

RECOVERY

Personal debt

**Personal debt is still rising:
how can IPs help those in trouble?**

Personal insolvency – does it pay?

The pros and cons of
available debt solutions

Overview of personal insolvency

The IS is reviewing personal
debt options

Bankruptcy tourism

Why is this happening?

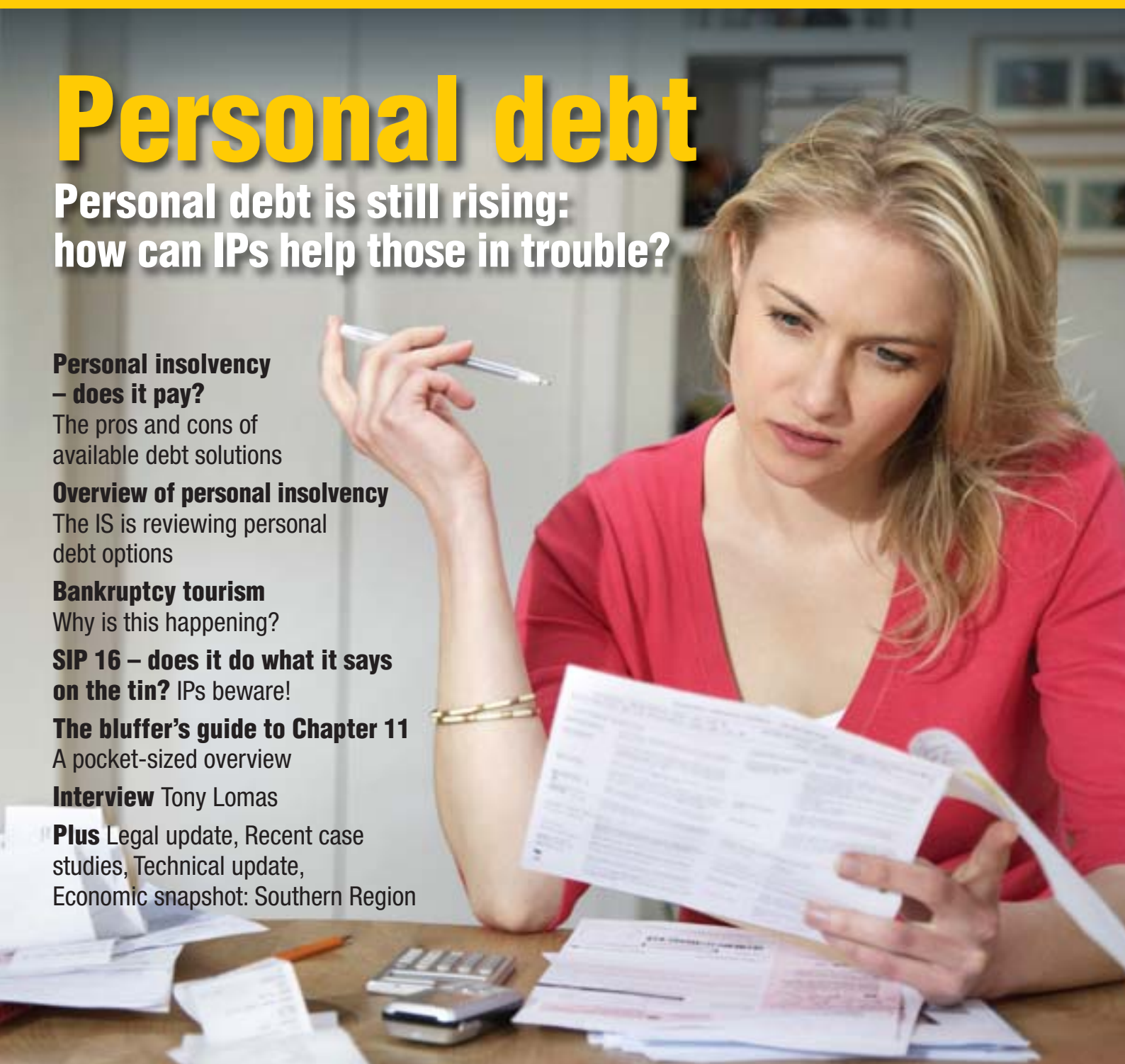
SIP 16 – does it do what it says on the tin? IPs beware!

