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Spring 2017

RECOVERY

Fraud

Fraud: hot pursuit or cold case in insolvency? What can an office-holder *really* do about fraud?

Intelligent investigation How to track individuals or companies online without breaching privacy

The funder's perspective: fraud claims Litigation doesn't have to be out of reach when all parties work together

Not Chapter 11 but Chapter 11ish Exploring whether the UK is really moving towards a US insolvency system

Privilege – a fundamental human right The outcome of *Schlosberg* v. *Avonwick* and what it means for trustees in bankruptcy

Pulled from the pensions lifeboat: Covpress An in-depth look at the rare instance of a full rescue from the PPF

An interview with… Alun Milford The general counsel for the SFO talks about the work of the office and reporting fraud

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What do you think? Readers' views are welcome. Have an opinion about a burning issue? Want to comment on articles or *RECOVERY* itself? Please contact me on **recovery@r3.org.uk**.

From the editor

Less than a month after this issue of *RECOVERY* is published the Insolvency Rules 2016 will take effect. As you read this, you will have familiarised yourself with the new rules and will be ready to see them in action. IPs in particular, and their staff, will need to have considered them with care. Some of the new regime is memorable, such as creditors' meetings taking place only if required by 10, or 10 per cent in number or value of, creditors. For those who would value another look at the details, Andrew Brown revisits the decision-making procedures in our Technical Update on page 12.

Caroline Sumner, R3's technical director, writes on page 13 about some of the challenges that IPs will face in practice. It merits reflection that the solutions to those challenges may well come at a cost greater than the savings from doing away with physical meetings, especially for small practices. Maintaining creditor engagement will further test IPs' ingenuity (and restrict cost savings).

What these two articles say to me is that the devil is in the detail and the homework should have been done by now!

It is the time of year for the president's valedictory column. Andrew Tate's (page 4) is especially worth absorbing for his explanations of the changing nature of IPs' work and of developments in the profession's relationship with HMRC. But we have more reflections as Graham Rumney retires after 12 years at R3 (page 6). One of Graham's key themes is R3's influence, not least on government, regulators, commentators and other influencers. *RECOVERY*'s contribution to that is supported by the high standard of communication skills displayed by its many volunteer authors. But mostly it originates in the passion they share for restructuring and insolvency; a passion Graham has always been keen for R3 to capture. We certainly welcome contributions from all who care about our profession.

Fraud has been a popular theme among contributors. Addressing its consequences is certainly an area to which IPs' attention has turned in the last year or so. We offer a variety of perspectives on pages 18 to 30.

Our other thought-provoking features include Howard Morris exploring the development of UK insolvency law in a world context at a time when the UK faces challenges to its position as a key capital market and centre for restructuring (page 32). In a different sphere, Lexa Hilliard QC examines the impact of legal professional privilege on the ability of a trustee in bankruptcy to use information contained in documents that passed between a debtor and his lawyers before the bankruptcy order was made (page 34). Interestingly, creditors of a bankrupt appear to be at a disadvantage to creditors of an insolvent company in this respect.

C. Laughton

CHRIS LAUGHTON is editor of *RECOVERY* and a partner at Mercer & Hole.

Legal update

8 Steel-ing a march: English scheme still the procedure of choice
Hannah Valintine | Jennifer Marshall
Metinvest's restructuring demonstrates that the English scheme is still in demand.

11 Recent case summaries
James Hannant
The latest insolvency update.

12 Unbending the Insolvency Rules 2016
Andrew Brown
The new insolvency rules: deemed consent and technical details.

13 Out with the old system, in with the new rules?
Caroline Sumner
The new insolvency rules: sweeping changes and modernisation? Or a major challenge for IPs?

16 Legal Q&A
Nick Hill
Your insolvency questions answered.

Regulars

1 From the editor
Chris Laughton
IPs need to be ready for the new rules, reflections on the profession and an exploration of the features in this issue.

4 President's column
Andrew Tate
The outgoing R3 president writes about restructuring and delves into survey results.

6 Retrospective
Graham Rumney
A message for all members as he steps down as CEO of R3.

47 Interview with…
Alun Milford
The general counsel for the Serious Fraud Office talks about the office's work and reporting fraud.

47

Fraud

18 Fraud: hot pursuit or cold case in insolvency?
Bree Taylor
Is it feasible to pursue cases and what can an office-holder do when faced with fraud?

22 Intelligent investigation
Dino Paganuzzi | Darren Bradshaw | Martin Stockdale | Chris Stubbs
Technology can help track down individuals, companies and relationships in an insolvency situation.

24 A forum to fight fraud
David Ingram
An example of cross-border communication working to trace and recover assets previously lost to fraud.

26 The funder's perspective: fraud claims
Steven Cooklin | Jamie Riley
What do various parties seek in a claim for fraud, and what are the funders looking for in a claim?

28 Putting assets on ice
Tina Kyriakides
What are the limits of a freezing order?

29 Unexplained wealth orders
Oliver Powell | Robert Starkins
A look at proposed legislation to root out tainted cash.

18

22

24

28

R3 matters

41 **R3 events, courses and conferences**

43 **R3 contacts**

44 **Bonding: between a rock and a hard place**
Michelle Butler
A look at what changes to bonding might mean for smaller practices.

45 **SPG update and the SPG forum**
Simeone Gilchrist | Caitlin Powell
Changing members, hard facts and zoo stories – what the SPG Committee learned last winter.

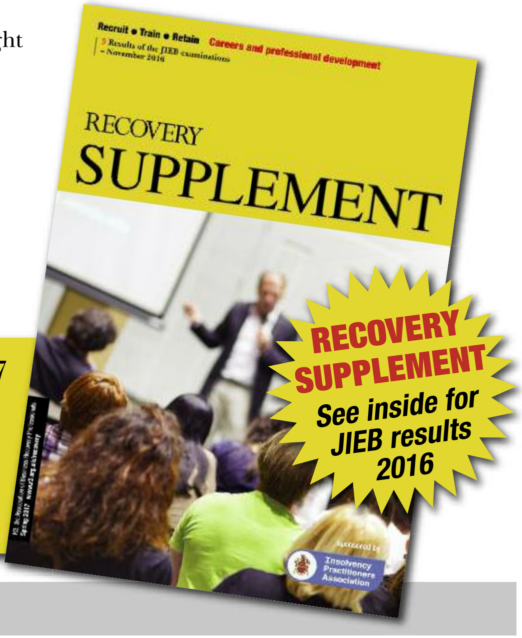
46 **Advertisers' index**

Themes of *RECOVERY* 2017

SUMMER	Tax
AUTUMN	Regulation
WINTER	Avoiding insolvency (turnaround)

Advertising feature

30 **Finding the money to fight fraud**
Mark Beaumont
What you need to know before seeking funding for your litigation.



Features

32 **Not Chapter 11 but Chapter 11-ish**
Howard Morris
Is the UK insolvency system creeping slowly towards the US model?

34 **Privilege – a fundamental human right**
Lexa Hilliard QC
How far does privilege extend in the case of a bankrupt? – lessons from *Schlosberg* v. *Avonwick*.

36 **Pulled from the pensions lifeboat: Covpress**
Mark Howard | Duncan Lockhart
A look at the fine details of the case that saw an entire pension scheme pulled from the PPF.

38

38 **What's eating the UK's restaurant sector?**
Steven Cottee | Andrew Robertson
After advising the administrators of Ed's Easy Diner, the authors take a look at the rest of the UK's restaurant sector.

34

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President's column

Andrew Tate notes the move away from the 'i-word' into advisory and restructuring and delves into the results of some of R3's member surveys.

One of the best things about being R3 president has been the opportunity to meet so many people from outside of our profession to gauge their view of the work we do. Whether it's representatives from the banks, charities, government, campaign groups or other business groups, it's fascinating to find out how our profession is perceived, have the opportunity to correct the odd misconception and get the message out about the value of our profession.

But, more importantly, my year as president has also been a chance to meet more members of the insolvency and restructuring profession than I have ever had the chance to meet before.

R3 is well placed to bring together the profession's shared experiences and pass those on to policy-makers and put our ideas and views to use. I've seen the input R3 receives and wanted to share some of the recent highlights in this column.

The rise of restructuring

One of the key topics I wanted to explore during my term was the growing importance of 'advisory' and restructuring work outside of statutory insolvency procedures. Formal insolvency numbers are falling – so what is our profession doing instead?

Behind the scenes we've been out and about speaking to people who focus on restructuring or advisory work one-on-one, but it was also important to me to seek the thoughts of the wider profession. We've been able to do this through one of the regular R3 member surveys, and the results are illuminating.

From our survey, we can see that advisory work is becoming established across the profession. While the majority of teams, firms or practices are likely to focus on formal insolvency work, survey respondents, on average, spend about two-fifths of their time on advisory work and this is responsible for around a third of their practice or firm's revenues. Just under half of respondents said that their firm or practice offers a mix of both financial and operational advisory services.

Demnd for advisory work is on the rise too: 68 per cent of survey respondents said demand for this work had risen in recent years, driven by – according to those surveyed – a desire among creditors and debtors to avoid formal insolvency procedures and a growing awareness that heavily regulated statutory insolvency procedures are not the be-all and end-all for rescuing distressed businesses or protecting investments.

Interestingly, although smaller practices are comfortable using the word 'insolvency' to describe their work publicly (66 per cent say it's in their practice's name), 'advisory' and 'restructuring' are far more likely to appear in the descriptions of larger practices than the 'i-word'. Only 10 per cent of respondents from larger firms or practices say they would publicly describe themselves as offering 'insolvency' work (while 78 per cent use 'restructuring').

> "My year as president has been a chance to meet more members of the profession than ever before."

This isn't to say that advisory work is replacing traditional 'insolvency' services though and the statistics show this:

- Just under two-thirds (62 per cent) of respondents said that advisory work is complementing formal insolvency procedure-based work whereas just 15 per cent said insolvency work was being supplanted by advisory work
- R3 members also feel that their insolvency backgrounds are a significant advantage when it comes to advisory work: 77 per cent feel their insolvency experience helps bring in advisory business, while 90 per cent say it helps them to actually carry it out.

This underscores an argument I made at last year's annual conference. Although we may not always use the term 'insolvency', advisory and restructuring work sit firmly inside our skill set and R3 members are uniquely placed to offer support to distressed businesses *outside* of the formal insolvency regime.

R3 members have a vast and flexible skill set; we have the experience of what works when fixing a business and what doesn't. We are adaptable to different types of business, with different structures and in different sectors. Our profession has developed significantly in recent years to provide a valuable contribution to the business world and the economy, far beyond what might be traditionally expected of us.

The survey also identified some challenges when it comes to advisory work: 83 per cent of respondents say they use on-the-job training only, which suggests there is an opportunity for more formal skills development. In addition, 83 per cent say that clients still seek advice too late, while 65 per cent say there is still a lack of awareness of the advisory support R3 members can offer.

Your voice does make a difference

One of the long-standing issues raised by members at both regional and national levels is how HMRC supports business rescue and insolvency. Last February, R3 sought members' views on working with HMRC and its impact on our restructuring and insolvency work so that we could get to the bottom of things.

Although the survey produced negative results, it was actually welcomed by senior people at HMRC and its response to the profession's concerns has been fantastic. HMRC has adopted a constructive approach to working with R3 to ensure that long-standing frustrations and concerns are addressed. In February I was invited to meet HMRC's permanent secretary, Edward Troup, to discuss tax and insolvency issues. That has never happened before. Hopefully, R3 members will start seeing a difference in their day-to-day engagement soon.

Farewell to Graham Rumney

On behalf of all R3 members, I would like to thank R3's chief executive, Graham Rumney, for all his hard work for our profession over the past decade. Graham, who retires from R3 in March, has played a big part in ensuring R3 fights so effectively for us and has helped achieve real regulatory and legislative change that benefits the profession and wider business community. I strongly recommend you read his thoughts on his experiences in the insolvency world on page 6, and I wish him all the best for his retirement. I would also like to introduce you to Emma Lovell (formerly Hobson) who has been appointed interim chief operating officer at R3. Emma is known to many of you for her work with the SPG community and her involvement with our regional committees and many policy areas. You will hear much more from Emma in due course. □

For a full summary of the restructuring survey results, please see the R3 Thinks section of the R3 website **www.R3.org.uk/R3-Thinks.**

ANDREW TATE is president of R3 and a partner at Kreston Reeves LLP.

Reflecting on more than a decade at R3

Graham Rumney offers a CEO's retrospective after 12 years at R3 – the accomplishments and the people that have made the organisation stronger.

Since I joined R3 12 years ago, the UK's insolvency and restructuring trade body has grown in a multitude of ways, as has R3's response in meeting the resultant challenges. Externally, this has been via R3's expanded influence and outreach to policy and law makers, government departments, journalists, other business groups and the charity advisory sectors. Across the globe, we have forged stronger relationships with our peer associations, especially ARITA in Australia, Insol Europe and the umbrella association, Insol International, where R3 represents the largest single source of its 10,000 individual members.

Within the UK insolvency and restructuring arena, R3 directly represents the overwhelming majority of those accountants and lawyers who hold insolvency licences who, with their restructuring and advisory colleagues, play a vital part in regenerating businesses that stumble or fall; assisting private individuals who become over-indebted; and in protecting the interests of the creditor community.

A model for good practice

Our industry is a community of individuals who, since R3's inception in 1990, have been generous in sharing their experience, good practice and fellowship – whether as course lecturers, contributors to our world-class quarterly magazine, *RECOVERY*, as hard-working members of our council and committees, and members.

We have ten regions covering the entire UK, and I have always been impressed by the support, enthusiasm and engagement exhibited by those members who serve as council members, local chairs, committee members and active supporters of national and local events.

I have been keen to develop an effective and mutually respecting relationship with all the profession's regulators: the ACCA, ICAEW, ICAI, ICAS, and the IPA, from which R3 (firstly as SPI) was an offshoot and, until they ceased to be individual regulators, the SRA, the Law Society of Scotland and of course the Insolvency Service itself, the regulator of regulators.

R3 has a keen interest in the exercise of the regulation of its members, and we have contributed, and continue actively to contribute, via various fora to the development of standards (SIPs) and to successful regulatory initiatives, such as the IVA Protocol, the Insolvency Complaints gateway, the pre-pack pool and the R3/Insolvency Service/Jobcentre Plus Memorandum of Understanding on early notifications of potential redundancies.

Unavoidably, the work of IPs can be misunderstood, not just by directly impacted debtors or creditors, but also by politicians and other observers. The epithet 'corporate undertakers' still gets trotted out, but a better analogy, I contend, is that of the caring medical professional. The skills exercised, and the dedication demonstrated by IPs is enormous, whether at the big ticket end of the spectrum or dealing with smaller value, personal debtor cases where the IP can help individuals make a fresh start and, in some cases, truly to escape from debt 'slavery'.

> “It really has been a pleasure to serve and help colleagues and members develop and achieve their potential.”

One particular piece of independent research carried out by ComRes during the early years of the global financial crisis identified that the work of UK insolvency professionals in the preceding year had preserved some 2 million jobs. While the recession had eased by 2013–14 when we updated the research, IPs were still saving hundreds of thousands of jobs per year.

Not just insolvency

Another manifestation of our member IPs' work is the provision of restructuring and advisory services, for example transplanting viable parts of failed businesses into healthy ones, or even the entire business into a new structure, thereby preserving productive capacity and in turn providing revenue for other concerns and generating tax revenue for government.

Inevitably, some businesses fail and some personal debtors will need to enter bankruptcy or an IVA, but the work of IPs allows and facilitates rehabilitation, recovery and restitution in suitable and fair measure. The UK is at the top of the influential World Bank insolvency rankings, and scores higher than the USA, Germany or France in the amounts recovered, the speed and cost of recovery.

The people of the profession

Reflecting upon the 60 or so staff members with whom I have been privileged to work with at R3, I can say that R3 has always attracted an enormous amount of talented people to work for it, and it has been pleasing to see many of those move on to bigger and better roles, aided by the learning and development opportunities R3 has given them.

Women comprise a significant number of R3 members, and I am pleased that in the dozen years of my tenure, their influence has grown within R3 itself, along with their representation on R3's committees, council and as president, with Patricia Godfrey being the first ever in R3, and latterly Frances Coulson and Liz Bingham. It is also fitting that I am passing over the reins to Emma Lovell, who I have worked with for six years since recruiting her from the Insolvency Service.

The Service's own staff, especially those working in the Official Receiver offices, make up the public sector part of our industry, and whose successive heads, Desmond Flynn, Stephen Speed, Richard Judge and now Sarah Albon, have helped me and my colleagues develop open lines of communication to the benefit of the profession and those we all serve.

Finally, I would like to thank the thirteen presidents I have been privileged to work with starting with Gareth Hughes leading up to today's Andrew Tate. They helped us direct and shape R3's development into the successful and influential trade body it is today, and it is well placed today to evolve and create value as our industry faces up to the challenges presented to it.

It really has been a pleasure to serve and help colleagues and members develop and achieve their potential, contemporaneously enhancing and promoting the work of IPs and restructuring professionals. I wish you all a successful future.

GRAHAM RUMNEY is the chief executive officer at R3.

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Steel-ing a march: English scheme still the procedure of choice

Hannah Valintine and **Jennifer Marshall** take a look at steelmaker Metinvest's scheme of arrangement and why the English process is so popular.

The third Metinvest scheme of arrangement was sanctioned by the English court on 8 February 2017. The scheme was used to restructure the bank and bond debt of the Dutch holding company of one of the largest Ukrainian corporate groups, a vertically integrated steel and iron ore producer.

There has been some debate as to whether the English scheme will retain its popularity for debt restructurings of European companies following the UK's departure from the EU as a result of the referendum last June. The three Metinvest schemes show (once again) just how flexible the English scheme can be and why, in our view, it will continue to be used following Brexit. In this article we look at recent developments in the law and practice relating to schemes and consider what the future may hold for their continued use.

Metinvest

In 2015, Metinvest began experiencing financial difficulties. This was a result of ongoing civil disturbances, military action and political instability in eastern Ukraine coupled with the precipitous drop in the prices of steel products, coal and iron. Given the complex debt structure (combining bank and bond debt), it became clear that it would take time to agree the terms of a restructuring of the financial indebtedness. While bank lenders were able to quickly enter into contractual standstill arrangements on enforcement actions, a hostile bunch of note-holders threatened the financial stability of the group. Against this backdrop, the scheme of arrangement was used in January 2016[1] and then again in June 2016[2] to achieve a standstill of the bond-holders while the commercial terms of the restructuring were negotiated and documented. Metinvest's third and most recent scheme (which implemented the financial restructuring) was a two class scheme – one for the note-holders and one for the bank lenders.

As well as being another example of an English scheme of a foreign company, Metinvest's use of the scheme tool to achieve a moratorium (referred to colloquially as a 'scheme lite') was highly innovative. At present, such a moratorium is not generally available outside of an English insolvency process (although in the Vinashin restructuring in 2013, involving an English scheme of a Vietnamese company, the English court was willing to exercise its discretion to stay legal proceedings brought by dissenting creditors). The Insolvency Service is considering whether to introduce a moratorium as part of its reforms of corporate insolvency law[3], and this is also in keeping with Europe's proposed directive on preventative restructuring frameworks[4], but these reforms are still in their initial stages and, until then, the 'scheme lite' moratorium is a helpful extension of this flexible restructuring tool. Schemes can be used to achieve simple 'amend and extend' restructurings, to deal with banks and regulatory capital issues or to achieve full-blown corporate and debt restructurings – and restructuring professionals will no doubt continue to find innovative ways of using the scheme in years to come.

> The three Metinvest schemes show (once again) just how flexible the English scheme can be and why, in our view, it will continue to be used following Brexit.

While the flexibility of the English scheme, and its popularity when restructuring the debts of foreign companies, are key selling points, it is important that its use remains subject to close judicial scrutiny so that its international reputation is maintained. Recent cases have made clear that getting leave to convene the relevant class meetings, or obtaining court sanction, are not mere 'rubber stamping' exercises. This is how it should be: the courts are there to keep us honest. Certain judges have indicated that there are aspects of scheme practice that are on their 'watch list' (such as the use of lock-up agreements or evidence of the insolvency comparator). In the recent decision regarding 'share splitting' in relation to the *Dee Valley Group PLC* scheme [2017] EWHC 184, the court held that members (in that case) voting at a class meeting must exercise their power to vote for the purpose of benefiting the class as a whole, and not merely individual members only; where they have not done so, their votes should be ignored by the chair of the meeting and ultimately by the court. Again, this shows a welcome level of intervention by the courts, although, where investors have debt at different levels in the stack, it may be difficult to evidence their motivations for voting in a particular way. The clear message is that schemes are not commoditised products and companies (and their advisers) should ensure that, when they come to court seeking to propose a scheme, they are well prepared. One issue of particular judicial interest (regarding the jurisdictional requirements for an English scheme) is explored below.

