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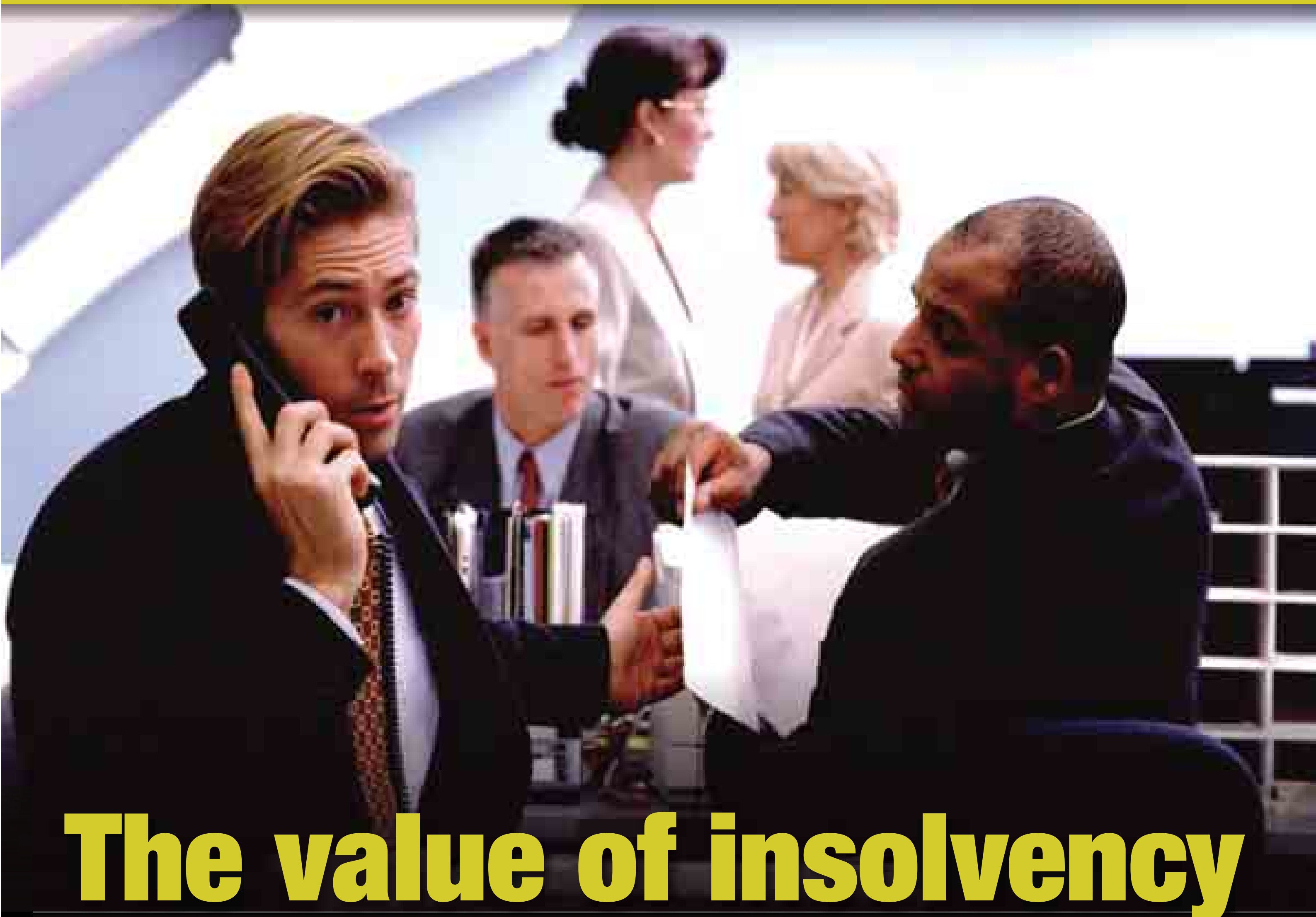
Autumn 2012

RECOVERY



The value of insolvency

Why transparency matters
Additional information required under the latest version of SIP 9

Zombie companies
What a drag… how IPs can break the cycle of 'no returns'?

The value of the insolvency industry: UK v. The World
Speedier returns to creditors will boost the economy

Merchant acquirers: more stakeholders! What are they? Why should you talk to them?

The football creditor rule and unsecured creditors
Should FCs with unsustainable costs pay a deposit?

Plus
Legal update, R3 matters, book reviews

What do you think?

Readers' views are welcome. Got 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

I am firmly of the view that insolvency – both as a process and as a profession – has significant value. The theme of this issue explores that value. Kevin Murphy's fascinating interview with Richard Law on page 44 emphasises the need for IPs to represent all creditors, rather than the secured lenders whom some IPs appear to treat as their masters. The general body of creditors, including secured, unsecured, preferential and contingent creditors is a concept that all IPs should bear constantly in mind.

Paul Williams, on pages 20 and 21, identifies that public education about insolvency is critical and this is endorsed by Will Black (on page 39). As individual practitioners it really is incumbent upon us to ensure that the public we deal with generally or on a case-by-case basis understands what we do and why we do it.

Sam Hawkins (page 24) makes clear that there needs also to be social and political will to use insolvency to preserve business value. Zombie companies compete unfairly against genuinely entrepreneurial businesses and should be allowed to fail to make way for more viable and progressive companies with the working capital and investment to expand. Banks, including those that are state owned, are not currently contributing to such recycling of assets.

A final point about the insolvency process is that director disqualifications are a more significant part of the regime than appears sometimes to be recognised. Our president, Lee Manning, on page 5 does not seek to criticise The Insolvency Service, but it remains the case that IPs are hugely frustrated by the small proportion of directors subject to disqualification, given the inappropriate behaviour by directors that IPs have seen and reported.

All the above points are encapsulated in the statement made by Peter Smith J in relation to *Farepak* (**www.judiciary.gov.uk/Resources/JCO/Documents/Judgements/farepak-judges-statement.pdf**).

The existence of the judicial statement is an example of the need for public education: such education is its *raison d'être*. The learned judge also makes clear that despite the legal position, there is undoubtedly a social will and perhaps should also be a political will to ensure that all creditors, not just the senior secured creditors, receive meaningful returns from an insolvency, particularly where the secured creditors are closely involved in the triggering or otherwise of formal insolvency proceedings.

Indeed, the judicial statement goes to the heart of the issue for ordinary unsecured creditors in insolvency proceedings – the position of secured creditors by virtue of their lending on conditions of priority in the event of insolvency proceedings. There is no suggestion that there should be no such security arrangements, but there is a hint that the insolvency process should recognise and deal with the position of ordinary unsecured creditors more equitably than they might experience in the event of a controlling secured creditor triggering a formal insolvency procedure at the most beneficial moment for him- or herself.

Finally, the *Farepak* case revealed an example of The Insolvency Service's endeavour to disqualify directors being unsuccessful. The effectiveness of our insolvency system depends on the disqualification of directors who fall short of a recognised level of propriety. That requires an adroit prosecution regime. The Insolvency Service is under-resourced and faces a real challenge if the public is to recognise the value that our insolvency procedures and insolvency practitioners can produce when businesses fail.

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

Regulars

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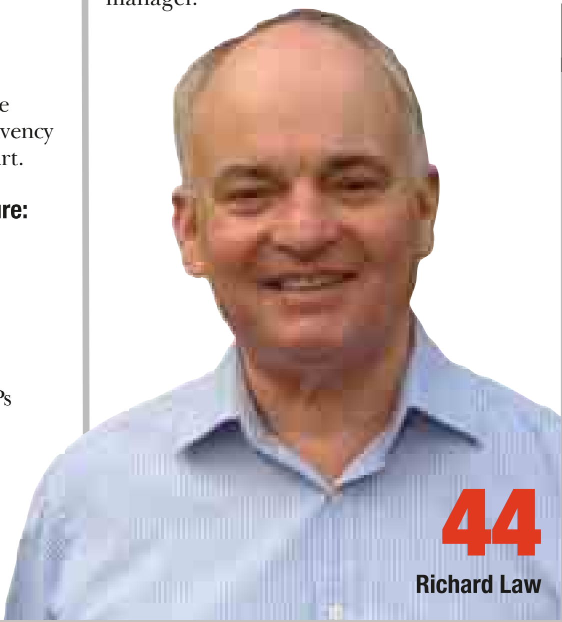
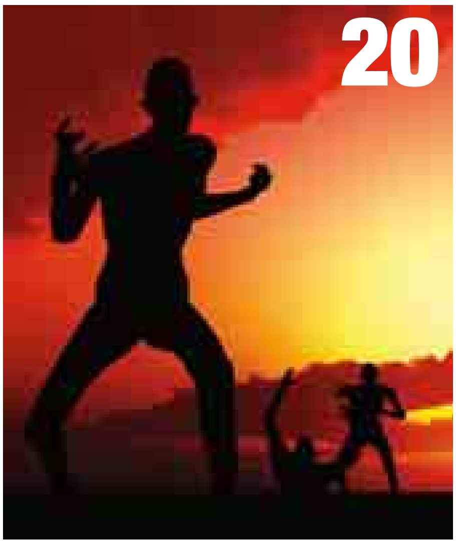


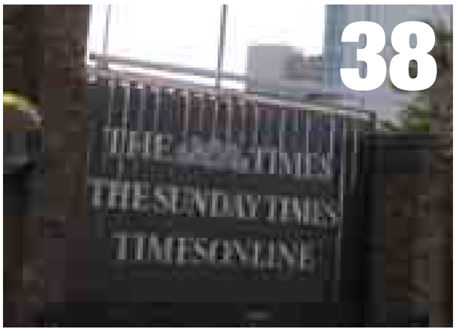
Legal update

Features

The value of insolvency



R3 Matters



Book reviews

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Theme of *RECOVERY* Winter 2012
Personal insolvency

Features

Image credit: mnewrc

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NHS Foundation Trust failure: fiction or finally fact?

Paul Dutton asks: are Foundation Trusts next?

After speculation over many months, in July 2012 the headlines reported that Matthew Kershaw became the first ever trust special administrator of South London Healthcare Trust, not to be confused with being a Foundation Trust (FT). Should this development be a cause for concern or give a sense of some relief? Has an independent, certain, fair and transparent solution finally arrived, allowing lenders and creditors properly to evaluate their risk?

The Department of Health has said it considers 21 NHS Trust hospitals to be clinically and financially unsustainable and in need of radical restructuring. There are another five FTs that are also considered to be failing financially and a further five have severe financial problems.

An escalating problem

In the autumn 2006 edition I wrote an article proposing that the legislative failure regime for FTs was so poor and uncertain that it actually inhibited one of the primary purposes of FTs: to be able to raise private finance to better provide free care of need.

I said: '*No lender [or supplier] is likely to provide funding [or credit] where the nature of its security is unclear, still less when its already limited realisation options are open to interpretation and, arguably, subject to change at any time… The outcome is less private funding at greater cost to achieve the primary purpose of Foundation Trusts. That can't be right. It's almost sufficient to require the first Foundation Trust failure to give clarity and certainty for the better good and health of all.*'

Since the Health and Social Care Act 2012 came into force, I have increasingly been asked by (among others) a number of private sector suppliers heavily exposed to FTs to help explain and interpret what their risk is, if any, to failing FTs.

Once they have recovered from the initial shock that an FT could have gone into either liquidation or CVA as long ago as 2004, they regain composure in the comfort it has not yet happened. However, is past performance really an indication of what the future holds? Can suppliers and lenders still treat FTs as being 'gilt edged' government backed? An air of concern is evident now when seeking reassurance – will we still get paid on failure?

Answer: no guarantees anymore.

Will austerity make the unthinkable a reality?

The initial legislation in 2004 allowed CVA or liquidation, though curiously there was no mention of administration, notwithstanding the Enterprise Act making this regime the route of choice. Even then, these regimes were only available after Monitor, the regulator, had exercised its powers. The stipulated procedure then was, after close financial and performance monitoring prescribing failure – consultation, transfer all or part to another FT, then winding up and dissolution of the remainder.

> "More than one special administration will be needed to provide anything like a suitable road map to what is a complex series of problems."

However, there was no visibility on any FT failure as to who was accountable for these decisions, what rules or criteria apply, how or which creditors get paid what, when and in which order, or the interaction of this with the Insolvency Act avoidance principles and indeed generally.

As I briefed NHS FT boards from 2004 on the failure consequences, it was often predicted that, despite the new law, it would never be allowed to happen. I suspect that this view was reassured by the political suicide of denying care and closing hospitals. So far they have been right. But will austerity finally force the politicians into submission, and the unthinkable: a closed sign above a FT hospital front door, unpaid creditors and no medical care, or are the changes an attempt to simply reorganise and update the NHS through the use of administration?

More clarity required

Under the recent legislation some further and needed reforms have been implemented for FT failures. It has remedied the glaring error to now provide for 'special' administration by providing some suitably moulded objectives for the administration to occur and, while only Monitor can apply for the procedure, the administrator is a court officer and must be an IP. However, the limitations and, critically, the uncertainty of outcome for lenders and creditors and the lottery of who gets paid remain.

Good luck to the first IP who has to balance the books, satisfy the politicians and provide adequate free care that is genuinely needed while, ideally, paying everyone at the same time. That might take a while. In addition, the IP has to balance implementation with the principles laid down in the Insolvency Act although the regulations contemplate power to modify the Insolvency Act 1986 to ensure that the health special administration regime may be tailored to meet the needs of the health care sector.

So it seems the rule is still that the rules can change at any time. It is said that, as a lawyer, you desire from the law either certainty or justice. It is often difficult to provide both at the same time, hence each case is distinguishable at law on its own facts and circumstances. I strongly suspect that more than one special administration will be needed to provide anything like a suitable road map to what is a complex problem (or, more accurately, series of problems). In corporate terms, even moderately sized trusts often equate to plc scale and solutions will no doubt vary considerably.

Let's hope that special administrations will provide more certainly for creditors, funders and not least patients of FTs. Clearly though, some treatment will have to be administered and by IPs, which may range from a relatively straightforward procedure to a major operation.

PAUL DUTTON is a partner at Eversheds LLP.

President's column

Lee Manning has been progressing the issues that exercise IPs with the people who count.

As my Presidency pulls away from the starting blocks, I have embarked on a marathon of engagement with MPs and journalists. The sun of Barcelona is now a faded memory! Indeed at a recent meeting with *The Times*, the journalist noted the huge number of 'bad news' economic reports out.

Topics for discussion

Retail (including pre-packs and landlords), administration expenses, director disqualification and establishing clarity for creditors are my calling cards. Seeking resolution on administration expenses, which I mention every time, was the topic on the agenda at a round table meeting with The Insolvency Service and Pensions Regulator earlier this month. I also raised the issue at the R3 peers lunch, an informal lunch that took place between senior R3 members and a small group of Lords: including Baroness Hayter, shadow business minister and Baroness Kramer, chair of the Liberal Democrat Treasury Committee.

Other parliamentarians I have met with include Tessa Munt MP, parliamentary private secretary to Vince Cable MP and Gordon Banks MP, shadow Scotland minister. I have also met with Ministry of Justice Officials to discuss Law Commission proposals on termination of tenancies and I spoke to Iain Wright MP, shadow business minister, after he asked for my view on a possible amendment to the Enterprise and Regulatory Reform Bill, which is currently making its way through parliament.

Director disqualifications

As highlighted, director disqualification is a big issue for IPs and R3 has been working with The Insolvency Service to make changes to the reporting process. We have proposed updating the 'D1 form' but this is on hold given that it requires change in secondary legislation. So in the meantime we've been exploring other options. You will have seen revised Guidance Notes for completing D1 forms in Dear IP 54. The guidance incorporates input from R3 and should result in better information to the Service. The Service is now reviewing the letters they send to IPs when a decision has been made to not take a case forwards, to ensure that they fully explain the reasons behind the decisions. And the Service has proposed to extend their outreach programme and establish a Disqualification Stakeholder Forum: a number of small changes that can only mean improvements.

Image credit: Chris Brocklebank

Red Tape Challenge

Dear IP 54 also draws attention to the fact that it is the turn of insolvency to come under the spotlight of the Cabinet Office-sponsored Red Tape Challenge (RTC). It would be easy to regard this with a jaundiced eye and ignore the invitation. But this would be a mistake. There is an opportunity to highlight unnecessary or misguided legislation. We'll be seeking members' views and submitting some ideas, such as abolishing the initial 12-month time limit of administrations. No other procedure has a time limit so why should administrations be different? Given the recent surfeit of cases on administration appointments such as *Minmar*, the savings in professional time and costs could be substantial. So please put your suggestions on the Cabinet Office website or pass your ideas to the R3 technical team, or both.

Also, the issue of commissions was raised at the latest Council meeting, with the consensus remaining that they should not be allowed, as set out in the Ethical Guide. We will be surveying our members on the prevalence of this serious issue.

The new professionals

On the press front, I was pleased to be interviewed by *Economia*, the ICAEW's magazine, for an article to be published in the autumn. I'm promoting the profession and R3, rather than myself, by outlining the issues that affect us for the next six months or so. The interviewer posed an interesting question: *'What happened to the 'flash IP' of 20 years ago?'* Well, they have gone. To a certain extent, the profession needed to smarten up, and we saw more accountability on fees and more regulation. Today there are more techniques for rescuing businesses, and the IP is accountable to all creditors, but all the while we still have to be confident in the capabilities of everyone in the profession. Today IPs are competent and professional, and members should be aware of the work R3 is doing on their behalf with MPs and media. ◻

LEE MANNING is president of R3 and a partner in the Restructuring Services division at Deloitte LLP.

Bankruptcy too short, says GB population

Fifty-eight per cent of the population believes that bankruptcy should last longer than a year, according to research by R3. Eighty-two per cent consider that some people take advantage of the bankruptcy system to write off their debts, built up through reckless spending.

Lee Manning, R3 president, comments, 'Our bankruptcy regime, lasting only a year, is quite lenient compared with other countries. Our research shows that there is a strong feeling that a debtor's spending behaviour should be factored into the length of the term of bankruptcy.'