The bluffer's guide to Chapter 11

A pocket-sized overview

Interview Tony Lomas

Plus Legal update, Recent case
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Editorial

Pre-packs continue to be misunderstood by creditors and commentators, and IPs who undertake them remain in the regulatory spotlight.

The profession suffers from the popular misconception that pre-packs cause loss to creditors. It is, of course, galling for creditors to see directors acquire a company's business and assets through a new vehicle, shorn of most of its liabilities, and to continue to be paid salaries and generate profits with apparent impunity. But it is the underlying insolvency that caused the creditors' loss, not the use of the pre-pack mechanism, which must have been chosen to maximise the return to creditors. As a profession we should not tire of getting that message across.

The transparency required by SIP 16 will help us, especially given the encouragement of Dear IP 42 emphasising the need for SIP 16 reports to creditors to be both comprehensive and 'within a few days of the practitioner's appointment or *upon completion of the sale*' (emphasis added). Producing a comprehensive report upon completion of the sale may appear unrealistic but The Insolvency Service points out that practitioners should be preparing for such notification from the moment the decision to execute a pre-pack is taken.

One of the issues that needs to be addressed in relation to pre-packs is the potential conflict of interest of an administrator who advises the company on negotiating a transaction prior to his appointment and then, once appointed, executes it. Such a situation is highlighted by Robert Smailes on pages 28 and 29. The clear point in such cases is the perceived conflict of interest. An IP may well be satisfied that he has acted in the best interests of creditors throughout but it may not look that way to creditors.

Perhaps it is time for a new approach to pre-packs. Why not – voluntarily in appropriate cases – have one IP undertake the pre-appointment work in relation to the sale and have an independent IP take the appointment and execute the transaction? It has worked effectively and it may be a small step to take to give creditors confidence about a particular transaction and in the profession generally.

C. Laughton



Chris Laughton is editor of **RECOVERY** and a partner at Mercer & Hole.



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Change is in the air for Debt Management Plans

Derek Oakley suggests an urgent re-examination of DMPs to ensure they are fair to the consumer and commercially viable.

Current debates about personal insolvency tell us a lot about how legislators, lenders and the public see the role of the IP. One hot topic is the Debt Management Plan (DMP), a perfect example of a non-statutory product that co-exists with statutory solutions. The future of DMPs holds lessons for anyone working in recovery.

What's it about?

The Ministry of Justice (MOJ) has issued a consultation document on the future of DMPs. The dominant personal insolvency solution, a DMP is essentially a 'time to pay' product. Consumers approach a DMP provider, who calculates what is available after reasonable living costs to service unsecured debts. The provider acts as a negotiator and then collects payments from the consumer, remitting them to creditors pro rata. Crucially, the debt must still be repaid in full. Some lenders will agree to suspend interest, some won't. Even for those who do, the suspension is unlikely to be permanent. Because a DMP is non-statutory, agreements are not binding. Lenders or debt purchasers can change their minds.

Market distribution

The market is served by free sector advisers such as Citizens Advice and by commercial firms. There are several large commercial organisations, such as my own, and more than 700 smaller providers. Larger providers tend to offer other solutions such as bankruptcy and IVA.

DMPs follow two pricing models. The 'fair share' model favoured by the 'free sector' remits the consumer's contributions to lenders without deduction, but lenders are then invoiced by the DMP provider (at a typical rate of around 10 per cent). This model credits the consumer's account with the gross receipt. There are two established debt solution providers and one new provider who operate in this way.

The pricing model used by the rest, and the majority, of the market involves deducting an amount from the consumer's contribution before remitting to lenders; fee structures here vary widely.

Why change?

There are many reasons why change is needed. Inadequate regulation is one – a

Consumer Credit Licence issued by the Office of Fair Trading (OFT) is all that's needed to administer a DMP. Indeed, most of the industry's practitioners have no professional insolvency qualifications. This means that there are widely varying standards, from excellent to dismal. Around 250,000 new DMPs are written each year, dwarfing IVAs and bankruptcies at around the 110,000 mark. The dominant product is therefore delivered by the least regulated organisations.

DMP customers are typically vulnerable and inexperienced, with no way of telling good from bad; variation in fees compounds the problem. Advice varies widely, without even an industry-wide agreement on what basis a consumer's income and expenditure should be assessed. What debt solution a consumer ends up following often depends simply on who they approach to start with, since most consumers use the first organisation they contact. If that organisation offers only DMPs, the customer will follow a DMP.