English schemes of foreign companies

Despite the large number of English schemes in respect of foreign companies, it is still unclear as to whether schemes fall within the remit of the European judgments regulation, which governs the recognition and enforceability of judgments[5]. To date, the English courts have avoided answering this question and, instead, have developed a practice of considering whether jurisdiction would exist on the assumption that the judgments regulation does apply. The focus in recent cases has been on establishing jurisdiction in respect of scheme creditors by reference to either Article 8 (where it can be shown that at least one scheme creditor is domiciled in England and it is expedient for the claim to be brought before the English court) and/or Article 25 (where the parties have agreed that the English court shall have jurisdiction to settle any disputes arising in connection with a particular legal relationship)[6].

The Article 8 'expediency' test has been brought into sharp focus following the *Rodenstock* [2011] EWHC 1104 (Ch)

Popular debt restructuring options

	UK	Netherlands	Spain
Procedure	Scheme of arrangement	Composition (*dwangakkoord*)	Collective refinancing agreement with court sanction (*homologación*)
Ability to use for foreign companies?	Yes (provided that sufficient connection with England can be established)	Yes (but COMI must be in the Netherlands)	Yes (but COMI must be in Spain)
Need to treat junior creditors in a separate class?	Yes	Yes	No
Voting requirements	In each class, 75 per cent by value and a majority in number of the creditors voting	In each class, 2/3 by value and a majority in number of the creditors voting	Creditors representing 51 per cent of financial indebtedness, or, to bind dissenting creditors (depending on various factors) from 60–80 per cent
Court supervision?	Limited	Limited	Yes
Moratorium?	No	No	Yes

and *Re Van Gansewinkel Groep BV* [2015] EWHC 2151(Ch) decisions. The recent *DTEK* decision [2016] EWHC 3563 (Ch) notes 'something of a division of view' on the point, citing *Re Global Garden Products* [2016] EWHC 1884 (Ch) where two alternative views were set out. On the one hand, it could be argued that the expediency test will be satisfied if a single creditor is domiciled in the United Kingdom 'because of the desirability of binding all scheme creditors to the same restructuring'. The alternative view is that the 'the answer may depend upon a consideration of the number and value of

> **The clear message is that schemes are not commoditised products and companies should ensure that they are well prepared.**

the creditors domiciled in the United Kingdom' (both quotes are taken from [25] of *Global Garden Products*). The *Metinvest* and the *DTEK* decisions came down on the side of the former of the two approaches but, given the uncertainty on the point, companies (and their advisers) should provide the court with as much information as they can collect regarding the number and value of scheme creditors domiciled in the UK.

The question of whether jurisdiction can be established under Article 25 of the judgments regulation is often dealt with in obiter comments as it is usually possible to rely on Article 8 instead. Recent schemes have raised the question of whether asymmetric jurisdiction clauses (which require the borrower to sue in a specific court while allowing lenders to sue in that court or any other with local jurisdiction) are sufficient to engage Article 25, with Snowden J suggesting (obiter) in *Re Van Gansewinkel Groep BV* that they are not. However, the recent decision in *Commerzbank AG* v. *Liquimar Tankers Management Inc* [2017] EWHC 161 (Comm) that asymmetric jurisdiction clauses are exclusive jurisdiction clauses for the purposes of both Article 31(2) and Article 25 of the judgments regulation will no doubt be considered (and will be extremely persuasive) the next time Article 25 is raised in the context of schemes.

Foreign competition

The popularity of the English scheme is due to its flexibility, predictability and the speed of access to and commercial attitudes of English judges. In addition, until fairly recently, it has been a 'one horse race' as there have not been other credible European alternatives. However, this is changing rapidly with other European jurisdictions developing pre-insolvency and compromise proceedings as they aspire to be the jurisdiction of choice for international restructurings and insolvencies.

A recent addition to the scene is the Spanish *homologación* procedure, which is gaining a reputation as a robust and credible restructuring tool, having been used in the recent Abengoa and Isolux restructurings (among others). The Netherlands has also proposed draft legislative revisions that contemplate the introduction of an out of court composition process similar to the English scheme, with some US Chapter 11 elements; a draft was circulated for public consultation in August 2014 and a substantially revised draft is due to be presented in the Dutch Parliament during the first part of 2017. Both procedures have the ability to bind dissenting or secured creditors. The table above compares some key features of these procedures.

> **Until fairly recently, it has been a 'one horse race' as there have not been other credible European alternatives to the English scheme of arrangement.**

These of course are not the only European composition proceedings that are being developed and, when the proposed European directive referred to above is implemented, we are likely to see more member states introducing similar proceedings. Such proceedings are likely to have the benefit of automatic recognition under the recast European insolvency regulation[7] whereas the recognition of English schemes following Brexit may be more uncertain (as discussed below). This could make the European alternatives more attractive.

Of course, the existence of a compromise proceeding is not, in itself, enough to ensure that such a proceeding is utilised. Other factors that come into play » include whether the local court system can ensure sufficient speed and certainty of execution and whether the restructuring procedure is compatible with other laws, including tax laws. By way of example, in a ruling of 28 November 2016 (published 8 February 2017) the German Federal Fiscal Court, through its Great Senate, declared unlawful the German Restructuring Decree (pursuant to which the tax authorities were able, by way of equitable measures, to give certain tax relief). Although this ruling might apply regardless of the tool chosen to restructure the debt, it does show how restructuring laws need to fit into the wider legal framework in a particular jurisdiction.

Impact of Brexit on schemes

The impact of Brexit on English schemes was considered in some detail in the Autumn 2016 edition of *Recovery* (see Legal Update, p11) and so this is merely a reminder and expansion of some of the key points. When deciding whether or not to sanction a scheme of a foreign company, the English court will want to ensure that its order will be effective in practice and, in doing so, will require evidence to be provided that the scheme would be recognised and have effect in any relevant foreign jurisdiction. This leads to the question of how the recognition of schemes might be affected by Brexit.

> **"It is still too early to tell whether, as part of the UK's exit from the EU, any parallel legislation will be put in place to replicate the benefits of the judgments regulation."**

Schemes of arrangement are clearly (and deliberately) not listed in the annexes to the European insolvency regulation and will not be a 'rescue' procedure listed in the recast European insolvency regulation. There is some debate (as referred to above) as to whether schemes fall within the remit of the judgments regulation. Alternative methods of recognition include the Rome I regulation on choice of law[8] or rules of private international law.

It is still too early to tell whether, as part of the UK's exit from the EU, any parallel legislation will be put in place to replicate the benefits of the judgments regulation. If not, it may be possible to rely on another regime to fill the void. One such possibility is the Lugano Convention, which imposes a similar (although not identical) regime to the judgments regulation as between EU and EFTA states other than Liechtenstein (ie Switzerland, Iceland and Norway). The UK is not a party to the Lugano Convention but is currently bound by it because the UK is part of the EU. Assuming that the UK does not become a member of EFTA (which seems unlikely at present), it could join only with the unanimous consent of the other parties.

An alternative is the 2005 Hague Convention on Choice of Court Agreements, which provides for the allocation of jurisdiction where parties have agreed to an *exclusive* jurisdiction clause in favour of a contracting state and for the recognition of judgments rendered pursuant to such clauses. At present, the UK is bound by the Hague Convention because it is part of the EU but, when the UK leaves the EU, it would be entitled to become a party in its own right without the consent of the EU or other contracting states.

The Hague Convention would only apply to schemes where the relevant finance documents contain an exclusive jurisdiction clause in favour of the English courts and if the sanction order can be considered a judgment rendered pursuant to that clause. On the first point, the obiter comments of Cranston J in the *Commerzbank* case that will assist in arguments that asymmetric clauses do constitute exclusive jurisdiction clauses for the purposes of the Hague Convention. On the second point, however, given the breadth of scheme sanction orders, they are not an easy fit in this respect.

Where an English scheme is proposed in relation to English law governed finance documents, a better route to recognition may be the Rome I regulation. As this requires courts of member states to respect governing law clauses irrespective of whether the country whose law is to be applied is an EU member state, the UK will continue to benefit from the Rome I regulation in relation to the exporting of English law even post Brexit. Furthermore, some member states may have rules of private international law that recognise the variation of English law governed agreements by an English law process such as the scheme. Indeed, the (much criticised but still upheld) English common law principle in *Antony Gibbs & Sons* v. *La Société Industrielle et Commerciale des Métaux* (1890) 25 QBD 399 (that a discharge or compromise of debt can only be effective when done in accordance with its governing law) may mean that, post Brexit, only an English scheme (and not a foreign compromise proceeding) could be used to vary or discharge English law finance documents. The argument against using a foreign proceeding would be that such a proceeding would not be recognised in England because of the rule in *Gibbs*. This could perhaps be used as the 'stick' to encourage the EU to adopt legislation replicating the benefits of the European insolvency regulation.

> **"Foreign debtors may in future be tempted to choose alternative European restructuring processes given the uncertainties surrounding the recognition of the English scheme post Brexit."**

Except in the case of English law-governed finance documents, foreign debtors may in future be tempted to choose alternative European restructuring processes given the uncertainties surrounding the recognition of the English scheme post Brexit. While the English scheme remains so flexible, predictable and quick to implement, however, its immediate future seems assured. Signed, steeled and delivered, as Metinvest might say. ◻

1 Re Metinvest B.V. [2016] EWHC 372 (Ch).
2 Re Metinvest B.V. [2016] EWHC 1868 (Ch).
3 See A Review of the Corporate Insolvency Framework published on 25 May 2016 and the summary of responses published on 28 September 2016.
4 2016/0359 (COD).
5 Regulation (EU) 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast).
6 Article 26 was also cited at the convening hearing in the Gulf Keystone Petroleum Limited scheme; however, Article 8 was subsequently relied on at the sanction hearing.
7 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on Insolvency Proceedings (recast).
8 Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations.

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Recent case summaries

Latest insolvency update from **James Hannant**.

PERSONAL INSOLVENCY

***Harvey* v. *Dunbar Assets PLC (formerly Dunbar Bank PLC)* [2017] EWCA Civ 60**
The respondent bank (the bank) made a formal demand on Mr Harvey (H) against a guarantee given by H in respect of a company. H did not make payment and the bank issued a statutory demand (SD1).

H applied to set aside SD1 and his application was dismissed on the merits. However, SD1 was subsequently set aside on the basis that there was a dispute as to the validity of the bank official's (L) signature as found on the guarantee. The bank commenced proceedings under CPR part 7 and successfully established that L had signed the document and that the bank was entitled to enforce under the guarantee.

> The decision provides a useful analysis of the principle as set out in *Turner* v. *Royal Bank of Scotland* [2000] BPIR 683 CA (the *Turner* principle) and its relationship with the doctrine of issue estoppel.

The bank served a second statutory demand (SD2) on H and H sought to set aside SD2 on the same grounds as SD1. That application was dismissed, the district judge holding that issue estoppel precluded H from relying upon the same argument as H had done previously.

On a second appeal to the Court of Appeal, H argued that it was open to him to apply to set aside SD2 on the same grounds that he had unsuccessfully raised in opposition to SD1.

H submitted that (see: [46] of the judgment):

(i) It was not a case of *res judicata* because there was no extant previous judgment against him on the merits.
(ii) Nor was the case one of issue estoppel because an adverse finding on one issue against a party who was ultimately successful on appeal would not found an estoppel.
(iii) Further, the case was not covered by *Turner* v. *Royal Bank of Scotland* [2000] BPIR 683 CA because he was not seeking on the hearing, to raise an issue on which he was previously unsuccessful.

The Court of Appeal dismissed the appeal holding that while the case could not be described as one of issue estoppel, there was nothing to displace the *prima facie* application of the *Turner* principle, and it would be an abuse of the court's practice if H were to be permitted to re-argue the case on the same grounds as before.

The decision is of interest for two reasons. First, it resolves the (novel) question of whether it is open to a debtor to apply to set aside a second statutory demand on the same grounds which he unsuccessfully raised in opposition to a previous statutory demand, and which he never sought to uphold on the appeal from that first statutory demand. A point on which there was no prior authority.

Second, the decision provides a useful analysis of the principle as set out in *Turner* v. *Royal Bank of Scotland* [2000] BPIR 683 CA (the *Turner* principle) and its relationship with the doctrine of issue estoppel.

CORPORATE INSOLVENCY

***Gillan* v. *HEC Enterprises Ltd (in administration) and Ors* [2016] EWHC 3179 (Ch)**
In *Gillan* v. *HEC Enterprises Ltd (in administration)* Morgan J considered the circumstances in which administrators would be entitled to be indemnified out of trust assets for the expenses and costs incurred in administering those assets under the *Berkeley Applegate* principle.

In 2015 the claimants (members of the rock band Deep Purple) brought proceedings against two companies for unpaid income deriving from various rights, and for the transfer of certain shares held on trust by two companies. Following the companies entering into administration, the administrators refused the claimants permission to continue with those proceedings but accepted that the rights and shares were held on trust by the companies.

The administrators relied upon what was referred to as the *Berkeley Applegate* principle after the decision in *Re Berkeley Applegate (Investment Consultants) Ltd* [1989] Ch 32. This provided an exception to the rule that an office-holder is not entitled to recover his remuneration and expenses out of assets that the company holds on trust for third parties and in which the company has no beneficial interest.

Morgan J undertook an extensive analysis of the relevant authorities before observing that the administrators had been appointed in respect of companies that were already engaged in contentious litigation. The administrators had to decide what to do in respect of that litigation, *prima facie* the sums claimed by the administrators in relation to that litigation should be dealt with under the court's jurisdiction as to the costs of litigation and not separately, and not differently, by applying the *Berkeley Applegate* principle (see: [101] of the judgment).

> The administrators in *Gillan* v. *HEC Enterprises Ltd (in administration)* relied upon what was referred to as the *Berkeley Applegate* principle.

Importantly, the judge then held that the administrators ought not to be able to recover remuneration and charges in relation to work that they did which was for the benefit of the unsecured creditors and adverse to the interests of the beneficiaries under the trusts (see [102] of the judgment).

Morgan J did not make final determinations as to what (if any) entitlement the administrators had to payment. However, the judgment provides a useful analysis of the relevant authorities and emphasises the fact that whilst the jurisdiction is discretionary, it is unlikely that the court will make an order that allows office-holders to recover remuneration and charges in respect of work that is not of benefit to the beneficiaries of the trust property. □

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Unbending the Insolvency Rules 2016

Andrew Brown lays out, in crystal clear fashion, the changes coming in from April 2017.

Much like a river in flood, the evolution of insolvency law in this country flows inextricably onwards, bearing us ever closer to the commencement of the new Insolvency Rules 2016 on 6 April 2017.

Working in conjunction with the amendments to the Insolvency Act 1986 made by the Deregulation Act 2015 and the Small Business Enterprise and Employment Act 2015, the new rules have a threefold goal: to consolidate the various 26 amending statutory instruments adopted since the original commencement of the 1986 rules, to update and simplify the language to be more accessible, and to modernise the rules to take account of changes in communication technology and procedure introduced by the above mentioned acts.

At first glance it might appear that such alterations to the rules would bring sweeping changes to the practice of insolvency law in this country, a prospect that terrifies certain members of my chambers who recently published a practical guide to insolvency proceedings. However, the reality is that little of substance has changed in the world of insolvency law and procedure, which not only means that many of us don't have to relearn the subject from scratch, but also that barristers who have authored practical guides might breathe a sigh of relief as their publications remain relevant.

For the purposes of this article I propose to focus on the area of modification, which represents a significant change from the previous rules: the rules against physical creditors' meetings, the new voting procedures and the deemed consent procedure.

Creditors meetings, voting and old rules

Traditionally, and with only a few exceptions, decisions needing the approval of creditors were required to be reached at a physical meeting. I do not propose to dwell on these old systems as they are well known to anyone reading this article, but I merely note that in the era predating electronic communication and virtual spaces such physical meetings made sense as they allowed equal communication and debate between creditors and the office-holder. However, most of those reading this article will be well aware that recent practice has seen creditors' meetings become expensive propositions that often result only in small

to non-existent attendances, or 'meetings' conducted at an office-holder's desk where a preponderance of proxy votes render the original purpose of a physical meeting largely moot.

The new rules

Into such a world is born change in the form of s122 (company insolvency) and ss123 (individual insolvency) of the Small Business Enterprise and Employment Act 2015, which made amendments to the Insolvency Act 1986 by introducing ss246ZE–246ZG and 379ZA–379ZC, both of which come into force on 6 April 2017. To save readers the trouble of finding and interpreting these sections I shall briefly summarise their effect: the new default

> "The reality is that little of substance has changed in the world of insolvency law and procedure."

position for decision making is that no physical meeting of creditors/contributories is to be called where previously a physical meeting and decision was required, and that the office-holder must first use any 'qualifying decision making procedure' or the deemed consent procedure rather than a physical meeting. It must be stressed that an office-holder *must not* summon a physical meeting unless specific conditions allowing/requiring such a meeting are met. Rather, under a 'rule of 10', a meeting may only be called where 10 per cent of the total value of the creditors/contributories, 10 per cent of the total number of creditors/contributories or 10 total creditors/contributories make written requests for a physical meeting. In that case a physical meeting *must* be summoned by the office-holder.

Qualifying decision making procedures

The new rules stipulate that where a decision must be reached by the above procedure, and pursuant to one of the procedures under rule 15.3, the office-holder may seek a decision by sending notice pursuant to rule 15.8, which includes among other information a description of the issue to be determined, the means of reaching said decision and a date/deadline for any decision. It is crucial to note that a decision date must be included in such a notice, and that no decision is reached under new rule 15.9 unless at least one valid vote is received by the decision date. These decisions might be reached via means such as correspondence, electronic voting, a virtual meeting, or via an elastic clause, which allows for any other procedure that permits all creditors to participate equally. Under new rules 15.4 and 15.5, where electronic voting or virtual meetings are sought for decisions, the office-holder must give proper notice of the requisite information about how to electronically access any such meeting or voting system, ie telephone numbers, login details or passwords, etc.

Deemed consent procedure

While the above options for decision procedures still require the active consent of at least one of the creditors/contributories, there is also an alternative in the deemed consent procedure, which is intended to streamline office-holder decisions to an even finer extent. Found in s246ZF and s379ZB IA 1986 and rule 15.7, the procedure is as follows: in almost all decisions (with the exception of those mentioned later in this section), which would require a vote of creditors/contributories via the above mentioned means the office-holder might send a rule 15.8 notice specifying that the deemed consent procedure is being followed, and giving directions for how to object to the decision. As opposed to the normal decision procedure above, the issue will be deemed to have been accepted as if it were voted through in the qualifying decision making procedure unless the requisite number of creditors/ contributories object.

In the deemed consent procedure the creditors/contributories may object to the decision following an abbreviated 'rule of 10' procedure: if 10 per cent of the value of creditors/contributories object to the notice of deemed consent then the creditors/contributories will be considered not to have made the decision. In the event that the deemed consent notice is rejected, the office-holder may bring the issue forward for a second consideration via the qualifying decision making procedure, employing one of the methods under Rule 15.3. It naturally flows from the rules that only after a second rejection by the 'rule of 10', under the qualifying decision making procedure, that a physical meeting may be called for a third and final consideration of the issue.

> An office-holder *must not* summon a physical meeting unless specific conditions allowing/requiring such a meeting are met.

For obvious reasons involving conflict of interests the deemed consent procedure is *not* available for decisions regarding office-holder remuneration, nor is it available for CVA and (presumably) IVA proposals where the standard voting procedure described above must be followed after a physical meeting of the members of a company under new rule 2.25.

Conclusion

The intended effect of the changes to decision making procedures under the new rules is to allow for a streamlined procedure whereby office-holders can make decisions quickly, and without the expenses currently incurred through physical meetings. Office-holders will have to be aware of the technical aspects of the notice provisions in rule 15.7 to ensure that creditors are supplied with the full and correct information necessary. The embrace of electronic voting procedures and the deemed consent procedure will hopefully ease the burden on office-holders, and allow for an increase in creditor involvement in decision making procedures. □

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Out with the old systems, in with the new rules?

Caroline Sumner welcomes the new insolvency rules, but asks whether it will really be so easy for insolvency practices to adapt.

The Insolvency (England and Wales) Rules 2016 (the rules) should be welcomed by the insolvency profession. Having been talked about for a number of years they finally come into force on 6 April 2017 and we can now implement the changes and get on with our work instead of worrying what they will contain. While they do represent the most significant change to insolvency legislation to affect the profession for 30 years, as Andrew Brown has identified on page 12, they do not introduce sweeping changes to the practice of insolvency law in the UK. So what do they change for the insolvency profession and how will this affect IPs in practice? There are three main aims that the legislators have, outlined below.

To consolidate existing rules and amendments

They have been largely successful in this regard and the new rules are simpler, easier to read and contain modernised, gender-neutral language. The grouping together of common procedures across all types of insolvency processes into the common parts has removed much of the repetition from the old rules and has also removed some of the annoying niggles caused by discrepancies in approach across the different procedures.

To effect the changes introduced by the Small Business Enterprise and Employment Act 2015 and the Deregulation Act 2015

These changes have been much written about and will by now be familiar to IPs – such as the removal of physical meetings and the removal of the requirement for a creditor with a small debt to formally prove in order to receive a dividend. While these changes sound simple and the rules are easier to read, the devil is in the detail.

In order to take full advantage of the different decision procedures available the IP is required to have access to modern technologies. It is by no means certain that these technologies to enable virtual meetings and electronic voting are readily available at the present time. In addition, the costs associated with installing the necessary software may mean that the smaller IP practice is unable to take full advantage of the different options available.

