
~~STATEMENT OF INSOLVENCY PRACTICE~~

~~14 (E & W)~~

~~A RECEIVER'S RESPONSIBILITY TO PREFERENTIAL CREDITORS~~

~~ENGLAND AND WALES~~

SIP 14 Draft

An office holder's responsibility to Preferential Creditors

~~1. INTRODUCTION~~

~~1.1 This statement of insolvency practice is one of a series issued by the Council of the Society with a view to harmonising the approach of members to questions of insolvency practice. It should be read in conjunction with the Explanatory Foreword to the Statements of Insolvency Practice and Insolvency Technical Reminders issued in June 1996. The statement has been prepared for the sole use of members in dealing with receiverships where any assets of the company are subject to a floating charge. Members are reminded that SPI Statements of Insolvency Practice are for the purpose of guidance only and may not be relied on as definitive statements. No liability attaches to the Council or anyone involved in the preparation or publication of Statements of Insolvency Practice. This statement applies to England and Wales only.~~

~~1.2 This statement has been prepared to summarise what is considered to be the best practice to be adopted by receivers of the assets of companies where any of those assets are subject to a floating charge so that the office holder has legal obligations to creditors whose debts are preferential. Its purpose is to:~~

- ~~• ensure that members are familiar with the statutory provisions;~~
- ~~• set out best practice with regard to the application of the statutory provisions;~~
- ~~• set out best practice with regard to the provision of information to creditors whose debts are preferential and to responses to enquiries by such creditors. Whilst this statement does not specifically address the treatment of preferential claims in liquidations, members acting as liquidators (or in any other relevant capacity) should have due regard to the principles which it contains.~~

~~1.3 The statement has been produced in recognition of the likelihood that creditors whose debts are preferential may be concerned about the categorisation of assets as between fixed and floating charges and the manner in which costs incurred during a receivership are charged against the different categories of assets.~~

~~1.41. The statement is divided into the following sections:~~

- ~~• the statutory provisions~~
- ~~• the categorisation of assets and allocation of proceeds as between fixed and floating charges~~
- ~~• the apportionment of costs incurred in the course of the receivership~~
- ~~• the determination of claims for preferential debts~~
- ~~• the payment of preferential debts~~

~~1. disclosure of information and responses to queries raised by creditors~~ 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.

- ~~• 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
- ~~• other matters~~

~~2. THE STATUTORY PROVISIONS~~

~~2.1 The rights of creditors whose debts are preferential in a receivership derive from section 40 of the Insolvency Act 1986 ('the Act').~~

~~Where a receiver should be confident that proper consideration is appointed on behalf of the holders of any debentures of a company secured by a charge which, as created, was a floating charge and the company is not at the time in the course of being wound up, its preferential debts shall be paid out of the assets coming into the hands of the receiver in priority to any claims for principal or interest in respect of the debentures. Where the receiver is appointed under both fixed given to their rights and floating charges, this requirement does not extend to assets coming into the receiver's hands pursuant to the fixed charge(s).~~

~~2. Preferential debts are defined in section 386 of the Act and are set out in Schedule 6 to the Act (as amended from time to time), which is to be read in conjunction with Schedule 4 to the Pensions Schemes Act 1993. The date at which they are to be ascertained is the date of the appointment of the receiver (section 387(4) of the Act) being treated fairly.~~

~~2.2—Members should note that the statutory provisions give a right to creditors whose debts are preferential to be paid those debts in priority to the claims of floating charge holders, and the corollary of this right is the obligation of the receiver to pay them. Failure by a receiver to pay preferential debts out of available assets is a breach of statutory duty. However it is recognised that circumstances may arise when it is administratively convenient or cost effective to cooperate with a company's liquidator and arrange for him to pay the receivership preferential debts, and guidance on such arrangements is given in paragraph 6.2 below. It should be noted that such arrangements do not exonerate the receiver from his obligations.~~

~~2.3—There are no statutory provisions requiring creditors with preferential debts in a receivership to prove those debts in any formal manner and no statutory obligation is imposed on a receiver to advertise for claims.~~

~~3.—CATEGORISATION OF ASSETS AND ALLOCATION OF PROCEEDS~~

~~3.13._____ In order to ascertain what assets are subject to the statutory rights of creditors whose debts are 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'.~~

~~3.2—The overriding principle, as laid down by the courts, is that 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. There have been cases where the courts have struck down charges that purported to be fixed and held that they were floating.~~

~~3.3—It is the duty of a receiver to effect the right categorisation and legal advice should be taken in cases of doubt. In some instances where there is doubt as to the correct categorisation it may be possible to consult preferential creditors and reach agreement with them and the chargeholder. However, if this is not possible and the receiver, in conjunction with his legal advisers, cannot determine the correct categorisation, it may be necessary to apply to the court for directions.~~