Consumer incentives are misaligned, with no clear relationship between how hard a consumer works to reduce their debt and the level of interest forgiveness achieved. Sometimes interest is even suspended initially and then re-applied if the consumer performs well – hardly an incentive.

Creditors must observe 'Treating customers fairly' regulations. There is little or no consistency in how this is applied and, therefore, the consumer suffers. Creditors need to show that their approach is not driven by a desire to defer provisioning.

Finally, market distribution is distorted. Consumer groups and government sponsor free sector advice but there are serious capacity limitations and so consumers are asked to queue. Some of them give up at that point and inertia takes over. Others try the commercial sector and, as discussed, have an experience that depends on the organisation they happen upon. Some will be lucky, many more won't, and this issue is too important to leave to luck.

It's clear that the DMP market is dysfunctional. This manifests itself in the longevity of plans, which are estimated to last only '24 months at best' (Source: *Money Advice Trust report*, 2009). The need for change could hardly be clearer.

Options under consideration

The MOJ suggests three options:

1. **Marginally enhanced regulation by the OFT.** The need for change is too great for this to deserve consideration.
2. **Industry self-regulation with voluntary codes of practice.** Is there sufficient common ground for this? Many providers do not want significant change.
3. **A new statutory solution – the Statutory DMP.** This should have been the best available option. But, as currently drafted, the legal framework prohibits a provider from making a profit. So this solution is unlikely to be embraced by the commercial sector.

There's a real danger that the consultation generates no meaningful consensus. This would represent a huge missed opportunity. I urge the MOJ to examine ways in which the legal framework can accommodate fair commercial provision. In the meantime, an opportunity exists for DMP providers, lenders and other stakeholders to create change on a voluntary basis. Here's my blueprint for what a good DMP should include:

- **Market standout** – it must be clearly the best DMP product available. The most obvious way to achieve this would be a form of automatic interest suspension.
- **Strong control on quality** – providers must consistently demonstrate the highest advice and delivery standards and be regularly inspected. Just like IPs, scheme administrators should provide a bond. A licence cost could make the regulation self-funding.
- **A standard and fair fee** – the fee needs to be sufficient to attract commercial provision. It should be operated on a fair share basis (creditor pays). Provider incentives must be aligned to the success of the DMPs delivered. □



Derek Oakley is debt solutions director at Fairpoint Group plc.

President's column

Peter Sargent gives an update on R3's events, current initiatives and consultations.

OFT 'study'

The most important news update, as mentioned in the single issue email from Graham Rumney on Thursday 12 November, is the OFT 'study' of the insolvency industry, with the emphasis on IPs' fees and the appointing process as regards the corporate sector.

I suspect few members will be surprised that Insolvency fees are in the spotlight, not least as it was a feature of the BIS Select Committee hearing in January, being covered in their report and the government's official response in spring this year.

As Steven Law said in our press release (see link below), we should welcome this opportunity to demonstrate the worth and value of our industry, as it allows us to dispel some of the myths about IPs and their work; and the value for money we deliver to the debtor and creditor communities, as well as the wider benefits to society as a whole. As we have said previously: 'IPs didn't lend it; IPs didn't spend it; IPs are there to mend it'. Ours is a highly regulated industry,



Peter Sargent (R3 president, centre front) signing the agreement with JCP. (L to R) Phil Wilson (MP for Sedgfield), Stephen Speed (CEO, Insolvency Service), Jim Knight (Minister for Employment), Ian Lucas (BIS Minister) and Sue Vespremi (Jobcentre Plus).

that the UK's system doesn't need an overhaul – just a few 'tweaks' here and there so that IPs can make the best of an already flexible and efficient system. Picking up on what our members have been telling us, I called for changes to CVAs to encourage usage and more action by the Insolvency Service on director's disqualification. I also

companies. This will help to ensure that people threatened with redundancy are offered support quickly and efficiently.

Getting great coverage and having a well attended event doesn't come easy and can be attributed to a mixture of the hard work of the communications team and also the ideas flowing from the new policy group headed by Mark Andrews. This group should boost the number of proposals we can bring to the media and parliamentarians while acting as a filter for ideas from the R3 membership to feed into.

I have taken my soapbox round to various R3 conferences both training and political, including the McSpic conference in Dunkeld, the SPG conference held near Leamington Spa, the ICAS conference at Gleneagles and a number of regional events around the country.