Many of the new decision procedures rely on having fast, reliable internet access, which simply doesn't exist in many rural spots outside of the major cities. The rules do recognise some of the challenges to be faced and introduce the concept of the 'excluded creditor', but the reality is that in practice this will add to the burden of IPs when seeking to ensure that a decision sought has been validly obtained. How does an IP ensure that only those entitled to vote actually do so? How are votes made electronically going to be kept confidential and secure? How will IPs demonstrate to their regulator that the decision procedure used has been appropriately monitored and evidenced? Getting to grips with the different decision procedures, the varying notice periods, the additional information to be provided to creditors, understanding the restrictions on using deemed consent in certain circumstances and the ability of creditors to object to the procedure decided on and request an alternative will all take time for IPs and their staff to get used to.

> In order to take full advantage of the different decision procedures available the IP is required to have access to modern technologies.

To encourage more modern means of communication

The new rules recognise that email is a fast, efficient and effective way of communicating, and that many creditors really do not want to receive endless hardcopy reports and correspondence from IPs, particularly where there is little »

likelihood of a dividend being received. Under the new rules, creditors will be able to opt out of receiving correspondence (with the exception of dividend details), which may well be welcomed by repeat creditors such as HMRC. The reality of administering this, however, means that IPs will need to keep two address lists, ensuring that opted-out creditors don't receive general communications but do receive dividend letters.

> How will IPs demonstrate to their regulator that the decision procedure used has been appropriately monitored and evidenced?

In an instance where a company used email as the main form of communication, IPs will be able to adopt email to correspond with creditors without first seeking their individual consent. This will be convenient for IPs, particularly on larger assignments; however, they are going to have to ensure that their systems are sophisticated enough to deal with the increased email traffic a decision procedure could produce. What happens if an anticipated key vote languishes unseen in an IP's spam file?

In a move designed to keep costs down, IPs will be able to inform creditors that all future communication will be via the IP's website and that all reports and requests for decision procedures will simply be placed onto the website. While this will be a useful tool in older cases where there is little happening, this is unlikely to increase creditor engagement on those cases where an IP needs the creditors to respond to requests for a decision to be made, for example, approval of remuneration. Will creditors really be interested enough to log onto an IP's website just in case something new has been posted? And as an IP how do you ensure that those creditors who are entitled to have access will only be able to see correspondence relevant for their cases?

What about the costs?

Will these changes lead to the reduced costs and increased returns for creditors anticipated by the Insolvency Service? The cost savings attributed to not holding physical meetings are likely to be relatively small. Consider the additional costs for individual IPs implementing the new rules to bring their systems and procedures up to date, replace current standard document packs and forms with new prescribed content, ensure that initial circulars to creditors contain all of the relevant information and explanations, make the necessary changes to website security and functionality, as well as investing in new technologies to permit virtual meetings and electronic voting. How will these costs be met and what are the additional burdens on an already stretched profession going to be?

An important step forward

Time will tell if we do end up with a streamlined procedure that will enable office-holders to make decisions quickly, as well as ensuring creditors are fully engaged and take an active part in supporting IPs in administering cases effectively and efficiently.

> IPs will need to keep two address lists, ensuring that opted-out creditors don't receive general communications but do receive dividend letters.

I am going to give the new rules a cautious welcome at this stage. Reform was overdue, common parts make sense and the ability to embrace technology is essential.

CAROLINE SUMNER is R3's technical director.


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Legal Q&A

Nick Hill answers your insolvency queries.

Q The directors of a company are looking to appoint me as administrator. There is an outstanding debenture registered at Companies House but I am told it is historic and the debt was discharged in full several years ago. Can the directors immediately appoint me or must they serve notice of intention on the charge-holder?

A Paragraph 26(1) of schedule B1 to the Insolvency Act 1986, requires that where directors propose to make an appointment of administrators they must give notice to any person who is or may be entitled to appoint an administrator under paragraph 14 (qualifying floating charge holder (QFCH)). The question is therefore whether this requires notice to be given to a charge-holder who is not owed any money by the company.

> If you are to be appointed immediately I would advise that the directors must satisfy you not only of the repayment of the debt, but also of the discharge of the security.

It might be thought, not unreasonably, that such a charge-holder does not need to be given notice, due to the fact that if no monies are owing to the charge-holder they would not have a power to appoint administrators under paragraph 14.

However, when this question came before the court in *Adjei* v. *Law for All* [2011] BCC 963, a different conclusion was reached. It was accepted that the charge was historic, that no monies were due under the charge and that the continued registration of the charge had been overlooked. Nonetheless, the court confirmed that the charge-holder must be served with notice of intention to appoint administrators.

This judgment contradicts an earlier authority which held that notice did not have to be given to a charge-holder who had been repaid (*Re OMP Leisure Limited* [2008] BCC 67). Which authority should be preferred?

It is of note that the OMP case was in regard to a paragraph 14 (QFCH) appointment and was not referred to in the *Adjei* judgment. As a result, as *Adjei* is the more recent judgment and decided under paragraph 26, it is probably the better authority to follow. The wording of paragraph 28 ('An appointment *may not* be made under paragraph 22 *unless*…') means that a failure to comply with the requirements of paragraph 26 will render the (purported) appointment of administrators invalid.

Therefore, if you are to be appointed immediately I would advise that the directors must satisfy you not only of the repayment of the debt, but also of the discharge of the security. If, however, the security remains registered I would advise it is necessary to serve notice of intention on the charge-holder, and of course on other parties entitled under paragraph 26(2), irrespective of whether there is evidence that the debt has been settled.

Q Following service of a statutory demand by my client, the creditor company has applied for an injunction to restrain presentation of a winding-up petition. However, my client has not given any undertaking and the creditor has not obtained an interim injunction. Can my client go ahead and present a petition?

A If your client has given no undertaking and the company has not obtained any interim relief, then your client's rights under the insolvency legislation, namely its entitlement to present a winding-up petition, cannot have been compromised (I assume no other insolvency process has been commenced). The legal position is straightforward: if the company wants interim relief, it must seek it. However, we have found that the court counter has refused to issue a winding-up petition in these circumstances. There is no legal basis for that practice and, upon referral of the matter to a registrar, the counter staff were directed to allow presentation of the petition.

Your client therefore *could* proceed to present a winding-up petition, but must consider carefully whether it *should* do so.

If there is some merit to the company's application, the court might not look favourably on the presentation of a petition in the interim. In particular, the company may be compelled to respond to the petition by issuing a second application to restrain advertisement, duplicating costs and possibly requiring a further listing. It is easy to see how a registrar would not be

> The legal position is straightforward: if the company wants interim relief, it must seek it.

impressed by this sequence of events. There might then be costs consequences for your client and the petition could potentially be struck out.

Having said that, if your client is confident that the company's application is a mere delaying tactic, they might wish to go ahead and present the petition. Bearing in mind the significance of the presentation of a petition (in particular, for the commencement of the winding up, for the purposes of section 127, and for the appointment of a provisional liquidator) there may be good reason to do so as soon as possible.

If there is a serious concern about dissipation of the company's assets, your client might consider the appointment of a provisional liquidator. ◻

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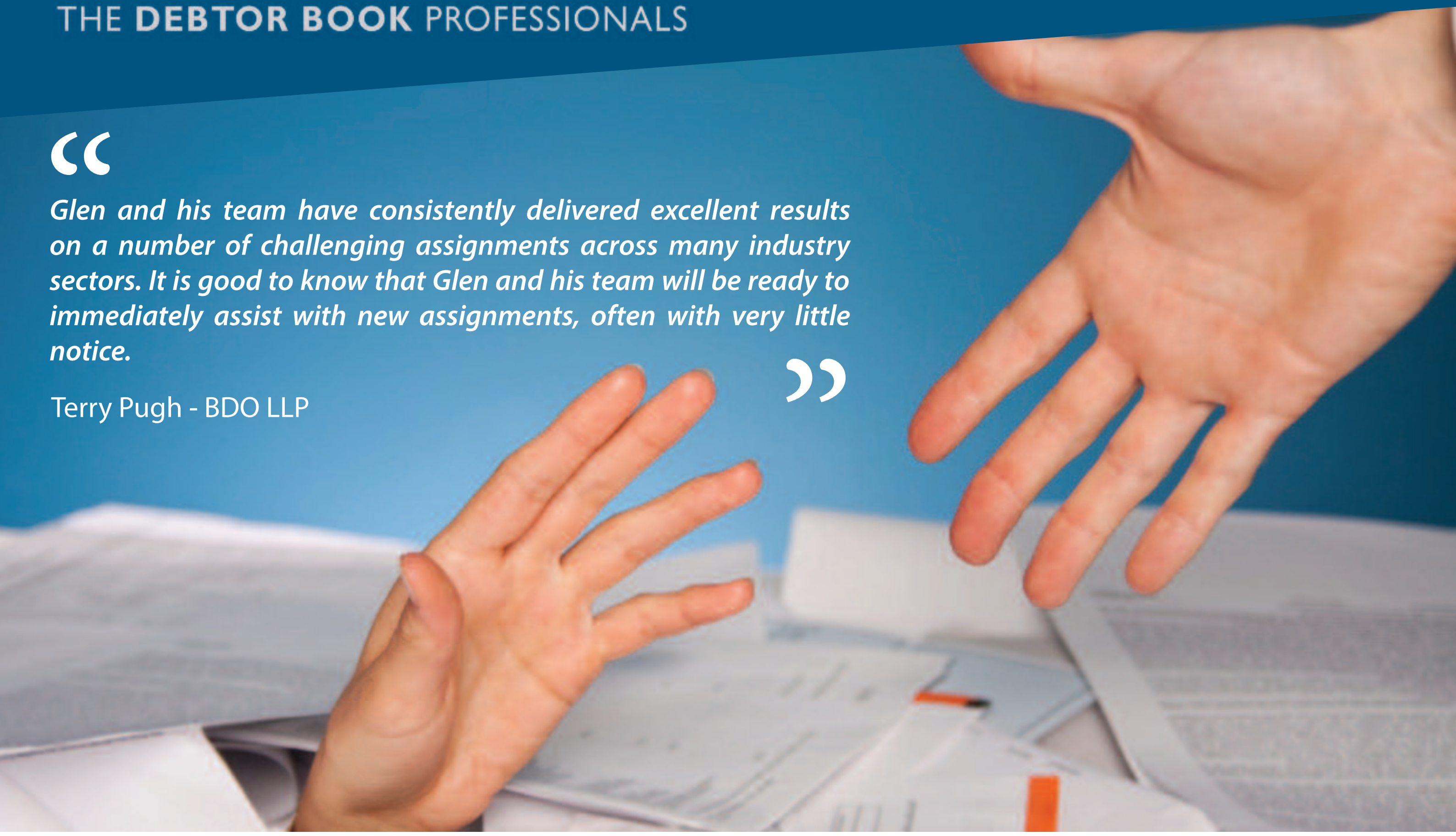

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Fraud: hot pursuit or cold case in insolvency?

Bree Taylor asks the big question: what can an office-holder really do about fraud?

Following parliamentary inquiries into high-profile retailers over summer 2016, the government promised an overhaul of corporate governance law. The rhetoric was strong and the claims by members of select committees were sensational as they spoke against well-known business people, particularly in relation to the sums they had paid to themselves. There were accusations of people having *'worked the system'* and been *'deplorable'* and the early signs were that the

> There does seem to be a perception among the public that company directors who line their own pockets '*get away with it*'.

government was not merely looking to tinker with company law but to effect change at the heart of the capitalist system itself. When the government's green paper came out at the end of the year, it outlined proposals in relation to executive pay and employee representation on company boards. The tone and contents of the paper make it clear that the problem the government believes it needs to address is morally dubious conduct in big business rather than unlawfulness or fraud as such.

Members of the insolvency profession will have ample experience of cases where directors and others involved in companies flout the rules for their own benefit. All too familiar is the task of explaining to creditors and those affected that there are no '*quick wins*' and pursuing a legal claim will be a long and expensive process. There does seem to be a perception among the public (a mood perhaps caught by the government last summer) that company directors who line their own pockets *'get away with it'* because they are well-resourced enough to find the loopholes and tend to be one step ahead of those in pursuit of them.

This article examines the tools available to administrators/liquidators where there has been fraud or serious wrongdoing by directors or others involved in the management of a company. The question is whether the existing tools are fit for purpose. Do directors '*get away with it*'? If so, what changes in the law would need to be made to ensure those guilty of fraud or serious wrongdoing pay the price?

A table of the fraud toolkit can be seen on the next page.

Are these tools used enough and are they effective?

There are no official statistics available to show how many claims have been brought against company directors for fraud or serious wrongdoing but it is possible to get an overall impression by searching for court judgments in civil cases that have been brought under the common 'fraud' type actions in the Insolvency Act and under the common law. For example a search for judgments in cases brought under section 213 (fraudulent trading) in the last few years, brings up no more than a handful of cases that have made it to trial (whether successful or unsuccessful). At least 14,000 companies have gone into liquidation in each of the last five years in England and Wales, but it is a tiny fraction of those that see fraudulent trading claims pursued. We have all seen examples of companies run for years by people who had no intention of paying any tax, but few of us will have been involved in a full trial of a company director for fraudulent trading. There are only slightly more judgments under section 423 (transactions defrauding creditors), even though we can all think of cases where directors have paid dividends notwithstanding a looming potential liability that had not quite hit the balance sheet at the time. There are greater numbers of cases involving claims under s212 (misfeasance), which includes claims of negligence and breach of duty, without any dishonesty or fraud necessarily being involved. There are also greater numbers of cases involving knowing receipt and dishonest assistance but few of those are where the claimant is a liquidator.

Why so few?

It is fairly widely believed in the insolvency profession that it is difficult, perhaps too difficult, to obtain a favourable judgment against a fraudulent director to warrant the huge costs and risks of litigation. I have advised office-holders and creditors on many occasions where there has clearly been some substantial diversion of assets to directors, family members or related companies, and yet the office-holder and the creditors have reluctantly decided it was not worth bringing a claim with all that entails. This is in part a cost/risk driven problem. The problem is compounded by the ubiquitous 'grey areas' in English law.

The key thing to note about the statutory and other provisions in the table over the page is that they all require proof of a particular state of mind – usually a dishonest state of mind – but even where it is not necessary to prove actual dishonesty (like in section 423 cases where the title 'transactions defrauding creditors' is a little misleading), the claimant still has to prove that the wrongdoer acted with a

> The claimant still has to prove that the wrongdoer acted with a particular purpose in mind. This often leads to surreal examinations of people's motives and the posing of bizarre hypothetical questions.

particular purpose in mind. This often leads to surreal examinations of people's motives and the posing of bizarre hypothetical questions such as *'If I took the dog for a walk and posted a letter, was the purpose of my walk the dog or the letter?'*. The state of mind of the wrongdoer and the purpose for which he/she acted has to be decided on the evidence, including what the wrongdoer says about it and any documents produced at the time that might provide insight.

The drafting and formulation of the above statutory provisions means each case is decided on its own facts, a favourable decision in one case does not mean you can expect a favourable decision in the next, and there is real uncertainty about outcome in all but the most egregious of cases. The same applies to the law of tort where principles, not firm rules, have developed over a long history.

s423 – too difficult to win?

I take the most recent reported case under section 423 (transactions defrauding

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What actions can an office-holder bring?

Claim	Basic description	Insolvency process needed?	Necessary to prove 'state of mind'?	Claim against directors?	Claim against others?	Damages always flow to company?
s212 **Claims against delinquent directors**	A claim to recoup losses where director has misapplied property or committed breach of duty. This is mainly used for negligence or breach of duty (not fraud).	✔	✔	✔	✘	✔
s213 **Fraudulent trading**	A claim to recoup losses where business of company has been carried on to defraud creditors.	✔	✔	✔	✔	✔
s423 **Transactions defrauding creditors**	A claim to restore property that has been transferred away at an undervalue 'for the purpose of' avoiding creditors.	✘	✔	✔	✔	✘
Dishonest assistance (tort)	A claim to recover compensation from people who have assisted in breaches of trust or fraud.	✘	✔	✔	✔	✘
Knowing receipt (tort)	A claim to recoup losses from someone who has received or passed on the proceeds of a fraud.	✘	✔	✔	✔	✘

creditors), *JSC BTA Bank* v. *Ablyazov* [2016] EWHC 3071, to demonstrate how difficult it is to obtain a favourable judgment and recover assets for the benefit of creditors. The case does not involve an insolvent company but the legal reasoning about the 'purpose' of a transaction will be applied in cases where assets are diverted by bankrupts or company directors.

Facts

Mr A was being sued by his former employer, a bank in Kazakhstan, in connection with a massive fraud that he was alleged to have perpetrated against the bank. Mr A was eventually found by the court to have embezzled a large sum of money. Shortly before claims were commenced against Mr A in England and his assets were frozen, Mr A transferred £1.1m to his son, a 17-year-old student studying in London.

Claim

The claimant applied for a declaration that the transfer by Mr A to his son of the £1.1m was a 'transaction defrauding creditors' under section 423 and should be set aside so that the money would be returned to Mr A and thus available to his creditors, such as the bank. Both Mr A and his son opposed the application.

> "D&O insurance does not pay out for fraud/dishonesty, but it usually does pay out damages for negligence, including negligent breaches of duty."

Decision

The claim failed. The court held that the transfer of money to the son was a gift and it was to help the son get an investor visa in the UK to replace his student visa. The gift was therefore not 'for the purpose of' putting assets beyond the reach of creditors as per the wording of section 423. The court accepted that Mr A would have been aware when he transferred the money that legal claims were going to be commenced against him in relation to money missing from the bank. But the court found that Mr A would have given his son the money regardless and this was a major factor in the decision. The court also appeared to be influenced in part by the fact that the £1.1m was only about 0.03 per cent of the total assets embezzled.

Comment

This case involved a gratuitous payment by Mr A, under investigation for a large fraud, of a substantial sum of money to a family member fairly shortly before Mr A's worldwide assets were frozen. The judge concluded early in his judgment that Mr A and his son's evidence was 'unreliable'. Yet the analysis of the 'purpose' of the transaction led the judge in this case to a view based on what *would have happened* in a counter-factual scenario, ie if Mr A would have transferred the money anyway (in the absence of looming claims) then his purpose cannot have been to avoid those bringing the claims. To some this might seem a curious way to reach a conclusion about someone's intentions. The court's reasoning may well be sound and within the perimeters of the statutory framework, »

Other reasons for few cases going to trial

1 Cases settle
The frequency of settlement in cases of the types mentioned above should not be under-estimated. Litigation is expensive and both sides run the risk of having to pay the opposing party's costs. Any director who has received company property will consider carefully giving some or all back to avoid the risk of a worse outcome. When cases settle before trial, there is no judgment to search out and there is often little or no searchable information in the public domain to record that a claim was ever made.

2 Funding problems
In a fraud where company property is transferred away, the office-holder often inherits little in the way of cash to spend on litigation. There are no 'quick win' options when investigating, pursuing and proving fraud. The third-party funding market can be extremely useful in this sort of scenario. This is where a third party provides the money to pay legal costs in return for a share of the recoveries. However, this sort of funding only tends to be available where there is an identified cache of money to recover so the funder has certainty that it will be paid its share. The most difficult scenario is the blatant fraud where the perpetrator has absconded or has spent the proceeds and the company has no money to spend on legal action. Third-party funding is unlikely to be available in this scenario. To compound matters for office-holders, it has become much more difficult to obtain and pay for the insurance needed to bring legal claims – this is largely thanks to the Jackson reforms, which have affected insolvency litigation from 2015. These reforms have shifted a great deal of the cost and risk of litigation back to the victim.

3 Tactical use of D&O insurance
Office-holders and their lawyers sometimes choose to characterise wrongs as breach of duty or negligence rather than fraud because bringing fraud claims against former directors can be counter-productive if the directors will be looking to the company's D&O insurance to cover any damages ordered by the court. D&O insurance does not pay out for fraud/dishonesty, but it usually does pay out damages for negligence, including negligent breaches of duty. Many a 'fraud' claim has been pursued as a misfeasance or breach of duty claim in order that the insurance policy covers the damages at the end (there is still the significant risk, however, that the court makes findings of dishonesty of its own volition). This practice would undoubtedly skew any statistics on the frequency of fraud claims against company directors (if there were any statistics).

4 There are 'easier' legal actions available
It is difficult to prove someone has dishonest intent. There is no point in setting the burden of proof higher than it needs to be. Most cases of fraud/dishonesty include, and can be framed as, claims for misfeasance or breach of duty where it is only necessary to prove carelessness or a failure to act in the best interests of the company. There are no punitive damages available in fraud cases so the damages are often not much different between a misfeasance and a fraud claim. It is usually necessary to prove dishonesty in order to recover money in the hands of a third party so fraud claims are still useful when bringing in non-director third parties such as accomplices and advisers. The fact that a claim can be brought as a negligence claim (even where there has been a fraud) would also skew statistics for the frequency of fraud claims against directors (again, if there were any statistics).

but a layperson would ask, fairly enough, whether it should make any difference whether a payment to someone who had not 'earned' the money and which had the *effect* of avoiding obligations to creditors is any more or less culpable because it was made with the intention that the recipient spent it on something useful.