New personal insolvency law introduced in Ireland

Ireland's new Personal Insolvency Bill, introduced at the end of June 2012, is radical legislation designed to overhaul the law on bankruptcy and personal insolvency. It establishes a non-judicial debt settlement system and sets up an independent body called the Insolvency Service to oversee the non-judicial system. It also radically reforms the length of bankruptcy from 12 to three years.

It has been estimated that over 21,000 people could make use of the personal insolvency law over the coming year. Fifteen thousand applications are expected for non-court related settlements and insolvency arrangements as well as upwards of 3,000 bankruptcy applications. There were about 30 bankruptcy decisions made last year. A further 3,000 to 4,000 applications are anticipated for debt-relief notices.

INSOL Europe host EIR debate

INSOL Europe hosted a debate on the European Commission's review of the Regulation on Friday 6 July. Robert van Galen and David Marks QC spoke in support of INSOL Europe's proposals and proposed the motion, *'This House believes that detailed substantive and technical changes to the European Insolvency Regulation, as proposed by INSOL Europe, are now required'*. The motion was opposed by Gabriel Moss QC and Felicity Toube QC, who took the position of 'not much change needed'.

This unique event, was well attended and took place at the Supreme Court in Westminster, London. It was a real opportunity for attendees to appreciate the arguments for and against significant legislative change and to influence thinking as the principal legislation governing European cross-border insolvency is reviewed.

JIEB awards

R3 hosted an awards ceremony for successful JIEB candidates on 15 June at BMA House, London. The certificates were presented by Peter Windatt, chairman of the JIEB. Celebrating passing the challenging examination that will further their careers are (left to right): Tracey Howarth, a manager at Leonard Curtis; Samantha Hawkins, an insolvency practitioner at Exell Hawkins Associates; and Sarah Hawksworth, a director at Augusta Kent Limited.

Two new IS reports

Two reports have recently been published on The Insolvency Service's website that will be of interest to IPs.

- *The 2011 Annual Review of Insolvency Practitioner Regulation:* http://www.bis.gov.uk/insolvency/insolvency-profession/Regulation/review-of-IP-regulation-annual-regulation-reports, and
- *The 2011 Report on the Operation of Statement of Insolvency Practice 16:* http://www.bis.gov.uk/insolvency/insolvency-profession/Regulation/statements-of-insolvency-practice/SIP-16-Reports-pre-packs.

For queries about the above please contact:
Annual review: Catherine Collinson, 0207 291 6873, catherine.collinson@insolvency.gsi.gov.uk.
SIP 16 report: Joseph Sullivan, 020 7637 6495, joseph.sullivan@insolvency.gsi.gov.uk.

Dr Judge new chief executive for The Insolvency Service

Dr Richard Judge became the new chief executive of The Insolvency Service at the end of July. He took over from Stephen Speed who has been in the post for over four years and is moving on to become the director of the Energy Development Unit at the Department of Energy and Climate Change.

Richard joins The Insolvency Service from Cefas (Centre for Environment, Fisheries & Aquaculture Science, an agency of DEFRA). Prior to that he had a varied career in industry that spanned the nuclear, rail and environmental sectors in the UK and internationally.

Encouraging confidence in financial regulation

Confidence in the UK financial sector is one of the main factors that are crucial in ensuring the financial stability and sustainable recovery of the economy. To that end, over the last two years, the government has been working towards a restructuring of the UK's financial regulatory framework. In 2013, the FSA will be replaced by two new regulatory bodies:

- The Prudential Regulation Authority (the PRA), which will be a subsidiary of the Bank of England. This will be responsible for promoting the stable and prudent operation of the financial system through regulation of all deposit-taking institutions, insurers and investment banks.
- The Financial Conduct Authority (the FCA) will be responsible for regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets. The FCA will also have responsibility for the prudential regulation of firms that do not fall under the PRA's scope.

Martin Wheatley, currently a managing director of the FSA, will be chief executive of the FCA. John Griffith-Jones, former chairman of KPMG, has been appointed as the non-executive chair designate. Griffith-Jones joined the FSA Board on 1 September 2012 as a non-executive director and deputy chairman. Together, he and Martin Wheatley will work to oversee the creation of the FCA.

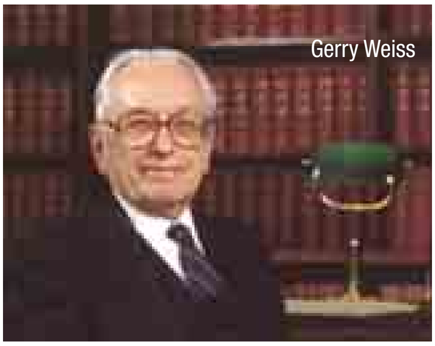
Lord Turner will remain as executive chairman of the FSA until its transition into the PRA and FCA is complete.

Obituary: A farewell to Gerry Weiss

Renowned for his accomplishments as an outstanding insolvency practitioner, and for his commitment to reform of the subject, Gerry Weiss died at the end of May, at the age of 88. We extend our most sincere condolences to his wife Ruth; they were married for over 60 years.

Born in Berlin, his parents bought Gerry to this country in about 1933, shortly after the rise to power of the Nazis in Germany. Between 1936 and 1940 he was a pupil at a somewhat unconventional school in Golders Green; the policy there at the time was co-educational and in particular did not require the passing of exams.

In 1947, Gerry qualified as a chartered accountant, and soon after joined the firm of Cork Gully, where his mentor was the then Kenneth Cork, later Sir Kenneth Cork. During this period of his professional life, Gerry absorbed from Kenneth, and also from his less well known brother, Norman Barrington Cork, not only the fundamental principles of insolvency law, but more especially the techniques for handling complex cases and conducting creditors' meetings. This training stood him in good stead during the mid 1960s when he was required to mastermind the rescue of the then financially distressed London Festival Ballet. This experience provided Ruth and Gerry a new and abiding purpose; in that he was for many years chairman of this important institution, but also gave both of them the opportunity to look after the welfare of individual dancers.



The commitment to the modernisation of insolvency law began for Gerry in the early 1970s, if not before, when he became a member of the Justice Committee on Bankruptcy Reform. At about the same time he was also a member of the first committee set up by the Board of Trade concerned with the possibility of adopting a European Bankruptcy Convention.

In early 1977 the Secretary of State called upon Kenneth Cork to chair a major committee on Insolvency Law and Practice. It was Gerry's responsibility to chair what became known as 'The Accountants' Panel'. It held 24 meetings and produced 24 working papers and 50 miscellaneous working papers!

Gerry never forgot his commitment to the basic idea that insolvency practitioners should be adequately trained, disciplined and form part of a well respected professional body.

Among his many accomplishments, Gerry was a founder member and president of the Insolvency Practitioners Association, general secretary of INSOL International from 1982 to 1996, and technical director of the Society of Practitioners of Insolvency (as it then was) from its inception in 1990 until 1994. In all these roles his wisdom and advice was invaluable.

To mark his retirement, there was a review of his career in the summer 1994 edition of *Insolvency Practitioner*.

Before taking leave of such a fascinating friend, it is appropriate to say how much pleasure through many nights at the ballet Gerry has provided to his colleagues; without him the writer would never have had the good fortune of knowing great stars such as Sir Anton Dolin and John Gilpin.

For a period of no more than six weeks, and before his untimely death; Gilpin was married to Princess Antoinette, Baroness of Massy; she was the sister of Prince Rainier of Monaco, and she died earlier this year. It has been said of her that she was known to be somewhat eccentric. Having been banished from Monaco in the late 1950s she lived down the coast at Eze, with a large collection of dogs and cats.

Again, thanks to Gerry, the writer was lucky enough to visit the princess. Nonetheless he was terrified by the dogs. □

PROFESSOR DAVID GRAHAM QC is Visiting Professor of Insolvency Law and Policy, Centre for Insolvency Law and Policy, Kingston University. He served with Gerry Weiss on the Review Committee on Insolvency Law and Practice chaired by Sir Kenneth Cork.

- **Edition** First
- **Author** Reinhard Bork, 2012
- **Publisher** Oxford University Press
- **ISBN** 978-0-19-964421-6
- **PRICE** £95.00

Rescuing Companies in England and Germany

This scholarly work is a comparative study of the insolvency and restructuring regimes in England and Germany. Professor Bork wrote it during a year as a visiting fellow at Magdalen College, Oxford while on a sabbatical from his post at the Law Faculty of the University of Hamburg.

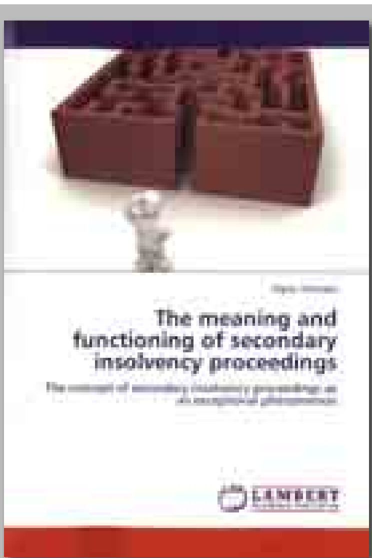
Principles based but with detailed references to statute and case law from both sides of the North Sea, the book has an underlying theme of restructuring using insolvency procedures. As in England, such a perspective is not uncommon among German IPs, although some turnaround professionals and international legal advisors in both jurisdictions prefer to avoid IP involvement as such.

The well known *Schefenacker* and *Deutsche Nickel* cases are noted as an impetus for the work, alongside the need for restructuring arising from the financial crisis and the legislative reform occurring in Germany while the book was being written.

Dipping into the text alone facilitates an understanding by the casual reader of the similarities and differences of approach between the two systems, but those using the work for academic study will benefit from the compendious footnotes and extensive bibliography.

The concluding chapters distil much of what has gone before, highlighting the strengths and weakness of each system and painting a picture of each regime's orientation towards restructuring. As you would expect, the learned author does not stoop to a value judgment of one system over the other. Rather, Professor Bork identifies the peculiarities that allow the professionals in each jurisdiction to restructure distressed business entities.

CHRIS LAUGHTON is a partner at Mercer & Hole.



- **Edition** First
- **Author** Signe Viimsalu, 2011
- **Publisher** Lambert Academic Publishing
- **ISBN** 978-3-8465-9225-0
- **PRICE** £66.00

The Meaning and Function of Secondary Insolvency Proceedings

Secondary proceedings under EC Regulation 1346/2000 on Insolvency Proceedings (the Regulation) are not only a regular feature of European cross-border insolvency, but also a frequent point of contention. So much so that contributors to the debate on reform of the Regulation have suggested on several occasions that the concept be abandoned.

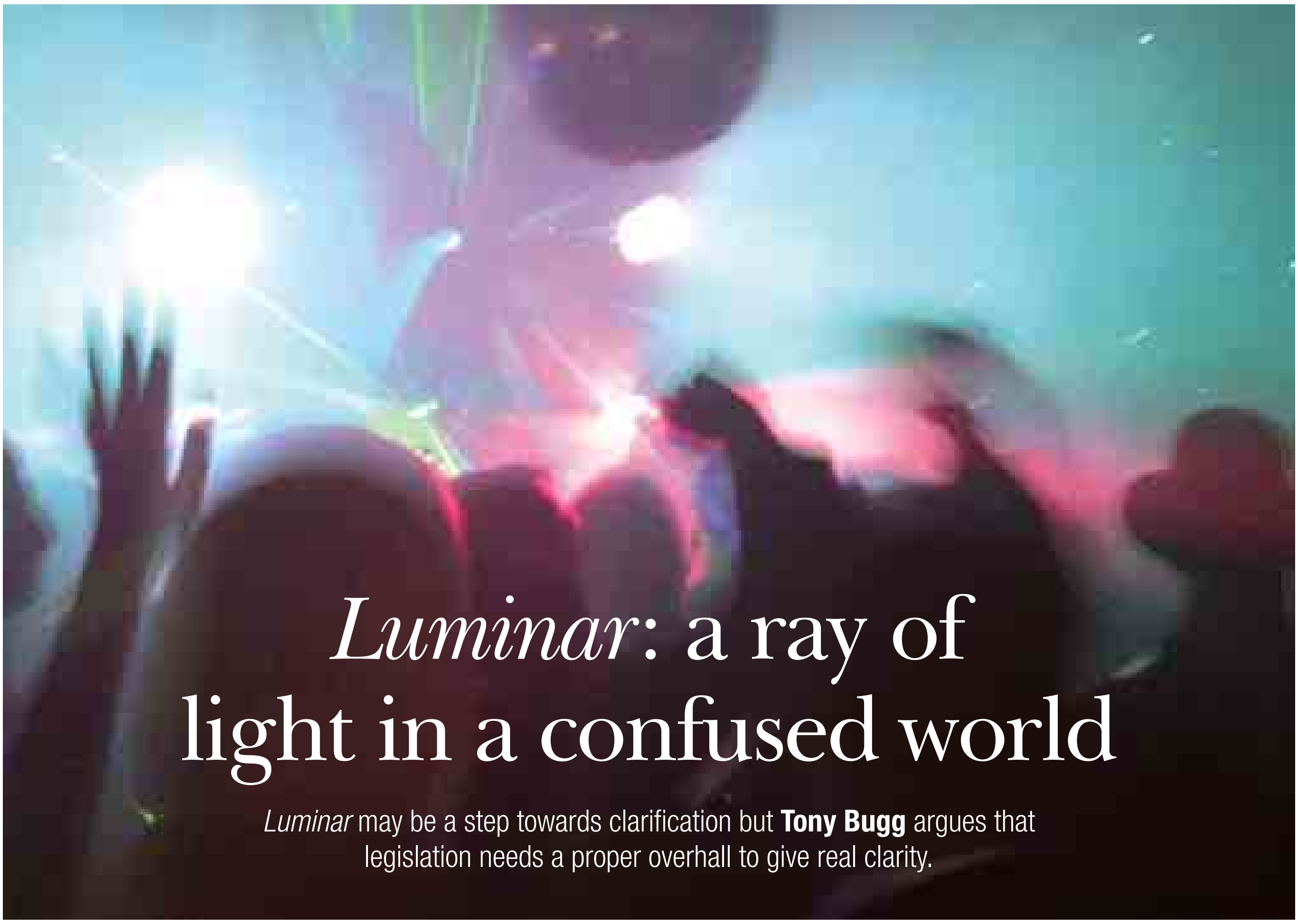
Signe Viimsalu's doctoral thesis examines secondary proceedings in considerable detail, starting with the principles on which such proceedings are based and extending to a comprehensive study of the implementation of both the Regulation and national laws relating to secondary proceedings.

The work's detailed conclusions are wide ranging, but together support the concept of secondary proceedings as justified and necessary, while noting that changes to both member states' laws and the Regulation are needed to facilitate the efficient and effective administration of insolvent European cross-border estates.

For those involved in administering insolvent estates that are subject to secondary proceedings, the book is a useful and highly detailed discussion of the inherent challenges. However, it remains the case that for the current system to work well, insolvency practitioners need to be pragmatic and constructive within both their national frameworks and that of the Regulation.

At a time when the Regulation is under review, this work is a useful reminder that making insolvency law work across borders, even just within the EU, is likely to remain a significant challenge. It is, however, a detailed and scholarly analysis of an aspect of European insolvency law that cannot wholly be resolved through the pragmatism of practitioners.

CHRIS LAUGHTON is a partner at Mercer & Hole.



Luminar: a ray of light in a confused world

Luminar may be a step towards clarification but **Tony Bugg** argues that legislation needs a proper overhall to give real clarity.

The High Court decision in *Leisure (Norwich) II Ltd* v. *Luminar Lava Ignite Ltd (in administration)* [2012] EWHC 951 (Ch) (*Luminar*) has given some clarification as to the treatment of rent arrears in an administration that are already due as at commencement of the administration.

By way of reminder, the decision of *Goldacre (Offices) Limited* v. *Nortel Networks UK Limited (in administration)* [2009] EWHC 3389 (Ch) (*Goldacre*) held that if administrators were using premises at a quarter day then rent was payable for the entire quarter as an expense – even if only part of the premises were being used or the premises were vacated during that quarter (since where rent is payable in advance the Apportionment Act 1870 does not apply (*Ellis* v. *Rowbotham* [1900] 1 QB 740)). In upsetting the generally accepted practice before that decision of paying rent on a daily basis as an expense in so far as the premises were being used, *Goldacre* has made the timing of the commencement of administrations a key factor as to whether or not landlords are paid for a period of occupation. It was essentially this consequence that gave rise to the dispute in *Luminar*.

Background

A number of nightclub operating companies within the Luminar group entered administration in October 2011. The administrators initially refused to give permission to the landlords to forfeit the leases, but shortly before the hearing agreed to do so. The only substantive issue before HHJ Pelling QC sitting as a deputy High Court judge concerned whether the administrators had to pay, as an administration expense, the quarterly rent payable in advance and falling due on the September quarter day *before* their appointment (the September rent), as a result of the events that happened during the administration. The position of the parties was as follows.

- **Landlords**: where a landlord seeks to forfeit a lease after an administration has commenced and permission is refused by the administrators, all rent arrears should be paid as a condition of the court granting relief from forfeiture as an expense, irrespective of when it accrued due, provided it relates to a period of occupation by the administrators. Accordingly, the September rent was payable as an expense;
- **Administrators**: relying on *Goldacre*, the only rent that can become payable as an administration expense is rent falling due after appointment where the administrators elect to retain the relevant property for the purposes of the administration. While they accepted that the December 2011 and the March 2012 quarter rents were due in full as an expense (even though permission to forfeit was given a few days after the March quarter day), the September rent was a provable debt only.

Decision

The High Court held that:

- the decision in *Goldacre* represents the current law on rent and administration expenses, so that where property is used for the benefit of the administration, rent payable in advance, which falls due *after* the appointment of administrators (ie where the rent quarter day is after the date of appointment) is payable as an administration expense in full without any apportionment, even if only part of the property is used or the property is used for only part of the rental period; but that
- *Goldacre* cannot be extended to apply to rent payable in advance that falls due *before* appointment and such amounts are merely a provable debt; and
- where property is used for the benefit of the administration, rent payable in arrears that falls due after the appointment of administrators is payable as an expense, at least as regards that rent accruing from day-to-day for so long as possession is retained. There is case law to suggest that liability for the rent accruing in arrears relating to the period before commencement may be payable as an expense, but it was not clear whether it would be followed and, on the facts, was not relevant.