Bankruptcy Tourism

On page 22 of this issue of *RECOVERY* there is an article dealing with bankruptcy tourism. I am of the view that here in the UK our systems are fair and modern and allow for the rehabilitation of the honest debtors, ie they get a second chance, while the dishonest ones are roundly dealt with via a mixture of BROs and the IA legislation, which is available to a trustee to recover assets and unwind transactions.

Airing the views of R3

R3 has also submitted its views on the CVA consultations and we were pleased to see that we were quoted extensively in their summary report, which was issued on 11 November. We are also currently working on the DMP consultation document. I recently attended a round table event at BIS to discuss the protection of customer deposits. There were no firm conclusions, but those who have been charged to look into this issue now have a list of ideas to deal with the problem, including designated customer deposit accounts, insurance and personal liability for directors (if all else fails).

Talking of soapboxes, they don't come more extreme than standing on the Fourth plinth in Trafalgar Square at the end of September. This is not something I would quite frankly want to do again in a hurry – give me a room full of MPs, IPs or creditors any day! □



Peter Sargent
is a partner at
Begbies Traynor.

“I was pleased when John Penrose made points on financial literacy for the general public and educating disqualified directors that chimed in well with R3 policy.”

comprising well trained professionals. The financial accidents we arrive at, and the damage we work to repair are not of our making, but we are uniquely well placed to bring relief and, in some unavoidable cases, an end to situations that are unsustainable in a managed way. (<https://www.r3.org.uk/newsandpress/default.asp?page=1&i=4&id=327#PressStory>)

Defending the UK's insolvency system

Moving away from the OFT study, seventeen years ago former prime minister John Major climbed aboard his soapbox in the depths of a recession. I feel I have been doing much the same for R3 in the last few months! We had a solid platform at our fringe events at both the Labour and Conservative Party conferences. On each occasion we had the relevant minister (Ian Lucas MP, parliamentary under secretary of state in the Department for Business, Innovation and Skills) and shadow minister for business (John Penrose MP) on the panel plus Jonathan Guthrie of the *Financial Times*.

At both conferences, I defended the UK's insolvency system, arguing that World Bank data demonstrates that we have one of the best systems in the world. I am adamant

used the events to defend pre-packs, arguing that they can be a vital tool for protecting jobs and businesses.

The Conservative party fringe event was particularly lively and reminded me of a good old fashioned creditors meeting, with lots of difficult questions being fired at the top table! I was pleased when John Penrose made points on financial literacy for the general public and educating disqualified directors that chimed in well with R3 policy. You may have seen the *Sunday Times* and *Mail on Sunday* on 11 October, both of whom picked up on the story and my comments.

Ministers sign agreement with Jobcentre Plus

Government ministers have even come into the R3 office at 120 to sign an agreement with Jobcentre Plus to help those facing redundancy. Employment minister, Jim Knight MP; minister for the Department for Business, Innovations and Skills, Ian Lucas MP; Insolvency Service chief executive, Stephen Speed; and Sedgfield MP, Phil Wilson attended an event to mark this initiative that will develop a system to share information about possible job losses in struggling

News update

Coastal towns hardest hit for personal insolvencies

Hull was recently reported in a survey by Wilkins Kennedy as being the country's insolvency capital with 26.6 bankruptcies per 10,000 adults. Other seaside towns that have been badly hit are Plymouth with 26, Poole with 22.4 and Bournemouth with 22.1. This sorry story is taken up by Andy Beckingham on page 40. The national average is 15.7 bankruptcies per 10,000 adults.

Landlords call for retail therapy as 25,000 shops close

Figures published by the Local Data Company show that 10 per cent of retailers closed between January and September this year. From a survey of 251,462 firms across over 705 centres across the UK, 25,090 closed. In London alone, 7,628 firms shut their doors in the first nine months of the year.

The British Property Federation has called for greater government help to support retailers. The trade body has also been advocating a cut in service charge costs for businesses and urging greater transparency in business leases.

Some dodgy directors go unpunished

R3 is calling for The Insolvency Service (IS) to be allocated greater resources to pursue more cases of directors referred to them by insolvency practitioners (IPs). Last year, out of 4,752 referrals by IPs, the IS disqualified 1,252 directors, or about 26 per cent. Six years ago, 45 per cent of directors were disqualified. Peter Sargent, R3 president, maintains that this strike rate is not high enough. The trade association is also urging government and opposition to consider introducing compulsory education for disqualified directors.