> Do directors 'get away with it'? If so, what changes in the law would need to be made to ensure those guilty of fraud or serious wrongdoing pay the price?

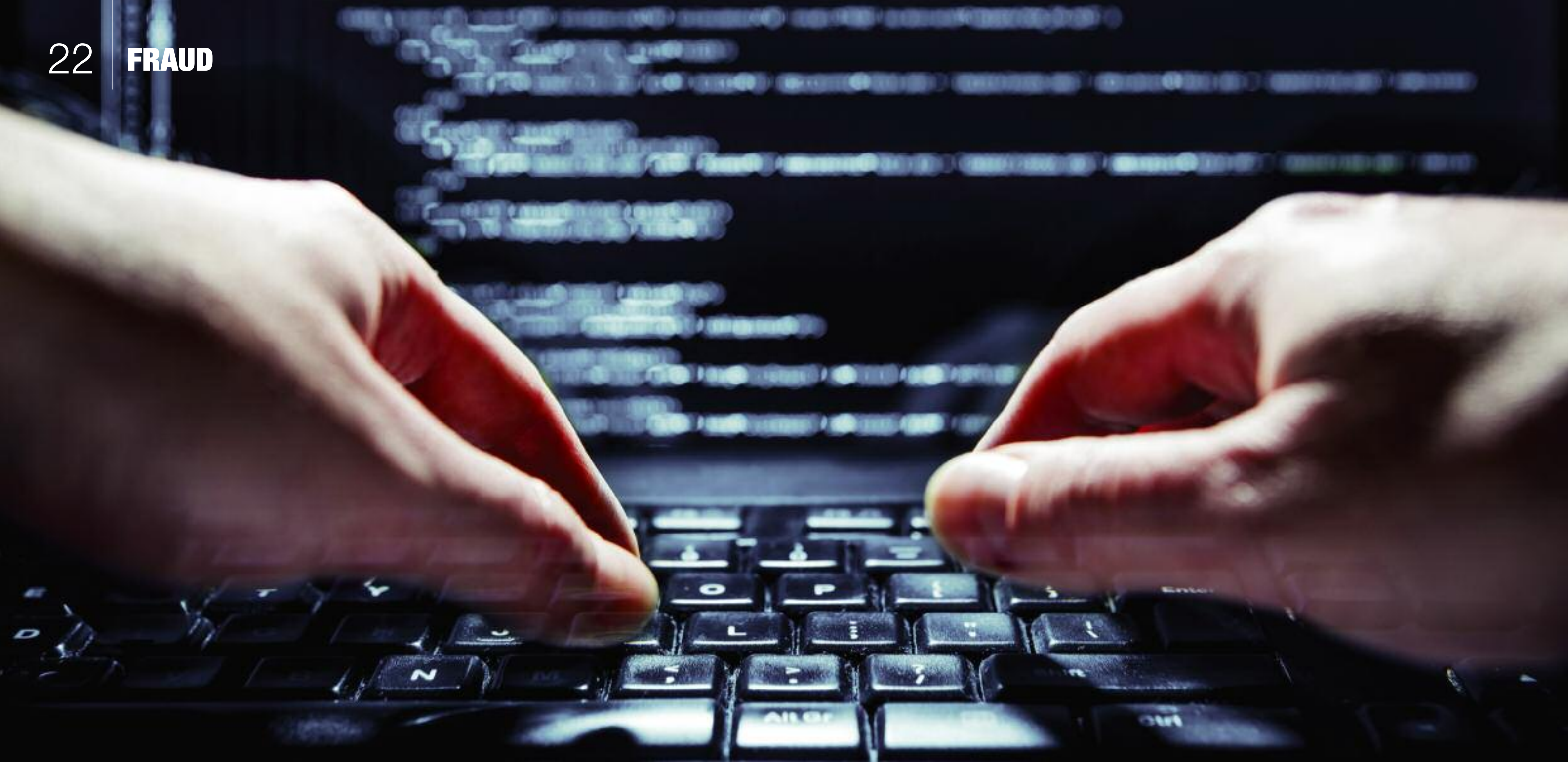
Legal uncertainty aside, there are a number of other possible reasons why there are so few cases under the statutory provisions above. Some of these reveal that the system 'works' because recoveries are achieved by ways other than High Court trials while others reveal the realities and economic constraints of insolvent companies.

Conclusion

The evidence seems to suggest that the tools available to pursue directors for fraud and serious wrongdoing are not used with high frequency. It is possible therefore that the tools are inadequate or external considerations such as costs and funding are impacting negatively on the ability of office-holders to pursue fraud claims.

Unless the government is willing to instigate a radical move away from a traditional common law principled approach and turn to a codified set of rules, there seems little prospect that any overhaul of company law is going to make a difference to the behaviour of directors or the ability of office-holders to pursue claims to trial. If the government wants to equip office-holders to be more effective at pursuing fraud and serious wrongdoing, which has an overall public benefit quite aside from the benefit to the creditors, a better focus and easier change would be a reversal of the Jackson reforms as they relate to insolvency cases. ◻

BREE TAYLOR is a partner at Fladgate LLP.



Intelligent investigation

A team from **Kennedys Law LLP** hack into the methods of investigating individuals and companies in an insolvency situation.

Litigation is rarely a simple pursuit, but insolvency practitioners are increasingly trying their hardest to make use of litigation as a tool against directors and other parties in order to create a return for insolvent estates.

Practitioners face many difficulties in this area and the involvement of relevant specialists, such as specialist lawyers, is crucial. One such difficulty relates to investigating relationships between companies and individuals. There are a number of requirements in this regard, and we will touch on the main ones in the article below.

> "The key is to know where to look to find the data that can be used to inform your further enquiries. However, this must be done in an efficient way."

Data driven and intelligence led

The best investigations draw information from a number of sources and social media can play a key role in profiling lifestyles, assets and links between parties. Birth and marriage records are also great sources of intelligence when it comes to investigating potential family connections and are regularly used to show close links between companies and individuals.

The UK has some of the richest free company information available, but what if you're investigating a shell company and you suspect the directors are ghosts? For example, their names might be fictitious or their addresses might lead to a mail redirection service. There are a number of ways of tackling this issue, but the following outline is drawn from our own experience on one case. Using the information available, we were able to look at the IP addresses from which emails were sent and trace those back to a physical location. Company or individual links to this location were then explored and we were able to exploit embedded computer usernames identified from an analysis of emails to link individuals with a particular company. The key with such an investigation is to know where to look to find the data that can be used to inform your further enquiries. However, this must be done in an efficient way to maximise the benefit from it.

The intelligence team at Kennedys Law LLP, for example, has developed an investigation system called Ki, which has access to real time data via the integration of numerous sources. These sources include the edited electoral roll, consented data and business/company data that can be used to trace people and identify contact email addresses and telephone numbers quickly, efficiently and at limited cost.

Tracing

A further issue is to locate the relevant defendant, or others who are able to provide information to assist in the investigation and potential litigation. Speed is of the essence when tracing and establishing contact with individuals who are likely seeking to avoid being contacted.

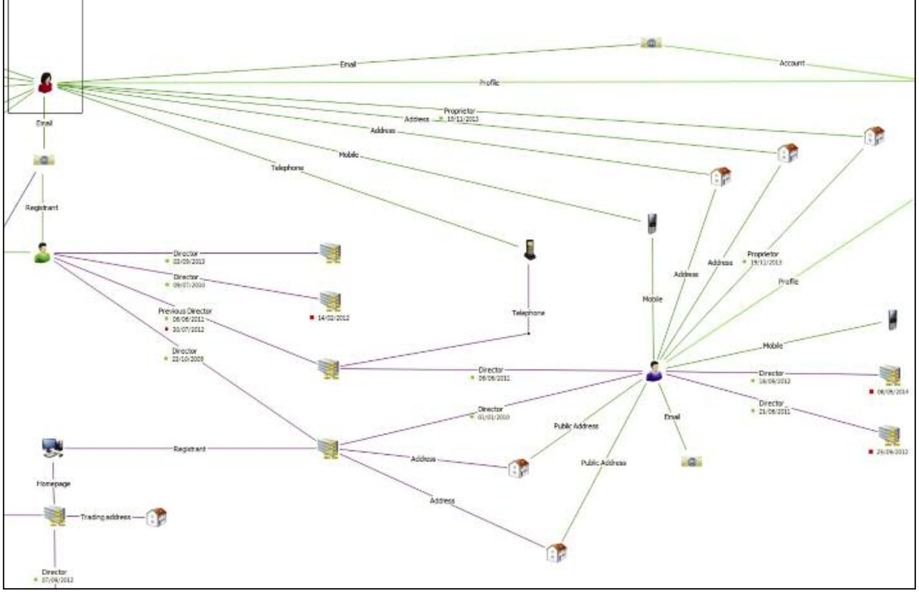
It is therefore important to engage specialists who are able to simultaneously conduct searches of many types of data records quickly. Agents and process servers that advertise that they are able to trace individuals may only have access to limited resources and making these enquiries yourself by accessing a number of database services can be time consuming and costly.

> "Open source and social media investigation, if effectively done, can make the difference when identifying assets and securing your clients' position."

Assets and lifestyle assessment

Practitioners can avoid becoming bogged down in the minor details of a claim against individuals or entities involved and keep an eye on the broader picture. It is vital to know that your target has the financial standing to ensure a successful recovery. Ascertaining if your target is likely to be a flight risk, or whether they could potentially transfer unencumbered assets quickly, is also critical. Such information could also bolster an application for a freezing injunction, or arm you with

An example of the work of the Ki system



Rapper 50 cent posted a picture on Instagram showing him surrounded by piles of cash at a time when he was undergoing bankruptcy proceedings.

information about assets to ensure full financial disclosure or a better outcome at a settlement meeting.

The sooner the information is gathered, the more likely you are to be able to secure the assets and make early, informed decisions as to the conduct of the case. Open source and social media investigation, if effectively done, can make the difference when identifying assets and securing your clients' position.

Again, this is an area where innovation can provide a cutting edge. Services such as Spokeo (**www.Spokeo.com**) help to identify an individual or company's social media accounts. At Kennedys, the intelligence team harnesses open source social media through geo-fencing, the technique of analysing social media emanating from a certain physical location by searching online content that is tagged as having been generated there. Chris Stubbs, intelligence manager at Kennedys, explains:

'While this sounds like Big Brother, the technology does not infringe on privacy rights. It analyses social media that the user has published into the public domain. Some users choose to share their location via GPS data embedded with the social media post. When used in conjunction with Ki and other data sources the results are very powerful.'

Establishing links and relationships

Understanding the links between insolvent entities or individuals and potential defendants or others can also benefit your case. Certain provisions of the Insolvency Act will apply in different situations. There is also the issue of fraud, which can be exposed when inappropriate links and relationships can be identified.

As part of these investigations, it is necessary to understand the structure, management and ownership of the insolvent company, and once those have been explored and the relevant individuals or companies identified, to look at what relationships or company involvements they have. It can be easy to fall into the trap of looking for direct evidence of fraud, which in many cases is not present or cannot be found, particularly if the fraud is complex. A broad picture, when established, can provide indirect but compelling evidence of fraud and in many cases understanding the relationships between various parties is key to this.

> "While this sounds like Big Brother, the technology does not infringe on privacy rights."

Experts in intelligence gathering use specialised software that can explore these relationships. This is a process that would ordinarily take many hours, but with software can be turned into one that takes a matter of minutes. The software also visualises and 'maps' relationships so that they can clearly be seen and understood. As these cases often involve a complex factual matrix, having easy to understand digestable information assists with comprehending and communicating fraud issues.

Conclusion

Tracing entities, individuals or their assets has come a long way since the days of instructing a local process server to carry out a few discreet checks. Prospective defendants are becoming better at hiding their assets and frauds are becoming increasingly more complex.

It would be unthinkable in classic insolvency cases to try to get by without experts such as valuers. In a similar way, it is now important to instruct competent experts in the field of investigation who have access to the latest techniques to assist with recovery claims. They will, in recoveries cases, be a crucial part of the insolvency team from the inception of the case through to the enforcement of any judgment and recovery of funds. □

FROM LEFT TO RIGHT

DINO PAGANUZZI is the head of the commercial division and insolvency partner at Kennedys Law LLP.

DARREN BRADSHAW is a senior associate in the insolvency team at Kennedys Law LLP.

MARTIN STOCKDALE is partner and head of the fraud team at Kennedys Law LLP.

CHRIS STUBBS is the intelligence manager at Kennedys Law LLP.

A forum to fight fraud

David Ingram talks about the work of INSOL Europe's Anti-Fraud Forum and what we can learn from our European neighbours about the tracing and recovery of assets.

INSOL Europe's Anti-Fraud Forum (AFF) was established at INSOL Europe's Annual Congress in Brussels in September 2012 following a series of meetings in Poznan, Poland, earlier that same year. The first meeting was a small handful of insolvency practitioners from three or four European jurisdictions, all of whom had an interest in the tracing and recovery of assets that have been stolen through fraud. Although the name of the group might suggest a mission to implement rigorous counter-fraud measures, the group is very much focused on the job of dealing with the consequences of fraud. The name was chosen to ensure that it should be clear that the group is not promoting fraud.

At this juncture, it is worth saying something about INSOL Europe. Firstly, INSOL Europe is a quite separate organisation to INSOL International, although both organisations work closely with one another. While membership of R3 provides automatic membership to INSOL International, the same does not apply to INSOL Europe; separate membership is required. INSOL Europe traces its roots back to 1980 when Sir Kenneth Cork was one of its founding members and a driving force in the organisation that now has over 1,200 members from 50 countries. Membership fees of INSOL Europe are quite reasonable and any member of INSOL Europe is very welcome to join the AFF for no additional fee; all I ask is that members of the forum have a genuine interest in asset tracing and recovery and a willingness to participate in the group.

> "When I established the AFF I asked myself, 'who can I ask if I need a freezing order in Latvia, a search and seize order in Norway and a disclosure order in Spain?'"

The AFF now has 68 members from 23 jurisdictions across Europe. Its principal aims are to promote the use of insolvency processes to assist with the tracing and recovery of assets, to share experiences among members of the group, and to provide a forum to educate a wider audience on the threats of fraud. This is probably best demonstrated by looking at a couple of the projects that the group is considering at the moment.

Nil-asset insolvency cases

This scenario is all too familiar to insolvency practitioners from the UK. While there are many instances where individuals and companies become insolvent with little or no immediate assets to distribute to the creditors of the insolvent, there may well be a route to recovery through an examination of the insolvent's affairs in the run up to insolvency, recovering assets through various legal actions. Many insolvency practitioners (including myself) have built a practice in dealing with such cases, and we are able to draw upon support from solicitors and counsel who are prepared to work on a conditional fee agreement basis (CFA) or, more recently, a damages based agreement (DBA). In the UK litigation funding is a possibility, as are products to insure against adverse costs. But what about Europe? Clearly nil-asset insolvency cases are just as common in Europe as they are in the UK.

The Netherlands

In the Netherlands there is an ability for the equivalent body to our official receiver to fund an insolvency practitioner to undertake investigations and recovery actions. However, funding is fairly rare and litigation funding is, at present, unavailable.

Latvia

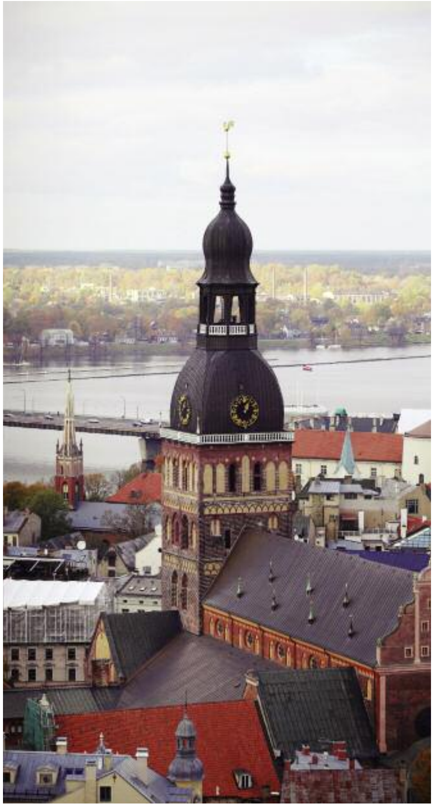
The position in Latvia is that the court appointed insolvency practitioner is obliged to consider the affairs of the company, the reasons for its insolvency and, if there is a prospect of recovery, will ask creditors whether they will fund further investigations and recovery actions. In the event that creditors decline to put the insolvency practitioner in funds, he or she will report to court seeking closure of the case. The Latvian insolvency practitioner's costs are met from the petitioner's deposit (currently €760 (£646)).

“While I think that the UK (at least in Europe) leads the way in funding nil-asset insolvencies, we have much to admire of our European neighbours about their approaches to working with criminal prosecutors.”

France

The position in France is that, like Latvia, there is no obligation to investigate in the absence of funding, and it is likely that the case will be closed if creditors or a third party is not prepared to fund investigations and recovery actions. In both of these jurisdictions, litigation funding is not yet available and there may be some legal hurdles to overcome to allow litigation funding.

The purpose of this project is to raise awareness across the membership of the AFF of what can and cannot be achieved in other jurisdictions and, possibly, influence change. The membership of INSOL Europe is fairly diverse and does include members of the judiciary. As such, there is a real prospect of change. INSOL Europe was influential in shaping the UNCITRAL code, and continues its activities in cross-border insolvency and turnaround work. There is no desire to produce a definitive guide to nil-asset insolvencies across Europe, the least of the issues being that



any such guide would immediately be out of date, such is the speed of change in legislation and approach. What is more suitable, and the AFF is getting there, is an open forum to discuss what can and cannot be achieved, and what needs to change. While I think that the UK (at least in Europe) leads the way in funding nil-asset insolvencies, we have much to admire of our European neighbours about their approaches to working with criminal prosecutors.

The topic of nil-asset insolvencies is the theme of INSOL Europe's Eastern European Countries' Committee (EECC) conference, which will take place in Budapest in May. As the name suggests the EECC is focused on Eastern European members of the insolvency community. The conference will be an opportunity to discuss the different approaches to these cases across Europe. Details of the conference can be found on INSOL Europe's website.

Attitude to fraud

In common with the UK, every European practitioner that I have spoken to has an obligation to report suspected criminality to the police or appropriate authorities. My experience with the UK criminal authorities, at least in my capacity as an insolvency practitioner, has been mixed and I am sure readers will have had their own experiences. In many European jurisdictions it is common for practitioners to work alongside criminal authorities, usually the police, and exchange information to mutually assist the tracing and recovery of assets and the prosecution of the fraudsters.

This is a topic that the AFF will continue to explore; it would be useful to obtain statistics from various jurisdictions rather than relying upon anecdotal evidence.

Conferences

The AFF held a joint conference with INSOL Europe's Young Members' Forum in London in November 2016, which was a great success. The AFF will be present at a conference in Tel Aviv in June, which will be very-much focused on the tracing and recovery of assets. The Tel Aviv conference will be hosted by my co-chair of the AFF, Eitan Erez, and is a joint event between INSOL Europe and INSOL International. These conferences demonstrate the growing interest in fraud-based insolvencies, and how much the AFF has grown in the space of just a few years.

In an article of this length, I can only hope to provide a flavour of INSOL Europe's AFF. The AFF is to provide a network of like-minded individuals who come together a couple of times a year and keep in touch in the interim, and share a common interest in the tracing and recovery of assets. Through this network, members of the AFF can contact members in other jurisdictions to establish what can and cannot be achieved and deal with fellow professionals who have practical experience in this area. When I established the AFF I asked myself, 'who can I ask if I need a freezing order in Latvia, a search and seize order in Norway and a disclosure order in Spain?' Through the AFF, I now have a network of professionals who can properly answer such queries and have real experience of this complex and ever-changing area of work.

