

A Receiver's Responsibility to Preferential Creditors

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Revised February 2005

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INTRODUCTION

1. This Statement of Insolvency Practice is one of a series issued by the Association of Chartered Certified Accountants to insolvency practitioners with a view to maintaining standards by setting out required practice and harmonising members' approach to particular aspects of insolvency practice.

2. The purpose of Statements of Insolvency Practice is to set out basic principles and essential procedures with which insolvency practitioners are required to comply. Departure from the standards set out in the Statements of Insolvency Practice is a matter that may be considered by the Association for the purposes of possible disciplinary or regulatory action.

3. This Statement summarises required practice to be adopted by receivers appointed over assets of companies pursuant to securities which include a floating charge so that the officeholder has legal obligations to creditors whose debts are preferential. Its purpose is to:

- ensure that members are familiar with the statutory provisions;
- set out required practice with regard to the application of the statutory provisions;
- set out required practice with regard to the provision of information to creditors whose debts are preferential and to responses to enquiries by such creditors.

4. 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.

5. 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;
- disclosure of information and responses to queries raised by creditors whose debts are preferential;
- other matters.

6. 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.

STATUTORY PROVISIONS

7. Where a receiver is appointed on behalf of the holders of any debentures of a company secured by 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 and floating charges, this requirement does not extend to assets coming into the receiver's hands pursuant to the fixed charge(s).

8. A summary of preferential debts and their statutory bases, as of June 2004, are set out in the Appendix.

9. 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 not only a breach of statutory duty, but is also likely to give rise to a claim against the receiver by those who have been wrongfully deprived of monies to which they were entitled.

10. 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.

CATEGORISATION OF ASSETS AND ALLOCATION OF PROCEEDS

11. In order to ascertain what assets are subject to the statutory rights of creditors whose debts are preferential, 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".

12. 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.

13. It is the duty of the 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.

14. Members are reminded that

- it is the type of charge at the time of appointment which determines whether the assets are available to meet preferential debts. Crystallisation of a floating charge into a fixed charge upon the appointment of a receiver does affect the rights of creditors with preferential debts.

- the conversion, during receivership, of assets (for example, stock) subject at the date of appointment of the receiver to a floating charge into assets (for example, book debts) subject to a fixed charge will not remove them from the pool of assets which is available to pay preferential debts.

15. Section 98, Companies Act 1963 requires that the preferential debts “shall be paid out of the [floating charge] assets coming into the hands of the receiver in priority to” the debenture holder. Where any action which he or she proposes to take could result in a diminution in the amount available to meet preferential debt the receiver should give the most serious consideration to the risks of such action.

16. When assets are sold as part of a going concern (or otherwise in parcels comprising both 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 the financial interests of the different classes of creditors in the individual assets or categories of assets. In these circumstances the receiver should ensure that he or she will be able properly to discharge his or her obligations to account to holders of fixed charges on the one hand and creditors interested in assets subject to floating charges on the other.

APPORTIONMENT OF COSTS

17. The amount available to meet preferential debts is the funds realised from the disposal of assets subject to a floating charge net of the 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.

18. 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 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.

19. 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.

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

- the statutory rights of preferential creditors as set out in the Appendix;
- the provisions of the charging document(s);
- the maintenance of a proper balance between the classes of creditors with whose interests the receiver is required to deal in the light of their legal rights.

21. In order to enable a receiver to allocate costs on an appropriate basis, contemporaneous records of the dominant reasons for incurring costs should be maintained. These will also assist the receiver in providing explanations as to how he or she arrived at what he or she considers to be an appropriate allocation and provide evidence should that allocation be challenged by any of the parties involved.

22. In allocating costs a receiver 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 case. Such costs may enhance realisations in both categories;
 - the benefits actually obtained for those financially interested in one or other category of assets 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 has been enhanced by action which proves to be detrimental to those interested in floating charge assets;
 - 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.

23. A receiver will incur costs in complying with the relevant statutory duties. The extent of those duties depends upon the nature of the appointment. In apportioning the costs of fulfilling their statutory duties and in the absence of any guidance from the

courts, members should have regard to the general principle referred to in paragraph 20 above of maintaining a proper balance.

24. The allocation of a receiver's remuneration and disbursements should be undertaken adopting the same principles as those applicable to costs. The receiver should ensure that contemporaneous records are maintained which will enable him or her to make an appropriate division of the remuneration and disbursements between the different categories of assets.

25. When the receiver has completed the allocation of overheads as between fixed charged assets and floating charge assets it is sometimes advisable to inform the substantial preferential creditors of the allocation in advance of payment.