Maximum bankruptcy restriction imposed

Duncan Lawrie Herd who used a series of ruses to defraud numerous people of sums totalling almost £123,000 has had a 15-year Bankruptcy Restriction Order (BRO) imposed on him, the maximum length possible.

The BRO was made against Mr Herd on 16 June 2008, and normally this would have led to a discharge 12 months later. However, the automatic discharge was suspended in March 2009 and that suspension is ongoing. Barnstaple county court imposed the BRO on him in October after an investigation by the IS found that he had engaged in elaborate deceptions to convince people into handing over sums up to £38,000.

Under the terms of the BRO Mr Herd is restricted from acting as a company director without the permission of the

court. He must also disclose his bankruptcy restriction when applying for credit of more than £500, or when seeking to do any business in a different name.

Mr Herd's last known address was in Barnstaple. His current whereabouts are unknown and it is believed he may be operating under the assumed name of David Mann. If anyone has further information about him they should get in touch with the IS.



News from INSOL Europe

Patricia Godfrey, partner at Nabarro, has succeeded to the presidency of INSOL Europe; Chris Laughton, partner at Mercer & Hole, becomes deputy president.



New policy officer for R3

Esme Harwood joins R3 as policy officer as part of the press, policy and public affairs team. Prior to this, she worked for political research agency ComRes and as a parliamentary researcher for Don Foster MP, Liberal Democrat spokesperson for culture, media and sport. She will be overseeing the production of key policy papers and is responsible for commissioning research to support R3's communication strategy. If you have any interesting policy ideas please contact her at esme.harwood@r3.org.uk.

Peter Sargent on the plinth in Trafalgar Square



Peter on the plinth

Peter Sargent, partner at Begbies Traynor and president of R3, appeared on the fourth plinth in Trafalgar Square at the end of September. He spent his hour inviting questions on debt and giving free debt advice to help people with their debt problems.

HMRC to continue TTP scheme

HMRC's 'time to pay' (TTP) scheme is aimed at helping to ease money pressures on businesses during the recession as it allows companies to delay PAYE and VAT payments. It was introduced following the November 2008 budget, and has now been extended. So far, over 177,000 requests have been approved involving more than £3 billion in taxes. HMRC says more than 90 per cent of what it expected to receive has been paid. Around 60 per cent of the arrangements cover delay periods of up to three months.

However, some of the applications have been from companies that are bordering on insolvency and some IPs have questioned whether this is putting other businesses at risk. Andy Wood, at the P&A Partnership, wants HMRC to publish a register of all businesses benefiting from the scheme to allow suppliers to decide whether they should consider trading.

In addition, if a company that has deferred tax should fail, on liquidation HMRC would only rank equally with other creditors. Yet until it files for bankruptcy, the manager is likely to use up available cash paying other creditors and suppliers to try to keep the business going. Afterwards, little would be left to pay tax owed. So it has been suggested that TTP may have turned tax into nothing more than a deeply subordinated loan.

Obituary: Ian Cuthbertson

Ian Cuthbertson, who died suddenly in October aged 58, headed the UK corporate recovery practice at the law firm Dundas & Wilson.

A former pupil of Jordanhill School in Glasgow, where he was school captain and played in the rugby team, Ian continued to hold a great affection for all sports and was a lifelong Rangers fan.

After school, Ian studied law at the University in Glasgow, graduating in 1972 and qualifying as a lawyer two years later.

He became a partner in Boyds law firm in 1978, just four years after qualifying, and from there set up Dorman Jeffrey in 1979 with business partners Brian Dorman, Alasdair Jeffrey and Ron Murray. Dorman Jeffrey launched with a strong client service ethos, working weekends and through the night if clients demanded – a new step for a Scottish law firm and a habit that would remain with Ian throughout his career.

The company soon built a reputation as the 'go-to' firm for Scottish corporate recovery, leading to its becoming associated with Arthur Andersen in 1996 followed by its merger in 1997 with Dundas & Wilson, now the largest commercial law firm in Scotland.

As part of the Andersen legal network, Ian continued to build on his reputation as the most formidable corporate recovery lawyer in Scotland.

Murdoch McKillop, a former client and now a partner in corporate recovery specialists Talbot Hughes McKillop, appointed Ian's team for the first time in 1984 for legal advice on the administration of a housebuilder in Fort William. The two men would work together on some of the UK's biggest restructurings over the next ten years, including the administration of companies in the Maxwell Private Group following the death of Robert Maxwell.