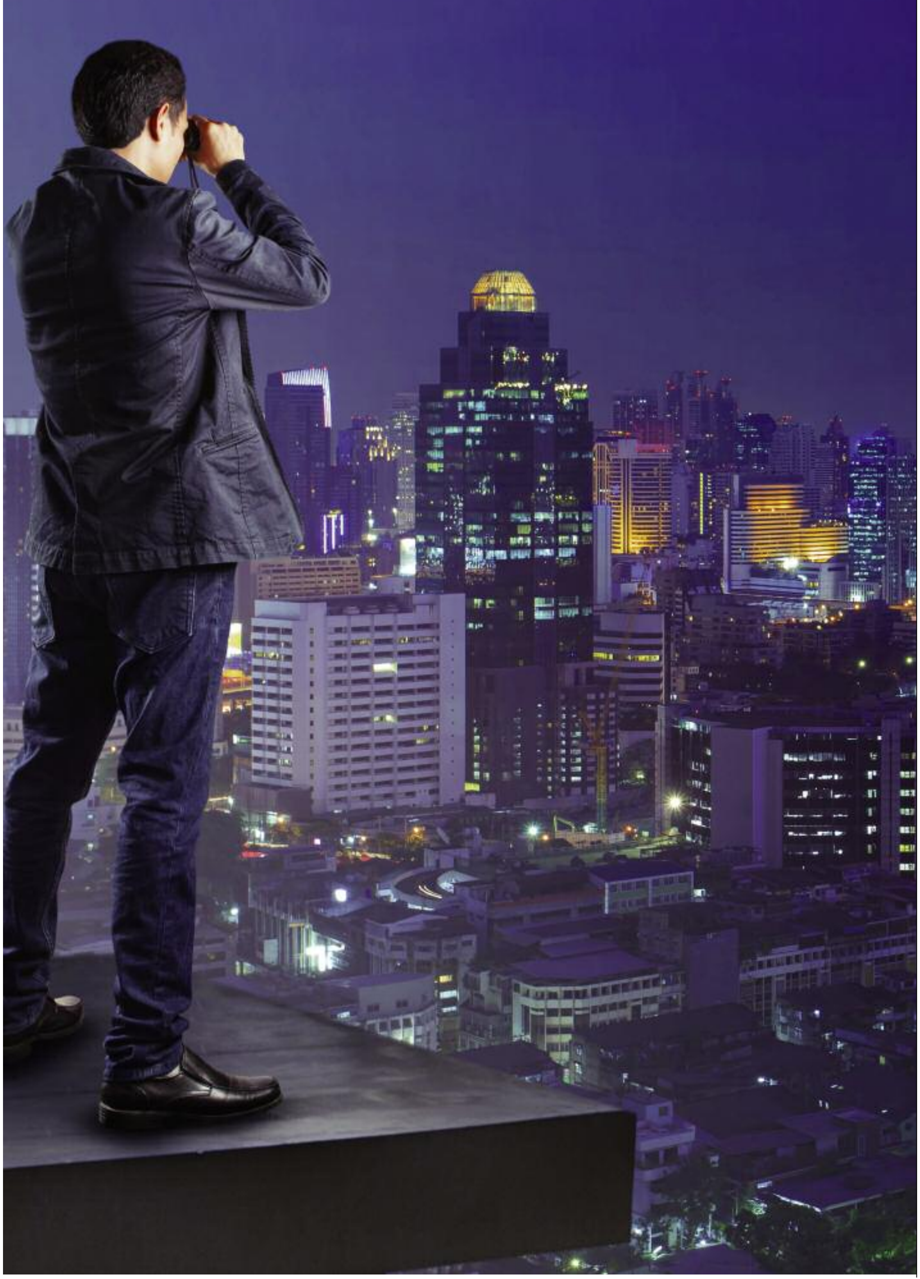
“In many European jurisdictions it is common for practitioners to work alongside criminal authorities.”

*If you are interested in joining INSOL Europe and its Anti-Fraud Forum, please refer to its website at **www.insol-europe.org**.*

DAVID INGRAM
is a partner at Grant Thornton UK LLP.

The funder's perspective: fraud claims

Steven Cooklin and **Jamie Riley** examine third-party financing of insolvency-related fraud claims.



Before turning to fraud claims, let's start by reminding ourselves of exactly what the key parties in an insolvency scenario are primarily trying to achieve:

The insolvency practitioner

He/she is tasked with maximising the returns for the insolvent estate (corporate or personal). This means maximising the *net* recovery to the estate – maximising recoveries but at proportionate cost to the estate, resulting in a distribution to creditors.

The funder

Happily, the funder/financier has the same aim as the IP: minimising capital at risk and maximising returns on that investment. It too is only concerned with the ultimate *net* result.

What is different about fraud?

There are broadly five elements to fraud:

1) a false statement of a material fact
2) knowledge that the statement is untrue
3) intention to deceive a victim
4) reliance by the victim on the statement, and
5) loss suffered by the victim as a result.

A fraud allegation essentially asserts that the defendant has been intentionally dishonest. Proving 'intent' and 'dishonesty' (both largely subjective, psychological states) is not a simple matter. Absent a plain admission of guilt (for example, during examination under s236 IA 86 or cross-examination at trial), the claimant will have to find clear evidence from third-party sources, for example, incriminating emails, letters or phone and text messages etc, which demonstrate dishonesty or from which it may be inferred. Most fraudsters are cunning operators and very often they will have been careful to cover their tracks, for example, by destroying evidence.

> "In certain cases an allegation of fraud may not only be unnecessary to aid recovery but may even be counter-productive."

Therefore the prospect of finding a smoking gun is by no means certain. This means that fraud claims are likely to impact upon the commercial aims of the IP and the funder: the more difficult the evidence gathering exercise, the costlier the investment to the funder and the IP, and the greater the risk to achieving a net recovery.

Nonetheless, depending on the facts of a particular case, there may be some advantages to pleading fraud, which include:

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- recovery of losses are not restricted to those that are 'reasonably foreseeable';
- the usual limitation periods for bringing claims may be extended; and
- personal liability for company directors.

However, an allegation of fraud must be clear and express and while the standard of proof is on a 'balance of probabilities', where fraud is alleged the evidential burden on the claimant is likely to be greater than in an ordinary civil claim. Therefore a careful legal assessment needs to be made before committing to an allegation of fraud.

Is a 'fraud' allegation necessary?

The Insolvency Act provides IPs with a powerful toolkit of legal weaponry to recover assets for the estate. This includes the ability to compel parties to attend interview, deliver up property, attend public and private examinations before the court, search and seize property, and the ability to have transactions set aside. While many claims brought by IPs *could* include an allegation of fraud, that allegation will often add little or nothing to the main purpose of the claim: maximising the net return to the estate/funder. Many cases Manolete Partners has financed have almost certainly involved an element of fraud, but taking on the additional evidential burden of proving the fraud adds nothing to the ultimate aim of the claim or the recovery. The unpaid loan account, the wrongful preference and the transaction at undervalue are all perfectly valid claims without the need to allege and prove fraud. Therefore, before embarking upon a fraud claim, the first question must be: what does it really add? In claims brought under the Insolvency Act, a fraud allegation will invariably add cost and is unlikely to increase recoveries. Indeed, as 'fraud' is more difficult to prove, it further exposes the IP and the funder to potential adverse cost consequences, should the fraud claim fail.

> "Any delay on the part of the IP in making an application is likely to be a factor to be weighed in the balance by the court in determining a risk of dissipation or prejudice to the respondent."

In certain cases an allegation of fraud may not only be unnecessary to aid recovery but may even be counter-productive. In particular, careful consideration should be given before alleging fraud against a director who is covered by a directors and officers liability insurance (D&O) policy. In such cases, fraud may either be excluded from the scope of the cover or may invalidate the policy, thereby reducing or even removing altogether the prospect of any recovery.

Where fraud is appropriate

However, there is no doubt that where material assets have been dishonestly misappropriated, fraud claims provide powerful tools in the recovery of those assets. Fraud claims give more scope for powerful interlocutory reliefs. A *prima facie* fraud could enable the IP to freeze the defendant's assets and protect his/her potential recovery position while further investigations and procedures are undertaken. Therefore if there is a real risk of defendant flight and dissipation of assets, domestic and worldwide freezing injunctions or provisional liquidator orders can be effective weapons to ringfence assets. Applications for such orders can be made without notice and provide the IP with a potent element of surprise.

However, freezing injunctions and provisional liquidations are not lightly granted. In the case of freezing injunctions the court has to be satisfied that there is merit in the claim or, in the case of a provisional liquidation, that a winding-up order is likely to be made. In both situations a key element is the existence of a real risk that assets are likely to be dissipated. In many cases this may be difficult to establish and the evidence will need to be carefully assembled. It is rarely the case that the applicant can refer to a statement on the part of the respondent that he/she intends to dissipate assets and so it will be necessary to demonstrate that risk of dissipation may be inferred. If the claim involves an allegation of fraud, such as dishonest misappropriation, for which there is good supporting evidence, this may itself be relied upon as establishing a risk of dissipation. However, not every case of dishonesty will support such an inference and it should not be assumed that the court will equate previous dishonest conduct with a present intent to dissipate assets.

Timing is also a key factor. Any delay on the part of the IP in making an application is likely to be a factor to be weighed in the balance by the court in determining a risk of dissipation or prejudice to the respondent. These important considerations all point to freezing injunctions and provisional liquidations as being expensive and not straightforward to obtain. There is also the likelihood that the court will require the provision of cross-undertakings in damages from the applicant IP. If the claim is funded, it is likely that the funder will be required to provide an indemnity to support the cross-undertaking and there are some insurers who offer specific products.

How does this impact the funder?

The allegation of fraud within a claim will tend to front-load more cost and increase the funder's perception of overall risk. More cost is required upfront to finance the initial investigation work, which will give the IP the best chance of obtaining emergency interlocutory relief such as a freezing injunction. Furthermore, many fraud claims have international aspects that require assembling legal teams across multiple jurisdictions. The freezing injunction process is expensive and the funder will also be keenly aware of its exposure if it has provided a cross-undertakings indemnity. However, if the merits of the case look strong, the quantum substantial (as a multiple of likely costs) and the path to the assets viable, then there is no reason why fraud claims cannot be financed.

> "The size of the claim needs to be substantial to justify the investment, otherwise the creditors and funder stand to make little or no return."

Despite strong interlocutory reliefs being available, fraud cases tend to last longer than most domestic insolvency claims. So, going back to the initial purpose of the entire exercise, given the time and cost involved, the size of the claim needs to be substantial to justify the investment, otherwise the creditors and funder stand to make little or no return. Manolete's minimum claim size for a standard UK insolvency/company claim is £20k. However, a claim with a realistic chance of recovering sums into the millions of pounds would in all likelihood be needed to justify supporting a complex fraud claim.

STEVEN COOKLIN is CEO at Manolete Partners PLC.

JAMIE RILEY is a barrister at Littleton Chambers.

Putting assets on ice

Tina Kyriakides explains what you can get and find out from a freezing order, and what are the limitations and extent of an order.

In *JTC BTA Bank* v. *Ablyazov* [2013] EWCA Civ. 928, Beatson LJ identified three principles that come into play in the exercise of the court's jurisdiction to make a freezing order: (i) the purpose of a freezing order, namely, to stop a defendant from dissipating or disposing of assets that could be the subject of enforcement; (ii) the flexibility of the jurisdiction, which enables the court to deal with new situations and new ways used by 'sophisticated and wily operators' seeking to make themselves immune from, or to thwart the effective enforcement of, court orders; and (iii) finally, ensuring the strict construction of orders in view of the seriousness of the consequences if they are breached.

> The NCAD may be joined as a party to the claim and an order may be made against it relating to those assets under the Chabra jurisdiction.

To enable orders to be policed, the court has the power to make disclosure orders either under its inherent jurisdiction and/or under the Civil Procedure Rules (CPR) 25.1(g).

In light of the above, the following principles emerge from the case law.

Assets

Assets that are covered by the CPR Practice Direction 25A standard form of freezing order (including the disclosure order) (the standard order) are assets that belong to the cause of action defendant (CAD) (whether or not in his name) and assets that the CAD has the power, directly or indirectly, to dispose of or deal with as if they were his own. These include assets held by a third party in respect of which the CAD retains beneficial ownership or effective control, but do not include a CAD's interest under a discretionary trust or assets held by him on trust for a third party. In such cases, good reason has to be shown why assets subject to such trusts should be made subject to an order, for example, because the evidence shows that the CAD, in fact, controls the trust or the trust is a façade or sham (*JSC BTA Bank* v. *Solodchenko* [2011] EWCA Civ. 1436).

Shares and company assets

Where assets of a company are controlled by a CAD, because, for example, he owns all the shares in the company and is a director, without more, the assets of the company are not caught by the standard order and no disclosure is required to be made of the company's assets. This is because the assets are not the CAD's assets nor are they assets that the CAD has the power to dispose of or deal with as if they were his own. The standard order will, however, catch the CAD's shares in the company. The consequence of this is that the CAD is restrained from procuring the company from making dispositions of its assets, which are likely to result in a diminution in the value of the CAD's shares, other than dispositions made in the ordinary course of the company's business (*Lakatamia Shipping Co Ltd* v. *Su* [2014] EWCA Civ 636).

NCAD and Chabra jurisdiction

Where there is good reason to suppose that assets held by a non-cause of action defendant (NCAD) are in truth the assets of the CAD, the court may extend the scope of the standard order to cover those assets or the NCAD may be joined as a party to the claim and an order may be made against it relating to those assets under the Chabra jurisdiction (see *TSB Bank International SK* v. *Chabra* [1992] 1 WLR 231 and *PJSC Vseukrainskyi Bank* v. *Maksimov* [2013] EWHC 422). This jurisdiction is more likely to be invoked successfully in cases where a CAD has, for example, dishonestly misappropriated funds and operates behind corporate vehicles.

Disclosure

Where a claimant is not sure whether a CAD has assets that should be covered by a freezing order, for example, an interest under a discretionary trust, he might consider seeking a disclosure order under CPR 25.1(g) for such information either at the same time as making his application for a freezing order or prior to making it with a view to subsequently making an application for a freezing order or extending an existing order (*JSC Mezhdunarodniy Promyshlenniy Bank* v. *Pugachev* [2015] EWCA Civ 139 where the court held that the test for obtaining a disclosure order was less stringent than that for obtaining a freezing order).

> Where assets of a company are controlled by a CAD, the assets of the company are not caught by the standard order and no disclosure is required to be made of the company's assets.

Norwich Pharmacal and foreign jurisdiction

In the case of a non-co-operative CAD, if, for example, a claimant is aware of the CAD's interest under a discretionary trust and of the identity of the trustees, he might consider applying for a disclosure order against the trustees themselves using the Norwich Pharmacal jurisdiction if the trustees are within this jurisdiction, as happened in *Pugachev*. This jurisdiction is not available, however, where the third party is resident abroad (*AB Bank* v. *Abu Dhabi Commercial Bank PJSC* [2016] EWHC 2082). In such cases, advice will need to be sought on whether similar relief is available in the foreign jurisdiction.

TINA KYRIAKIDES
is a barrister at Radcliffe Chambers.

Unexplained wealth orders

Oliver Powell and **Robert Starkins** examine
the latest measure to tackle money laundering and corruption.

Every year vast sums of money are laundered through London's banking system. The National Crime Agency (NCA) believes that up to £100bn of tainted cash could be passing through the UK each year. Much of the money is then integrated into the economy through the purchase of real estate, luxury cars, art and jewellery.

In June 2015 Transparency International UK issued a report proposing the introduction of 'unexplained wealth orders' (UWOs). Fast forward to October 2016, the criminal finances bill was introduced to the House of Commons and included specific provisions in relation to UWOs.

The aim of the bill is to improve the government's ability to: tackle money laundering and corruption; recover the proceeds of crime; and counter terrorist financing. The bill was introduced to the House of Lords on 22 February 2017 with a second reading on 9 March 2017.

This article explains the UWO provisions and seeks to give the reader an understanding as to how they may operate once in force.

What is a UWO?

A UWO will be an order made by the High Court that requires a person (the respondent) who is suspected of involvement in serious crime to explain the origin of assets that appear disproportionate to the respondent's income.

Such an explanation will be given as a statement setting out the nature and extent of the respondent's interest in the property identified in the UWO and explaining how the respondent obtained the property.

The following government agencies and officers (each referred to as an enforcement authority) will be able to apply for a UWO: the NCA; HMRC; Financial Conduct Authority; the director of the Serious Fraud Office; and the Director of Public Prosecutions.

To obtain a UWO, the enforcement authority will need to satisfy the court that:

1) the respondent holds property of a value greater than £100,000;
2) there are reasonable grounds for suspecting that the known source of the respondent's lawfully obtained income would have been insufficient to enable the respondent to obtain the property; and
3) there are reasonable grounds for suspecting that the respondent has been involved in a serious crime, or has been connected with another person involved in a serious crime (whether in the UK or elsewhere).

Where the respondent is a 'politically exposed person' (PEP) there is no need to satisfy the court of the third element (suspicion of involvement in criminality). It will suffice for the enforcement authority to prove the first and second elements only.

Interim freezing orders

At the same time that it makes a UWO, the High Court will also be able to make an 'interim freezing order' (IFO) over the respondent's property. The IFO will prohibit the respondent (or anyone else) from dealing with the property that is subject to the UWO.

> "At the same time that it makes a UWO, the High Court will also be able to make an interim freezing order (IFO) over the respondent's property."

The court will make an IFO when it considers it necessary to avoid the risk that all or some of the property that is the subject of the UWO will be disposed and/or dissipated before the process has run its course. In short, it avoids the risk of any recovery order that might subsequently be made being frustrated.

In making an IFO, the court may make provision for (among other matters) the respondent's ordinary living expenses. The court may vary or discharge an IFO at any time.

Compliance and defiance

If a person fails to respond to a UWO, the property that is the subject of the UWO will be presumed to be recoverable for the purpose of any subsequent civil recovery proceedings under part 5 of the Proceeds of Crime Act 2002 (POCA 2002).

It should be noted that a person will also be convicted of a criminal offence if they make false or misleading statements in response to a UWO.

Once served with a UWO, the respondent must comply within the time specified in the UWO. After the respondent complies, the enforcement authority has 60 days to decide on further enforcement or investigatory proceedings.

If there is no IFO in place, the enforcement authority has an unlimited time (subject to the general principle of delay contained in abuse of process case law) to determine what (if any) enforcement or investigatory proceedings may need to be taken.

Regardless as to whether an IFO has been granted, the proceedings that may be taken by the enforcement authority after a person has complied or purported to comply with a UWO include: confiscation proceedings (following a criminal conviction) under part 2 and part 4 of POCA 2002; civil recovery proceedings under part 5 of POCA 2002; or investigatory proceedings under part 8, chapter 1 of POCA 2002.

It should be noted that a UWO respondent statement may not be used against the respondent in criminal proceedings.

Conclusion

Since the leak in April 2016 of 11.5 million confidential documents belonging to the Panamanian law firm Mossack Fonseca, corruption has received fresh attention as a global concern. The so-called 'Panama Papers' revealed that billions of dollars had been placed in tax havens, shell companies and other vehicles designed to conceal wealth. Concerns expressed at the Anti-Corruption Summit, London in May 2016 indicated that UK property was being purchased by foreign investors to this end. While the full extent and use of the UWO will not be truly known until the bill is passed, it is an indicator that the UK is seeking to clamp down on corruption.

OLIVER POWELL is a barrister at Outer Temple Chambers.

ROBERT STARKINS is a director and insolvency practitioner at CVR Global LLP.

Finding the money to fight fraud

Mark Beaumont explains that you don't necessarily need a multi-million pound claim and a QC's opinion before you litigate, there are other options.

This month's *RECOVERY* topic is particularly relevant for me, as in March 2017 I'm scheduled to appear as a prosecution witness in a fraud trial. I didn't expect the case to get this far as the sums involved are not huge, and in my day-to-day life I'm often forced to look at things from a purely economic perspective – I'm certain that no funder would have wanted to take that case to trial!

The essential questions

When solicitors or IPs approach us for third-party funding or after-the-event (ATE) legal expenses insurance, our starting point is always the same three questions:

- How much are we seeking to recover?
- What will it cost to run the case?
- Is the defendant good for the money?

> There's far more misinformation in relation to funding and ATE than there is genuine information, and that leads to poorly informed decisions and missed opportunities.

The key question to answer is number three: recoverability. If the defendant has assets or insurance, then it's worth looking at questions one and two to enable a settlement or satisfy a judgment: costs versus likely damages.

Some funders will only look at multi-million pound claims, but there are at least six funders that will look at any claim where recovery is likely to be at least three times costs (so, if the claimant costs budget is £100,000 then the claim value needs to be at least £300,000).

Know your options

When it comes to funding insolvency litigation there are many options, including:

- sell the claim outright, or with an overage
- run on a CFA-supported ATE cover and disbursement funding
- third-party funding for part or all of the legal costs
- third-party funding for part or all of the IP's time costs.

This list is not exhaustive, but it does give an indication of the options available for insolvency disputes. There are a dozen ATE insurers and almost 30 active funders in the market now, with a wide range of approaches and risk appetites. It's typical to present more than one option for any claim, and the route taken is often just as much about the IP and the lawyer's attitudes to WIP as it is about the merits of the claim itself.

Check the market

I find it frustrating that so many potential claims either fail to get off the ground, or get going and then settle far too low because funding avenues have not been fully explored – the creditors lose out and the professionals involved miss out.

With such a wide variety of insurance, disbursement funding and non-recourse funding available, I think it always makes sense to do a quick check of the market to see what could be possible. That way, your worst case scenario is that you have a file note to say you've checked the market and explored the options for creditors.

Sadly, I'd say there's far more misinformation in relation to funding and ATE than there is genuine information, and that leads to poorly informed decisions and missed opportunities. In my experience some of the common misconceptions are:

- Funders only want the perfect case: while this is true of many funders, there are many who embrace risk.
- Funding is only for multi-million-pound claims: again, only true of part of the market.
- We need the opinion of a QC before we seek funding: again, some truth but by no means the whole picture.
- I will have to change my legal team for a funder: I am yet to see this happen even once.
- Funders want three or four times their money, even if a case settles early: most of the deals we have done involved staged agreements and far lower returns than this.
- Funding is complicated and time-consuming: it can be, but there are many ways to streamline the whole process and make it much more efficient.
- ATE insurers want up-front premiums: virtually every insurance policy we've handled has been fully deferred and contingent (you only pay if you make a recovery).
- ATE is becoming more and more expensive: there are a dozen credible insurers and premiums are generally calculated as a percentage of the costs being insured, starting at around 10 per cent and often rising in stages to between 30 per cent and 60 per cent (of costs) at trial.