~~3.4—Members are reminded that:~~

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 a receiver and 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 receivership and insolvency, of assets (for example, stock) subject at the date~~
- of appointment of the receiver a liquidator to a floating charge (for example, stock), into assets (for example, book debts) 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. Section 40 of 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

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

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. ~~At~~The insolvency legislation requires that the preferential debts 'shall be paid out of the {floating charge} assets coming ~~to~~ into the hands of the ~~receiver~~office holder in priority ~~to~~ to the prescribed part creditors and to the debenture holder. The effect is that a receiver is under a liability in tort to the preferential creditors if, having had available assets in hand, he fails to apply them in payment of the preferential debts. (bond and floating charge holder in Scotland). Where any action which ~~he~~the office holder proposes to take could result in a diminution in the amount available to meet primary or secondary preferential debts the ~~receiver~~office holder should ~~give~~assess the most serious consideration to the ~~risks~~risk of ~~such~~any impact on primary and secondary preferential creditors and consider and document their reasons for ~~action~~ or forbearance.

- 3.512. ~~When assets are sold as part of a going concern (or otherwise in parcels comprising both~~Office holders should ensure that the allocation of the sale proceeds and associated costs between fixed and floating charge assets) ~~the apportionment of the total consideration suggested by the purchaser (for example for his own financial reasons) may not properly reflect~~reflects the financial interests of the different classes of ~~creditors~~creditor in the individual assets or ~~categories~~classes of assets. ~~In these circumstances the receiver should ensure that he will~~This allocation may be able properly to discharge his obligations to account to holders of fixed charges on the one hand and creditors interested in assets subject to floating charges on the other~~different from any apportionment of sale consideration suggested by the purchaser.~~

4. APPORTIONMENT OF COSTS

4.113. 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 of realisation. It is dependent, therefore, not only on the correct categorisation of the assets but also on the appropriate allocation of costs ~~incurred in effecting realisations.~~

4.2 ~~These costs will normally fall into one of three categories:~~

- ~~• liabilities incurred by the company (the receiver being its agent until winding up supervenes) and costs incurred by the receiver and recoverable by him out of the company's assets under his statutory indemnity (other than those referred to below);~~
- ~~• the costs of the receiver in discharging his statutory duties;~~
- ~~• the remuneration and disbursements of the receiver.~~

4.3 ~~Liabilities incurred by the company and the receiver's reasonable costs are sometimes readily identifiable as applicable to either the fixed charge or floating charge assets, but in other cases may not be so easily allocated between the two categories of assets.~~

~~Where costs are clearly identifiable as having been incurred in the realisation or collecting in of one or other of the two categories they should be recorded as such in the receiver's records so that they can be deducted from realisation proceeds in ascertaining the amount available for each class of creditors.~~

4.4 ~~It is in the nature of receiverships, and particularly receiverships where trading is continued, that there will be continuation of employment of the company's directors and staff, ongoing occupation of its premises, purchase of supplies for manufacturing and other purposes and much of the other expenditure normally associated with a company's operations. In these circumstances it may be difficult to arrive at an appropriate allocation of costs. Many of the activities in a trading receivership will~~

~~enhance the realisations of assets in both of the categories identified above. They may of necessity be incurred before full categorisation has been completed.~~

~~These factors do not affect the duty of a receiver to allocate costs appropriately but that allocation will involve the exercise of professional judgement undertaken with a full appreciation that it must be made with independence of mind and with integrity.~~

4.5 ~~The key principles for a receiver in his consideration of the allocation of costs (including any trading losses) are:~~

- ~~• the statutory rights of preferential creditors as set out in the Insolvency Act 1986 and the decisions of the courts in cases under that Act and predecessor legislation;~~
- ~~• the provisions of the charging document(s);~~
- ~~• the maintenance of a proper balance as between the classes of creditors with whose interests he is required to deal in the light of their legal rights.~~

14. In order to enable a receiver 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 him them in providing explanations as to how he they arrived at what he consider they consider to be an appropriate allocation of costs and provide evidence should that allocation be challenged by any of the parties involved 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.

4.617. In allocating costs a receiver 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 another:¹². In another case such costs may enhance realisations in both categories.
- the benefits actually obtained for those financially interested in one or other category

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.

of asset in terms of protection of those assets or their value and any augmentation of that value.

- 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 book debts 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.

~~4.7—A receiver will incur costs in complying with his statutory duties. The extent of those duties depends upon the nature of his appointment and they are more onerous in the case of administrative receivers.~~

~~An administrative receivership arises only when there is a floating charge and the charges under which the receiver is appointed are over the whole or substantially the whole of the company's assets. There are no decided cases as to how the additional costs incurred by an administrative receiver (as opposed to a receiver not so designated) should be allocated.~~

~~¹For 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.~~

- 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, members office holders should have regard to the general principle referred to in paragraph 4.517 above of maintaining a proper balance.