DETERMINATION OF PREFERENTIAL DEBTS

26. As stated in paragraphs 7 and 9 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.

27. Following initial notification to potential preferential creditors of his or her appointment and before beginning the process of determining preferential debts, a receiver should assess whether there are likely to be sufficient floating charge realisations to pay a distribution. Where no payment will be made, it is not necessary to agree preferential claims. However, in such circumstances the receiver should write to the creditors explaining why he or she is unable to make a payment to them.

28. Where there will be a distribution to preferential creditors, the receiver should assist those creditors, where possible, by providing information to enable them to calculate their claims. In the case of all preferential creditors other than employees, the receiver is entitled to assume they have full knowledge of their legal entitlements and should invite them to submit their claims. The receiver should then check those claims, and accept or reject them as appropriate.

29. In determining the preferential claims of employees, the receiver is not entitled to regard an individual employee as having full knowledge of his rights and entitlements. Accordingly, the receiver should obtain information from either the company's records or from the employee before calculating the claim (other than one which is payable to the Department of Enterprise, Trade and Employment by way of subrogation).

30. Members are reminded that Section 285, Companies Act 1963 and Section 10, Companies (Amendment) Act 1982 provides that anyone 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.

31. When an employee's preferential debt has been paid by the Minister for Enterprise, Trade and Employment, the Minister is entitled 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 is not obliged to accept the preferential claim from the Minister without being satisfied that it is correct. If unable to accept the Minister's claim the receiver should contact the Redundancy Payments Section, Department of Enterprise, Trade and Employment, to explain why and attempt to reach agreement on the amount to be admitted.

PAYMENT OF PREFERENTIAL DEBTS

32. As soon as practicable after funds become available and the amount of the preferential debts has been ascertained, the receiver 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.

33. In the event of there being a surplus on the realisation of assets secured only by a fixed charge, after discharge of outgoings and the indebtedness to the secured creditor, this surplus does not form part of the fund for payment of preferential liabilities in a receivership.

DISCLOSURE TO CREDITORS WITH PREFERENTIAL DEBTS

34. 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 or she has already written to them as suggested in paragraph 27) send those creditors a statement setting out:

- 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.

OTHER MATTERS

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

36. A receiver is classified as an "accountable person" under Section 571, Taxes Consolidation Act 1997, the definition of which includes "...any person appointed to enforce or give effect to the security, charge or encumbrance". If, as an "accountable

person”, a receiver makes a disposal of an asset, then any capital gains tax is assessable on the receiver and is treated as a necessary disbursement out of the proceeds of sale.

37. Section 319, Companies Act 1963, as amended, obliges the receiver, when ceasing to act as receiver of the property of the company, to submit a statement of his opinion as to whether or not the company is solvent to the Registrar of Companies. The Registrar forwards a copy of that statement to the Director of Corporate Enforcement.

EFFECTIVE DATE

38. This Statement is effective from 1 May 2005.

APPENDIX

Summary of Preferential Creditors Including Statutory Bases – June 2004

Title	Description	Basis
TAXES, et		
1. Taxes assessed on company: Corporation Tax Capital Gains Tax Income Tax Other assessed taxes	All taxes assessed or assessable on the company up to 5 April prior to the relevant date, together with interest thereon. The Revenue Commissioners are entitled to preference for one year of each tax and will select the largest outstanding year for each tax. Assessed taxes include tax on loans to participators in close companies and tax deductible at source from payments.	S.285 (2)(a)(ii) S.931, 974, 976 and 1080 TCA 1997
2. Sub-contractors deductions	Income Tax deductions made on payments to sub-contractors in the 12 months before the relevant date.	S.1000 TCA 1997
3. VAT	VAT due (less VAT refundable) for the six complete taxable periods ending within the 12 months before the relevant date together with interest thereon – <i>Where a company forms part group for VAT purposes, each company in the group can be jointly and severally liable for all group VAT liabilities.</i>	S.21 VAT Act 1972 S.62(2) FA 1996

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|----|----------|--|--|
| 4. | PAYE | PAYE due (i.e. which should have been deducted from payments to employees) for the period of 12 months before the relevant date together with interest thereon. | S. 285 (2)(a)(iii) CA 1963 S.995 TCA 1997 |
| 5. | PRSI due | Employer's PRSI contributions due (i.e. which should have been operated in respect of payments to employees) for the period of 12 months before the relevant date, (but not interest thereon, which ranks as an unsecured creditor.)