Did the *Lundy Granite* principle apply to the September rent?

The issue before HHJ Pelling QC depended on whether the *Lundy Granite* or » *salvage* principle applied to the September rent. Under the *Lundy Granite principle*, which takes its name from the nineteenth century case *Re Lundy Granite Co, ex parte Heavan* [1871] LR 6 Ch App 462, certain liabilities that arise out of pre-liquidation contracts but that fall due during the liquidation, and that would therefore ordinarily be provable as unsecured debts, may nevertheless be treated *as if* they were expenses of the liquidation if they relate to property that is retained by the liquidator for the benefit of the insolvent estate. It was accepted by the tenant in *Luminar* that this principle applied in administrations too (having formed the basis of the conclusion in *Goldacre*).

The *Lundy Granite principle* was analysed, although on the facts it was not applicable, by Lord Hoffman in *Re Toshoku Finance plc* [2002] 1 WLR 671 where the House of Lords held that a statutory liability to pay corporation tax on profits deemed to arise during the liquidation was payable as a liquidation expense. The principle requires that, exceptionally, a liquidator or administrator who retains property, for example by refusing permission to forfeit, for the purpose of the liquidation or administration concerned, will be liable to pay rent that becomes payable in priority to all other creditors as a liquidation or administration expense.

HHJ Pelling QC held that Lord Hoffman's analysis did not support the proposition put forward by the landlords. Drawing support from a consideration of other nineteenth century case law, he held that it was clear that debts already due at the date of the commencement of the liquidation or administration did not fall within the principle's scope and could not be payable as if they were an expense.

Distinction between rent payable in advance and rent payable in arrears

The main authority relied on by the landlords was *Re Silkstone and Dodsworth Coal and Iron Company* (1881) 17 Ch D 158 (*Silkstone*). In *Silkstone*, Fry J held that the liquidator had to pay the rent in full, including for the period before commencement of the winding-up. However, on closer analysis, HHJ Pelling QC pointed out that *Silkstone* was not a case where the rent became due *before* the winding-up. Rather, the rent was payable in arrears (as was common at the time) and had become due *after* the winding-up.

Accordingly, the issue in that case was how much, if any, of the rent arrears that had become due after commencement of the winding-up but was referable to the period before winding-up, could be recovered by the landlords when distraining. Fry J held that all the accrued rent should be paid because the company had to comply strictly with all obligations that arose for performance under the lease once the liquidator had elected to continue in possession. Since the obligation to pay did not arise until after such election, it was equitable that all rent falling due was payable – it did not matter that some of it was referable to a period before commencement of the winding-up.

The judge decided that *Silkstone* could not, therefore, help the landlords, since it was only of application where rent is payable in arrears and accrues due after the commencement of the winding-up or administration, and after an election to retain possession for the purposes of the liquidation (or administration). HHJ Pelling QC cited the Court of Appeal decision in *Re Oak Pits Collilery Co* [1882] 21 Ch D 322 in support.

While it was not necessary to the decision in this case, HHJ Pelling QC also pointed out that there is now, but not at the time of *Silkstone*, a statutory bar on a landlord's remedy of distraint in some insolvent situations such as administration, so that *Silkstone* would possibly not be decided in the same way, ie the equitable basis on which *Silkstone* was decided – that the price for remaining in possession was satisfying all the conditions of the lease in full so as to preclude the landlord from exercising its right to re-enter – was no longer relevant, given the statutory moratorium. There may be an ongoing debate as to whether that rejection should apply to the equitable basis of a court granting relief from forfeiture but the argument did not convince the deputy judge in *Luminar*.

> "The issue before HHJ Pelling QC depended on whether the *Lundy Granite* or *salvage* principle applied to the September rent."

So what should landlords and administrators do?

The decision in *Luminar* is in line with the law stated in *Goldacre* (which was adopted by both sides in *Luminar*) and on that basis it is hard to fault the reasoning of HHJ Pelling QC. The decision apparently prevents landlords from seeking to extend *Goldacre* to rent due pre-appointment. It also means that the practice of issuing a notice of intention to appoint shortly before a rent-quarter day (and in some cases, successive notices of intention to appoint) in order to obtain the benefit of an interim moratorium preventing landlord forfeiture action in respect of non-payment and of appointing administrators immediately after a rent-quarter day will continue and will attract protection for administrators.

Landlords may wish to maximise their returns by negotiating leases with monthly rents, so as to minimise the rental loss when an administrator is appointed after the day on which rent is due. A move to monthly rents would also be welcomed by tenants more broadly, particularly in the struggling retail sector, and is often used as a way, albeit temporarily, of providing a retailer with room to recover, whether as part of a company voluntary arrangement or as agreed with individual landlords. While the timing of an appointment will remain a key concern for administrators for so long as the position on apportionment is as per *Goldacre*, it becomes less critical where rent is payable monthly, rather than quarterly, in advance. However, a move to monthly rent may make pre-administration planning all the more key, since administrators may have to start paying rent as an expense two months earlier than at present.

It is unlikely that we will see a return to leases being granted where rent is payable in arrears, even if that *might* improve a landlord's position on insolvency. It is unclear if *Silkstone* would be followed today or whether an administrator would be able to apportion the liability between pre- and post-commencement occupation. More importantly, payment in arrears is not seen as an attractive proposition outside of insolvency, save in specific cases such as turnover rents. Administrators should also take care when outstanding rent reviews are resolved, triggering an immediate liability for substantial arrears of rent and interest, and which a landlord might argue would be payable as an expense if the liability falls post administration while the company is trading from the premises at the relevant quarter day.

As a result of the decisions in *Goldacre* and *Luminar*, landlords may find themselves with a tenant in administration able to occupy the premises for almost three months with rent only recoverable (if at all in practice) as an unsecured debt. On the other hand, administrators may be in the position where they have to meet, as an expense liability, rent for almost three months – despite the company no longer being in occupation. There is a real concern that this stark position could endanger good-faith negotiations between administrators and landlords more generally.

Where next for rent and administration expenses?

Few would dispute that the law on administration expenses as a whole is a 'legislative mess' (as Briggs J described it in *Re Nortel* [2010] EWHC 3010 (Ch)). The treatment of rent is a good example of this mess. An appointment a few days either side of a quarter day can have significant ramifications for administrators and landlords creating an arbitrage that is questionable in an area of law where there should be a coherent and justifiable policy.

The reforms to administration made by the Enterprise Act 2002 created a hybrid rescue/quasi liquidation process with subsequent changes made to the rules applying to administration to mirror those, as far as possible, applying in a liquidation. The transfer across of liquidation provisions on expenses into administration – in addition to other provisions such as those on distribution and set-off – has led to the courts forming the view that the more flexible pre-Enterprise Act case law recognising the differing policy objectives of administration and liquidation (the so-called *Re Atlantic* approach) has no place when considering the new expense provisions that should instead be interpreted by reference to the approach in *Toshoku*. For example, Richards J in *Exeter* v. *Bairstow* [2007] BCC 236 rejected the argument that the rigid 'in-out' *Toshoku* approach to liquidation expenses should not apply in administration because of such policy difference. Since the language of the rules on administration expenses is substantially the same as that used in the corresponding rules for liquidation expenses and was introduced after the decision in *Toshoku*, he said that it could not be 'sensibly suggested' that The Insolvency Service was not fully aware of the House of Lords' decision when making the changes. Ostensibly attractive as this may sound, it is in fact highly likely that little thought was given at the time to the consequence of adopting the same language in administration expenses to that used in liquidation expenses. As a result, flexibility and commercial pragmatism (with rent being paid as an expense on a *per diem* basis) have been replaced, as highlighted by

> "The decision in *Luminar* apparently prevents landlords from seeking to extend *Goldacre* to rent due pre-appointment."

the decisions in *Goldacre* and *Luminar*, with rigidity (no discretion) and a possible all-or-nothing result for landlords/administrators.

The current state of the law gives rise to inefficiencies for both the landlord and administrator communities. The decision in *Toshoku* will be examined thoroughly in May 2013 when a panel of seven Lords of the Supreme Court will hear the appeal in the Nortel/Lehman pensions case. It seems inevitable that, perhaps before then, the Court of Appeal will be faced with a challenge to the correctness of *Goldacre*, and its unpalatable consequences in *Luminar*, in the context of an administrator appointment over a large retailer.

The British Property Federation is lobbying for landlords to receive special treatment on insolvency arguing rent accruing during any interim moratorium should be an expense or treated as if it were secured. Whether such lobbying works or not, there remains a more fundamental issue at stake. What is needed is a rethink on expenses and clarification of the anomalies caused by the post-Enterprise Act transfer of some liquidation provisions into administration. It should not be left to the courts to create a piecemeal system of priority where it is hard to reconcile decisions treating some claims as expenses and others as ordinary unsecured debts. There may always be items that fall in the gaps, but parliament should identify and express a philosophy to underpin why claims are to receive expense status, rather than parties having to rely on or distinguish case law that is almost 150 years old. ◻

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Technical update

The European Insolvency Regulation: an update

In the spring edition of *RECOVERY* we wrote about the European Commission's programme for review of the EC Regulation on Insolvency Proceedings. We noted that the Commission was required under Article 46 to submit a report by 1 June 2012 on the application of the Regulation.

Well, June has come and gone with no report, so what is happening? The answer is, quite a lot, but not in a particularly co-ordinated manner.

In March, the Commission issued a public consultation document on the working of the Regulation, under the title *Consultation on the Future of European Insolvency Law*. Then, in late June, we became aware of an evaluation of the Regulation being carried out by the Universities of Heidelberg and Vienna on behalf of the Commission, with a very tight deadline for responses, but which, nevertheless, forms one of the key elements in the Commission's review. Presumably this is the external study referred to in the Commission's 'Road map' issued last year.

The consideration of the evidence collected from these sources will be through a 'panel of experts', 25 specialists drawn from across the EU, which will eventually guide the Commission and on which the UK is strongly represented.

Meanwhile in May, INSOL Europe published its own proposals for revision of the Regulation, which have been submitted to the Commission. This was the subject of a debate held in the Supreme Court on 6 July, and will be the subject of a further seminar in Leipzig on 14 September 2012.

At the time of writing (early July), the most recent event of note has been an ACCA-sponsored round table to discuss the Regulation held in the European Parliament building on 10 July.

The Commission's consultation

The Commission's consultation document is divided into sections, covering: general assessment; scope; competent courts; groups; co-ordination between main and secondary proceedings; applicable law; recognition and enforcement; publication of proceedings; differences in national laws; and costs of proceedings.

The questions posed in the document give a clue to the sorts of issues that cause the Commission particular concern. One of the main areas of contention is 'forum shopping': the selection by the debtor of the most favourable jurisdiction in which to enter a formal insolvency process. The 'forum' is determined by the centre of main interests (COMI) of a debtor. The document seeks views on whether the concept of COMI has been sufficiently clearly interpreted by the courts, and whether there has been evidence of 'abusive relocation of COMI to obtain a more favourable insolvency regime'.

> "The questions posed give a clue to the sorts of issues that cause the Commission particular concern. One of the main areas of contention is 'forum shopping'."

Among other questions posed in the document are: whether pre-insolvency or 'hybrid' proceedings should be brought within the scope of the Regulation; whether the Regulation deals adequately with groups; whether co-ordination between main and secondary proceedings works satisfactorily; whether problems are caused by differences in national laws; and whether the exceptions intended to protect third parties, such as the laws governing rights in rem (security rights), set-off, retention of title, contracts of employment and 'detrimental acts' (transfers at an undervalue, preferences etc), work satisfactorily.

In its response to the consultation, R3 argued for a light-touch approach to any reform of the Regulation. The Regulation is not perfect, but functions reasonably well to co-ordinate cross-border proceedings. Any very radical change could lead to greater complexity and more uncertainty.

With regard to COMI, R3 believes that the case law has established a reasonably consistent and flexible approach to determining COMI questions. The principles are well understood, but flexibility is still required to accommodate future developments. R3 is therefore not attracted by the idea of introducing a tighter definition of COMI within the Regulation.

R3 also pointed out that the relocation of COMI for the purposes of choosing a particular insolvency regime may be undertaken for entirely valid reasons. COMI changes are often made to enable the use of a different insolvency regime for the benefit of creditors or to facilitate the survival of a business. UK experience is that the courts are adept at determining the difference between 'good' COMI shifts and 'bad' COMI shifts, and dealing appropriately with the latter.

R3 is also opposed to bringing pre-insolvency or hybrid proceedings within the scope of the Regulation. In the UK such proceedings often take the form of Companies Act schemes, which can be applied to contracts governed by English law regardless of the domicile of the company. Their inclusion in the Regulation would mean that they could only be used where a company has an establishment within the UK. R3 suggests that it would be preferable for amendment to be made to the Brussels Judgments Regulation to make it clear that such schemes fall within its scope.

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With regard to groups, R3 argued for a cautious and limited approach. UNCITRAL's Insolvency Working Group spent many years considering the problems posed by groups, and came to the conclusion that the best approach was to encourage and facilitate procedural co-ordination, court-to-court communication and the use of protocols. The Working Group concluded that it would be inappropriate and potentially too restrictive to seek to promote any form of central co-ordinating body for each multinational group insolvency. We believe that the Commission would be wise to take account of UNCITRAL's deliberations.

On the question of the co-ordination of main and secondary proceedings and differences in national laws, there is definitely considerable room for improvement. To mitigate some of the problems that can be caused where secondary proceedings are opened by a party other than the office-holder in the main proceedings, R3 suggested that there should be a requirement to notify the office-holder in the main proceedings and to hear representations from him or her before secondary proceedings are opened. In addition, the requirement for secondary proceedings to be winding-up proceedings should be removed as being unnecessarily restrictive.

Among other recommendations made by R3 are for the establishment of an EU insolvency register, and the mandatory adoption by all EU member states of the UNCITRAL Model Law on Cross-Border Insolvency.

As for any moves to harmonise substantive insolvency law across the EU, R3 believes that there are too many differences between the underlying laws of member states to make this practicable.

The full text of the R3 response to the consultation is on the members' section of the R3 website.

The Heidelberg study

The Heidelberg study is based on questionnaires completed by national reporters, which in turn are based on questionnaires completed by interested stakeholders such as IPs, lawyers and the judiciary. The questions are very similar to those posed in the Commission's own consultation document although some areas are dealt with in more detail. With a closing date for submissions of 15 July we had very little time to arrange for questionnaires representing UK views to be completed. We are extremely grateful to Samantha Bewick of KPMG for agreeing to act as the UK national reporter, and to Joanna Perkins of South Square for collecting and collating answers to the questionnaires under very tight time constraints. The national reporter questionnaire is to be followed by a symposium in Heidelberg on 27 and 28 July. At the time of writing we do not yet know the programme, let alone the outcome, of the symposium.

The INSOL Europe proposals

INSOL Europe has set out its recommendations for amendment to the Regulation in a booklet entitled *Revision of the European Insolvency Regulation – Proposals by INSOL Europe*, which was published in May. The proposals are set out in the form of a complete text of the Regulation, modified in accordance with the recommendations, with detailed commentary on the reasons behind the proposed changes. Among INSOL Europe's recommendations are the following:

- The inclusion of a definition of insolvency in Article 1. This takes the form of a liquidity test, and would appear to supplant the insolvency tests in member states' national laws. However, the Regulation is intended to deal with jurisdiction, recognition and applicable laws: R3 believes that it is undesirable to try to use the review process to introduce changes to the substantive insolvency law of member states.
- To deal with the perceived mischief of forum shopping, the proposals provide that where a debtor has moved its COMI less than a year before the request to open proceedings, only the court of the member state where the COMI was located one year prior should have jurisdiction to open proceedings if the debtor has left unpaid liabilities there. However, all the creditors must consent in writing to the transfer of COMI out of that jurisdiction.
- INSOL Europe also suggests that the restriction requiring secondary proceedings to be winding-up proceedings should be removed.

> "R3 suggested that there should be a requirement to notify the office-holder in the main proceedings and to hear representations from him or her before secondary proceedings are opened."

The proposals would make changes to the rules governing antecedent transactions. At present, where there has been a 'detrimental act', the counterparty is protected if the transaction concerned is subject to the law of another member state, and the law of that state provides no means of challenging it. This is intended to protect legitimate expectations and provide legal certainty, as set out in Recital 24. Under the proposals, the counterparty would only be protected if the law of the state where COMI was located at the time of the transaction provided no means of challenging it.

The proposals include new chapters on insolvencies of groups of companies, a European Rescue Plan, and incorporation of the UNCITRAL Model Law on Cross-Border Insolvency into the Regulation itself.

These proposals were the subject of a debate in the Supreme Court on 6 July, on the motion 'This House believes that detailed substantive and technical changes to the European Insolvency Regulation, as proposed by INSOL Europe, are now required.' The motion was defeated on a show of hands.

The Brussels round table

On 10 July a round table discussion on the reform of European insolvency law took place in the European Parliament building in Brussels under the auspices of ACCA, UEAPME (a body that represents the interests of SMEs in Europe) and the European Conservatives and Reformists Group. There were presentations by various organisations, including DG Justice, DG Enterprise, UEAPME, an Italian accountancy body, INSOL Europe and R3. The keynote speaker was the Director DG Justice, and it was apparent from her speech, and those of others, that the Commission and other EU institutions are looking at the Regulation in the context of the perceived need to encourage enterprise, reduce the stigma of insolvency and support SMEs. There was also widespread reference to the need to accommodate groups within the insolvency regime.

According to Director DG Justice, there have been 130 responses to the Commission's consultation document. The Commission will put forward a proposal for a revised Regulation in December 2012, and at the same time present a report on the application of the Regulation and a communication setting out recommendations for the future.

Interesting times lie ahead!

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JOHN FRANCIS is the technical director at R3.

Recent case summaries

Corporate and personal insolvency update from **Dawn McCambley**.

