



CPA Ireland Skillnet

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The CPA Ireland Skillnet provides excellent value CPE (continual Professional Education) in accountancy, law, tax and strategic personal development to accountants working both in practice and in industry. However our attendees are not limited to the accountancy field as we welcome all interested parties to our events.



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The Institute of Certified Public Accountants in Ireland www.skillnets.ie



Trainee Accountant Webinar on Priority of Payment of Company Debts upon Liquidation - Summer 2010, Question 2



Summer 2010, Question 2

Petulia and Gardenia are the sole directors and shareholders in Pandora Blooms Ltd, a nationwide chain of organic florists. Since the company's incorporation in 2000 it has created a number of debentures to finance the expansion of the business. Upon incorporation they secured a fixed charge against the company's main premises in Baggot Street in Dublin to the value of €250,000 in favour of the People's Bank of Dublin plc. This charge was duly registered in accordance with Section 409 of the Companies Act 2014. In 2015 they secured two further fixed charges on these premises, each valued at €50,000.



Summer 2010, Question 2

The first charge was created by a legal mortgage on the 21st September in favour of Lloyd's Allied Bank plc and registered on the 10th October. The second charge was created by an equitable mortgage on the 22nd September in favour of Royal Bank of Cork plc and registered on the 8th October.

In March 2016, the company created a floating charge in favour of the Limerick Provincial Bank Ltd over the company's stock to the value of €100,000. Due to an error on the part of the company this charge was never registered.

In September 2016, they created a second floating charge against their stock to the value of €50,000 in favour of Galway Prudential Investments Ltd, and this charge was duly registered.



Summer 2010, Question 2

Due to a downturn in their corporate business the company has been incurring losses for the last year. In October 2016 the company was contacted by one of their creditors Fabulously Flirty Flowers Distributors, who threatened to sue the company if their outstanding account in the amount of €35,000 was not paid immediately. As Pandora Blooms Ltd was not in a position to make this payment they agreed to secure this debt by creating a floating charge against the company's debtors, if Fabulously Flirty Flowers Distributors gave them a four month grace period to make this payment and extended them a further €20,000 in credit. Fabulously Flirty Flowers Distributors agreed to this and this charge was duly registered.



Summer 2010, Question 2

However, despite this extended line of credit Pandora Blooms Ltd's financial position did not improve and in December 2016 the company was put into compulsory liquidation on the grounds that it is unable to pay its debts. Lilly is appointed as the company's official liquidator.

Following a review of the accounts Lilly informs you that the company's Baggot Street premises is currently valued at €315,000, and that in addition to the outstanding charges the company also owes €15,000 to its trade creditors and €17,000 in unpaid taxes to the Revenue Commissioners.

Summer 2010, Question 2

Required:

- A. Define a debenture and evaluate the distinction between a fixed charge and a floating charge, and between a legal mortgage and an equitable mortgage.

(15 marks)

- B. Evaluate the legality of otherwise of all of these charges and assess the priority of payment of the company's debt.

(10 marks)**(Total 25 marks)**

Debenture

- Document acknowledging a debt, due and owing by a company
- Document will acknowledge the obligation of the company to repay the debt
- Set out the terms of repayment, including interest
- Issue of security



Charges

- Distinction:
 - Assets
 - Priority of payment
 - Ability to deal with the asset



Fixed Charge

- Attaches to a specific tangible asset (generally a fixed asset)
- Restricted in relation to “dealing” with the asset from the moment of creation
- Issue re disposition of the asset
- Ranks in priority to all other existing debt
- Created by a legal mortgage and/or equitable mortgage



Mortgages

- Legal mortgage
 - The mortgage holder receives a legally registered title to the property
 - Execution of a Deed – transferring legal ownership
 - Reversion upon repayment
- Equitable mortgage
 - Depositing title deed/documents with the lender
 - Equitable owner to lender – legal ownership with the borrower



Floating Charges

- Attaching to a current non-specific asset until crystallisation
- Defined in *Re Yorkshire Woolcombers Association Ltd (1903)*
- Reasons behind creation
- Default – crystallisation:
 - Liquidation
 - Receivership
 - Pre-determined date/specific event
 - Cessation of the company business



Floating Charges

- On crystallisation the floating charges attaches to the asset over which it previously floated
- Results in the transfer of equitable title to the debenture holder
- Borrower cannot deal with the asset without permission of the charge holder
- Appointment of a Receiver
- Only repaid after fixed charge-holders and preferential debtors

Priority of Debts

Draw a Table with TWO columns as follows:

Priority of Debts

In the left hand column – list the priority of debts on liquidation

Priority of Debts	
Cost of Liquidation	
Fixed Charges	
Preference Debts	
Floating Charges	
Unsecured Debt	
Return to Shareholders	

