a liquidator, administrator or creditor in the event of liquidation or administration (section 395 CA 1985);
- v) liabilities which may be extortionate credit transactions, both those outstanding and paid (section 244 IA 1986).

d) General

The member should also consider:

- i) whether the person(s) making the proposal is/are credible and making a full disclosure. The member should explain the consequences of making false representations;
- ii) whether (any of) the directors have been involved in any previous business failure, either individual or corporate, and if so the details of that failure and the person's responsibility for it; and,
- iii) the timetable for the CVA.

The extent of the member's enquiries into these issues is likely to vary according to the particular circumstances of the case but should be such as will enable the member to properly discharge his duty to report to the court as nominee (see section 6 below).

5 CONSIDERATION OF THE PROPOSAL

5.1 Throughout his consideration of the above factors the member should be forming his opinion of the appropriate method of dealing with the company's affairs. Although this will be partly a subjective review of the factors already referred to, the member should take into account:

- a) the directors' attitude;
- b) the likelihood of the company adhering to the terms of the proposal;
- c) the extent of the control over the assets exercised by the company as opposed to the supervisor of the proposal, bearing in mind that in a CVA the assets do not automatically vest in the supervisor by operation of the law;
- d) the removal/absence of the restrictions otherwise imposed by formal winding up.

5.2 In considering the proposal the member should bear in mind the following questions:

- Is it feasible?
- Is it fair to the creditors?
- Is it an acceptable alternative to formal insolvency?
- Is it fit to be considered by the creditors?
- Is it fair to the company?
- Where the company has previously put forward a proposal which has been rejected by the creditors, are there good reasons why the creditors should be asked to consider the current proposal?

In view of the importance of the contents of the proposal the member should, prior to submitting his report and supporting comments to the court, satisfy himself that the proposal, (with any modifications), is structured and drafted in such a way that the terms of the CVA can be clearly understood and that the arrangement is likely to proceed to a successful conclusion.

5.3 The member should ensure that the proposal addresses all those matters prescribed by the Rules. The member should also consider the inclusion of appropriate other provisions in order to facilitate the practical implementation of the arrangement (see Appendix) but should bear in mind that the terms of a proposal cannot extend or fetter the jurisdiction of the court. The proposal should specify clearly whether the arrangement is to be a composition in satisfaction of the company's debts or whether it is to be a scheme of

arrangement. It should also set out what action is to be taken in the event of deviation from, or failure of, the arrangement. The use of the standard terms issued by the Association of Business Recovery Professionals will assist in ensuring that these matters are adequately dealt with.

5.4 The following information should also be provided, either in the proposal or in the nominee's comments:

- The source of any referrals to the nominee or his firm in relation to the proposed CVA.
- Any payments made, or proposed to be made, to the source of such referrals.
- Any payments made, or proposed to be made, to the nominee or his firm by the company whether in connection with the proposed CVA or otherwise.
- An estimate of the total fee to be paid to the supervisor together with a statement of the assumptions made in producing the estimate.

5.5 The proposal must include a statement whether the EC Regulation applies and, if so, whether the proceedings are main or territorial proceedings.

6 THE NOMINEE'S STATEMENT/REPORT AND COMMENTS

6.1 The nominee is required to state whether, in his opinion:

- the proposed arrangement has a reasonable prospect of being approved and implemented, and
- a meeting of creditors and the company should be held to consider the proposal.

In cases where the directors intend to obtain a moratorium under section 1A IA 1986 this statement must form part of the statement which the nominee is required to submit to the directors and which they in turn are required to file in court. In all other cases it must be included in the nominee's report to the court.

Where a moratorium is in force under section 1A IA 1986 the nominee is required as part of his monitoring duties to keep under review the question of whether the proposal has a reasonable prospect of being approved and implemented, and must withdraw his consent to act if he forms the view that it no longer does.

6.2 In the English case of *Re A Debtor* (No 140 IO of 1995), *Greystoke v Hamilton-Smith and Others* ([1996]2 BCLC 429; [1997] BPIR24) the court set out three tests which the nominee should apply before concluding that a meeting should or should not be summoned and held that he should satisfy himself on all three counts. They are:

- a) that the company's true position as to assets and liabilities is not materially different from that which it is represented to the creditors to be;
- b) that the directors' proposal has a real prospect of being implemented in the way it is to be represented it will be; and,
- c) that there is no already-manifest yet unavoidable prospective unfairness.