Corporate insolvency

***Re Ceart Risk Services Ltd* [2012] EWHC 1178 (Ch)**

The company was authorised by the Financial Services Authority (FSA). A resolution was passed to place the company into administration on 19 January 2012 and a notice of appointment of administrators was filed on the same date, pursuant paragraph 22 of schedule B1 of IA 1986 (the Act).

Section 362A(2) of the Financial Services and Markets Act 2000 provided that an administrator *'may not be appointed...without the consent of the [FSA]'*. The company failed to obtain prior approval from the FSA; however, the requite consent was subsequently provided.

The administrators applied for a declaration that they had been validly appointed, despite the absence of prior consent from the FSA.

Held

1) On a proper construction of s362(A), although the wording of the section indicated that the requirement to obtain the FSA's consent was an important one, it did not mean it was essential to obtain such consent *prior* to the appointment of an administrator. Subsections (3)(b)&(4)(b) simply provided that the consent must be filed *'along with the notice of intention to appoint'* or *'must accompany the notice of appointment'*. There was no stipulation that the consent must be filed at the same time.
2) In view of the purposes of section 362A(2), the consequences of non-compliance, the wording of the section and the other provisions in section 362A, it could not be said that parliament intended that a purported appointment, prior to consent being obtained, was incurably invalid. Rather, it was merely a defective appointment and could be cured by subsequent consent where appropriate.
3) Paragraph 29 of schedule B1 provided that a person who appointed an administrator under paragraph 22 shall file with the court a notice of appointment and any other documents as prescribed. By virtue of paragraph 31, the said appointment took effect when the requirements of paragraph 29 were satisfied. The appointment of the administrators did not, therefore, take effect until the FSA's consent was filed at court on 8 February 2012.
4) Although the administrators were defectively appointed on 19 January 2012, paragraph 104 of schedule B1 could be relied upon to validate any acts between 19 January 2012 and 8 February 2012.

Comment: The unfortunate difference of judicial opinion regarding the applicability of paragraph 104 was highlighted. However, the judge emphasised that a distinction must be made between a defective appointment and situations where there was no appointment at all. Although it was unlikely that paragraph 104 could assist in the latter case, if it did not apply to situations where the defect in the appointment was curable, then it was difficult to see in what circumstances it would ever apply. Accordingly, the judge declined to follow the decision in *G-Tech Construction Ltd* [2007] BPIR 1275 in this respect.

Personal insolvency

***Marvin Gittins v. Serco Home Affairs* [2012] EWHC 651 (Ch)**

This was an appeal by Mr Gittins against the decision to annul a bankruptcy order that had been made against him.

Mr Gittins had been detained in prison since 2003 and he had commenced proceedings against Serco Home Affairs (Serco), a private prison operator. The action was dismissed with costs and a default costs certificate was issued. Mr Gittins was ordered to make a four-weekly contribution towards the costs at a rate calculated by reference to his income/receipts.

Prisoners were able to 'earn' money by undertaking various jobs whereupon such 'earnings' were paid into an earnings account. Money could also be received externally and paid into a private account. The sums due to Serco were to be deducted from Mr Gittins' prisoner accounts by Serco directly.

Mr Gittins presented his own bankruptcy petition and was adjudicated bankrupt on 23 December 2010.

Serco applied to annul the bankruptcy order as it should not have been made, on the grounds that Mr Gittins was not insolvent.

Held

1) The primary test for an inability to pay debts as they fall due is the cash-flow test in respect of assets and immediate liabilities.
2) The sum payable was uncertain as it depended upon a future event, namely the amounts of Mr Gittins' receipts from various sources.
3) The judge did not have jurisdiction to make the order in question. In particular, it was not a third party debt order, nor was it a charging order as this could not have been obtained over a fluctuating balance in the prisoner accounts. Moreover, it could not be viewed as an instalment order under section 71 of the County Courts Act 1984 as it did not include sufficient particulars.
4) As the order was not an instalment order, the whole of the sums under the order remained due. On any view, Mr Gittins was unable to pay the sums due under the costs certificate.
5) Accordingly, it was not an abuse of process for Mr Gittins to petition for bankruptcy. As it could not be said that the bankruptcy order should not have been made, the judge should not have annulled the bankruptcy order.

Appeal allowed.

Comment: Serco had regularly been adopting a different approach from the Home Office in enforcing costs orders against prisoners. It had been Serco's policy to enforce such orders against the prisoner accounts and to 'educate' judges as to the existence of such accounts against which an adverse costs order could be enforced. This decision confirmed that the court did not have the jurisdiction to make such an order.

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Legal Q&A

Roger Elford answers your insolvency queries.

Q I have been appointed trustee in bankruptcy of an individual who is eligible to draw income from his pension scheme but to date has elected not to do so. Am I able to compel the bankrupt to start drawing an income or taking a lump sum from the pension scheme for the purposes of obtaining an income payments order pursuant to s310 Insolvency Act 1986?

In accordance with section 11 of the Welfare Reform and Pensions Act 1999, the rights of a person under an approved pension scheme are excluded from his bankruptcy estate and will not vest in his trustee in bankruptcy. This is, however, subject to an exception for excessive contributions made by a bankrupt to his pension scheme with the effect of unfairly prejudicing the individual's creditors.

In the absence of excessive contributions, and where the bankrupt has not taken his pension benefits, the position is less clear. The issue recently came before the court as to whether the court could compel the bankrupt to draw upon his pension scheme upon an application by the trustee in bankruptcy for an income payments order pursuant to s310 Insolvency Act 1986.

> "The trustee applied for an income payments order and requested that the court order the bankrupt to take his pension benefits."

In the case of *Raithatha* v. *Williamson*, the bankrupt had a pension scheme from which he was entitled to draw a lump sum together with annuities immediately. He had elected not to do so as he was still working and had no intention of drawing his pension rights at that time.

The trustee applied for an income payments order and requested that the court order the bankrupt to take his pension benefits. Counsel for the bankrupt argued that to compel him to draw on his pension would be an interference with his property under the ECHR, and that no income payments order could be made against the lump sum because it is not *'a payment in the nature of income'* under section 310(7) Insolvency Act 1986.

The court rejected all of the bankrupt's arguments. The judge ruled that 'income' for the purposes of s310 could include a one-off payment and need not be of a recurring nature. The court also determined that s310 had been intended to apply to undrawn pension entitlements, rejecting counsel's human rights arguments.

In finding for the trustee, the judge was unconvinced that parliament had intended that those who had elected to take their pension benefits could be liable to an application under s310, whereas those who had not yet elected to do so should be granted immunity. The judge also upheld an injunction granted to the trustee to prevent the bankrupt from seeking to exercise his pension rights pending the determination of the trustee's application. However, the decision is currently being appealed, and so watch this space.

Q I am the liquidator of a company, where there are sufficient realisations to make a payment to unsecured creditors under the 'prescribed part'. There is one secured creditor who has not been repaid from fixed charge realisations. Is that creditor permitted to participate in the prescribed part as an unsecured creditor and are there any other issues of which I should be aware?

Section 176A(2) of the Insolvency Act 1986 stipulates that a proportion of the company's net property must be made available for the satisfaction of unsecured debts as a 'prescribed part'. Floating charge-holders are not permitted to participate in the prescribed part if they have an unsecured shortfall to their claim, and this section has also been found to apply to all other secured charge-holders (*Re Airbase Services (UK) Ltd*). The purpose of the prescribed part is to avoid secured creditors from consuming the entirety of the company's property and prevent unsecured creditors from making any recovery whatsoever.

A secured charge-holder is able to prove in respect of any unsecured portion of their debt, but only if there are assets available for distribution after other secured charge-holders' claims have been met and the prescribed part has been allocated. The exception to the rule is where a secured creditor releases its security entirely, in which case they are entitled to prove as an unsecured creditor and bring a claim from the prescribed part (*Re PAL SC Realisations 2007 Ltd*).

However, the recent case of *Re Frith* illustrates that secured creditors may circumvent the prescribed part prohibition by entering into inter-creditor agreements. Inter-creditor agreements commonly provide that junior creditors must turn over their recovery from the liquidation to senior creditors to the extent that their claim has not already been satisfied.

> "Secured creditors may circumvent the prescribed part prohibition by entering into inter-creditor agreements."

A senior creditor may, by employment of an inter-creditor agreement, also require junior creditors to prove in the insolvency as an unsecured creditor by releasing their security and so that they may participate in the prescribed part. If a secured creditor is concerned that they will have an unsecured shortfall where the company in liquidation has limited assets, then an inter-creditor agreement of this nature would be a shrewd move.

Secured creditors should note, however, that such an agreement may not be upheld by the court where junior creditors have security over the same assets as the senior creditor. Nevertheless, secured creditors will be encouraged by *Re Frith* and will no doubt increasingly attempt to participate in the prescribed part by use of inter-creditor agreements. ◻

ROGER ELFORD is a partner and joint head of the Property Insolvency Group at Charles Russell.

Why transparency matters

Under the latest version of SIP 9 office-holders are required to provide additional information including the nature of the case, its context and complexity – particularly if costs are high. **Allison Broad** explains.

Hardly a day goes by without insolvency hitting the headlines. With our industry constantly in the news, it's more important than ever that we ensure people have confidence in our profession.

IPs' fees are always going to be of interest to the world at large, and particularly when high-profile, well known names are hitting the press regularly. IPs' costs are also likely to cause consternation in cases where there's little prospect of a return for unsecured creditors. Couple these situations with the public's lack of understanding about what an IP does, and a lack of appreciation of the constraints and difficulties IPs often work under, and you can see why it's important your reports include enough detail about your costs and, perhaps more importantly, give sufficient narrative about what you've done.

More information for creditors

The April 2010 changes to the insolvency rules included provisions to increase transparency around IPs' fees and costs, by requiring IPs to give more information to creditors in reports. The new rules also enhanced creditors' rights to challenge excessive fees and expenses. The latest version of SIP 9, which came into effect in November 2011, continues this theme.

One of the key underlying principles of the latest version of SIP 9 is that an office-holder should give those responsible for approving the basis of their fees enough information so they can make an informed judgement about the reasonableness of the office-holder's requests.

How do you know what's sufficient?

In most cases, the level of disclosure you need to give will go far beyond that in the standard SIP 9 table; you need to disclose more than just the costs and hours that you've incurred.

Helpfully, the appendix to the SIP summarises the areas you might include in any narrative; for example, an explanation of the nature of the case and what you're dealing with. Is it a small local business with a single site or is it a more complex multi-site operation? You need to give creditors some context around the case, and explain the level and type of assets you are dealing with. You shouldn't just rely on providing a statement of affairs. Give more detail (where possible) about the size and value of the key assets you're handling.

> "You owe it to yourselves, and your fellow practitioners, to include enough detail in your reports so that those who authorise your fees feel confident they understand what you've done and the value you've delivered."

Does your report make it clear whether the case is a straightforward one or whether you're dealing with difficult and complex issues? And if the latter, have you explained the complexities as far as possible, without obviously disclosing information that might prejudice realisations? The pre-2010 rules for administrations, liquidations and bankruptcies already stipulated that those responsible for approving an office-holder's fees should take into account the complexity of the case, whether any exceptional responsibility falls on the office-holder, the effectiveness with which the office-holder appears to be carrying out their duties, and the nature and value of the assets that they're dealing with. Nevertheless, creditors can only consider these issues if you've already given them enough detail about the case and what you've done.

It's very hard to be prescriptive about the appropriate level of detail you should provide, as each case will be very different – that's what's so interesting about working in insolvency. But the disclosures need to be proportionate to the level of costs. SIP 9 makes it very clear that proportionality requires office-holders to provide a greater analysis of the work done, and more narrative detail, if their costs exceed £50,000. But also bear in mind that if you've incurred significant time costs in relation to a particular aspect of a case, your disclosures should be more extensive than a brief line about what was done: they should reflect the breadth of the task.

Demonstrate your value

Although many IPs now have sophisticated time recording systems with numerous sub-codes that capture a further level of detail about the work done, creditors don't always see this. And it's not always clear what's included in the standard SIP 9 categories so you may need to give additional information about the work included within work categories, such as administration and planning.

IPs invariably deal with angry and confused people, in difficult circumstances. You owe it to yourselves, and your fellow practitioners, to include enough detail in your reports so that those who authorise your fees feel confident they understand what you've done and the value you've delivered. ◻

ALLISON BROAD is a senior manager and heads the insolvency monitoring team at the ICAEW.

Zombie companies

UK and other Western economies are suffering from the drag of zombie companies. **Paul Williams** explains why this is and how IPs can help to break the cycle of 'no returns'.

What is a zombie company?

The general consensus is that a zombie is a company that is living a hand-to-mouth existence, only generating sufficient cash to pay ongoing bills and any profit is being spent on covering interest payments on debts, and not being reinvested. Often these businesses are in intensive care and require continual financial support from lenders or investors in order to continue trading. This 'support' is usually confined to not enforcing a lender's security rather than actually promoting investment or growth. This is hardly unsurprising given that zombie companies lack the ability to grow or even the prospect of growth. Historically, these businesses have been considered to be the bedrock of the economy. However in the face of a prolonged economic slump, in reality zombie businesses are stifling the prospects of an economic recovery.

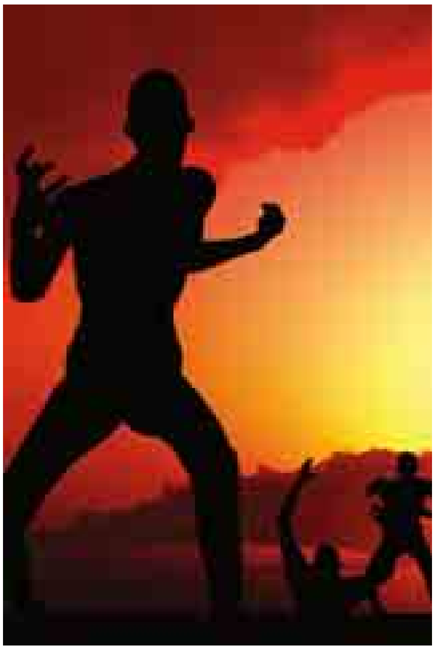
Are zombie businesses stifling the prospects of an economic recovery?

Given the macro-economic outlook, many observers fear that these businesses are facing a prolonged cycle of dependence. Many have already been in the business support units of banks for far longer than previously experienced.

Therefore, given the current government's commitment to growth, the real question is whether to continue to support zombie companies to maintain short-term stability or whether a more radical approach is required? Are these businesses in effect holding back the prospect of an economic recovery given that they often cannot pay their own way, let alone generate opportunities for investment and growth?

There are many who believe that the zombie companies should be 'killed off' for good and that they are obtaining a disproportionate market share from viable companies. The impact of the ongoing economic downturn, rising unemployment and, more significantly, large-scale state support for the world banking system has placed immense social and political pressure on lenders to preserve the current status quo. This has effectively allowed near insolvent businesses to continue to survive in a market where they would ordinarily fail.

In the current economic situation, many observers had anticipated a significant rise in the number of formal insolvencies – but the statistics would suggest that they have not materialised. As an Ernst & Young (E&Y) report recently showed, the number of year-on-year administrations actually fell in 2011, despite a 42 per cent rise in profit warnings among listed companies. The report went on to comment that the mismatch could be explained by a change in attitude among Crown and many institutional creditors, which has allowed more breathing space for businesses since the start of the financial crisis way back in 2007. It could be argued that this strategy is in reality making markets incredibly inefficient and simply delaying the inevitable.



> "Given the macro-economic outlook, many observers fear that these businesses are facing a prolonged cycle of dependence."

So what is preventing zombie companies from failing?

You may recall the previous government's initiative to promote Time-to-Pay arrangements on social taxes. It was argued by some that this initiative provided a much needed relief to struggling businesses. Others believe that it simply distorted the market economy and shored-up failing companies for too long.

Further evidence of the zombie phenomenon was provided by a recent Red Flag survey by Begbies Traynor, which showed that businesses in the South West were being kept artificially alive, despite the growing number of writs issued against them, because creditors were not willing to pull the plug as there was a growing feeling that nothing was to be gained by taking action; although there are always exceptions to every rule, as can be seen from the article on page 24.

E&Y also argue that banks are unwilling to be seen to be pulling the financial rug from underneath companies that are facing difficult trading conditions. Given the recent public hostility towards the banking sector, it is not surprising that banks are attempting to rebuild their public perception.

Furthermore, as many banks are now effectively state owned, it is easy to see how huge political pressure is being brought to bear on these institutions to be seen to be providing lending to their customers (many of whom are members of the electorate that put the current government in power). The cynical among us may be drawn to the conclusion that sound economic judgment is being hampered by what is effectively a 'conflict of interest'. However, the real result of intervention is clear for all to see – businesses that should probably be allowed to fail, do not.

A survey by PIRC, the UK's leading shareholder advisory group, suggests that UK banks may be sitting on £40 billion of undeclared losses. PIRC argues that this backlog of undisclosed bad debts is preventing the banking sector from making vital growth-boosting loans to credit-worthy businesses and households. The UK and European banking system has become gridlocked as a result of non-performing loans and toxic debts to zombie companies, a significant number of which are property related.

PIRC goes on to argue for a policy of 'full disclosure' by banks, which was previously employed in the US to break the Great Depression in the mid-1930s. This involves forcing banks to recognise all their excess liabilities so that they push the zombies into insolvency; then they can focus their support on the companies worth saving and rebuild their capital levels.

Investors are nervous about investing in banks as they don't know what they are buying. As a result interbank lending remains extremely sluggish.

A recent article in the *Daily Telegraph* suggests that the UK and the rest of the

Western world's response to 'sub-prime' – what it describes as a 'bank insolvency-led crisis' – has been to follow the 'Japanese model'. I have heard this referred to in some circles as 'extend-and-pretend' or 'delay-and-pray'. History shows this model does not work. It was only in 2010 that Japan's GDP recovered to its 1991 pre-bust level. Almost 20 years!

How can IPs help?

It has long been held that insolvency plays an important function in a healthy and prosperous economy. Much like my wife's roses require pruning or deadheading in order to flourish, the economy needs the removal of dead or zombie companies to facilitate growth or add value.

The question remains, how can we as a profession add value without giving the perception that we are praying on the poor and unfortunate?