Priority of Debts

Check the question to see if there are any liquidation costs stated – if so, put them into the right hand column or make reference to them

Priority of Debts	Debts of Pandora Blooms Ltd
Cost of Liquidation	Lilly's liquidation costs

Priority of Debts

Next, check to see if there are any fixed charges – these are paid in order of registration (provided they are registered within 21 days) – so ranking them correctly is vital

Priority of Debts	Debts of Pandora Blooms Ltd
Fixed Charges	1. People's Bank of Dublin plc €250,000 (2000) 2. Royal Bank of Cork plc €50,000 (8 th October) 3. Lloyd's Allied Bank plc €15,000 (10 th October)

Priority of Debts

Always check to see if there is enough equity in the asset to cover the debt – in this question the value of the Baggot Street premises is valued at €315,000 upon liquidation – therefore, there is only €15,000 payable towards the debt due to Lloyd's Allied Bank – any residue should be ranked as an unsecured debt – so put this into the Table:

Priority of Debts	Debts of Pandora Blooms Ltd
Unsecured Debts	Lloyd's Allied Bank plc €35,000

Priority of Debts

Next for payment are preferential debts as follows:

- Local rates payable within the previous 12 months,
- All assessed taxes – assessed within the previous 12 months,
- All social welfare contributions payable within the previous 12 months,
- All wages and salary payable within the last 4 months, up to a maximum payment of €10,000 per employee,

Priority of Debts

- All accrued holiday pay,
- All sickness and pension payments in respect of employees
- All unfair dismissal and minimum notice claims
- All redundancy payments payable within the last 12 months, and
- Damages in respect of personal injuries to employees.

Priority of Debts

Looking at the question – list the preferential debts (always being careful regarding outstanding salaries) – these are all equal, so the order you list them in is unimportant

Priority of Debts	Debts of Pandora Blooms Ltd
Preferential Debts	€17,000 in unpaid taxes to the Revenue Commissioners

Priority of Debts

Next look at the floating charges – being careful to check to ensure that:

- A. You are listing them in the correct order, as they are paid in order of registration
- B. They are registered within 21 days
- C. When they were created – here the dates are really important, as they can be invalidated

Priority of Debts

Invalidity:

- Floating Charge if created within 12 months of liquidation (does not apply to fixed charges)
- A floating charge in favour of a connected person created within 2 years of liquidation
 - Unless the company was solvent at the point of creation of the charge
- Section 604: Unfair preference – 6 months of liquidation (extended to 2 years re connected person) – invalidates the debt – *Re Creation Printing Company Ltd (1981)*

Priority of Debts

Looking at the question:

Priority of Debts	Debts of Pandora Blooms Ltd
Floating Charges	Galway Prudential Investments Ltd €50,000 – however, as this was created in September 2016 and the company was put into liquidation in December 2016 – the Liquidator may invalidate this charge, unless there is evidence that the company was solvent when the charge was created – if it is invalidated then the debt will rank as an unsecured debt

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Priority of Debts

As the charge in favour of Limerick Provincial Bank Ltd was not registered this debt will rank as unsecured debt

Priority of Debts	Debts of Pandora Blooms Ltd
Unsecured Debt	Limerick Provincial Bank €100,000

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Priority of Debts

Regarding the floating charge in favour of *Flirty Flowers Distributors* the Liquidator may strike it down as a unfair preference (this can be defined as any act relating to property done by a company, which is unable to pay its debts, in favour of a creditor, with a view to giving that creditor preference over other creditors) – as the status of an existing debt was changed and a charge created within 6 months of the liquidation of the company, in order to obtain further finance, this charge will be invalidated and will be struck out

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Priority of Debts

The only debt left to list is the unsecured debt:

Priority of Debts	Debts of Pandora Blooms Ltd
Unsecured Debt	The €15,000 due to the trade creditors

Priority of Debts

This debt can be added to the other unsecured debts already listed (ranking order is unimportant, as they are all equal) as follows:

Priority of Debts	Debts of Pandora Blooms Ltd
Unsecured Debt	<p>The €15,000 due to the trade creditors</p> <p>Limerick Provincial Bank €100,000 (unregistered floating charge)</p> <p>Lloyd's Allied Bank plc €35,000 (unsecured portion)</p> <p>Galway Prudential Investments Ltd €50,000 (potentially, if the Liquidator invalidates it)</p>

Priority of Debts

If any monies are due to shareholders, these should be ranked as follows:

Priority of Debts	Debts of Pandora Blooms Ltd
Shareholders	<p>Declared by unpaid dividends</p> <p>Capital return to preference shares (where preferred as to capital)</p> <p>Capital return to ordinary shares</p>