- 6.3 Test (b) is effectively the same as that which is now required by statute. If the nominee cannot satisfy himself that the other two conditions are met but still recommends that a meeting should be held, he should explain in his comments the basis on which he is making that recommendation and qualify his comments so that the fact that conditions are not met is conspicuously brought to the attention of the court.
- 6.4 Where the nominee reports in the affirmative on the matters referred to in paragraph 6.1 he is required to set out his comments on the proposal and to annex them to his statement or report. The matters upon which the nominee will wish to comment will vary from case to case but they should normally include:-
- a) the extent to which the nominee has investigated the company's circumstances;
 - b) the basis upon which assets have been valued;
 - c) the extent to which the nominee considers that reliance can be placed upon the directors' estimate of the liabilities to be included in the CVA;
 - d) information on the attitude adopted by the directors with particular reference to instances of failure to co-operate with the nominee;
 - e) the result of any discussions between the nominee and secured creditors or other interested parties upon whose co-operation the performance of the CVA will depend;
 - f) information on the attitude of any major unsecured creditor which may affect the approval of the arrangement by creditors;
 - g) details of any previous history of failures in which any of the directors has been involved, insofar as they are known to the nominee;
 - h) an estimate of the result for the creditors if the CVA is approved, explaining why it is more beneficial for creditors than any alternative insolvency proceeding;
 - i) the likely effect of the proposal's rejection by the creditors;
 - j) details of any claims which have come to his attention which might be capable of being pursued by a liquidator or administrator if one were appointed;
 - k) where the conditions set out in paragraph 6.2 above have not been met, the basis on which the nominee is recommending that a meeting be held.
- 6.5 If not already dealt with in the proposal, the nominee's comments should include the information referred to in paragraph 5.4 above.
- 6.6 If the company has, within the previous twelve months, put forward a proposal that has been rejected, the nominee's comments should include a statement

to that effect, and an explanation of why it is considered appropriate for the creditors to consider and vote on the current proposal.

- 6.7 If the nominee reports that the proposed arrangement does not have a reasonable prospect of being approved and implemented or that meetings should not be held he must give his reasons for that opinion.

7 THE MEETINGS OF CREDITORS AND OF MEMBERS

- 7.1 Notice of the meeting of creditors must be given to all creditors of whose claim the person summoning the meeting is aware, in strict accordance with the Rules. The minimum notice period of fourteen days excludes the day the notice is deemed to have been served and the day of the meeting. Refer to Rule 7.22 to determine the date of service.

- 7.2 It should be noted that although an approved arrangement will be binding on creditors who did not receive notice of the meeting, such creditors have the right, on becoming aware that the meeting has taken place, to apply to the court on the grounds that the arrangement unfairly prejudices their interests or that there has been a material irregularity in relation to the meeting. It is unacceptable for notice to be deliberately withheld from a creditor.

- 7.3 Before the creditors' meeting the nominee should take the following steps:

- a) record all proxies received in advance of the meeting, and details of claims;
- b) complete the meeting record as far as possible detailing the names and voting value of creditors;
- c) discuss with the directors any modifications suggested by creditors prior to the meeting;
- d) review the proposal in the light of creditors' responses and possible changes in circumstances;
- e) prepare a report for presentation at the meeting, summarising the proposal, outlining the likely effects of acceptance and rejection and giving details of any changes in circumstances which have arisen since the proposal was sent to creditors;
- f) consider voting rights and requisite majority.

- 7.4 The chairman must decide the amount for which creditors are to be allowed to vote and must have regard to the provisions of the Rules. Proxies and statements of claim to be used at the meeting may be lodged at any time, even during the course of the meeting.

- 7.5 After the chairman has presented his report to the creditors' meeting he should allow creditors an opportunity to make comments, ask questions or propose modifications to the proposal.

- 7.6 Although it is not a statutory requirement for directors to consent to modifications, it is recommended that the nominee should find out and report

to the meeting their views on any proposed modifications which they may be required to implement if approved.