Growth through restructuring

Pre-packs and CVAs have now become more frequently used restructuring tools, albeit that there is a need for greater public understanding of the processes. While the stigma of an insolvency process can often result in some negative publicity, these procedures can be extremely beneficial in preserving enterprise value, securing continued employment and more significantly releasing zombie businesses from the repetitious cycle of lender dependency.

Public education is critical to ensuring that there is an acceptance that these practices are genuinely adding value and provide a real public benefit. I strongly believe that as a profession, we need to place more emphasis on the social benefits of our role and promoting some of the many successful restructuring deals.

> "IPs support aspiring entrepreneurs, restructure underperforming businesses, save jobs and promote enterprise."

Without question, IPs can have a valuable role to play in generating growth. We support aspiring entrepreneurs, restructure underperforming businesses, save jobs and promote enterprise. All of these attributes are consistent with the aspirations of government and although it appears counter-intuitive, in many ways, in the face of a recession, the IP should be the natural choice to implement significant elements of a growth strategy. In fact, the introduction of the Enterprise Act forms part of the blueprint for this strategy.

It does therefore seem ironic that, some ten years on, the legislation that was specifically created to promote enterprise is not able to be used effectively to do so – due to factors outside the control of the insolvency community.

The culture of 'too big to fail' that appears to have been adopted in relation to many Eurozone countries and financial institutions is permeating down to companies of all sizes. Successive governments have sought to introduce policies in good faith that have ultimately interfered with natural market forces.

An obsession with avoiding a double-dip actually looks like prolonging a recession and the dip is yet to come.

What is clear is that we have our role to play and most IPs want to be part of the solution. The difficulty is persuading stakeholders to buy into procedures that often have short-term, negative public perception, although ultimately provide a pathway to growth. ◻

PAUL WILLIAMS is a partner at Duff & Phelps Ltd.

TUPE and the current state of play

The results of a DBIS consultation on TUPE may clarify the situation regarding insolvency.

TUPE (Transfer of Undertakings (Protection of Employment) Regulations) has been around for a while now and has often been seen as an impediment to the rescue culture. R3 recently undertook a survey on this point. We reflect upon these results below as well as the current regulatory regime.

TUPE safeguards the rights of employees in the event of a transfer of a business (or part thereof). It covers several types of transfers, including outsourcing, insourcing or reassigning of an outsourcing contract. TUPE does not apply to share sales. Overall, employee rights are protected by automatically transferring to the new owner, with employees' original terms and conditions being retained and continuity of service being maintained. Where the seller is insolvent, the TUPE regulations make for certain relaxations (depending on the type of insolvency). These broadly mean that some liabilities do not transfer to the buyer. But there are not many that fall into this category for administrations. This is often perceived as giving rise to an impediment to the rescue culture.

The history of TUPE

It is perhaps worth reflecting on how far things have moved on over the preceding decades. When Mrs Thatcher had only been in office for a couple of years (naturally both authors are far too young to remember much of this) and prior to the introduction of TUPE,[1] it was a very different story. Then, when a business was sold it was possible to pick and choose which employees were transferred, what their pay and conditions were and also no liability transferred in relation to pre-sales employment debts. After the introduction of TUPE in the early 1980s, employees were given more rights. These were broadly that the new purchaser took on all rights, obligations and liabilities relating to the employees.

> "TUPE was revised in 2006 with the rules relaxed for some insolvency proceedings and dis-applied for others."

Finally, TUPE was revised in 2006 with the rules relaxed for some insolvency proceedings and dis-applied for others. To effect this relaxation, the UK government chose to 'copy out' an EU Directive's generic description of different categories of insolvency proceedings (which were to be treated differently), rather than specifying which type of proceeding fell under what category description. It was not immediately obvious in some cases. Although this reduced the risk of the UK government not properly implementing EU requirements, it did leave ambiguities in the categorisation of different insolvency proceedings. As a result, employment

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tribunals and the courts have had to resolve the issues, particularly in relation to administrations.

TUPE and administrations

There had been some debate about whether administrations qualified as ‘relevant insolvency proceedings’. This technical term within TUPE was used to categorise an insolvency as being about either rescuing a business, in which case TUPE regulations broadly apply (subject to certain small carve outs, see below), and those that don’t. The latter insolvency processes are categorised as being instituted with a view to the liquidation of a company’s assets. In these cases, TUPE does not apply to anything like the same extent. This is likely to make such a situation more attractive to the purchaser.

R3 survey

The impact of the current TUPE arrangements on the so-called rescue culture has been the subject of an R3 survey. It isn’t positive. During December 2011 ComRes conducted an online survey of 379 R3 members in the UK. The results showed that in the 12 months prior to the survey just under 50 per cent of these IPs had dealt with a case(s) where a purchaser had withdrawn or discounted their bids due to TUPE. Just under 40 per cent of the same constituency of IPs surveyed had also dealt with at least one case in the prior 12 months where the company had entered liquidation rather than being sold as a going concern.

IPs were also asked how TUPE had impacted on cases more generally. It was found that overall, where TUPE had impacted on a case, around two thirds of the IPs who responded stated that the purchaser had withdrawn or reduced their bid due to the impact of TUPE. In the balancing one third where TUPE had impacted on a case, liquidation was the consequence.

Pensions and TUPE

Occupational pension schemes are sometimes the one area where there can be a big difference pre- and post-transfer. Benefits under an occupational pension scheme do not always transfer wholesale to the new owner. Instead, the new owner will need to offer an alternative. This can be either access to:

- a defined contribution or stakeholder pension scheme with an employer contribution equal to that of the employee’s (subject to a cap). The obligation to provide and contribute to a personal pension scheme will pass under TUPE to the purchaser if the transferring employees had a contractual right to one; or
- a defined benefit (including final salary) pension scheme subject to certain minimum standards. This is rarely the route followed.

A survey of the resulting loss of jobs that followed a liquidation indicated a whole range of businesses where jobs were lost as a result. This included ten occasions when the loss was in excess of 40 employees.

Impact on the rescue culture

We recently dealt with the administration of a media business that was the European publisher of a global magazine title, among others. For contractual and licensing reasons coupled with impending publication deadlines, it was determined that the business should be sold by way of a pre-pack administration. A buyer was identified and a sale agreed at a level that we felt was fair and would provide a good return for creditors in the circumstances. However, after taking legal advice on the potential TUPE issues, the buyer became extremely concerned as to its potential liabilities because of the uncertainty around the current legislation. As a result, the deal had to be restructured so that only discrete parts of the business would be acquired and that employees specifically associated with those parts would transfer. The remainder of the staff would be made redundant by the company in administration. Not only was there a restructuring of the deal, but the buyer reduced its offer for the business and assets significantly, with consequent effect on the prospects of returns to creditors. Despite all this, we understand that the buyer has subsequently settled a number of unfair dismissal claims brought by former employees of the company not included in the transfer.

> “Questions asked included those around ways to bring greater clarity to the application of TUPE in insolvency situations, and ways to reduce transaction costs and risks.”

There is also a recent example of a well known commercial estate agency business that we were marketing for sale as a going concern by its administrators. The business was long established and had grown by acquisition over many years. There was a significant number of high earners with long service among the workforce. The buyer had wanted to acquire the entirety of the business and assets but after receiving advice on the potential for post-acquisition TUPE liabilities, decided to acquire parts of the business only. As a consequence, only the employees specific to those parts of the business transferred and, because the buyer was concerned that even this would be insufficient to limit its potential liabilities, the price obtained for the business and assets was significantly reduced from that originally negotiated.

Other prospective employer obligations

Apart from TUPE obligations, a prospective purchaser/employer will shortly face new financial and administrative burdens. These relate to pensions’ auto-enrolment and provision of real-time PAYE information to HMRC.

Pensions auto-enrolment

In the course of the next few years, broadly, all employers will be required to enrol their employees into a pension scheme automatically. Not only will this place an administrative burden on a business (even down to very small employee situations, perhaps such as having a nanny) but also there will be a requirement that ultimately the employer will have to pay a contribution of at least five per cent based on the employees’ salary.

Provision of real time information (RTI) to HMRC

This will mean that, essentially, all businesses will have to submit more frequent details of PAYE-related liabilities to HMRC. As a result, HMRC will be in a much better position to pursue outstanding PAYE liabilities sooner than is the situation at the moment.

So where now?

There is the possibility of further regulatory change (yes, again) to clarify matters. The Department of Business, Innovation and Skills recently undertook a consultation on TUPE, including matters relating to insolvency. Questions asked included those about ways to bring greater clarity to the application of TUPE in insolvency situations, and ways to reduce transaction costs and risks. The consultation period closed on 31 January 2012. A response, including the way forward (as of August 2012) is yet to be published. We await it with interest. ◻

[1] SI 1981/1794

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Adding value to insolvency: getting the assets out earlier

Samantha Hawkins discusses the benefits of getting the assets out of zombie companies, which may, in turn, help stimulate the economy.

As a small, well established practice here in the South West, we are seeing an increase in the number of owner managers coming forward to enter a formal insolvency procedure before the assets run out. What is prompting this – perhaps an increased awareness in wrongful trading risks? A feeling the economic recovery is further off than first thought? This proactive approach assists in stemming losses and reducing the risk of increasing the liabilities in the company. Crucially it may release valuable assets locked into 'zombie' companies.

The living dead

A zombie company is a term used by the media to describe businesses unable to generate cash or development capital. Generally any profit made is used to service existing debt to creditors and/or cover interest payments on loans. This type of business is on artificial life support as lenders and other stakeholders vary the terms of their banking facilities or lending to prevent the companies from failing.

> This type of business is on artificial life support as lenders and other stakeholders vary the terms of their banking facilities or lending to prevent the companies from failing.

Nevertheless, the company may have valuable assets such as know-how, technology and brand identity but, without capital to invest in scaled development or production, they cannot be exploited or maximised in the current legal entity.

The relatively cheap funds once so readily available to investors, which in turn fed into interesting (often technology-based) start-ups, are no longer an option as the economy has stalled.

Some start-ups may have experienced early and rapid growth. This may have increased exposure to their creditors so that they are trading at their overdraft limit and carrying a highly leveraged debt-to-equity ratio from the prior, more generous trading years. Figures provided by R3 for March 2012 show that 30 per cent of businesses say they are regularly using their maximum overdraft facility.

Other supplier creditors may be pressing, abating risk with strategies such as shorter payment terms or even a refusal to supply other than on a cash-on-delivery basis. This über cautious approach will inevitably inhibit growth of the business and lock all the valuable assets until creditor enforcement action is initiated or the business owner/managers take charge of the situation.

Zombie companies take up valuable market share as they have been allowed to survive one liquidity crisis to the next – neither keeling over nor having the plug pulled by the banks. The net result is that they fail to make way for more viable and progressive companies with the working capital and investment to expand.

Unlocking valuable assets: the key to recovery

It is rare to find an insolvent company with no assets available for realisation, even if they are not immediately apparent, or indeed on the directors' Statement of Affairs. Once they are identified, the provisions of the Insolvency Act allow the practitioner to swell the estate and make distribution to creditors. If formal insolvency is not initiated, zombie companies could potentially be increasing their liabilities and exposing their directors to liability through wrongful trading claims due to failure of the s123 Insolvency Act 1986 tests.

Proactive insolvency

Undoubtedly one of the main features of the English and Welsh insolvency regime is to protect and preserve the interests of all major stakeholders, SIP 2 para 1 makes this clear. This group not only includes banks, investors, creditors and customers but also employees. These individuals may well be the key asset in a zombie company. By placing the company into liquidation and effecting a TUPE transfer their valuable know-how will be released and add value to the transferee company.

Increasingly, owner/managers are coming forward earlier to initiate insolvency. They are realising that there is no 'trading around the next corner' option available, as in earlier recessions. Rather, a root and branch restructure is required, often through a SIP 16 pre-pack administration or asset sale in liquidation. This results in the quantum and quality of assets available for sale increasing, which has to be good for the local and national economies.

Switching off the machine to resuscitate the economy in the South West

The Insolvency Service reported a 4.3 per cent rise in corporate insolvencies on last year to 4,303 for Q1 of 2012, the highest increase since 2009. This trend reflects the deep-rooted slowdown affecting almost every market across the UK.

> Increasingly, owner/managers are coming forward earlier to initiate insolvency. They are realising that there is no 'trading around the next corner' option available.

The silver lining though may be that the assets and skill base unlocked by these insolvencies are better placed in a reduced number of growing competitor companies, which would give the South West the boost it needs to resuscitate the local economy. So while many predict a 'bloodbath' on the high street citing that we are presently experiencing a comparative 'calm before the storm' this pessimistic outlook does not take into account the stimulus effect these corporate insolvencies may well provide, resulting in fewer and leaner companies and leading the way to recovery. ◻

SAMANTHA HAWKINS is an insolvency practitioner at David Exell Associates.

The value of the insolvency industry: UK v. The World

Returns to creditors and the speed at which they receive them are vital to a healthier economy. **Charlotte Towerton** compares the markets.

So we may have crashed out of Euro 2012 but is there another international field we can perform better on? How about the global insolvency league tables – where do we rank there? To fully define 'the value' of the insolvency industry we need to compare the UK's performance to the rest of the world's. Does our system ensure swift returns to creditors and recovery of business assets?

International standing

The World Bank's 'Doing Business Project' measures and compares regulations relevant to the life cycle of SMEs in 183 economies. Of all 39 indicators reported on by the World Bank, the recovery rate when a business is closed (ie the cents in the dollar recouped by creditors through the bankruptcy or insolvency proceedings) is the most strongly correlated to a country's prosperity (measured as GDP *per capita*). Likewise, the recovery rate and speed of closure are also strongly correlated to rates of investment in an economy, and overall rates of economic growth. The United Kingdom's insolvency regime performs well on these measures against other jurisdictions. It is successful in recovering an average of 89 per cent of assets when a business closes.

> "The insolvency sector helps to create an environment that is conducive for entrepreneurship and appropriate risk taking, while safe-guarding creditors."

According to World Bank data in June 2011 the UK's insolvency profession is ranked sixth out of 183 countries for the amount it recovers for creditors and eighth out of 183 countries for speed with which it deals with troubled businesses and returns money to creditors.[1] It may not come as a surprise that Greece's insolvency regime is 55th for the time it takes to close an insolvent business and 58th on the amount it recovers for creditors. The correlation between a good insolvency regime and a stable economy could not be clearer!

Economy specific research has shown that insolvency regimes that encourage debt restructuring and reorganisation reduce both failure rates among SMEs and the liquidation of profitable businesses. We may have been 'a nation of shopkeepers' but now we are a nation of SMEs, in fact SMEs contributes over 50 per cent to UK GDP and 60 per cent of employment so it's imperative that the UK's insolvency regime is working well to protect their interests.

The UK's regime plays a vital role in maintaining a business environment where creditors are willing to lend to SMEs, entrepreneurship is encouraged and the economy can flourish. The UK is ranked higher than both Germany (19) and the USA (42) in the standings – and I think we would all welcome this being the case at the Olympics or next World Cup!

Facts and figures

'Resolving insolvency' – the most recent round of data collection for the project was completed in June 2011.

The average time to close a business

Rank	Country	Time (years)
1	Ireland	0.4
2	Japan	0.6
3	Singapore	0.8
4	Canada	0.8
5	Norway	0.9
6	Finland	0.9
7	Belgium	0.9
8	**United Kingdom**	**1**
9	Denmark	1
10	Iceland	1
11	Australia	1
12	Belize	1
13	Palau	1
14	Solomon Islands	1
15	Netherlands	1.1
16	Hong Kong SAR, China	1.1
17	Austria	1.1
18	Jamaica	1.1
19	Germany	1.2
20	Columbia	1.3

Where is resolving insolvency easy?

Rank	Country	Recovery rate (cents in the dollar)
1	Japan	92.7
2	Singapore	91.3
3	Canada	90.7
4	Norway	90.6
5	Finland	89.1
6	**United Kingdom**	**88.6**
7	Netherlands	87.7
8	Belgium	87.3
9	Denmark	87.3
10	Ireland	86.9
11	Iceland	84.5
12	Colombia	82.8
13	Korea, Rep.	82.3
14	Taiwan, China	82.1
15	United States	81.5
16	Hong Kong SAR, China	81.2
17	Australia	80.8
18	New Zealand	78.8
19	Sweden	75.8
20	Spain	75.6

Rankings are based on the recovery rate: how many cents in the dollar creditors recover from insolvent firm.

A closer look at the UK

Direct measures of the impact of the insolvency sector underestimate its importance in contribution to national prosperity. This is because they fail to account for the enabling role played by the industry. This role includes creating an environment that is conducive for entrepreneurship and appropriate risk taking, while safe-guarding creditors, as well as providing expertise and services for businesses and consumers facing financial difficulty.

In 2009 the profession was responsible for rescuing 5,850 businesses and helped to save nearly 2 million jobs (estimated at 1,951,743) in companies experiencing solvency problems. It provided assistance to businesses with a combined turnover of an estimated £363 billion.

The cases in which an IP manages to save a business often fly under the radar, but a significant amount of IPs' work is restructuring and turnaround work. IPs spend over a quarter (27 per cent) of their time on rescue work, turnaround and preventing insolvencies; the Centre for Economics and Business Research estimated that over two thirds of IP organisations are involved in the restructuring or turnaround of companies.

Our findings on the number of businesses saved, jobs retained and rescue work undertaken therefore highlights the importance of the insolvency regime in delivering a robust and vibrant economy. Jurisdictions such as the United Kingdom, that treat creditors appropriately in times of business difficulties, are the most likely to be prosperous in the longer term. Perhaps the prognosis for the UK is not all that gloomy based on that criterion alone. ◻

[1] http://www.doingbusiness.org/data/exploretopics/resolving-insolvency

CHARLOTTE TOWERTON is the external communications officer at R3.

Merchant acquirers: more stakeholders!

Check whether a merchant acquirer is involved in an administration – and then talk to them – fast, advise **Jeff Woolgar** and **Paul Medcalf**.