> The route taken is often just as much about the IP and the lawyer's attitudes to WIP as it is about the merits of the claim itself.

I'm sure there are many other misconceptions out there in the market. For some reason funding seems to attract incredibly strong opinions based on outdated or minimal experience. Of course, the best way to change people's attitudes is by practical demonstration. To this end, feel free to run any cases by us and we'll give you an independent view on what options could be available and at what cost.

There is absolutely no reason why fraudsters, or anyone else, should 'get away with it' when there are so many options available to insure and fund insolvency disputes.

MARK BEAUMONT is co-founder of Annecto Legal, an FCA-regulated, full-market broker of ATE insurance and third-party litigation funding for insolvency disputes. Annecto Legal works with 12 insurers and 28 third-party funders to source the best deal for clients.

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3 Results of the JIEB examinations – November 2016

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Joint Insolvency Examination – November 2016

Congratulations to all the successful candidates.

JIEB 2016 prize winners

Insolvency Practitioners Association Prize for First Place
Victoria Ryan

PricewaterhouseCoopers Prize for Second Place
James Long

Leonard Curtis Prize for Third Place
Andrew Dyson

Association of Chartered Certified Accountants' Prize (awarded to the ACCA member with the highest mark)
Andrew Dyson

ICAEW Prize (awarded to the ICAEW member with the highest mark)
Louise Rigby

ICAS Prize (awarded to the candidate in the Scottish papers with the highest marks)
Gavin Park

BPP Prize (awarded to the candidate with the highest mark in the Personal paper)
Timothy Vance

R3 Smaller Practices Group Prize (awarded to the candidate with the highest mark from a smaller practice)
Luke Brough

A

Adams M (1076) Walton-On-Thames
Ahmed R (1082) Bradford
Allen D (1080) Chatham
Arakapiotis A (1084) London
Ashford K (1046) Bedford

B

Ballard P (1090) Sutton Coldfield
Banfield M (1089) London
Barry J (1087) Birmingham
Berkovi P (1075) London
Bourne K (1058) Coventry
Brough L (1104) Sheffield

C

Charalambous P (1095) Hatfield
Chillery-Belcher J (1105) Chester
Collins D (1097) Cardiff

D

Dixon K (1092) Manchester
Downey R (1094) London
Dunbar E (1135) Birmingham
Dyson A (1103) Whitley Bay

E

Errington C (1158) Reading

F

Fish J (1120) Manchester
Forbes S (1119) Hornchurch

G

Gatley J (1128) London
Goldsmith S (1042) Eastleigh
Green M (1043) George Town

H

Hall J (1122) Manchester
Hamblin E (1060) Leicester
Holley J (1047) Wickford
Howlader H (1129) London
Hutton N (1052) Sheffield

I

Iacovou P (1055) London

K

Kennedy C (1072) London
Kicks K (1163) Chelmsford

L

Leith B (1142) London
Littlejohn L (1005) Leicester
Long J (1107) London
Lunt O (1002) Leeds

M

McMath D (1010) Belfast
McVeigh W (1014) Belfast
Mader M (1011) Hounslow
Mason S (1154) Leicester
Mawhinney M (1012) London
Mulgrew T (1013) Romford
Munro A (1167) Aberdeen
Murcott S.L (1009) Sutton Coldfield

N

Nagi M (1165) London
Nalliah A (1016) Peterborough

P

Park G (1145) Dunfermline
Parkinson J (1021) Hull
Peel R (1106) Eastbourne
Prior J (1020) Southampton

R

Richards K (1029) Birmingham
Rigby L (1023) Altrincham
Rogers S (1101) Stoke-On-Trent
Roome M (1024) Long Eaton
Rushworth C (1028) Leicester
Ryan V (1151) Leeds

S

Schofield R (1032) Oldham
Simpson R (1147) Pershore
Slade A (1146) London

T

Taylor A (1156) London
Taylor D (1110) Stockport
Trusler D (1149) Lewes
Tucker B (1069) London
Tucker M (1083) Isle Of Man

V

Vance T (1085) Leeds

W

Willard S (1078) Chislehurst

Y

Young J (1111) Worcester

Analysis of November 2016 results

Papers sat	Papers passed				
	3	2	1	0	Total
3	29	12	9	6	56
2	–	20	14	17	51
1	–	–	38	21	59
Grand total	29	32	61	44	166

Specialist insolvency qualifications (JIE/CPI/CPPI/CPCI)

The principal recognised professional qualification for people wishing to specialise in insolvency and act as a licence holder is the Joint Insolvency Examination (JIE). A pass in JIE is a prerequisite to becoming a licensed insolvency practitioner.

Joint Insolvency Examination (JIE)

To sit the JIE, you need to be a member of the Insolvency Practitioners Association (IPA) or registered with another Recognised Professional Body (RPB) or the Secretary of State for Business, Innovation & Skills. The examination consists of three papers:

- Paper 1 – Liquidations
- Paper 2 – Administrations, Company Voluntary Arrangements and Receiverships
- Paper 3 – Personal Insolvency

Each paper is 3.5 hours in length (including reading time) and is set at degree level. It consists of a mixture of written and numerical questions on practical insolvency issues. The examination is on an open-book basis, and is held in November each year. The deadline for applications will normally be the middle of September.

Partial Licence, may be obtained by sitting one or more papers relevant to the chosen specialism. The IPA can provide further information on options.

Certificate of Proficiency in Insolvency (CPI)
Certificate of Proficiency in Personal Insolvency (CPPI)
Certificate of Proficiency in Corporate Insolvency (CPCI)

The IPA offers established intermediate examinations, the CPI, CPPI and a new CPCI, for those specialising in insolvency. They are ideal preparation for the JIE, with their combination of multiple-choice and short form exam questions, as well as longer essay-style and computational questions, and are used by many as a stepping-stone to the higher qualification. The examinations are a test of competence in insolvency, and the CPI is widely recognised by employers as an established mark of achievement. It covers both personal and corporate insolvency.

The CPI can lead to membership of the IPA and to entitlement to use its designatory letters MIPA. CPPI and CPCI cover personal- and corporate-only insolvency issues respectively but are set at the same standard. They are ideal for those specialising in the personal or corporate insolvency sectors.

The CPI, CPPI and CPCI are designed for individuals working in or who have an interest in insolvency, who may or may not intend to become licensed insolvency practitioners. The examinations are held in June and December each year with results issued in the following month. These papers each take 3 hours. They are run exclusively by the IPA.

Contact the IPA

JIE tuition and courses are supplied by various providers, details of which can be found on the IPA website. Entry forms for the JIE, CPI, CPPI and CPCI can be downloaded from the IPA website http://www.insolvency-practitioners.org.uk/. The IPA values its students, as the next generation of insolvency experts. It is the only examiner and regulator specialising in insolvency. That is one reason why more students sit their JIE through the IPA than through any of the other RPBs.

Not Chapter 11 but Chapter 11-ish

Howard Morris looks at whether there is a shift towards a US method for resolving insolvency in the UK.

Parents, headmasters, hoteliers, restauranteurs, insurers and countries love them or hate them, depending on how their school or restaurant, company or nation is ranked. I'm referring to the World Bank's annual *Doing Business*, for countries, league[1] tables of course. For all their flaws, league tables are everywhere, and the World Bank is closely followed by our government and others[2]. The UK's plans for reforming insolvency law are profoundly informed by its ranking for the ease and efficiency of doing business and its ambition to move up the tables.

> Other parts of the world are reforming like fury and are seeking to seize the UK's crown as the centre for international restructurings.

Slipping down the ladder

To climb the World Bank league table the UK must move closer to the best practices and rubrics of the World Bank in each of the areas on which it is scored. We've slipped down the insolvency ranking since the scoring system changed and to climb again we must change, or 'close the distance to frontier of best practice' as the World Bank describes it. That is why the reforms proposed last spring by the Insolvency Service[3] were so redolent of Chapter 11, because certain elements of Chapter 11 are baked into the World Bank's (and UNCITRAL's) vision of best practice for an insolvency system.

We could stick with what we have, because we have a very fine system, but other parts of the world are reforming like fury and are seeking to seize the UK's crown as the centre for international restructurings. Most recently, the EU Commission has started a massive, heaving effort to modernise EU members' insolvency laws in order to push the EU up those same World Bank rankings[4]. We likely won't be part of the EU when those reforms come to fruition but doesn't it matter if the UK is left behind?

There is a deeper reason for embracing, or at least accepting, change and one that goes to the very philosophical heart of why nations need efficient insolvency systems. There is a pressing need for the UK to bring its insolvency laws closer into line with the World Bank's vision, all the more so as we aim to remain a leading capital market and economy after Brexit.

Changing scales

In its 2015 rankings, the World Bank had changed its approach to its 'resolving insolvency' analysis. That year the UK fell from 7th place to 13th, where we have languished since. In contrast the USA leapt from 14th place to 4th, and for 2016 and 2017 it has ranked 5th for resolving insolvency. What happened?

Until the 2015 rankings the World Bank's assessment for resolving insolvency was calculated on the time, cost and outcome for creditors. The UK did, and still does, very well on these measures. But the World Bank introduced a new measure to determine the strength of an insolvency framework. This new metric assesses the extent to which the best practices championed by the World Bank and UNCITRAL are represented in the country's insolvency regime.

The World Bank and UNCITRAL have been working on this topic for years. The World Bank has produced its *Principles for Effective Insolvency and Creditor/Debtor Regimes*[5] and UNCITRAL its *Legislative Guide on Insolvency law*[6]. These have been married together in a World Bank publication *Creditor Rights and Insolvency Standard*[7].

So, while the UK has scored nearly top marks since the 2015 table for the outcome of insolvency (sale as a going concern as opposed to a piecemeal sale), on the commencement of proceedings, the management of the debtor's assets, the cost to the estate and the recovery rate, our scores are much poorer than the USA on the new measures of reorganisation proceedings and creditor participation.

> Our scores are much poorer than the USA on the new measures of reorganisation proceedings and creditor participation.

The World Bank uses a descriptor of overall performance called 'distance to frontier' meaning the distance to the 'best performance across all economies in the Doing Business sample since 2005.' The UK's resolving insolvency – distance to frontier, with the new measures, fell from 95.33 to 82.04, while the USA (and other countries) went ahead of us. The USA went from a distance to frontier score of 87.72 to 89.20.

A big 'so what?' is a perfectly natural response. In the UK insolvency takes on average one year as opposed to one and a half years in the USA, the cost to the estate is 2 per cent less here than in the USA and the return to creditors is 8.2 cents in the dollar higher. To Britons our insolvency system, while not perfect, is excellent and that must be so because of the number of companies that flock here from around the globe to restructure. The obvious point here is that companies from abroad flock here to use the scheme of arrangement, which is nothing to do with the insolvency laws, and take advantage of the concentration of high quality professional expertise of great integrity and a legal and judicial system that is held in the highest esteem worldwide. The attraction of the UK to foreign debtors and creditors doesn't lie in the administration procedure.

Chaper 11 in disguise?

In May 2016, the Insolvency Service put out consultation proposals for the reform of UK insolvency law. Of the four central proposals below, the government is pressing ahead with three:

- A moratorium procedure, management remaining in control as debtor in possession.
- An extension of the 'essential suppliers' regime enabling debtors to specify contracts that then can't be terminated by reason of the debtor's financial distress.
- A new plan of reorganisation that goes further than any current UK procedure, including the scheme of arrangement, by permitting the cramming down of a whole class of creditors who don't support the plan.
- Super priority rescue finance or DIP lending.

> "Our current administration procedure responds well to a secured creditor but bond-holders, unsecured lenders of different rankings, simply don't have the representation that they do in a Chapter 11."

The fourth proposal, as was the case when it was previously canvassed in 2009, is not going forward.

There is, undoubtedly, something Chapter 11ish about the proposals. In his forward Sajid Javid, the former Secretary of State at the then Department for Business, Innovation and Skills, said:

'To remain at the forefront of insolvency best practice we also need to ask what a "good" regime looks like in 2016. An increasing international focus on company rescue has helped to shift the perceptions of what constitutes best practice; the UK needs to reflect this if our businesses, investors and creditors are to remain confident that the best outcomes can be achieved when things go wrong.'

The executive summary references the government's manifesto commitment to the UK being in the top five in the world and number one in Europe in the World Bank's annual *Doing Business* report.

Then, in November last year, the EU Commission came forward with a new draft insolvency regulation that will, if introduced, require EU members to create in their national laws an insolvency framework meeting minimum standards. The framework is uncannily like that envisaged by the World Bank and UNCITRAL and our Insolvency Service.

Familiarity with the USA

I trailed at the beginning of this article that there is a deeper reason for accepting, and actually welcoming, the Insolvency Service's proposals. The insolvency system, the law, the professionals who operate and police the system, the courts that oversee and adjudicate the procedures and disputes, are all part of the essential economic plumbing for an economy. The purpose of the EU Commission's ambitious insolvency harmonisation plan, something never attempted before, is to be an important part of creating Europe's single capital market. The 'Five Presidents Report' of June 2015[8] lists 'insolvency law among the most important bottlenecks preventing the integration of capital markets in the euro and beyond.'

If the system doesn't work efficiently and predictably then investors will choose someplace else to invest. In deciding the attributes, the emphasis and bias of the insolvency system towards the debtor or the creditor, there is no right or wrong answer other than the pragmatic one of what best promotes successful economic activity. The UK's insolvency regime is a product of our social and economic culture and, since the Cork Report, has held a conscious and deliberate aim of fostering a rescue culture.

Capital providers are most at home, and find it easiest to price insolvency risk, when the insolvency regime is not only efficient but also familiar. The capital markets are more international now than ever and money scours the world for investment opportunities. The hedge fund industry is a huge provider of capital for corporate restructurings and the simple truth is that they and a vast majority of the big sources of capital are either US based or have a strong US character[9] and it is the US restructuring and insolvency regime with which they are most familiar. I don't think that an investor in a new deal will be attracted because the applicable insolvency regime is familiar, but an unfamiliar system can certainly deter them from putting up their money or doing so at a keen price. Furthermore, in a world where enterprises have larger and far more complex capital structures than in the past, investors in all those different instruments and layers of debt want a system that gives them a voice in the restructuring. Our current administration procedure responds well to a secured creditor but bond-holders, unsecured lenders of different rankings, simply don't have the representation that they do in a Chapter 11 designed to accommodate an atomised constituency of creditors.

With so many countries reforming their insolvency laws to attract business and to smooth and enable the flow of capital the UK, with Brexit imminent, and a fight on its hands to retain its position as a key capital market and centre for restructuring, must be at the forefront of reform to attract investors. ◻

[1] The World Bank *Doing Business* Report www.doingbusiness.org

[2] See 'The wrangling behind the World Bank business stats beyond brics' www.ft.com/content/5e09fd45-a691-304e-8f86-7d2bc86ob70f

[3] https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf

[4] Proposal for a Regulation of the European Parliament and of the council amending Council Regulation (EC) No 1346/2000 on insolvency proceedings http://ec.europa.eu/justice/civil/files/insolvency-regulation_en.pdf

[5] Principles for effective insolvency and creditor and debtor regimes http://documents.worldbank.org/curated/en/518861467086038847/pdf/106399-WP-REVISED-PUBLIC-ICR-Principle-Final-Hyperlinks-revised-Latest.pdf

> "The purpose of the EU Commission's ambitious insolvency harmonisation plan is to be an important part of creating Europe's single capital market."

[6] UNCITRAL Legislative Guide on Insolvency Law http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf

[7] Creditor rights and insolvency standard http://siteresources.worldbank.org/GILD/ConferenceMaterial/20774191/ICR_Standard_21_Dec_2005_Eng.pdf

[8] The Five Presidents' Report: Completing Europe's Economic and Monetary Union http://ec.europa.eu/priorities/publications/five-presidents-report-completing-europes-economic-and-monetary-union_en

[9] The United States remains the largest centre of investment, with US-based funds managing around 70 per cent of global assets at the end of 2011 per TheCityUK (2012). 'Hedge Funds: March 2012'. TheCityUK's, 'UK fund management: An attractive proposition for international funds' report, released in 2014, reveals that UK assets under management reached a record £6.8tn at the end of 2014.

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Privilege – a fundamental human right

Lexa Hilliard QC examines legal professional privilege for trustees in bankruptcy.

The case of *Avonwick Holdings Limited & Ors* v. *Mikhail Shlosberg*[1] shone a spotlight on a power of a trustee in bankruptcy, which has been rather taken for granted until now. That power is the ability of the trustee pursuant to section 311 of the Insolvency Act 1986 (IA 86) to take possession of all books, papers and other records that relate to the bankrupt's estate or affairs and that belong to him or are in his possession or under his control (including any that would be privileged from disclosure in any proceedings).

The issue that arose was the extent to which a trustee in bankruptcy can use information contained in documents passing between a debtor and his lawyers before the debtor's bankruptcy. Such information would, ordinarily, be protected by legal professional privilege. The case discussed the extent to which the privilege continues after a debtor has been made bankrupt.

Background

The background facts were unusual. Avonwick Holdings Limited (Avonwick) had loaned $100m (£80m) to a company called Webinvest Limited (Webinvest). A Mr Shlosberg guaranteed the loan. The loan was not repaid. Mr Shlosberg did not pay under the guarantee. Avonwick sued Mr Shlosberg and Webinvest. Dechert LLP acted for Avonwick and in due course obtained judgments against Webinvest and Mr Shlosberg. Webinvest was put into compulsory liquidation and a bankruptcy order was made against Mr Shlosberg.

Thereafter, the trustees in bankruptcy retained the same individual at Dechert who had previously advised Avonwick. The same individual also continued to advise Avonwick in a conspiracy claim against Mr Shlosberg and others that Avonwick had commenced shortly before Mr Shlosberg had been made bankrupt. As the conspiracy claim was based on fraud, if successful, it would survive Mr Shlosberg's discharge from bankruptcy.

> "The Court of Appeal agreed that a trustee cannot waive a bankrupt's legal professional privilege even for getting in and realising the bankrupt's estate."

The trustees obtained documents from Mr Shlosberg's former solicitors that were passed to Dechert, to review as the trustees' solicitors. The trustees were willing to permit Avonwick to make use of the contents of some of the documents for the purposes of its conspiracy claim. Mr Shlosberg made an application against Avonwick, Dechert and the trustees for an order directing Dechert to cease to act as solicitors for Avonwick and the trustees.

The decision at first instance

At first instance Mr Justice Arnold directed Dechert to cease acting for Avonwick. The judge refused to direct Dechert to cease acting for the trustees but held that privileged documents could be used by the trustees in bankruptcy only for the purpose of carrying out their statutory functions. The trustees did not have carte blanche to make use of the documents in any way that they saw fit. Accordingly, the trustees could not make the privileged documents or information contained in them available to Avonwick even if their use might assist Avonwick in its conspiracy claim, which, if successful, might result in Avonwick's claim in Mr Shlosbergs' bankruptcy being reduced by such amounts as were paid by Mr Shlosberg's co-conspirators.

Appeal unsuccessful

Avonwick and the trustees appealed and lost. The main arguments on appeal were that:

- privilege was a form of property which vested in the trustees pursuant to section 306 IA 86;
- the trustees could waive privilege in respect of documents obtained pursuant to section 311 IA 86 so as to make the privileged documents or information available to Avonwick.

Is legal professional privilege property?

Prior to *Avonwick* trustees in bankruptcy and their advisers would, typically, cite *Re Konigsberg*[2] in support of a claim for delivery up by a debtor's former solicitors of documents containing privileged information. In *Konigsberg* it was conceded by opposing counsel that privilege was property which vested in the trustee. It is, therefore, not surprising that counsel for the appellants pursued the same argument. The argument was that the paper comprising the documents and the information contained in the documents was property which automatically vested in the trustee pursuant to section 306 IA 86. 'Property' is defined very widely by section 436(1) IA 86 as including:

> In essence, the Court of Appeal held that the privilege was a personal right of the bankrupt, subject to a right of access by a trustee by reason of section 311.

'money, goods, things in action, land and every description of property wherever situated and also obligations and every description of interest, whether present or future or vested or contingent, arising out of, or incidental to property.'

However, the Court of Appeal rejected the argument that the privilege was property. The court was heavily influenced by *R (Morgan Grenfell & Co Ltd)* v. *Special Commissioner of Income Tax*,[3] which confirmed that legal professional privilege is a fundamental human right which can only be invaded in exceptional circumstances. The Court of Appeal recorded the words of Lord Hoffmann in *Morgan Grenfell* where he said that legal professional privilege:

'… is a fundament human right long established in the common law. It is a necessary corollary of the right of any person to obtain skilled advice about the law. Such advice cannot be effectively obtained unless the client is able to put all the facts before the adviser without fear that they may afterwards be disclosed and used to his prejudice.'