- 7.7 If modifications are proposed by a creditor the chairman should give careful consideration to the manner in which he will use specific instructions given to him by creditors to vote for either the acceptance or the rejection of the original proposal. If the words in the proxy form allowing the exercise of discretion in the absence of specific instructions have not been deleted so as to entitle the proxy holder to vote only as directed, the proxy holder is entitled to vote or abstain on any modification at his discretion.
- 7.8 However, the chairman should consider most carefully the impact of the exercise of his discretion upon the expressed intentions of any creditor who has completed a proxy requiring a vote on any particular resolution. He should bear in mind that, if a creditor is aggrieved that a vote on proposed modifications has been taken and a decision reached which might have been different if creditors represented by proxy had been present at the meeting or had been given the opportunity of amending their proxy, the aggrieved creditor may challenge the decision by an application to the court (section 6 IA 1986). Accordingly, the chairman should consider an adjournment or suspension of the meeting to give him an opportunity to explain the circumstances to the creditor or creditors from whom he holds a proxy and to obtain their further instructions.
- 7.9 If a majority for approval of the CVA is not obtained at the creditors' meeting, the chairman may adjourn the meeting and must adjourn it if it is so resolved. The maximum period for adjournment allowed by the Rules is 14 days from the original meeting date, but within this period there can be more than one adjournment. If the meetings are to consider a proposal by the directors notice of the adjournment must be given to the court. The chairman should also consider the need to inform creditors of the adjournment and, where substantial modifications are proposed, of those modifications.
- 7.10 If the decision taken by the creditors' meeting differs from that taken by the company, the chairman of the meeting should draw creditors' attention to the provisions of section 4A IA 1986, which gives any member of the company the right to apply to the court within 28 days and allows the court to order the decision of the company meeting to prevail over that of the creditors.
- 7.11 The chairman's report of the meetings held under section 3 IA 1986 must include a statement whether, in the opinion of the supervisor, the EC Regulation applies to the voluntary arrangement and if so, whether the proceedings are main or territorial proceedings.

8 IMPLEMENTATION FOLLOWING THE MEETING OF CREDITORS

- 8.1 The supervisor's main duty is to ensure that the CVA proceeds in accordance with the terms of the agreed proposal. In order to do this he should maintain regular contact with the directors, obtaining reports as may be appropriate to the case. If the supervisor or directors consider that the terms of the arrangement may not be achieved then the supervisor should take steps to discuss the situation with the directors. If actual events suggest a deviation from the terms of the arrangement, the supervisor should take appropriate action. Such action should correspond to further detailed provisions of the proposal. If he is authorised to exercise discretion in any area and that

discretion is exercised, the member should explain the circumstances to creditors and members at the next available opportunity.

8.2 If it becomes clear to the supervisor that the fee payable to him will exceed the estimate provided in accordance with paragraph 5.4 above or this paragraph he must, in his next report to creditors:

- notify the creditors of that fact, and
- explain why the estimate has been exceeded, and
- provide a revised estimate.

9 CONCLUSION/TERMINATION OF THE ARRANGEMENT

9.1 Where the arrangement has been fully implemented the supervisor should conclude his administration as expeditiously as possible.

9.2 In circumstances of likely failure or default, it will be necessary to consider how matters should proceed. The term 'failure of the scheme' or 'failure of the arrangement' is not an expression found in the Act or Rules and it is essential, as stated in paragraph 5.3 above, that the proposal should have set out in specific terms the circumstances in which it shall be deemed to have failed and state what action the supervisor is required to take in the event of failure. Where failure has occurred the supervisor should notify the creditors accordingly and advise them what action he has taken or proposes to take. The standard terms and conditions produced by The Association of Business Recovery Professionals contain comprehensive provisions for dealing with breach of the arrangement.

9.3 In the event of failure particular care must be taken to ascertain who is entitled to the remaining assets and in the event of the presentation of a winding up petition, whether disposal of the assets would be void under section 127 of the IA 1986. In the English case of *Shierson and Another v Tomlinson and Another (Re N T Gallagher & Son Limited)* ([1992] 2 BCLC 133; [2002] BPIR 565) the Court of Appeal held that:

- where a CVA provides for monies or other assets to be paid to or transferred or held for the benefit of CVA creditors, this will create a trust of those monies or assets for those creditors;
- the effect of the liquidation of the company on a trust created by the CVA will depend on the provisions of the CVA relating thereto;
- if the CVA provides what is to happen on liquidation (or a failure of the CVA), effect must be given thereto;
- if the CVA does not so provide, the trust will continue notwithstanding the liquidation or failure and must take effect according to its terms.