Whoa, please tell me there's not another stakeholder creeping out of the woodwork? Well, yes we're afraid so. The funny thing is that this particular breed has been around for a long time but hardly anyone has heard of them, has any idea who they are or, in fact, understands what they do. What we must stress though is that without them, the commercial world in which we live would grind, very unceremoniously and dramatically, to a halt. Any more clues needed? They are the merchant acquirers.

> "Merchant acquirers act as the conduit between you, whichever piece of plastic you're bending, and the retailer."

Still no wiser, eh? Well they are the people that allow you to flex the plastic in your wallet. In the simplest terms, they act as the conduit between you, whichever piece of plastic you're bending, and the retailer.

Where the merchant acquirer fits in

There are only a handful of merchant acquirers in the UK but between them they process in excess of five billion transactions per annum with a total value in excess of £210 billion every year, that's roughly 6,700 transactions per second! With the growth in internet retail their importance in our day-to-day lives continues to increase alarmingly.

So why, if all they do is process plastic, are they yet another potential stakeholder in corporate entities? As most of you know, as a consumer purchasing goods or services with your credit card, you have certain protection granted to you courtesy of section 75 of the Consumer Credit Act. However, if the retailer fails, then it's whoever supplied that little box of electronic wizardry by the till that bears the cost. Your card issuer will refund you but they then bounce that claim firmly into the lap of the merchant acquirer.

Payback time

Let's say you have splashed out on a lovely new three piece suite and paid £2,000 for

the privilege. The retailer assures you that the goods will be delivered in six weeks' time. Four weeks later administrators are appointed and you have no chance of getting that suite. You submit a claim to your card issuer who in turn submits a claim to the merchant acquirer. They refund the £2,000. Now imagine a company that has thousands of unfilled orders and those payouts soon start to rack up.

So where and when are they exposed? Well it's fair to say that any supplier of goods or services where there is a delay between

> "If the retailer fails, then… your card issuer will refund you but they then bounce that claim firmly into the lap of the merchant acquirer."

payment and provision of those goods or services could potentially be cause for concern. Travel companies, online retailers, retailers that provide self-insured warranties, soft furnishing retailers are but a few.

The big problem for other stakeholders in a business arises when a merchant acquirer terminates the retailer's facility. In these modern times, a retailer that cannot accept plastic is, we think it fair to say, dead in the water. So why may they pull a facility? Well for much the same reason as other stakeholders: poor or no financials, lack of dialogue, significant change in management or ownership, or basically anything else that causes them significant concern.

IPs need to advise merchant acquirers – as well as their clients

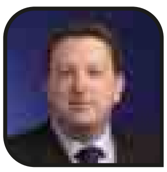
From the merchant acquirer's perspective, it is, without doubt, sensible to hold early discussions with the insolvency practitioner as all too often precipitous and sometimes selfish action is taken by either side without a full understanding of each other's position.

> "If a merchant acquirer has exposure…they could bring your well planned turnaround strategy tumbling down around you."

They understand that it's much better to work together in order to avoid, or at the very least mitigate, any potential loss.

Your client will already have a direct relationship with the acquirer and, in the case of those merchants collecting payment prior to supplying the goods or services, may well be either providing security, or suffering delayed settlement of funds.

You will find there is none of that bloated pomposity that you can get with certain other stakeholders. The merchant acquirers are proactive and surprisingly willing to talk. If you only get one message from this article then please let it be: consider whether there is a merchant acquirer involved, could they have some exposure; and then talk to them before they do something that could bring your well planned turnaround strategy tumbling down around you. ◻



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Olympic Airlines S.A. (in liquidation in Greece): a torch for defined benefit pension scheme beneficiaries

Multi-jurisdictional cases in which a firm has become distressed or faces insolvency pose problems for employers who have deficits in their defined salary pension schemes. **Louise Webb** explains.

Deficits in defined salary pension schemes continue to play a key role in a large number of insolvencies. Often the Pension Protection Fund (PPF) is the last resort for members of these schemes. One of the triggers for assessment for entry into the PPF is the insolvency of the scheme's employer. However, under pensions legislation only a qualifying insolvency event (QIE) will suffice. Foreign insolvency processes do not constitute a QIE. In this case an office-holder of an overseas sponsoring employer that was in main proceedings elsewhere in the EU resisted a petition for winding-up, designed to trigger a qualifying insolvency event and the PPF assessment process.

Background

Olympic Airlines SA (OA) is a Greek company and was the Greek national airline providing flights to global destinations. On 2 October 2009 OA was put into 'special' liquidation by the Greek Court of Appeal following a finding that it had received illicit state aid. The special liquidation constitutes main proceedings pursuant to Council Regulation (EC) 1346/2000 (Insolvency Regulation) and a Greek liquidator (the Greek liquidator) was appointed.

At the time main proceedings were opened, OA had *circa* 27 UK employees. Most were members of the Olympic Airlines SA Pension and Life Assurance Scheme, a defined benefit scheme in deficit (the Scheme). On 2 July 2010 the Greek liquidator gave notice to the employees that their employment would be terminated on 14 July 2010. Three were retained after this date to assist with the general winding-up of the English operation.

The Scheme deficit, as valued pursuant to section 75 of the Pensions Act 1995 was £15,995,000. As OA was unable to meet the deficit the trustees of the Scheme (Pitmans Trustees Limited and two individuals) (Trustees) presented a winding-up petition to the court on 20 July 2010 in order that the Scheme could enter the PPF.

The petition was opposed on the grounds that OA did not, on the petition date, have an establishment in England and Wales.

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Legal position

Insolvency position

Main insolvency proceedings are opened in the member state where a debtor has its centre of main interests and permit the insolvency office-holder to deal with all of the assets or creditors of the debtor no matter where situated. Secondary insolvency proceedings, on the other hand, can be opened only where the debtor is in main proceedings elsewhere and can be opened only if the debtor has an establishment in the second jurisdiction. Secondary proceedings must be winding-up proceedings.

Article 2(h) of the Insolvency Regulation provides that an establishment is a place of operations where the debtor carries out a non-transitory economic activity with human means and goods. In

> "Article 2(h) of the Insolvency Regulation provides that an establishment is a place of operations where the debtor carries out a non-transitory economic activity with human means and goods."

Interdil srl v. *Fallimento Interdil srl (2011) Case C-396/09* the European Court of Justice held that an establishment required a structure with a minimum level of organisation and a degree of stability necessary for the pursuit of an economic activity.

Pensions position

For a scheme to be considered for entry into the PPF, a 'qualifying insolvency event' must occur in relation to an employer of an eligible scheme. For the purposes of s121(3) of the Pensions Act 2004 the appointment of an overseas liquidator does not fall within the definition of a QIE.

However, s121(3)(g) states that *'an insolvency event occurs in relation to a company where an order for the winding-up of the company is made by the court under part 4 or 5 of the Insolvency Act 1986.'* Accordingly the trustees sought to open secondary proceedings in the form of an English liquidation to trigger a qualifying insolvency event.

Relevant facts

Two former managers of OA's London business were retained on short-term *ad hoc* contracts following their respective retirements. These *ad hoc* arrangements continued after the termination of other employee contracts on 14 July 2010. Their ongoing roles included paying invoices, dealing with bank and accountancy issues, sending documentation to the Greek liquidator, and dealing with post and telephone calls.

Both managers attended the offices at 11 Conduit Street, London (leased by OA) three or four days a week to deal with ongoing matters.

At the time of the petition, OA had assets in England that included bank accounts, computers, computerised accounting records and office furniture. OA also had use of a van that was owned by a related company. One of the managers was tasked with disposing of these assets, which had negligible resale value. The disposals were not completed until well after the petition date. Telephone and internet services at 11 Conduit Street remained active until the end of 2010 and at least some overheads such as council tax, electricity and cleaning were paid by OA in respect of periods after 14 July 2010. The leased premises were eventually closed in December 2011.

After June 2010 there was limited customer interaction as most customers were aware at that point that OA was in liquidation, airline tickets were no longer being sold and the Olympic Airlines sign was removed from the London premises.

Judgment

The date of the petition was the relevant time for determining the existence of an establishment. However, this date should not be viewed in isolation as a snapshot. Instead circumstances around this date should be taken into consideration.

Although it was not argued that OA did not meet the establishment test in respect of human means and assets, the court was required to consider what constituted a non-transitory place of operations with economic activity for the purposes of proving the existence of an establishment:

Non-transitory place of operations

It was argued and rejected by the court that, as OA was in wind-down, it conducted only internal and non-transitory operations and could not therefore be shown to have an establishment. In reaching its conclusion the judge emphasised that to adopt this stance might preclude any company from entering secondary proceedings. Secondary proceedings must be winding-up proceedings and companies in liquidation are, by their very nature, in a state of wind-down and frequently conduct activities of a primarily internal nature.

The chancellor added that activities need not be permanent to be found to be non-transitory as permanence was not expressed to be a requirement of the establishment definition.

Economic activity

The argument that the term 'economic' implies some kind of external market activity was rejected on two grounds.

1) *'The word economic does not, at least in English, carry any external market overtones;'* and
2) *'External market activities are inconsistent with the generality of companies in liquidation which, by definition, do not engage in external market activities any longer.'*

This second ground appears linked to the chancellor's view that, to deny a company in liquidation an establishment on the basis that it has the standard attributes of a company in liquidation, would seriously limit the intended purpose of secondary proceedings.

> "It was argued and rejected by the court that, as OA was in wind-down, it conducted only internal and non-transitory operations and could not therefore be shown to have an establishment."

The court determined that the activities of OA needed to be outward facing to allow the establishment to be ascertainable by third parties on objective factors. However, it held that these factors were fulfilled in this case as it was possible for members of the public to contact the two OA managers by visiting the office, calling the telephone number or writing a letter to 11 Conduit Street, notwithstanding the removal of the OA signage at the premises.

This led to the conclusion that it was sufficient for the purposes of economic activity that two managers were employed and that those managers carried out activities of a more internal nature.

For these reasons the winding-up order was granted.

Comment

This decision is subject to an outstanding request for permission to appeal and for this reason the authors have refrained at this stage from providing detailed comment.

Suffice to say that, for so long as the operations of most significant groups remain multi-jurisdictional, and for so long as many defined benefit pension schemes remain in deficit, this issue will remain relevant for sponsoring employers that are in distress or facing insolvency and for the trustees of their defined benefit pension schemes. ◻

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Balancing creditors' and debtors' interests in personal bankruptcy

Ron Cheriyan explains how the Human Rights Act has influenced case law in bankruptcy and encouraged trustees to realise debtors' properties more speedily.

Human rights and insolvency are not natural bedfellows. However, when it comes to dealing with the family home, the two spheres of law often collide with significant force. Insolvency practitioners need to be especially careful when handling such cases as it is often the most valuable asset in a bankrupt's estate. The task of balancing creditors' interests against debtors' needs has not always been easy, particularly given the constant pressure from creditors to satisfy debts.

Legal framework

The Insolvency Act 1986 (the Insolvency Act) permits a bankrupt and his or her family to remain in the family home for 12 months, following the appointment of the trustee in bankruptcy under section 306 of the Insolvency Act.[1] The court presumes that, during the first year of the bankruptcy, the bankrupt's needs are more significant compared with the interests of their creditors. However, after the first year of the bankruptcy, the creditors' interests take precedence and the court will only refuse an order for sale in 'exceptional circumstances'.

Section 335A of the Insolvency Act[2] gives trustees the power to apply to court for an order for the sale of the family home. The trustee must apply to the court that has jurisdiction over the bankruptcy. When deciding on whether to make an order for sale, the court must take account of the following five factors:

1) The interests of the bankrupt's creditors;
2) Conduct of the spouse or former spouse contributing to bankrupt;
3) The needs and financial resources of the spouse or former spouse;
4) The needs of any children; and
5) All the circumstances of the case other than the needs of the bankrupt.

Section 335A(3) of the Insolvency Act states that the interest of the bankrupt's creditors outweigh all other considerations unless the circumstances of the case are exceptional. Section 336[3] applies to spouses that have rights of occupation under part IV of the Family Law Act 1996. Section 337[4] concerns the occupation rights of bankrupts themselves.

Exceptional circumstances

So what then constitutes 'exceptional circumstances'? As there is no definitive guidance within the Insolvency Act, the Trusts of Law or Appointment of Trustees Act, it has been left to emerging case law to provide the (often unclear) answer.

Prior to the adoption of the Human Rights Act (HRA) 1998,[5] the courts generally gave greater weight to the interests of creditors, compared with the needs of debtors. This approach was seen

> "During the first year of the bankruptcy, the bankrupt's needs are more significant compared with the interests of their creditors. However, after [that] the creditors' interests take precedence and the court will only refuse an order for sale in 'exceptional circumstances'."

quite clearly in *Re Citro (Bankrupts)*[6] in 1991, where Lord Justice Nourse held that the distress of an evicted family did not constitute exceptional circumstances. In practice, this meant that, unless the personal situation of the debtor or joint owner was severe, an order for sale would ordinarily be made. However, since the advent of the HRA, trustees have faced a plethora of human rights arguments when applying for orders for sale.

The Human Rights Act

While conducting their public functions, trustees in bankruptcy are considered to be 'public authorities' for the purposes of the HRA. Furthermore, under section 6 of the HRA, domestic legislation must be reviewed and implemented in a manner that is consistent with the European Convention on Human Rights (the Convention). The key provisions that come into play are articles 6[7] and 8[8] of schedule 1 of the Convention and article 1of the First Protocol to the Convention.[9]

Barca v. *Mears*: broadening 'exceptional circumstances'?

In *Barca* v. *Mears*,[10] the court was forced to grapple with an order for sale and its potential effect on the right set out in article 8. The judge suggested a broader interpretation of exceptional circumstances, thereby permitting courts to find that needs of the family could outweigh the interests of creditors, even when considering the usual outcomes of bankruptcy.

This interpretation of exceptional circumstances was later followed in the case of *Foenander* v. *Allan*.[11] Here, the bankrupt and his brother had made an insurance claim on a property, which they both owned. There was significant subsidence within the property and the brothers were waiting to hear from the insurance company in regard to cover. Meanwhile, the trustee had applied for an order for sale and Nicholas Strauss QC had to weigh up the detriment to the brothers (if the order was made) against the deferment in the creditors obtaining their funds.

Signs that the insurance company might finance the repairs would make a significant impact on the brothers' economic wellbeing and this was considered to be an exceptional circumstance. Therefore, the order for sale could be altered to permit the sale to go ahead and the brothers to request an additional stay.

However, in *Avis* v. *Turner & Anor*,[12] the Court of Appeal found that the trustee in bankruptcy was permitted to apply for an order for sale, irrespective of previous agreements that were made within the divorce settlement. The interests of creditors took precedence in the absence of exceptional circumstances.

Rooney and Paulson: shifting the goalposts?

The Northern Ireland case of *Official Receiver for Northern Ireland* v. *Rooney; same* v. *Paulson*[13] involved the possession and sale of the matrimonial homes of two families. In both situations, the husband was made bankrupt in 1990.

Waiting for 12 years before deciding on whether to claim the properties did not constitute a reasonable time for the purposes of article 6. The Official Receiver's inertia in taking the properties also constituted a breach of article 8, in light of the defendants' efforts to improve their respective values. In particular, Mr Paulson had specially adapted the property to fit the requirements of his disabled daughter.

Use it or lose it

Since 1 April 2004, trustees in bankruptcy have been restricted by the so-called 'use it or lose it provisions', contained within

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section 283A[14] of the Insolvency Act. If the trustee has not sold the property (or obtained an order for sale) within three years from the date of bankruptcy order, the beneficial interest must be returned to the bankrupt. However, the property must be the main residence of the bankrupt, the bankrupt's spouse or civil partner, or the bankrupt's former spouse or former civil partner.

The introduction of 'use it or lose it' has dealt conclusively with issues relating to delays by trustees in selling a bankrupt's property. Insolvency practitioners who fail to act within the three-year deadline are barred from realising a bankrupt's beneficial interest. Therefore, the decisions in *Rooney* and *Paulson* may not have as much practical significance, at least in regard to proceedings that are issued after 1 April 2007.

Possession orders and *Pinnock*

In *Manchester City Council* v. *Pinnock*,[15] the Supreme Court held that individuals facing eviction from their dwelling had a right to have the proportionality of the decision (to evict them) reviewed by a court. However, the court stressed that the ruling was only concerned with public authority landlords in possession claims.

While the ruling was concerned with possession orders and is not directly applicable to orders for sale, it nevertheless represents a sea change in the manner in which the courts now view debtors' occupancy rights. This means it is vital that trustees are properly armed to deal with human rights defences, particularly in relation to article 8.

The influence of the HRA

Since its adoption, the HRA has been used regularly by bankrupts as a defence to claims for possession and sale of their properties, gradually eroding the historic supremacy of creditors' rights. Evolving case law has helped to broaden the interpretation of exceptional circumstances, thereby permitting debtors' needs to outweigh creditors' interests, even when considering the usual outcomes of bankruptcy. Trustees in bankruptcy can no longer rely on judges to simply rubber stamp applications for orders for sale.

In many respects, the use it or lose it provisions have tackled procrastination by trustees in realising debtors' properties. Nevertheless, IPs cannot ignore the pervasive influence of the HRA on cases concerning orders for sale. As pressure from creditors continues to mount, trustees should ensure that the human rights implications of their actions are not overlooked. ◻

1 S306 Insolvency Act 1986
2 S335A Insolvency Act 1986
3 S336 Insolvency Act 1986
4 S337 Insolvency Act 1986
5 S6 of The Human Rights Act 1998
6 *Re Citro (Bankrupts)* [1991] Ch 142, CA
7 A6(1) to Schedule 1 of the Convention states that '*In the determination of his civil rights and obligations or of any criminal charge against him, everyone is entitled to a fair and public hearing within a reasonable time by an independent and impartial tribunal established by law. Judgement shall be pronounced publicly but the press and public may be excluded from all or part of the trial in the interest of morals, public order or national security in a democratic society, where the interests of juveniles or the protection of the private life of the parties so require, or the extent strictly necessary in the opinion of the court in special circumstances where publicity would prejudice the interests of justice*'.
8 A8 (1) to Schedule 1 of the Convention states that *'Everyone has the right to respect for his private and family life, his home and his correspondence.'*
9 A1 of the First Protocol to the Convention states that: *'Every natural or legal person is entitled to the peaceful enjoyment of his possessions and no one shall be deprived of his possessions except in the public interest and subject to the conditions provided by the law and by the general principles of international law.'*
10 *Barca* v. *Mears* [2004] EWHC 2170
11 *Foenander* v. *Allan* [2006] EWHC 2101 (Ch)
12 *Avis* v. *Turner* [2007] EWCA Civ 748
13 *Official Receiver for Northern Ireland* v. *Rooney; same* v. *Paulson* [2008] NI Ch 22
14 S283A of the Insolvency Act 1986

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The football creditor rule and unsecured creditors

Steven Fennell argues that legislation should be enacted to require a football club with unsustainable costs to pay a deposit.