Lord Hoffmann went on to say:

'the courts will ordinarily construe general words in a statute, although literally capable of having some startling or unreasonable consequence, such as overriding fundamental human rights, as not having been intended to do so. An intention to override such rights must be expressly stated or appear by necessary implication.'

Section 436(1) did not expressly or by necessary implication treat the privilege as property, therefore the inescapable conclusion was that there was no intention in the IA 86 to treat the privilege as property capable of vesting in the trustee as part of the bankrupt's estate. In essence, the Court of Appeal held that the privilege was a personal right of the bankrupt, which remained with the bankrupt subject to a right of access by a trustee by reason of section 311.

The right of waiver

The appellants argued that if a trustee only has access, and does not acquire title to material that would otherwise be privileged, the trustee could still deploy or waive the privilege in favour of Avonwick. The Court of Appeal preferred the bankrupt's argument. The bankrupt accepted that a trustee would be entitled to look at privileged material in order to obtain information that was relevant to the performance of the statutory purpose of getting in and realising the bankrupt's estate pursuant to section 305(2). However, the bankrupt's case was that a trustee could only use such material in a way that would not amount to a waiver of privilege. Accordingly, the trustee had no right to give Avonwick access to the privileged material even if that access might ultimately result in Avonwick ceasing to be a bankruptcy creditor because it succeeded in its claim against the other defendants in the Avonwick claim.

The prohibition on waiving privilege in favour of Avonwick can, perhaps, be readily understood because even if the use of the privileged material resulted in Avonwick having no claim against the estate, it would not assist the trustee to get in and realise the estate, it would only result in a reduction of the claims against the estate. However, the Court of Appeal agreed with Avonwick's wider submission that a trustee cannot waive a bankrupt's legal professional privilege even if it is for the purpose of getting in and realising the bankrupt's estate. In some circumstances this restriction could be unfortunate. In an anti-avoidance claim for example, the ability of a trustee to disclose to the defendant and deploy in court privileged communications between a bankrupt and his solicitor might mean the difference between success or failure in the claim. If the bankrupt is uncooperative (which is often the case) and the communications demonstrate the motivation of the bankrupt in entering into the transaction, the privileged material would be a vital component of the case. The result of *Avonwick*, however, is that the communications are not the trustees' to waive.

The Court of Appeal acknowledged that the prohibition on the deployment or waiver of privileged material would not apply to liquidators or administrators of insolvent companies. The Court of Appeal justified the different treatment on the basis that a liquidator or administrator is an agent of a company but a trustee is not an agent of a bankrupt. As an agent, a liquidator or administrator has total control over privileged material belonging to the company and is at liberty to exploit the privileged material in any way he thinks fit provided, of course, that it is for the purpose of carrying out his statutory duties. This difference means that, surprisingly, creditors of a bankrupt are at a greater disadvantage than creditors of an insolvent company.

A lost opportunity?

An argument not explored in *Avonwick* is whether the duty of a bankrupt in section 333(1)(c) IA 86 to do all other things as the trustee may, for the purposes of carrying out his functions, reasonably require, could be used to require a bankrupt to consent to the use of privileged material if by so doing it would assist a trustee to get in and realise the bankrupt's estate. In another context, in *Bishopsgate Investment Ltd* v. *Maxwell*[4] the Court of Appeal held that another fundamental human right, the privilege against self-incrimination, had been impliedly abrogated by section 235(2) IA 86, which requires officers and former officers of a company to provide information to and attend upon the office-holder if reasonably required to do so. Applying the same reasoning, it could be argued that the right of a bankrupt to refuse to waive legal professional privilege is impliedly abrogated by section 333(1)(c) by reason of the bankrupt's express duty to assist the trustee in getting in and realising the bankrupt's estate.

> It will take another trip to the Court of Appeal (or higher) to test whether the bankrupt can be compelled to waive privilege in this way.

Regrettably it will take another trip to the Court of Appeal (or higher) to test whether the bankrupt can be compelled to waive privilege in this way. In the meantime, it is unsatisfactory that office-holders of companies are in a more advantageous position as regards the use of privileged material than a trustee in bankruptcy of an individual.

[1] [2016] EWCA Civ 1138.
[2] [1989] 1 WLR 1257.
[3] [2002] UKHL 21.
[4] [1993] Ch 1.

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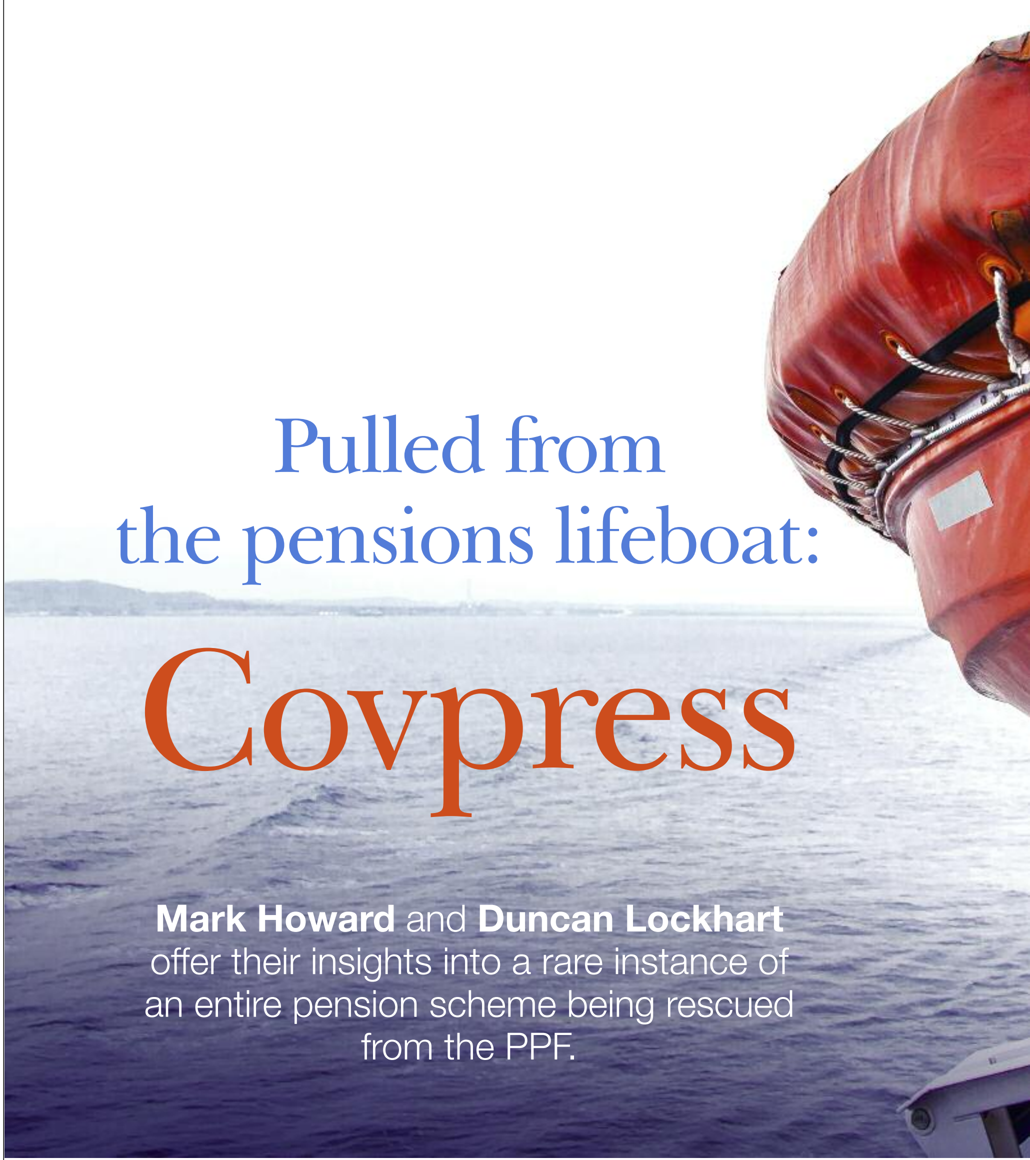

Pulled from the pensions lifeboat: Covpress

Mark Howard and **Duncan Lockhart** offer their insights into a rare instance of an entire pension scheme being rescued from the PPF.

The administrators of Covpress Limited sold the business and assets of the company to the Liberty Industries Group, part of the Liberty House Group and, as part of the sale consideration, the purchaser took on (and rescued) the defined benefit pension scheme.

Eddie Williams, Richard Lewis and David Dunckley of Grant Thornton were the administrators of the company, represented by Irwin Mitchell, while the Liberty House Group was represented by Clyde & Co.

Section 75 debt

As you will know, insolvency practitioners must give notice of an insolvency of a sponsoring employer of an occupational pension scheme to the Pension Protection Fund (PPF), the Pensions Regulator (tPR) and the pension trustees within 14 days of the insolvency date. In the case of Covpress, notice was given on the day the administrators were appointed.

The PPF then confirms whether the scheme contains defined benefits and that an 'assessment period' has commenced with effect from the insolvency date. There are a number of consequences of an assessment period, which include:

- no members may be admitted to the scheme and further benefit accrual in the scheme ceases (if it had not already done so);
- ordinary contributions to the scheme cease – although the insolvency will have triggered a liability under section 75 of the Pensions Act 1995 (see below); and
- pensions being paid from the scheme should be reduced to reflect the levels of PPF compensation (although in the case of Covpress, as a scheme rescue was anticipated from an early stage, no reduction was applied).

A valuation will also be carried out

> In this particular situation, the interests of the parties in achieving a scheme rescue were aligned (and all parties were willing to invest in the possibility of the scheme rescue as part of the sale process).

during this assessment period. If the scheme has insufficient assets to provide at least the equivalent of PPF compensation, then the assets and liabilities will transfer to the PPF, the trustees of the scheme will be discharged and the PPF takes on the responsibility for paying compensation. The PPF compensation is broadly 100 per cent of the pension in payment for pensioners over the scheme's normal pension age, ill health early retirees and surviving spouse/dependant pensions. For everyone else, it is 90 per cent of the pension subject to a cap (currently £37,420.42 at age 65). If the scheme has sufficient assets, it will simply purchase annuities and be wound up outside of the PPF.

The insolvency event also triggers a debt under section 75 (s75) of the Pensions Act 1995 on the insolvent employer. This will rank as an ordinary unsecured debt in the insolvency and the PPF steps into the shoes of the trustees to exercise their creditor rights. A s75 debt values the liabilities of the scheme on the assumption that all of the benefits are secured with annuities or deferred annuities. This could be significantly different to the valuation on an on-going basis. For example (and these are not the figures for Covpress), a scheme might have assets of around £6m and 'technical provisions' of £8m. So the deficit while the employer is continuing is £2m and the employer would be required to contribute to eliminate that deficit. But the cost of securing benefits with an insurer

> When the business and assets of a company in administration are sold, the pension scheme often becomes a very significant – often the most significant – unsecured creditor in the estate.

might be £10m. So on triggering a s75 debt, the PPF (on behalf of the trustees) would be proving for a deficit of £4m.

This usually means that when the business and assets of a company in administration are sold, the pension scheme becomes a very significant – often the most significant – unsecured creditor in the estate.

The Covpress deal

The Covpress situation was different in that the administrators believed the scheme did not carry a large deficit (on an on-going basis) and they would be paying a dividend to unsecured creditors, so removing the s75 claim would have a significant benefit to the other unsecured creditors in the estate (even if this liability reduced the consideration payable on completion). For the purchaser it also assisted in their goal to ensure the workforce was motivated and happy to have a new owner, and its customer base would view the business as a stable supplier going forward.

In order to ensure a s75 debt did not crystallise, the pension scheme needed to be rescued. The s75 debt triggered on an insolvency is conditional on a 'scheme failure notice' becoming binding. This brings us to the second notice that an insolvency practitioner has to issue in relation to a defined benefit occupational pension scheme. The insolvency practitioner must issue:

- a 'scheme failure notice' when he/she is able to confirm a scheme's rescue is not possible. This is usually the case (and sometimes is issued at the same time as the original notification to the PPF); or
- a 'withdrawal notice' when he/she is able to confirm a scheme rescue has occurred. This leads to the PPF assessment period ending.

A scheme rescue occurs either when the sponsoring employer is rescued as a going concern and remains responsible for the scheme or, as in the case of Covpress, another person assumes responsibility for the scheme. There have been a handful of scheme rescues since the PPF was first established in 2005, but it is rare for an entire scheme to be rescued from a company in administration by an unconnected party taking over responsibility.

The legislation says nothing about how a scheme rescue is to be achieved. In the case of Covpress, there were a number of documents to effect the scheme rescue:

- A framework deed between Covpress, the administrators, the pension trustees and the purchaser. This set out the process and documents to be entered into by the parties.
- A deed of succession substituting the purchaser as principal employer of the Covpress scheme in place of Covpress. This meant that the purchaser took on all of the responsibilities as employer of the Covpress scheme. In this case, as there was only one company participating in the scheme, the process of assuming responsibilities was relatively straightforward, but it might be more difficult for a multi-employer scheme.

In addition, the purchaser and the pension trustees entered into a memorandum of understanding as to the assumptions to be used for the next actuarial valuation. This gave the purchaser clarity over the level of contributions it might expect to pay to the Covpress scheme.

The framework deed, deed of succession and memorandum of understanding all took effect on completion of the sale of the Covpress business to the purchaser. Immediately following completion, the administrators notified notify tPR and the PPF of the scheme rescue and change of employer. The PPF assessment period does not end immediately. The PPF has to determine whether to approve the withdrawal notice sent to it by the administrators. The PPF had been kept up to date on progress of the deal and approved the Covpress scheme withdrawal notice the day after it was received.

There is then a 28-day review period before the PPF's decision to approve the withdrawal notice becomes binding and the PPF assessment period ends.

> "It is rare for an entire scheme to be rescued from a company in administration by an unconnected party taking over responsibility for the scheme."

At the end of a further 28-day review period, the parties entered into a deed of discharge to confirm that Covpress's involvement with the Covpress scheme had now fully ended. Finally, the Covpress scheme was then re-opened for a short period of time to new members to ensure that the purchaser became an 'employer' for the purposes of pensions legislation.

Conclusion

In this particular situation, the interests of the parties in achieving a scheme rescue were aligned (and all parties were willing to invest in the possibility of the scheme rescue as part of the sale process). The purchaser was willing to take on the burden of the pension scheme, which was reflected in the purchase consideration and important for the long-term stability of the business, the goodwill of employees and suppliers. Employees – many of whom would be scheme members – benefit from no reduction to their future pension. Suppliers would also benefit through the reduction of claims in the administration caused by the section 75 debt not crystallising. In addition the blue chip customer base would now view the business as a stable long-term partner in its tier 1 automotive supply chain.

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What's eating the UK's restaurant sector?

Having recently acted for the administrators of Ed's Easy Diner, **Steven Cottee** and **Andrew Robertson** look at the increasingly challenging landscape for the restaurant sector.

It was the famous American writer MFK Fischer who wrote 'First we eat, then we do everything else', and it is this sentiment that has been used by banks, investors and restaurant owners alike to underpin a boom in the restaurant sector in recent years.

Ed's Easy Diner was a prime example. Having opened its first store in London in 1987, between 2008 and 2016, Ed's expanded from three restaurants in London to a network of over sixty restaurants and concessions throughout the UK. Such growth was possible against the backdrop of record low interest rates and cheaper finance, consistently low levels of food inflation, more flexible employment rules in the sector and a consumer appetite to eat out more.

In the last year, as well as the failure of Ed's, we have seen closures of a number of restaurants operated by leading brands including Frankie & Benny's, Chiquito and Garfunkel's. A recent report from Moore Stephens suggests that over 5,000 restaurant businesses have at least a 30 per cent chance of insolvency in the next three years[1].

So why is this happening? There are a number of key factors that present a recipe for failure in the restaurant sector and we think may lead to an increase in the number of restaurant failures in the coming years.

Competition

With increased supply comes increased competition and restaurants are finding it increasingly difficult to cope. In the last year, over 200 new restaurants have opened in London alone but 76 have also closed[2]. It is clear that the bar is being raised all the time and, with greater choice (including pop-up restaurants), people are less loyal to their favourite restaurant or the big names that may have dominated custom previously.

Rising costs

Rising rents and business rates are hitting restaurants hard, especially in London and the South East. The recent changes in the valuations attributable to business rates means that average rates will go up by 14 per cent in London in 2017, and many businesses will suffer far higher hikes in rates[3].

Outside of London, larger towns and cities in the south such as Reading, Croydon, Guildford, Cambridge and Milton Keynes will all suffer average increases in excess of 20 per cent and in some cases, a lot higher. The impact of these rates revaluations further north is less drastic and in some places such as Liverpool rates will fall. However, if like Ed's Easy Diner you are trying to run a chain of restaurants across the country or if your business is based primarily in London and the South East, this will have a huge impact on profitability.

> "A recent report from Moore Stephens suggests that over 5,000 restaurant businesses have at least a 30 per cent chance of insolvency in the next three years."

Increases in the national living wage are also eating into restaurants' profits. Earlier this year, the government raised the national living wage from £6.70 to £7.20 per hour and it is due to rise again to £7.50 per hour from April 2017. In a sector where staff are often only paid the minimum wage, businesses now have to absorb these increased staff costs.

The final bitter seasoning for restaurant owners is that the de-valuation of sterling following the decision, in June 2016, to leave the European Union means that it is now more expensive for restaurants to import food and alcohol or to pay suppliers who import food and alcohol from outside of the UK.

As a result of these rising costs, restaurants face a difficult balancing act between absorbing costs and reducing margins, or increasing prices for the consumer and risk pushing custom away in an already overly competitive environment.

The rise of technology

People are eating out less and eating in more. The advent of technology from companies such as Deliveroo and Uber Eats means that people can quickly and easily order online from their favourite restaurants or takeaways and have dinner delivered to their door. In addition, supermarkets are now stocking a far greater variety of alcohol at much cheaper prices than pubs and restaurants and people are now buying more booze from supermarkets than pubs for the first time[4].

The combination of these changing habits means that pubs are losing even more trade (and continue to close at an alarming rate) and restaurants are losing out on the impulsive discretionary spend on drinks, starters and desserts that people only buy when they actually eat in a restaurant.

Add to this the increased demand for healthy eating, which restaurants have to respond to by adding additional variety and complexity to their menus, as well as the relative stagnation in the average disposable income in the UK, and it does not make good reading for restaurant owners, or those who invest or have exposure in the sector.

> It is difficult to see the political or economic landscape changing in the short to medium term in order to alleviate the increasing cost pressures that restaurants now face.

Preserving value in a distressed restaurant business

If you are advising a restaurant group or business that is facing financial distress and it is not possible to restructure the business in order to absorb the rising cost base or successfully propose a CVA, it may be necessary to affect a pre-pack sale of some or all of the business in order to preserve jobs and value. In the case of Ed's Easy Diner, through careful, practical and flexible planning the administrators, KPMG, were able to secure a pre-pack sale of over half of the existing sites, preserving jobs for nearly two thirds of the existing workforce.

This was achieved, in part, by identifying and managing key risks to value including in the following areas.

Beware pre-emption rights in operating leases

It is increasingly common to see restaurant leases, especially where the sites are in retail outlets or shopping centres, to contain pre-emption rights in favour of the landlord. Such rights allow the landlord to control the mix and quality of its tenants across multi-unit sites. The pre-emption rights will require the existing tenant (the seller) to offer to sell or surrender the existing lease to the landlord before the lease can be assigned or transferred to a buyer (the statutory moratorium in administration only protects the lease from forfeiture (without the permission of the administrator or of the court), it doesn't strip the landlord of its pre-emption rights under the lease. The value payable by the landlord is often based on a market value and can be subject to complex calculations. This means that a landlord could step in and prevent a buyer from taking an assignment of the existing lease.

In completing its due diligence, a buyer may identify pre-emption rights as a major risk to it completing a purchase of particular sites and this may impact on value for the overall sale as a result. Whereas a buyer may ordinarily be confident of reaching an agreement with a landlord on the basis of its strong financial covenant alone, if the landlord has the benefit of pre-emption rights and a wish to take back the site, it will be difficult for the buyer to persuade the landlord not to exercise this right.

In order to reduce the risk of pre-emption rights impacting on value, the administrator should look to apportion a fair value to the relevant lease, including the equipment and materials situated within the property, to ensure that the landlord has to match or beat this value in order to successfully exercise the pre-emption. Alternatively, a buyer may wish to defer elements of the consideration until it successfully obtains an assignment of certain leases. This will be less attractive for the administrator as it provides less certainty of payment and is more difficult for an administrator to assess in terms of whether or not the deal represents best value for creditors.

Cash, payments and stock

Managing the collection and apportionment of cash and card payments is critical on a multi-site restaurant business. In many cases, in an effort to remain competitive, restaurants now open early morning for breakfast and do not close until late in the evening. Both administrator and buyer will want the sale to complete outside of business hours to avoid disruption to the business.

The parties will need to agree a mechanism for apportioning cash, card payments and a value to stock either side of completion, which will normally be a fixed point in time. The administrator will want to ensure that it obtains the benefit of all pre-completion trading and the buyer will want to ensure that it can continue to use the existing card payment systems for an interim period as soon as the restaurants open for business after completion.