Employee's PRSI that has or should have been deducted is classed as Super Preferential and may rank ahead of other preferential creditors. There is no 12 month limit. | S.285 (2)(e) CA 1963 Ss.6 & 15 (I) HCA 1979 (Health Levy) S.26(1) YEAA 1981 (Youth Levy) S.15(4)(a) SWCA 1981 S.16 FA 1983 (Income Levy) |

EMPLOYEES

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|----|-----------------------|--|--|
| 6. | Wages and Salaries | Wages and salaries (including commission and piece work) for services rendered by any clerk, servant, workman or labourer, including remuneration in respect of periods of absence from work through good cause in the four months before the relevant date, subject to a maximum of €3,174 per individual. This includes lump sums due to farm labourers.

Directors fees per se are not preferential and care should be taken before admitting other amounts due to Directors or the Company Secretary.

Items such as VHI, union, or savings deductions can be preferential in so far as they fall within the general limit of €3,174 per employee. | S.285 (2)(b) & (c) & CA 1963 S.10(b) & (d) CAA |
| 7. | Holiday pay | All accrued holiday pay – no money or time limit. Legal advice should be obtained where holidays are outstanding for periods prior to the current holiday year as defined in the company's condition of employment. The position of Directors or the Company Secretary should again be considered. | S.285 (2)(d) CA 1963 HEA 1973 |
| 8. | Pay in lieu of notice | Any compensation awarded by the Employment Appeals Tribunal following a submission on behalf of the employee on Form T 1A. | S.13(1) MNTEA 1973 |
| 9. | Redundancy | Statutory redundancy lump sums (less 60% rebate from Dept. of Enterprise, Trade and Employment). | S.14 RPA 1979 S.14(5) RPA 1971 |

	Employers redundancy contributions due for the period of 12 months before the relevant date (included in PRSI contribution, see 5 above).	S.42 RPA 1967, as amended by S.14 RPA 1979
10. Unfair dismissal	Compensation awarded by Employment Appeals Tribunal under Unfair Dismissals Act, 1977, following application by employee.	S.12 UDA 1977
11. Sick pay	Sums due to an employee pursuant to any sick pay scheme.	S.10(a) CAA 1982
12. Superannuation contributions	Company contributions and contributions deducted from employees in respect of any superannuation scheme. (This matter is complex and great care should be exercised before admitting claims).	S.10(a) CAA 1982
13. Workmens compensation	Compensation under the Workmens Compensation Acts, 1934 to 1955, to the extent that it is not covered by insurance (including lump sums equivalent of weekly payments).	S. 285 (2)(f) and (5) CA 1963
14. Compensation for accidents	Damages and costs due to an employee as a result of an accident to the extent that it is not covered by insurance.	S. 285 (2)(g) CA 1963
15. Subrogated claims	a) Subject to limitations, money advanced to pay wages, salaries, holiday pay, sick pay or superannuation contributions by a bank or third party. b) Payments from the Employers Insolvency Fund in respect of claims which would rank as preferential. The Fund is entitled to be repaid in priority to any other unsatisfied claim of the employee.	S. 285 CA 1963 S.10(c) CAA 1982 PEEIA 1984
OTHERS		
16. Rates	Local rates struck within the 12 months before the relevant date (but not water rates)	S. 285 (2)(a)(i) CA 1963
17. Distraint	Distraint by a creditor can rank equally with the above claims in respect of the proceeds of sale of goods distrained upon.	S.285 (9) & (10) CA 1963
18. Training levy	Training levy payable on gross payroll within the 12 months before the relevant date	S.3 NTFA 2000

Notes:

1. All of the above rank equally for dividend and abate equally in the event that funds are insufficient.
2. Relevant date: Date of Winding-Up Resolution
Date of Winding-Up Order (or appointment of Provisional Liquidator)
Date of Appointment of Receiver under a floating charge

(S.98 CA 1963)

3. Abbreviations of Legislation:

1. CA 1963 Companies Act, 1963
2. CAA 1982 Companies (Amendment) Act, 1982
3. FA 1976 Finance Act, 1976
4. FA 1983 Finance Act, 1983
5. HEA 1975 Holidays (Employees) Act, 1973
6. HCA 1979 Health Contributions Act, 1979
7. ITA 1967 Income Tax Act, 1967
8. MNTEA 1973 Minimum Notice and Terms of Employment Act, 1973
9. NTFA 2000 National Training Fund Act, 2000
10. PEEIA 1984 Protection of Employees (Employers Insolvency) Act, 1984
11. RPA 1967 Redundancy Payments Act, 1967
12. RPA 1971 Redundancy Payments Act, 1971
13. RPA 1979 Redundancy Payments Act, 1979
14. SWCA 1981 Social Welfare Consolidation Act, 1981
15. TCA 1997 Taxes Consolidation Act, 1997
16. UDA 1977 Unfair Dismissals Act, 1977
17. VAT 1972 Value Added Tax Act, 1972
18. YEAA 1981 Youth Employment Agency Act, 1981

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