Thirty-six football clubs in the English Football League have gone into a formal insolvency procedure in the last ten years, in addition to a number of Scottish clubs. To date, no English Premier League club has gone into an insolvency procedure.

The 'football creditor' rule ensures that if a member of the Football League goes into an insolvency procedure, creditors associated with the business of football, such as other clubs, players, managers and the league itself, are paid in full in priority to any other creditors. The principal objections were summarised at paragraph 107 of the 2011 Report of the Culture, Media and Sport select committee:[1]

> *'The FA, Leagues and clubs all appeared defensive and uncomfortable about the Football Creditors Rule. They are right to be. The moral argument against it – that it harms the communities that football is supposed to serve – is persuasive on its own. There is, though, also a compelling systemic argument against it, namely that it positively encourages excessive financial risk-taking, in a system that already offers other inducements to so do, by offering a safety net to those who seek to benefit from such practices. The Football Creditors Rule should be abolished ... If the football authorities do not take the initiative themselves, and Her Majesty's Revenue and Customs loses its legal challenge to the Football Creditors Rule, we recommend that the Government consider introducing legislation to abolish it.'*

How the football creditor rule works

The Football League is a company limited by shares, and each member club holds a single share. When a club is promoted or relegated, it must transfer the share for a nominal payment. The League's articles of association allow the League's Board to require a club to transfer its share if it is subject to an 'insolvency event', but a transfer notice can be issued, suspended and then withdrawn if the football creditors are paid in full.

Without its share, the club's business has no value. It cannot play in the League; player registrations are terminated, so it cannot raise money by selling players; and it is not entitled to any further revenue for broadcasting rights, as payments are conditional on the club completing its fixtures for the season. Any balance due to the club becomes payable by the League to the football creditors.

The League's insolvency policy has three aims.

1) The survival of the club or a successor, and in particular completion of the current season.
2) The payment of the football creditors in full.
3) *'Protecting the interests of other creditors, giving them the opportunity to determine their own financial settlement'* by requiring their approval of a CVA or scheme of arrangement. The result is usually that the football creditors are paid in full, and unsecured creditors get a very low dividend, frequently from a lump-sum payment made by the purchaser of the business.

Why the courts have upheld the football creditor rule

HMRC expects CVAs to treat creditors in the same class equally, although it has been prepared on a case-by-case basis to consider the validity of CVAs that propose payments to key suppliers.

The first reported challenge by HMRC came before the abolition of Crown preference, in *Inland Revenue* v. *Wimbledon Football Club Limited*,[2] where football creditors were paid in full while the Crown's preferential debt was not. The challenge failed on the basis that all the money was coming from third party funds and not from the company's assets, so the priority of preferential creditors was not infringed.

“One ground where a challenge might succeed could be the loss of claims, which could be brought by a liquidator.”

The CVA in relation to Portsmouth City was challenged in 2010.[3] HMRC's most significant argument[4] was that it was unfairly prejudicial to vote through a CVA using the votes of the football creditors who would be paid in full, while a majority of other creditors voted against. The challenge was rejected, again on the basis that the football creditors were being paid outside the CVA (so the company's assets were not being used to make payments outside the statutory priorities), and the football creditors were still creditors who had an interest in the approval of the CVA, and were therefore entitled to vote.

In *Portsmouth City*, Mann J referred to HMRC's general opposition, and commented that this application was not the place for the court to tackle the potentially difficult area of the validity of the football creditor rules.[5] Judgment in an application to question the rule itself was given on 25 May 2012 by David Richards J.[6]

HMRC based its case on two principles: the anti-deprivation rule and the *pari passu* principle. Its arguments were rejected for the following reasons.

- The *pari passu* principle only applies where a distribution is being made to creditors, so in an administration that is when the administrator proposes to make a distribution. As administrators of football clubs rarely make distributions (because the exit is via a CVA), the principle is not relevant.
- The anti-deprivation rule applies to administrations and liquidations, but the League's articles and insolvency policy in relation to broadcasting revenue do not contravene it: the club is not deprived of an asset, since its right to payment is conditional upon completing the season.
- The League's power to require the transfer of the share is not a breach of the anti-deprivation rule. Other members of the League can refuse to play against insolvent clubs other than on their own terms, and the League's articles and insolvency policy represented the exercise of this right.

Implications of the decision

At first sight, the decision is consistent with established law and practice. In general, creditors do not have to continue to do business with an insolvent company, and can impose any conditions they choose.

A commercial decision by the members of the League that clubs should not be able to gain an unfair advantage by living beyond their means, or by defaulting on obligations to other members of the League, was found to be a decision made for commercial reasons, and the leading authority on the anti-deprivation principle states that it does not apply to a *bona fide* commercial transaction that does not have the purpose of depriving one of the parties of its property on insolvency.[7]

The court seems to have attached little importance to the point that there is a difference between debts owed to other clubs, and debts owed to players and managers.

David Richards J stated in the final paragraph of his judgment that *'The [League] should not regard the result of this case as an endorsement of its approach to football creditors. It is, as I said at the start, a decision on a challenge brought on a particular legal basis.'* He also rejected the League's argument that simply obtaining the necessary majority for a CVA was itself a justification for the differing treatment of football creditors and other creditors.

One ground where a challenge might succeed could be the loss of claims, which could be brought by a liquidator. For example, only a liquidator can bring a claim for fraudulent or wrongful trading under sections 213 and 214 of the Insolvency Act 1986. If there are grounds on which a liquidator could investigate wrongful trading, voting a CVA through with the votes of the football creditors might amount to unfair prejudice. This is relevant to all CVAs, but as so many football clubs have no realistic prospect of trading at a profit, there could well be future cases in which a liquidator might have grounds to bring a wrongful trading claim.

Concentrating on the football creditor rule risks losing sight of the wider problem, namely the lack of control of costs and the risk this creates for creditors. Financial support from owners appears to be the only reason why there have not been more insolvencies. According to the Deloitte Sports Business Group Annual Review for 2012, only four Championship clubs made an operating profit in 2010 to 2011, with Championship clubs as a whole recording an aggregate net operating loss of £130 million. Wages amounted to £381 million and the wages/revenue ratio was around 90 per cent. Around a third of clubs have wage bills in excess of their revenues and are reliant on owner funding. The 'financial fair play' regulations that are due to be introduced may mitigate this problem.[8]

HMRC already has the power to require security deposits to be paid in relation to VAT, PAYE and NIC, and its stated policy is to seek security only in the most serious cases of revenue risk, and to do so reasonably and proportionately. Factors that lead to security being required include phoenixism, habitual late payment, and suspected tax fraud. Is there any reason why the legislation and guidance should not be extended to require a football club with unsustainable costs to pay a deposit, rather than expect the Crown to take the risk that the owner will continue to support it?

“Concentrating on the football creditor rule risks losing sight of the wider problem, namely the lack of control of costs and the risk this creates for creditors.”

1. Culture, Media and Sport Committee – Seventh Report, Football Governance, published 19 July 2011, para 107
2. [2004] EWCA Civ 655
3. *Re Portsmouth City Football Club Limited (in administration)* [2010] EWHC 2013 (Ch)
4. It also raised case-specific points about a potential section 127 claim and the calculation of its own debt
5. [2010] EWHC 2013 (Ch) at para 43
6. *The Commissioners for Her Majesty's Revenue and Customs* v. *The Football League Limited and the Football Association Premier League Limited* [2012] EWHC 1372 (Ch); the Premier League has a similar insolvency policy and participated in the hearing
7. *Belmont Park Investments PTY Limited (Respondent)* v. *BNY Corporate Trustee Services Limited and Lehman Brothers Special Financing Inc (Appellant)* [2011] UKSC 38
8. The Football League published a statement on its website on 25 May 2012 saying that 'financial fair play' in the Championship will require clubs to stay within pre-defined limits on losses and shareholder equity investment that will reduce significantly over the next five seasons, and in Leagues 1 and 2 spending on total player wages will be limited to a proportion of turnover.

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'Stalking horse' agreements and administrations: part of the solution?

A US practice could offer a way of preserving value in a company.

Whither the pre-pack?

After two years of consultation, the government recently announced that it will not be introducing any new legislative controls on pre-pack administrations. While we can expect, therefore, that arguments will continue as to whether pre-packs are a good or bad thing, one thing is sure: that the practice will continue.

Much of the adverse commentary on pre-packs came, and continues to come, from unsecured creditors. Their arguments centre on the perceived lack of transparency of pre-packs and the lack of accountability of liquidators/administrators who can enter into pre-pack agreements without the sanction of creditors or the court. The core allegation, of course, is that rather than preserving value, they do not achieve the best available price due to the limited marketing process that is undertaken. The concept of 'phoenix' companies still causes consternation and those pre-packs where the business is sold back to the original owners or management come in for most criticism.

Of course, there are two sides to every argument and proponents of pre-packs rightly say that in some circumstances a quick transfer of the business can preserve value and prevent erosion of confidence. They can often preserve more jobs than the normal administration process. Equally, pre-packs are often unfairly criticised. In many cases, it is not possible to trade in administration and thus the choice is a pre-pack or liquidation. Thus creditors criticise the pre-pack when it is the underlying inability of the company to trade in administration that is the real cause of the problem.

Statement of Insolvency Practice 16 (SIP 16) has gone someway to assuaging concerns on lack of transparency and while failure to comply with its requirements can result in disciplinary action for the insolvency practitioner concerned, it is not legally binding. Creditor action remains by far the exception rather than the rule although when creditors do act it makes the headlines.

Notwithstanding the extensive consultation undertaken, no clear answer to the 'dilemma' has sprung forth, and this is not really surprising. It is probably not a matter for government in any event. The law as it currently stands affords disgruntled parties proper avenues of attack if they are so minded and SIP 16 keeps insolvency practitioners on their toes.

Valuations are the usual defence to an attack from creditors and much has been written on the subject.[1] The use of 'anti-embarrassment clauses' is another device that may be used to protect administrators from allegations of a sale at an undervalue.[2]

"Stalking horse agreements are relatively common in the US in sales of assets under section 363 of the Bankruptcy Code or pursuant to a plan of reorganisation under Chapter 11."

But is there anything else that can be done to deliver the best of both worlds: the certainty of the pre-pack with the assurance and protection for the administrators of having maximised value for creditors?

Well probably not in absolute terms. There may, however, be cases where considerable pre-filing work can be undertaken and an agreement prepared for the sale of business to a party (related or unrelated) executed upon the appointment of the administrators that has the characteristics of a pre-pack without actually being one.

The 'stalking horse' in the US bankruptcy sales

Its original derivation comes from the practice of hunting game birds. Hunters noticed that the birds would fly off if approached by humans on horseback but would not do so if approached only by horses. So the hunters walked alongside their horses with their upper bodies out of sight until the birds were within firing range. Horses trained for this purpose were called 'stalking horses'.

So called stalking horse agreements are relatively common in the US in sales of assets under section 363 of the Bankruptcy Code or pursuant to a plan of reorganisation under Chapter 11. In summary, what happens is that there is an initial bidder (the stalking horse) with whom the seller (the debtor) negotiates a purchase agreement. Typically, the stalking horse is in the strongest position to actually buy the assets and it is also assisted by the deal protections it puts in place as the *quid pro quo* for acting as such.

The stalking horse will protect its position in a number of ways. Being the initial bidder, it may have to expend considerable sums on due diligence and other costs. These costs are usually subject to reimbursement although there may be a cap at some maximum amount or a percentage of the purchase price. This will be subject to scrutiny by the Bankruptcy Court where the judge will be keen to ensure that such costs are reasonable, and not an unreasonable drain on the estate of the debtor. One of the issues likely to be debated between the stalking horse and the debtor is the circumstances in which the stalking horse is entitled to receive reimbursement and when payment is actually due. The stalking horse will want to be paid as soon as the higher and better bid is accepted; the debtor will want the deal to complete before payment is made. If a deposit is paid that can cover the reimbursement, it is not uncommon for the sums to be paid from that deposit upon submission by the stalking horse of the appropriate supporting documentation.

Alternatively, the stalking horse may negotiate a break-up fee (typically) 1–3 per cent of the ultimate deal value if its bid is unsuccessful. Break-up fees are much more controversial than expense reimbursement and different bankruptcy courts have different approaches to them. They are controversial because they are unrelated to the expenses incurred and are essentially compensation to the stalking horse to induce it to be the initial bidder. In some cases, break-up fees are paid in addition to expense reimbursement but the general rule appears to be that incentives given to the stalking horse that exceed three per cent will be viewed with heightened scrutiny; break-up fees in excess of five per cent are apparently rare.

Finally, the stalking horse will seek to put constraints on the bidding procedures to entrench its position. These incentives, if overly favourable, can result in the Bankruptcy Court not approving the terms but increasingly the courts are being a lot more flexible particularly as the market for distressed finance opens up again.

Stalking horses in administrations

So does the stalking horse model work in administrations? In theory, it can although they are rarely used. The sale and purchase agreement would proceed in the usual way either with a connected party or third party. That party would become the stalking horse and its agreement would contain certain conditions.

The most important condition would be that the sale would be conditional for an agreed period of time after which certain provisions would come into play. The stalking horse would of course wish to limit the period of conditionality and this would be the key issue. It may trade off this issue with the administrators with a break-up fee and/or expense reimbursement to give it comfort that if it did not or could not match the final bid price it would receive some compensation for its efforts.

The real issue is what happens on the ground during the period of conditionality. The administrators clearly could not pass physical possession of the business to the stalking horse. Of course, if the administrators are in a position to trade during the period of conditionality then there is no issue but where they cannot the usual balancing exercise will need to be undertaken.

"The real issue is what happens on the ground during the period of conditionality."

In certain cases, therefore, the administrators can have comfort, firstly, that they have a purchaser for the business and, secondly, that they can undertake appropriate marketing of the business thus being able more clearly to demonstrate the transparency and fairness of the process whether it ends up with a higher figure or not.

Stalking horse agreements cannot be regarded as a complete solution but clearly, in certain cases, their use would be worthy of consideration. ◻

[1] A particularly interesting case where valuations are discussed in detail concerned a scheme of arrangement in *Bluebrook Limited and Others* [2009] EWHC 2114 commonly referred to as the 'IMO Car Wash' case. This shows that the issue of valuations is far from straightforward.

[2] See for example *Re Maltby Holdings Limited* v. *Spratt and Another* [2012] EWHC 4. The anti-embarrassment clause was heavily criticised by the applicant's counsel. He described it as 'mere window dressing'. It is nonetheless an effective tool in the administrators' box in the right circumstances.

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Rolling out the Red Tape Challenge

Mike Chapman explains what the government's Red Tape Challenge is and how you can get involved.

Insolvency legislation is being reviewed this summer under the government's Red Tape Challenge (RTC) initiative. This gives anyone affected by insolvency an opportunity to give their views on over 100 insolvency related regulations, with an emphasis on identifying unnecessary, overcomplicated regulation that stifles business and economic growth.

Removing the red tape

The regulations under review include insolvency legislation that sets out how insolvency procedures work – the obligations of insolvency office-holders and the disqualification regime. The only insolvency legislation excluded from the RTC is fees orders.

The RTC is part of the government's commitment to reduce the existing burden of regulation in the UK as part of its plan for growth. The programme is being spearheaded by the Cabinet Office and the Department for Business, Innovation and Skills (BIS), and draws on the views of business, civil society and the public.

> "Regulations are grouped in themes…inviting comment from interested parties as to whether the regulations should be scrapped, simplified or achieved in a less bureaucratic way."

Regulations are grouped in themes and each theme is featured for a period of five weeks on the Cabinet Office website, inviting comment from interested parties as to whether the regulations should be scrapped, simplified or achieved in a less bureaucratic way.

The RTC initiative was launched in April 2011 and 20 themes, totalling over 3,700 regulations have been featured on the RTC website so far. Overall, of the 1,500 regulations where ministers have already made decisions, the government has committed to scrap or improve over 50 per cent; these decisions will bring real benefits to business, civil society organisations and individuals.

Image credit: Semajh

Insolvency law is quite detailed and lengthy, and reflects the significant impact that an insolvency can have on individuals and business, and the extensive powers given to insolvency practitioners to deal with an insolvent's assets. The Insolvency Service has already been working to make the legislation easier to understand and use. The project to modernise and consolidate the insolvency rules, which is well underway, will replace 24 statutory instruments with one set of rules that will be easier for stakeholders to use, clarify areas of law that have been subject to judicial consideration and encourage the use of electronic communication, to help save money. Deregulatory ideas that relate to the rules and that are captured as part of the RTC, will feed into the rules project.

Consulting IPs

Business minister, Norman Lamb, said: '*We want to have a flexible and fair insolvency framework which encourages entrepreneurs and businesses to compete and grow successfully. The Red Tape Challenge is a great way for the public and firms to tell us what is a nuisance or gets in the way of doing business effectively. The feedback we receive will allow us to build on existing projects to improve the insolvency regime.*'

Engaging insolvency practitioners, business groups and debt advisors is vital to the success of the RTC initiative. In order to facilitate this, The Insolvency Service has invited Philip King, chief executive of the Institute of Credit Management, to act as the sector champion for insolvency. In this role he will represent the interests of businesses and individuals overwhelmed by their debts, who can be expected to benefit from well defined regulation while helping to forge a link between those sectors and government.