Most memorable, said Mr McKillop, was the complex administration of British International Helicopters; a deal in which the Mergers and Monopolies Commission said a non-UK buyer had to be found, and



Ian Cuthbertson was born on 8 May 1951 in Glasgow and died on 28 October 2009 in Glasgow.

the Civil Aviation Authority insisted on a sale to a British buyer.

David Gibson, a partner of Ian's at Dundas & Wilson and a colleague since 1986, also remembers that deal.

'The completion meeting was being filmed by the BBC's *Money Programme*,' he recalls. 'It went on through the night and we were negotiating right up until the last minute. Ian was standing beside the banker as he was adding the last signature and he said: "There's only one more thing I have to say, and that's... whoope!" That nicely sums him up. He was an outstanding negotiator with a very powerful intellect, and sharp business acumen. Allied to that he had an innate understanding of human nature and all its foibles, and he could be great fun.'

Colleagues and clients, both past and present, speak of a larger-than-life character whose drive, commercial understanding and absolute commitment stood him at the very top of his game.

Jim Kilcullen head of UK business credit at National Australia Bank, which owns Clydesdale Bank, worked alongside Ian for the last 20 years and in that time became a close personal friend.

When the world's financial problems started to emerge, Jim said Ian was the first person he called: 'His reputation preceded

him, he really was the leading practitioner throughout Scotland and called on throughout the UK.

'When I first joined National Australia Bank he was the first person I brought in as an adviser. When the credit crunch hit, he was the first person I picked up the phone to for advice on the bank's strategic approach to the downturn.'

Outside of the law, Ian had a passion for good food and it was this that led him to set up a restaurant group with business partner Ryan James. He co-owned Glasgow's chain of Two Fat Ladies restaurants, having bought over the Dumbarton Road restaurant in 2002 and the city centre business opened in 2005. The pair then acquired The Buttery restaurant in Argyle Street in 2007.

He was described yesterday by one former acquaintance as 'without exaggeration, the man who single-handedly created the market for insolvency work in Scotland. He was the first person to concentrate on what had been a relatively arcane discipline and build up the sector to its position today.'

A lasting legacy is the restructuring team he leaves behind in Glasgow and London at Dundas & Wilson, five times the size of its nearest competitor based in Scotland.

Over the past 20 years, that team handled some of the most complicated, high-profile and important restructuring projects ever undertaken in the UK. The long list includes Albion Automotive, Hampden Stadium and HCI Hospitals.

But when asked recently what was the one rescue he was most proud of in his career, the answer illuminated the human side of a man some of his counterparts in other firms encountered as an implacable and driven opponent: 'Helping to save 3,000 jobs at Motherwell Bridge when it was ready to go under is something I'll always look back on with pride.'

Ian is survived by his wife Sally and children Gavin, Eilidh and Erin. □

Donald Shaw, managing partner at Dundas & Wilson.

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Schemes of arrangement

As schemes of arrangement continue to hit the headlines, recent examples highlight their parameters and deliver a clear message to mezzanine creditors with no economic interest. Patricia Godfrey explains.

The autumn 2009 Legal update in *RECOVERY* focused on some of the notable changes in the way debt restructurings are being carried out. It highlighted, in particular, some of the innovative uses of tried and tested restructuring tools such as debt for equity swaps and the use of Companies Act schemes of arrangement (schemes). In demonstrating the way in which schemes could be imposed upon dissenting creditors, two high-profile cases were cited: *McCarthy & Stone plc* and *Crest Nicholson plc*. Subsequent developments in this area have reinforced the growing popularity of schemes and how progress cannot be hampered by parties with no economic interest in the situation.

Recent developments that reinforce the ground rules

The decisions in *Bluebrook Limited & Others* (otherwise known as *IMO Carwash* and *Countrywide PLC*), both concerned proposals for schemes to restructure the debts of corporate groups facing financial difficulty. In both instances, the High Court approved the use of schemes to implement the restructuring of the corporate group's debt. *IMO Carwash* demonstrates that a creditor with no genuine economic interest in the distressed company has no standing to challenge the scheme. In ascertaining whether a creditor has a genuine economic interest, the valuation of the assets of the distressed company should be based on its present market value tested on a 'going concern' basis. Furthermore, the court will not readily reject a scheme approved by the majority of participants where the scheme has complied with the relevant rules and regulations.