It should be noted that this is an English case and has not been tested in the Scottish Courts.

9.4 Where a supervening winding up order is made against the company, the member should arrange for the prompt hand over of assets, funds, books and records to the interim liquidator.

10 IMPLEMENTATION

This SIP applies to all cases in which the proposal is dated on or after the effective date.

VOLUNTARY ARRANGEMENTS: CONTENTS OF THE PROPOSAL

The proposal must include a statement whether the EC Regulation applies and, if so, whether the proceedings are main or territorial proceedings.

In drafting the proposal it is helpful to follow the order in which the contents are listed in the Rules.

The proposal should include sections covering the following:

- a) the nature of the arrangement: i.e. whether it is a composition in full and final settlement of debts, or a scheme of arrangement;
- b) the background to the arrangement, including details of the circumstances in which the company has become insolvent and including any relevant personal circumstances of the directors;
- c) the statement of affairs, which should include full details of assets and liabilities;
- d) a realistic comparison of the estimated outcomes of the CVA and of winding up;
- e) the actual financial proposal to be put to the creditors. This section should include:
 - i) details of assets to be realised for the benefit of creditors and details of those which are to be excluded from the proposal, together with the reasons for the exclusion and whether alternatives are to be suggested;
 - ii) proposals regarding after acquired assets and windfall gains;
 - iii) proposals regarding future profit/income over a specific period;
 - iv) whether third party funds are to be injected;
- f) the intentions with regard to any business operated by the company stating in particular whether the business is to be continued, and if so, the extent, if any, to which the supervisor shall exercise any degree of control over the business. If the supervisor is not to exercise any degree of control, this should be specifically stated in the proposal. The purpose or aim of continued trading should be stated: have new opportunities been created that will generate profits to pay creditors; is the trade being wound down to generate funds from asset realisations or is the business being marketed (and, if so, how) as a going concern? Consideration should be given to including a summary cash flow projection;
- g) the powers, duties and responsibilities of the supervisor. This will need to deal with the question of admission or rejection of claims, the manner in which funds are to be distributed to creditors and the basis on which the supervisor is to report to creditors;
- h) miscellaneous matters which under the Act or Rules need to be included.

Other matters which the member should consider in order to facilitate the practical implementation of the proposal:

- i) whether a committee of creditors is to be appointed and if so what will be its powers, duties and responsibilities;
- j) what will happen to surplus funds arising, for example, from more beneficial trading than was originally envisaged, when the CVA is concluded;
- k) confirmation that when the terms of the CVA have been successfully completed the creditors will no longer be entitled to pursue the company for the balance of their claim: that the CVA is in full and final settlement of their liabilities;

- l) what will happen to unclaimed dividends or unrepresented cheques when the CVA is concluded;
- m) how to deal with creditors who have not made claims;
- n) the power of the supervisor to summon meetings of the CVA creditors for the purpose of obtaining their views and in particular for obtaining their approval to any modifications to the CVA;
- o) the requisite majorities required to pass resolutions at meetings of creditors and members summoned during the course of the CVA;
- p) in view of the fact that the assets do not automatically vest in the supervisor it may be advisable for the proposal to provide for such vesting or for the supervisor to be granted a charge over assets, or to be given some other suitable form of security or for a declaration of trust or power of attorney to be executed;
- q) the attitude to be adopted with regard to contingent creditors;
- r) the situation with regard to overseas creditors;
- s) the circumstances in which the supervisor is to present a petition for a winding up order;
- t) the situation with regard to tax liabilities arising on disposal of the company's assets, or the future income of or gifts to the company from a third party, that are applied towards the payment of creditors' claims;
- u) the inclusion of power for the supervisor or any creditors' committee to be able to determine that a CVA has no future and petition for winding up and authority to retain and use funds from the CVA for such cost.

When considering these issues the member should have regard to any relevant decisions of the court which have clarified points of law where the statutory provisions are either silent or ambiguous.

Many of these matters are dealt with in the standard terms and conditions produced by The Association of Business Recovery Professionals.