REMUNERATION AND EXPENSES

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

5. DETERMINATION OF PREFERENTIAL DEBTS

~~5.1 As stated in paragraphs 2.2 and 2.3 of this statement it is a receiver's obligation to pay preferential debts out of assets available for that purpose and no proof of debt or advertisement for creditors is required.~~

~~5.220. Following initial notification to potential preferential creditors of his appointment and before beginning the process of determining preferential debts, a receiver~~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. ~~However, in such circumstances the receiver should write to creditors whose claims are preferential explaining why he is unable to make a payment to them.~~

~~5.321. 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 receiver~~insolvent person or entity; accordingly, the office holder should assist ~~those creditorsthem~~, where ~~possible~~reasonably practical, by providing adequate information to enable them to calculate their claims. ~~With the case~~exception of all employees, the office holder may assume primary and secondary preferential creditors ~~other than employees, the receiver is entitled to assume they 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 receiver~~office holder should then check those claims, and accept or reject them as appropriate.

Employee preferential claims

~~5.422. In determining the preferential claims of individual employees, the receiver~~and of any other preferential creditor who has so advised, the office holder is not entitled to regard ~~an individual employeethem~~ as having full knowledge of ~~his~~their rights and entitlements. Accordingly, the ~~receiver~~office holder should obtain information from ~~either the company's insolvent entity's records or from the employee, or other preferential creditor, before calculating the~~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 his~~their claim and any further explanation that ~~he~~they may reasonably require.

~~5.5 Members are reminded that Schedule 6 (paragraph 11) of the Act provides that anyone~~

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'.

~~who has advanced money for the purpose of paying wages, salaries or accrued holiday remuneration of any employee is a preferential creditor to the extent that the preferential claim of the employee is reduced by such advance.~~

~~5.623. _____~~ When an employee's preferential debt has been paid out of the National Insurance Fund ~~under the provisions~~(NIF) of the ~~Employment Rights Act 1996, the Secretary of State~~relevant jurisdiction, the NIF is entitled, ~~by virtue of section 189 of that Act~~ to the benefit of the employee's preferential debt, in priority to any residual claim of the employee ~~himself. Members are reminded that a receiver in their own right. An office holder is not, however, obliged to accept the NIF's preferential claim of the Secretary of State without satisfying himself being satisfied that it is correct. If a member an office holder is not able to accept the Secretary of State's NIF's claim he 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.~~

~~6. PAYMENT OF PREFERENTIAL DEBTS~~

~~6.1 As soon as practicable after funds become available and the amount of the preferential debts has been ascertained, members should take steps to pay them. Under the statutory provisions preferential debts do not attract interest and payments to creditors should not be unnecessarily delayed. A receiver who does not comply timeously with his obligations under section 40 and against whom judgment is obtained may find himself ordered to pay interest by the court. While members cannot be expected to bear any financial risk by paying some preferential debts before all such debts are agreed, there are often circumstances when it is possible to make payment either in full or on account before all claims have been agreed and this course of action should be adopted whenever it is practicable to do so.~~

~~6.2 Situations may arise where, notwithstanding a receiver's statutory duty to pay preferential debts, it may (exceptionally) be administratively convenient or cost effective for a receiver to make arrangements for the liquidator to make payment of the preferential debts arising in the receivership. Such arrangements are made at the receiver's risk, and should not be on any basis which could result in payment of an amount less than that which would have been available to meet those debts if the receiver had himself paid them, or which would cause delay in paying them.~~

~~6.3 The receiver should provide preferential creditors with details of any such arrangements and the reason for making them.~~

7. DISCLOSURE TO CREDITORS WITH PREFERENTIAL DEBTS

~~7.124. When the funds realised from assets subject to a floating charge are inadequate to pay the preferential debts in full, the receiver should (unless he has already written to them as suggested in paragraph 5.2) send those creditors a statement setting out:~~ 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.

- ~~• the assets which have, in accordance with the charging document, been categorised as subject to the floating charge;~~
- ~~• the costs charged against the proceeds of the realisation of those assets.~~

~~7.225. Any further information which a creditor with a preferential debt reasonably requires should be provided promptly.~~

8. OTHER MATTERS

~~8.1 Difficulties may arise in determining the rights of creditors to have debts paid preferentially in priority to a prior floating charge holder when the receiver has been appointed under a second or subsequent charge. The law in this area is complex and members should seek legal advice (and if necessary apply to the court for directions) when appointed under such a charge.~~

~~8.2 Situations will arise where payments sent out are not encashed and the payee cannot readily be located. The insolvency legislation does not make provision for this eventuality and there have been no reported cases where the courts have decided the matter. Where a receiver decides to account to the next person entitled to such monies he should bear in mind his overriding obligation to pay preferential debts. He should make such arrangements as he considers appropriate to enable him to recover the funds from the party to whom he has paid them so that he will be able to discharge his obligation to any preferential creditor who subsequently asserts his claim to payment.~~

~~Issued June 1999~~ EFFECTIVE DATE

This SIP comes into effect on