Philip King said: '*The purpose of the Red Tape Challenge is to capture creative and practical ideas for removing regulations that serve no purpose, and simplifying those that need to be retained so that they can be better understood. The ultimate goal is to deliver a system that is transparent and in which all stakeholders can have confidence but is not bound up in regulations that add confusion rather than value.*'

How it will work

Once the theme window closes on the website, The Insolvency Service will produce a set of proposals on regulatory reform for review by ministers. Regulations will be cut unless departments can justify why they are needed. Well defined and necessary regulation will be kept.

If you know of any insolvency regulations that are unnecessary, could be simplified or achieved in a non-legislative way, the RTC provides a great opportunity to have your say, and share your views with others. □

Have your say

Progress reports and insolvency regulations up for review can be viewed at: **http://www.redtapechallenge.cabinetoffice.gov.uk/home/index**.

If you would prefer to keep your comments private, send an email to redtapechallenge@cabinet-office.gsi.gov.uk.

MIKE CHAPMAN is assistant director of policy at The Insolvency Service.

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Willis

Do IPs get the press they deserve?

Reaching opinion formers, be they journalists, politicians or creditors, and explaining what IPs do is key to their understanding and beneficial to everyone in the insolvency sector. **Will Black** explains how R3 is doing this.

This year's wave of retail insolvencies has focused the media on the administration process rather than administrators' fees, with more balanced coverage on jobs saved rather than only jobs lost. So does this mean that press reporting is getting fairer or is another round of insolvency practitioner (IP) bashing just round the corner? Do we want IPs in the papers every day? How do we judge whether a press story is 'positive or negative' when IPs are often in the business of managing bad news anyway?

The lazy shorthand of describing IPs as 'corporate undertakers' is a clear example of a negative 'take' on the profession. The *Daily Telegraph* reported the OFT's announcement of a market study (not 'investigation' as incorrectly stated) into corporate insolvency with the headline 'OFT insolvency report reads last rites for rip-off administrators'. We know this was not the real conclusion of the study. Although this extreme coverage is the hallmark of only a handful of

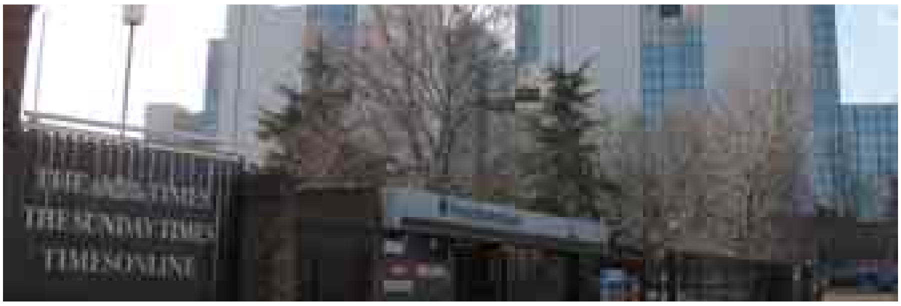
> "How do we judge whether a press story is 'positive or negative' when IPs are often in the business of managing bad news anyway?"

journalists, constant repetition has a 'drip drip' effect. The only redress is face-to-face meetings with journalists and supplying balancing comments, as we did in the OFT piece. At least reading the article in its entirety leaves the reader with a sense of what the IP is trying to do.

Do these negative articles matter?

Yes, they do. MPs and policy makers would be forgiven for thinking that 'something needs to be done' if their only source of information was negative headlines. MP expenses and more recently tax evasion are issues that started life with a dramatic headline.

Certain industry related issues portray the profession in a negative light, and will thus always be so: fees, pre-packs, regulation and importing Chapter 11 as a panacea. In terms of pre-packs, the



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coverage has polarised into a straightforward 'Punch and Judy' show. A *Times* headline in April this year was, 'Landlords say pre-packs deals are hurting pensioners', we commented in the article as well as generating two more strong pieces, 'R3 hits back at landlords' criticism of pre-pack administrations' and 'R3 refutes Insolvency Service's pre-pack figures' from *Insolvency News*.

There are issues that play out more favourably for the profession: notably director disqualifications, an issue that perfectly encapsulates the value IPs bring to the UK economy. We had another story this year in *The Times*, 'Directors are escaping bans, say insolvency practitioners' – with the aim being not to bash The Insolvency Service but to highlight a crucial, if little known, role IPs have in preventing delinquent directors starting up again.

Occasionally criticism in the media comes from practitioners themselves. One trade magazine article, authored by an IP, described other IPs as 'vampires of the recession', even though the article overall was positive about the profession. Practitioners all have strong opinions, but sometimes such opinions can be unhelpful to the profession while regulation remains a hot issue.

Promoting the alternative view

To counter this we have tried to build the profile of the R3 president and council members. Former president Frances Coulson was profiled by *The Times* 'At Leisure' in January this year – explaining what motivated her and her desire to recover money that had ended up in the wrong hands. Lee Manning, the current president, is a retail expert, and so is scoring upbeat headlines by focusing on the jobs saved rather than lost, such as 'High street jobs survive flurry of failures' from *The Times*. He has just been profiled by the ICAEW's *Economia* magazine for an autumn feature.

So what does the future hold? The Insolvency Service's case against the former directors of *Farepak* has collapsed, which can only stir up bad feeling. On a more positive note, R3 continues to debate the issue of payday loans – why there is a need for them in the first place, and whether providers should be regulated.

> "There are issues that play out more favourably for the profession: notably director disqualifications, an issue that perfectly encapsulates the value IPs bring to the UK economy."

Some of you will no doubt still be thinking 'what's the point of talking to the press' – but the profession is only as good as the last headline in some eyes. We have a new Insolvency Minister who will be influenced by many factors, including coverage of the profession. It is crucial we explain what IPs do, and not assume people know already. Sure, we need be realistic about the media – journalists will always need a supply of villains to fill their pages, but the vast majority of newspaper readers will understand what we do – if they are told.

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Commission payments

Andrew Turner reminds smaller practices of the prohibition contained in the Joint Ethical Code regarding the payment of commission for the introduction of work.

We had a lively discussion at a recent Smaller Practices Group committee meeting after a member of the SPG community had raised the issue of commission payments for the introduction of insolvency work, which they indicated had become prevalent in their region. It was evident from the discussion that this did not appear to be an isolated case and was certainly a cause for concern amongst the committee members.

The payment of commissions of any sort for the introduction of insolvency work is, of course, specifically prohibited under the Joint Ethical Code adopted by each of the RPBs (for instance, see the ICAEW Code of Ethics at 400.63 or paragraph 63 of the IPA's Ethics Code). This specific prohibition was no doubt introduced in order to avoid the commoditisation of advice in this specialist area and to protect those vulnerable businesses and individuals seeking professional advice from being directed to whoever was prepared to pay the most for the introduction, rather than to the most appropriate and capable practitioner for dealing with their case.

> "Where such payments are reviewed by their regulator and are found to be unsubstantiated…IPs could be found guilty of a breach of section 400.53 or their regulator could conclude that the payments are effectively a commission for the introduction of the work."

Third-party payments

It is of course necessary to draw a distinction between payments to employees of the practitioner and those to a third party. There is a specific exception, with commission payments to employees being acceptable, but any commission payments of any nature whatsoever to a third party are specifically prohibited under the ethical code.

In some instances, the practitioner will try to 'dress up' the payment of commission to an introducer, for example, in a creditors

voluntary liquidation, via a fee for work in producing information for presentation at the section 98 meeting of creditors. Practitioners should be reminded of the provisions of the Joint Ethical Code (ICAEW at section 400.53 and IPA at paragraph 53) that where they intend to rely on the advice or work of another, they need to evaluate whether reliance on their work is warranted and be able to demonstrate that any payment to the third party reflects the value of the work undertaken.

Insolvency practitioners who make payments without having considered whether reliance can be placed on the quality of the third party's work or that the amount paid is reflective of the value of the work undertaken, do so at their peril. Where such payments are reviewed by their regulator and are found to be unsubstantiated, at best IPs could be found guilty of a breach of section 400.53 (or its equivalent) or, alternatively, their regulator could conclude that the payments are effectively a commission for the introduction of the work.

Complying with the Joint Ethical Code

In seeking to gain new assignments, we always have to ensure that the desire and need to gain fee-generating work is not at the expense of complying with the Joint Ethical Code. I have no doubt that, putting aside the issue of payments of commission, creditors and other stakeholders could perceive there to be a threat to the objectivity of a practitioner where there is a reliance on the same third party for the introduction of a significant number of new appointments.

We debated at our committee meeting whether there should be a review and amendment to the Joint Ethical Code to remove the prohibition on the payment of commissions as, after all, we do live in a free market economy. While the debate was lively, the consensus was that this would not be appropriate in view of the points noted above and the notion that somebody in the process would have to cover the payments made by the IP and that would more than likely be the creditors. It was with some comfort that we learned later that dropping the commission prohibition was considered and dismissed by the Joint Ethical Code drafting committee after the first consultation phase.

My personal view is that if we are to level out the playing field and ensure that those in need of our expertise are best serviced, it is incumbent upon those of us that are playing by the rules to bring any evidence of suspected commission payments by an IP to the attention of their RPB for investigation. There may be a perception that even if brought to their attention, such matters may not be investigated, but I am aware of a recent case where the RPB established that commission payments had been made for the introduction of work. The IP in that case was reprimanded, fined and ordered to pay costs. The more reports the RPBs receive, the more likely they are to conclude that there is no smoke without fire! □

ANDREW TURNER is a partner at Lovewell Blake LLP and a member of R3's SPG committee.

COMING IN THE AUTUMN

12–13 September
Lite Conference
Chesford Grange, Warwick

4–5 October
SPG Forum
Hilton Metropole (NEC), Birmingham

SAVE THE DATE

24–26 April 2013
R3 Annual Conference,
Hotel Martinez, Cannes

R3 events, courses and conferences

Month	Date	Event	Venue
September	4	Introductory Programme – Liquidations 1	Prospero House, London
	4	Introductory Programme – Liquidations 1	Irwin Mitchell Solicitors, Leeds
	4	South West & Wales Regional Meeting	Aztec Hotel & Spa, Bristol
	5	Introductory Programme – Liquidations 1	Deloitte LLP, Birmingham
	6	JIEB Student Workshop 1	Baker Tilly LLP, London
	7	JIEB Student Workshop 2	Baker Tilly LLP, London
	10	Eastern Regional Meeting	
	12–13	Lite Conference	Chesford Grange, Warwick
	18	Yorkshire Women's Group Event	RSM Tenon, Leeds
	20	North West Women's Group Afternoon Tea	Midland Hotel, Manchester
	20	Personal Insolvency	The Thistle, Bristol
	24	JIEB Student Workshop 3	Lawrence Graham LLP, London
	25	JIEB Student Workshop 4	Lawrence Graham LLP, London
	25	Case Management	Strand Palace, London
	27	Property Insolvency	Life Conferencing, Newcastle
	27	Construction Insolvency	Life Conferencing, Newcastle
	27	Midlands Regional Meeting & AGM	
	27	Yorkshire Regional Meeting	Crowne Plaza, Leeds
October	4–5	SPG Forum	Hilton Metropole NEC, Birmingham
	9	Introductory Programme – Liquidations 2	Prospero House, London
	9	Introductory Programme – Liquidations 2	Irwin Mitchell Solicitors, Leeds
	10	Introductory Programme – Liquidations 2	Deloitte LLP, Birmingham
	11	Southern Women's Group Black Tie Dinner	Grand Café, Southampton
	23	Personal Insolvency	Hilton Tower Bridge, London
	23	Restructuring Day	The Met, Leeds
	25	Asset Recovery	Holiday Inn Bloomsbury, London
November	2	London & South East Ladies Lunch	Park Plaza, Westminster
	6	Introductory Programme – Liquidations 3	Prospero House, London
	6	Introductory Programme – Liquidations 3	Irwin Mitchell Solicitors, Leeds
	6	South West & Wales Regional Meeting	Aztec Hotel & Spa, Bristol
	7	Introductory Programme – Liquidations 3	Deloitte LLP, Birmingham
	8	Property Insolvency	Holiday Inn Bloomsbury, London
	8	Construction Insolvency	Holiday Inn Bloomsbury, London
	13	Case Management	Crowne Plaza, Birmingham
	14	Midlands Quiz Night	Villa Park, Birmingham
	15	Personal Insolvency	Cedar Court, Huddersfield
	20	Restructuring Day	Strand Palace, London
	22	Asset Recovery	The Midland, Manchester
	29	Property Insolvency	Park Hotel, Cheltenham
	29	Construction Insolvency	Park Hotel, Cheltenham
	29	Yorkshire Women's Group Wine Tasting Event	

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 full 2012 programme. Alternatively, call the Courses team on 020 7566 4234 to request a programme by post.

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We continually strive to improve benefits for all members. Membership benefits across categories include:

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- An invitation to the R3 annual conference
- Continuing professional education at discounted rates

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Full members are invited to contribute to the development of insolvency, business recovery and turnaround professions at both local and national levels.

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Associate members are individuals who do not meet the requirements for full membership but work significantly within the business recovery sector.

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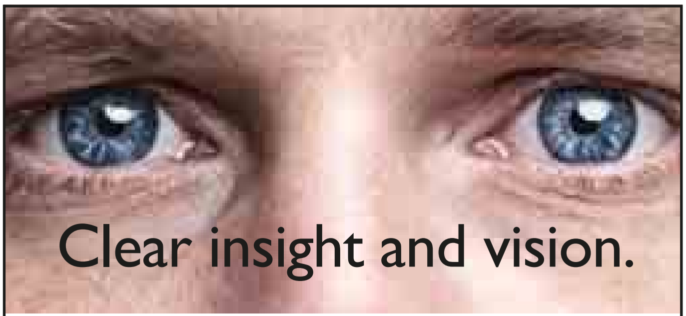
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Interview with…

Richard Law

Richard Law talks to Kevin Murphy about his 34 years as a creditors' service manager.

How did you get into insolvency?

I did articles with Thornton Baker in Coventry and soon realised that insolvency work was more commercial and interesting than auditing. In 1978 I joined the Insolvency Department of the Birmingham office of Deloitte & Co and stayed with the firm (now PwC) until retirement in March this year.

What was it like before the Insolvency Act 1986?

Quite competitive and fun. For a start there were not so many people taking on insolvency appointments and the insolvency community was relatively small. Up until the introduction of the Insolvency Act 1986, to win a liquidation from the floor you needed a majority in both number and value of votes cast. This voting procedure certainly encouraged all those taking insolvency appointments to market to unsecured creditors. The building of all these relationships was great fun and very social!

Anything else about life pre-1986?

Anyone could act as a liquidator. I remember a bus conductor taking liquidation appointments who did not properly account for asset realisations or EPA monies. There were a few undesirables taking appointments whom we closely monitored.

In your experience, how do unsecured creditors now view the insolvency profession?

Not very well to be frank. I think there is a small but growing number of IPs from a cross-section of big, medium and small firms, who do a poor job and have little respect for the unsecured creditors. This affects creditors' perception of the whole of the profession. Creditors consider that too many IPs are at best disinterested in unsecured creditors and their losses. They perceive very poor communication skills generally, and an obstructive attitude in dealing with ROT issues. Also there is quite strong feeling that many IPs present reports that are too often 'tick box' exercises, providing the bare minimum to comply with the regulations.

Were things better in the 'old' days?

When I started out, creditors were certainly treated with more respect, as were their professional representatives. I think that many IPs now focus on relationships with the secured lenders, and believe unsecured creditors are less important in terms of generating work. While court

work practitioners do value creditor votes, I believe this sector is interested more in obtaining creditor votes for a particular case job than in providing a full client service for all insolvency meetings. I also think that this court work approach is creeping into garnering votes for other insolvency procedures, which can be irritating to creditors whom, I believe, prefer IPs to provide a full creditors' market service, taking the rough with the smooth.

Were creditor meetings better in the old days?

Absolutely! For a start there were more professional creditor representatives to keep things lively. A number of the meetings' professionals were very adept at directing the outcome of a meeting, very skilful folk. The theatre was sometimes quite marvellous. In those days, the members' nominated liquidator would usually have a good knowledge of the workings of the company and certain records, such as bank statements, were available to the creditors meeting. Nowadays, I often see IPs who are ill prepared. They have little knowledge of the background of the case and the financial information provided to creditors is limited and poor. These days, how often do IPs dress-rehearse a meeting beforehand to ensure all creditors' questions can be answered fully? Not often. Some practitioners will say there is little point in detailed preparation, since creditors rarely attend. Funnily, the meeting fee charged is always on average £5,000 to £7,500, regardless of what is produced!

But on a positive note, I see a small number of IPs who consistently produce a good product for creditors.

What can be done to improve the perception of IPs with creditors?

Well, remember that unsecured creditors rarely receive a dividend and yet it is they who ultimately pay for the process. It would be much better if IPs showed more respect to creditors, communicated better and provided value for their money.

Are there any Rules you would change in relation to meetings if you could?

I can think of a couple quite readily. Now that the majority of cases (and certainly the larger ones) start out as administrations, I think it is quite inequitable that the administrator does not need to convene a creditors' meeting in certain circumstances. And the Rule that creditors owed in excess of ten per cent of the amount owed to unsecured creditors may request a meeting and then have to pay for the costs of holding the meeting is disgraceful. I think a meeting should always be convened to let creditors have their say. Also, I would encourage creditors to attend all meetings, or be professionally represented, and state their concerns.

The other Rules I would change relate to the convening of creditors' meetings and the requirements of lodging proofs and proxies prior to the meeting. The current Rules seem confusing to some IPs and I would suggest a standard requirement for all insolvency procedures.

Do you recall any memorable creditors meetings?

I do remember a particular S98 at which the director was rather facetious towards the creditors and their losses, and particularly towards one creditor – who then got fed up with the director, walked to the top table, delivered a right hook on the director, turned to the IP and said to cross him off the list of creditors as he now considers himself to have been paid in full!

There have been lots of amusing events at meetings over the years – angry creditors, former wives venting their anger from the floor, surprising outcomes using an S375 power of attorney. Also directors' reasons for the failure of their company have in some cases been rather amusing, including the fact that Christmas came at the wrong time of year!

All in all a good time over the last 34 years. □

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