The value of stock will need to be estimated across a multi-site business as it will not be possible or cost effective to undertake a stock take of each site between the restaurants closing (at which point completion will occur) and re-opening under the buyer's ownership the following morning.

Premises licences

If the seller company sells alcohol and goes into administration, premises licences for sites in England will automatically terminate and the buyer will have a small window to apply to the local council or authority to reinstate the licences. This is a risk for the buyer and it should prepare the relevant transfer forms in advance of completion to ensure that the applications can be made as soon as possible after completion.

If any restaurants are based in Scotland or Northern Ireland, the situation is more complex in an insolvency scenario. The existing licences do not terminate and will remain in the name of the insolvent company. Transfers involve urgent applications to the local authority (Scotland) and court applications (NI) and must be processed immediately upon completion to reduce risk for the administrator and buyer.

> In order to reduce the risk of pre-emption rights impacting on value, the administrator should look to apportion a fair value to the relevant lease, including the equipment and materials situated within the property.

Conclusion

We believe that the restaurant sector will face increased stress over the next 12 months. It is difficult to see the political or economic landscape changing in the short to medium term in order to alleviate the increasing cost pressures that restaurants now face. If advisers can be approached early enough, then recoveries can be enhanced through careful pre-planning and an understanding of some of the legal and commercial complexities that arise. ◻

1. Moore Stephens, 5 December 2016
2. Financial Times, 23 November 2016
3. Department for Communities and Local Government Business Rates Revaluation 2017, published September 2016
4. British Beer and Pub Association, September 2016.

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Save the date
6 June 2017
SPG Technical Review
The Queens Hotel, Leeds

R3 events, courses and conferences

Month	Date	Event	Venue
March	15	London New Professionals Group Drinks	Balls Brothers, London
March	16	The New Rules for Insolvency Work-Winners (breakfast briefing)	Linklaters LLP, London
March	23	Northern Conference	Ramside Hall Hotel, Durham
March	28	SPG Technical Review	Copthorne Tara Hotel, London
March	30	Southern Regional Meeting	Paris Smith LLP, Southampton
March	30	Women's Spring Ball	Edgbaston Cricket Ground, Birmingham
April	10	East Midlands New Professionals Group Greyhound Racing	Nottingham Greyhound Stadium
April	20	Yorkshire New Professionals Group Seminar	Clarion Solicitors Ltd, Leeds
April	25	Yorkshire Women's Group Seminar	Leeds
April	26-28	R3 Annual Conference	Clayton Hotel – Burlington Road, Dublin
May	4	Northern Ireland Annual Dinner	Riddel Hall, Belfast
May	9	CVAs/Restructuring Solicitors Firms	Crown Plaza, Leeds
May	12	Yorkshire Regional Meeting	PWC LLP, Leeds
May	16	Asset Tracing, Fraud and Forensics	Holiday Inn Regents Park, London
May	19	R3/INSOL Europe Conference	Hilton London Bridge Road, London
May	23	Public Sector Restructuring in Healthcare	Mercure Grand Hotel, Bristol
May	23	Care Homes & Private Sector Health Care	Mercure Grand Hotel, Bristol
May	23	Southern Breakfast Seminar	KPMG LLP, Eastleigh
May	31	Scotland Breakfast Seminar	Edinburgh

Regional events
R3 events

For further information on R3 courses and conferences, please visit the R3 website **www.r3.org.uk**, where you can download the 2017 Spring-Summer programme.

Alternatively, call the Courses team on 020 7566 4234 to request further details.

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CONFERENCE SESSIONS

- **The evolution of the sector**
- **The UK business landscape**
- **Brexit: Views from the EU**
- **Cryptocurrencies and Bitcoins**
- **Legal updates**
- **Reviewing digital assets and new trends in technology**
- **Litigation funding post Jackson**
- **Collective redundancies**
- **Tax and HMRC updates**
- **Corporate Insolvency landscape**
- **The road map for the future**

More sessions to be confirmed...

WHO SHOULD ATTEND?

- Insolvency practitioners and their key team members
- Restructuring professionals
- Accountants and business advisers
- Solicitors and barristers working in the restructuring and insolvency field
- Turnaround professionals
- Finance providers and brokers
- Private equity professionals with an interest in distressed businesses
- Valuers and brokers advising the restructuring and insolvency profession

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9
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Bonding: between a rock and a hard place

Michelle Butler puts forward her opinion on bonding arrangements for insolvency practitioners.

I emerged from a meeting of the last R3 working group feeling gloomy for SPG members. The discussion had surrounded the Insolvency Service's call for evidence on bonding – whichever way the bonding regime might evolve, it did not bode well. The 'do nothing' option could result in the already disproportionately high premiums for IPs in the smallest practices continuing to escalate and risks tempting bond insurers to leave this market altogether. At the other extreme lies the option of abolishing bonding completely: this would likely see a new kind of mandatory professional indemnity insurance introduced to plug the gap, but again SPG members in particular would face hefty premiums.

The problem: high premiums

Why *are* premiums so much higher, especially for the sole-IP and two-partner firms? Can it be that most fraudulent and dishonest acts are committed by IPs in this group? I think not, but I suspect that frauds and dishonesty occurring within this group are more likely to result in bond claims. After all, sole IPs don't have the luxury of a phalanx of partners to close ranks as soon as one of their group falls, eliminating the risk that a bond claim might strike.

Could it also be that larger practices exploit their greater bargaining power to good effect? Smaller practice IPs aren't exactly inundated with bonding options. And, to add insult to injury, larger practices can take advantage of special bonding models, for example, the £5m specific premium for every case, which lightens practices' compliance loads and thus reduces costs.

The call for evidence: more problems

Late last year, the Insolvency Service's call for evidence sought views on how to address problems in the bonding regime. Along with increasing premiums, the Insolvency Service identified a number of other perceived problems:

- cumbersome statutory requirements
- general penalty and specific penalty bond levels that no longer reflect the potential losses
- a framework that is dependent on an IP's honesty (and payment of premiums) to protect against their dishonesty
- expensive successor IP fees and the 'adversarial nature of claims' that substantially erode returns to creditors
- lack of protection for the fraud or dishonesty of an IP's employees.

Some of these sound presumptuous, don't they? And that is what worries me a little: the Insolvency Service seems to have jumped straight from asking what the problems are, to proposing a variety of solutions. Although it is a call for *evidence*, few questions are focused on collecting evidence. But it is difficult to determine what might solve a problem without first establishing what the problem is.

> "Why are premiums so much higher, especially for the sole-IP and two-partner firms?"

The proposed solutions

Many of the Insolvency Service's suggestions are aimed at improving the bond claims process, for example, by the introduction of a claims management protocol and/or a successor IP panel. Although opening the door of the hostile successor IP market to more competition might be beneficial to creditors, I think this would offer little relief for smaller practice IPs. I cannot see that it would reduce the amount paid out by bond insurers, so it would have no effect on premiums.

There are also proposals to fix apparent problems in the bonding regulations. From a compliance perspective, I have always found the regulations tortuous and illogical, so at first blush I welcomed this suggestion. Strict compliance with the bonding regulations has long been emphasised by the regulators and this has fostered a nervous anxiety in compliance teams about all things bonding-related. Many practices are layered with procedures and safeguards to ensure that prompt and adequate bonds are maintained, which to me seems such a sad waste of energy (when I remind myself that these bonds will expire without achieving anything). But I accept that such is the nature of insurance.

How would amending the regulations affect premiums? Among the suggested changes is an increase in bonds' upper limits, which have not changed since 1993. While this seems eminently sensible, undoubtedly it would increase premiums further.

Any measure that reduces compliance burdens gets my vote, so I was attracted to the Insolvency Service's suggestion that the bonding requirements be repealed entirely. Ahh, no more periodic reviews, no more bond level debates, no more cold sweats when a new appointment or bond increase somehow gets overlooked – heaven!

Is the Insolvency Service serious? Well, some other jurisdictions, eg Australia, have abandoned bonding, and some other professions, eg solicitors, handle client money without a statutory bond. There are other ways of providing protection.

Could a new kind of insurance be introduced, one that provides cover in case of fraud or dishonesty but that does not involve a complex framework of case-dependent initiation? Might such insurance open the market to new insurers leading to more competitive premiums? Or would the shift to global cover result in higher premiums?

No silver bullet

After much debate, the R3 working group settled on a response to the call for evidence. Please take a look at it on the R3 website **www.R3.org.uk**.

Throughout the response is the repeated warning that some proposals could increase premiums for smaller practices, threatening the existence of some. There seemed to be no silver bullet, but we have sought to ensure that the Insolvency Service's attempts to strengthen protections for creditors do not weaken the ability of smaller practice IPs to earn an honest crust.

MICHELLE BUTLER is a partner of the Compliance Alliance.

An update on the SPG Committee

Simeon Gilchrist and **Caitlin Powell** provide an update on changes to the SPG Committee and news of the forum.

The end of 2016 saw some changes to the SPG Committee. We said farewell to Stephen Allinson, Steven Wiseglass and Andrew Tate, all of whom we thank for sharing their knowledge, ideas and enthusiasm during their time on the committee.

In February we welcomed two new faces to the SPG Committee: Maxine Reid, restructuring partner at Kreston Reeves LLP, and Linda Farish, head of recovery and insolvency at RMT Accountants & Business Advisors Ltd.

SIMEON GILCHRIST is the R3 SPG chairman and a partner at Edwin Coe LLP.

The SPG Forum round up

17–18 November 2016

The 2016 SPG Forum was my first and, can I just say, what a fantastic experience! On behalf of the SPG Committee and everyone at R3, I would like to say a massive thank you to those who attended and we hope you enjoyed the programme. For those of you who were unlucky enough not to be able to make it, here's what you missed.

Day one

After a quick introduction and run-down of the SPG Committee's activities by the Forum chairman, the esteemed Simeon Gilchrist (Edwin Coe LLP), the Forum kicked off with an update on the new fees regime. Michelle Butler (Compliance Alliance) and our new committee member Maxine Reid (Kreston Reeves LLP) talked us through some of the problems and lessons learned since the regime was introduced. Next up were Chris Brockman (Guildhall Chambers) and Andrew Black (Eversheds LLP) with a look at the theory and practice of pursuing investigations and claims against dodgy directors. Interspersed with amusing real life cases, Chris and Andrew outlined the powers available to office-holders and offered some practical steps that can be taken to identify and evidence claims against those who may be guilty of malpractice or fraud.

Chief Registrar Stephen Baister then gave his highly entertaining update from the bench. Registrar Baister considered the role of the court in insolvency, as well as how technology and other changes are, and will continue, to affect the court system. In keeping with the legal theme, Mark Sands (Baker Tilly Creditor Services LLP) and Simon Passfield (Guildhall Chambers) advised delegates of the latest from the courts on personal insolvency. Mark and Simon, who both had high-profile roles in leading personal insolvency cases in 2016, discussed the key technical and practical points arising from cases that were currently, and previously, before the courts.

After lunch came the traditional UK Economic Update, this time given by Graeme Chaplin, the Bank of England's agent for the West Midlands. Graeme provided delegates with an insight into the decision-making processes (and the who's who) of the Bank of England and an overview of the Bank's latest forecast for the UK economy. It turns out that uncertainty (not orange) is the new black, thanks to Brexit. Next up was R3's President, Andrew Tate, who succinctly outlined R3's most important activities and achievements for 2016 and the foci for next year. Mark Davies (Aaron & Partners LLP) rounded off the after-lunch session with an exploration into joint appointments and succession planning for smaller firms. One of the more technical slots of the Forum was easily rendered interesting and accessible in Mark's capable hands.

Following a quick networking coffee-break, Stuart Frith and Paul Reeves (Stephenson Harwood LLP) began their slot on collective redundancies and the HR1 forms with an insolvency joke about a dog. With the groans still echoing (although it was a pretty good joke by insolvency standards!), Stuart and Paul delved into the current issues and risks associated with the collective redundancy process. Finally, Dean Beale and Dave Chapman ended Day one with an update for delegates on the relevant parts of the Insolvency Service's remit and current work.

Day two

After a three-course dinner, networking and magicians, Day two also delivered quality sessions. Paul Winterton and Ian Campbell of HMRC provided an overview of the authority's counter-avoidance strategies, while Kevin Hatt gave an update on voluntary arrangements. The keynote speaker, Benjamin Mee, then took to the stage and regaled delegates with the anecdotes and struggles of his experience buying Dartmoor Zoo. Ben's story of turning a zoo on the brink of closure into a resounding success was truly inspirational, and showed how, with some hard work and clever strategising, an effective business turnaround can result in a Hollywood movie!

Despite this undoubtedly being a hard act to follow, Graham McPhie (Moon Beever) remained unfazed and coolly delivered an incredibly broad, yet succinct, outline of all the important legal happenings in the world of corporate insolvency. Trevor Binyon (Opus Restructuring LLP) and Paul Davies (Menzies LLP) then explored in depth the tools and skills that can be effectively applied to restructuring and advisory options for SME businesses. Finally, R3's very own technical director, Caroline Sumner, finished off the day with an overview of the long awaited, much anticipated and newly laid Insolvency Rules.

We're looking forward to 2017!

All in all, the 2016 SPG Forum was a fantastic event, packed with excellent content and networking opportunities that received very positive feedback. While I'm not quite sure how we will top it for 2017, we will definitely try – planning is underway and we already look forward to seeing you there. ◻

CAITLIN POWELL Is the policy and committee assistant manager at R3.

Advertisers' index

Annecto Legal Limited 30, 40
Credebt 3, 17
Creditor Hub 31
Insolvency Risk Services....3, 15
IPA ....Supplement
JPS Chartered Surveyors 46
Nationwide Corporate Finance ....7, Supplement
Neil Taylor Insolvency ....OBC
Manolete Partners PLC 5
Turnkey IPS ....IBC
UK Insolvency Assistant....46
Visionblue Solutions....IFC
Wilkins Kennedy 46
Willis Towers Watson 3, 21

IBC: inside back cover, IFC: inside front cover, OBC: outside back cover

An interview with...

Alun Milford

Matt Jukes speaks to the general counsel of the Serious Fraud Office (SFO) to find out more about how it has changed over the last few years and how fraud is handled and reported.

Q Your move to the SFO was at a time when the press was speculating that 'heavy hitters' were being brought in to bolster the work of the office. Is that the case? And would you tell us a bit more about what prompted your move in 2012?

A From my point of view, what David [David Green QC, the director of the SFO, appointed in 2012] was doing with the SFO was very interesting. He had a very different vision to his predecessor. He wanted to focus on taking the SFO back to its roots as a specialist investigator and prosecutor; he was not interested in the SFO taking on the role of a regulator or an educator. That was not in the statute that established the office. We were established to investigate and prosecute serious and complex fraud. He wanted to take the SFO back to the top of its game and there was a challenge in that – one that I thought was interesting – so I threw my hat in the ring.

> "The challenge and the journey we've been on in the past four and a half to five years has been fascinating."

It was the right choice, as the challenge and the journey we've been on in the past four and a half to five years has been fascinating.

Q You took on the role at a time when the public was demanding retribution against bankers and Libor was in the spotlight. How has that helped shape your time at the SFO?

A There was a lot of genuinely challenging casework on the first day on the job, of which Libor was one aspect. Libor was one of the cases that I think reflected the change in approach by the two directors. The various investigations had commenced some years previously in the US and in London, handled in London by the Financial Services Authority. I think that the Libor case is a good example of the way in which the SFO can work and the benefits of the Roskill model (a process of detection, investigation and prosecution recommended by the Roskill report of 1986). The SFO has a particular set of powers: we get to investigate and prosecute, whereas those powers would ordinarily be split up. For example, you have the police, the National Crime Agency (NCA) and HMRC who have powers amongst other things to investigate crime, and they then pass cases to the CPS, which has powers to prosecute. As we combine both investigation and prosecution, in Libor we could put together multifunctional teams comprised of investigators, accountants, computer professionals and prosecuting lawyers to try to get through all the material we obtained, to rationalise it and make sense of it and to distil it into different criminal cases and then prosecute.

As the scale of the investigation grew, it became evident that it needed to grow to an entire division made up of different case teams all pursuing the wider strands of allegations of dishonest manipulation of the Libor rate. »

Alun Milford biography

- Alun Milford qualified as a solicitor via an articled clerkship at McKenna & Co, going on to work there as an assistant solicitor in construction litigation. Deciding that crime was a more interesting area of practice, Milford later moved to take a job as a crown prosecutor in inner London before becoming a prosecuting lawyer in the attorney general's office, specialising in contempt of court and unduly lenient sentences.
- In 2007 he helped the Revenue and Customs Prosecution Office (RCPO) establish its asset forfeiture division and moved to take over the Crown Prosecution Service's proceeds of crime unit when the RCPO was absorbed into the service. Within a relatively short period of time the post of head of organised crime came up and he was appointed to it and joined the SFO in 2012.

Q And how have things progressed since you've started?

A Since then it's been a question of taking cases on and working through them. And we've been working hard at our digital forensics capability. We are investing significantly with the focus on investigation and prosecution and developing our caseload.

Q Even in this issue (on page 22) we have a team talking about geo-fencing and tracking down people online. Does digital forensics mean the same thing to the SFO?

A It's our ability to absorb and organise the information that we receive. We're a small body but we hold a massive amount of data. We need to be able to hold that data and present it to our case teams so that they can work through it. In short, we need good

> We appreciate that IPs are going to come across fraud in the course of their work.

document management systems. One of the things that we've done recently on the Rolls-Royce case is apply the digital forensics capability to legal professional privilege, using IT as a more accurate, cost efficient way to help determine what is privileged and what is not. This saved us, and no doubt Rolls-Royce, a fair amount of money because we were able to focus more quickly on the material we are able to deal with.

Q Like many public bodies and services, budgets are down, but the workload is always rising. How are you meeting such challenges?

A The funding settlement lasts over the course of a parliament, so we have known how much funding we have since the last election and it has allowed us to plan. We also have the ability to get blockbuster funding from the treasury, which can be useful if we've got a case of a particular scale.

Q The SFO has a very specific remit for the types of fraud that it will take forward for investigation. Is the SFO the place for IPs to bring all instances of suspected fraud?

A As far as the fraud landscape is concerned, the SFO, as well as investigators in the police, NCA or HMRC are always interested in information about criminality, wherever it may come from. We have the Action Fraud portal (**www.actionfraud.police.uk**), which is managed by the City of London Police, who do triage work on allegations and parcel them up and distribute them across the law enforcement community.

> As far as the fraud landscape is concerned, the SFO, as well as investigators in the police, NCA or HMRC are always interested in information about criminality.

We, as the SFO, have a certain criteria, and we are particularly interested in cases that impact on the reputation of the UK and the City of London as a place to do business. We're looking for the very top tier of fraud to take on; we will look at the scale of the loss, actual or potential, and the extent of the gain, actual or potential. We also look at whether this is a new species of fraud or whether there's a public interest reason for taking it on, but we're always making sure that the cases we take on are going to benefit from the Roskill model. The other models work well: the policing-CPS model can work very well and the CPS has a specialist fraud division – they have a genuine specialism in the work that they do. What I'd say is that we appreciate that IPs are going to come across fraud in the course of their work. They're going to quickly develop a good understanding of the financial affairs of the people and institutions they're investigating, with a view to getting as much money back for creditors as possible. They are going to understand how those debtors operated and they're going to come across suspicions of fraud and we, the SFO and the wider community, are always interested in learning about that.

Q What procedure would you recommend to an IP that can sense 'something funny' with a case? Since the LASPO reforms, many IPs will be worried about litigating or perhaps they're not sure if the City of London police are willing to pick it up.

A The route here would be through Action Fraud portal. I really am not in a position to comment on the LASPO Act. It's always difficult if an investigator receives information about suspected criminality. The SFO view is that we do not give running commentary on the progress of cases and, if we're in the process of dealing with it, we do not want to, and cannot, comment on it, and I do not doubt that the City of London Police is in a similar position.

Q The SFO has been talking to R3. Is it normal for interactions between the SFO and the insolvency profession to take place?

A We do talk to receivers or make applications for the courts to engage receivers in cases where we think it's right. As far as R3's policy work is concerned, if it's entering the debate on how proceeds of crime may be more effectively taken from offenders then of course we want to be party to that discussion and R3 has been very clear on the case it wishes to make for insolvency practitioners.

We're not intrinsically opposed to private sector involvement and we're always open to ideas on how the system that operates at the minute may be improved to ensure better recoveries from defendants and for victims, but it's also important to us that this work is done in a certain way. Value for money is a key component in that. We always look for value for money from the receivers we work with and we will look for value for money

> We're always open to ideas on how the system that operates at the minute may be improved to ensure better recoveries.

with the private sector in any other capacity in which we may work alongside them. It's important that services do provide value for money because this means more of the money goes back to victims of fraud.

Q Is there a message you might like to leave for Recovery readers?

A It would be that we are actually interested in the information they might be able to get and don't be put off from reporting it. I'd urge them to use the Action Fraud portal and to start the flow of information moving from their case into the law enforcement community.

MATT JUKES is publishing manager of *RECOVERY* magazine.