IMO – problems at the car wash

In *IMO Carwash*, the court was being asked to sanction three schemes in relation to the restructuring of Bluebrook Limited and its subsidiaries, IMO (UK) Limited and Spirecove Limited (the companies) who collectively operate the world's largest carwash business.

Bluebrook Limited was £313 million in debt to a consortium of senior lenders. One of the subsidiaries, Spirecove Limited, was £119 million in debt to a group of mezzanine lenders. Interest due to both the senior and mezzanine lenders had not

been paid and the boards of all three companies were concerned that the companies could not pay their debts as they fell due. Various subordination arrangements in relation to debt and security were set out in the relevant intercreditor agreement. Under the documents, the mezzanine lenders were firmly subordinated to the senior lenders. The effect of the proposed scheme involved the senior lenders writing off approximately £126 million out of the total of £313 million due to them in exchange for substantially all of the equity in a newly formed vehicle to which the assets of the companies were to be transferred. The transfer of assets to the companies was to be done by an administrator. The mezzanine lenders would not receive any repayment of the debt due to them and would be left with claims against the old companies with no assets. This was justified on the basis that the mezzanine lenders had no economic interest in the companies because the value of the companies' assets was significantly less than the value of the senior debt.

Under the terms of the intercreditor agreement the mezzanine lenders were given an important right. In the event they were not content with enforcement actions, they could compel a sale to themselves of

the directors had not breached their duties.

The case is important given the ongoing use and popularity of schemes. In considering the jurisdiction of the court to sanction a scheme against a dissenting class of stakeholders, *IMO Carwash* focused on two particular issues:

1. The appropriate method of valuation of the companies

The companies and the mezzanine lenders based their valuations on different methodologies and it was for the court to decide which was the most appropriate. The companies based their own valuation on three separate valuation methodologies.

The first was a report commissioned by PricewaterhouseCooper. The report valued the companies on a going concern basis based upon:

- an income approach, which valued the companies on a discounted cash flow (DCF) basis;
- a market approach by way of comparison with multiples for other (publicly traded) companies; and
- a leveraged buyout basis, which looked at the debt capacity to assess the level of equity investment a potential private equity purchaser would be prepared to make.

The report concluded that a purchaser

“The companies and the mezzanine lenders based their valuations on different methodologies and it was for the court to decide which was the most appropriate. The companies based their own valuation on three separate valuation methodologies.”

the rights and obligations of the senior lenders for the amount of the outstanding senior debt.

The mezzanine lenders presented a challenge to the scheme on the grounds that it was unfair. They argued there was a realistic possibility that the companies had a value that would give the mezzanine lenders a sufficient prospect of having an economic interest in the assets. They also argued that the directors of the companies had breached their obligation to extract a benefit for all creditors by just looking at the position of the senior lenders.

Mr Justice Mann had little apparent difficulty in finding that the scheme was not unfair to the mezzanine lenders and

would pay a sum not exceeding £265 million for the business.

The second valuation method involved a market testing exercise by Rothschild that produced one indicative offer of between £150–£188 million on a cash- and debt-free basis.

The third valuation involved instructing King Sturge LLP to value a number of the companies' sites. This provided a range of values between £164–£208 million on a full market-value basis. All three methodologies generated values that were well short of the senior debt figure (£313 million).

Clearly unhappy with the outcome the proposed scheme would produce, the >>

mezzanine lenders relied on an alternative report by LEK Consulting. It carried out a DCF analysis and came to the conclusion that: *'The IMO Car Wash business is extremely sound and profitable.'*

The report undertook a 'Monte Carlo simulation', which involved a repeated valuation of a discounted cash flow valuation, using random sampling of input and assumptions and then aggregating the result into a distribution of the probabilities of different valuation outcomes.

The LEK report also carried out a comparable transaction valuation using five precedent transactions as a basis for valuation, and a comparable multiples valuation using nine comparable public companies from which data were extracted and applied to figures for the companies. This analysis resulted in a valuation of the companies in excess of the value of the senior debt.

2. Had the directors breached their duties by promoting a scheme that excluded the mezzanine lenders?

As part of their challenge, the mezzanine lenders claimed that the directors of the companies were obliged to extract a benefit for the creditors of the companies. It was further claimed that actions other than the scheme were not explored and that they should have used their negotiating position to ensure some benefit for the mezzanine lenders.

IMO – Mr Justice Mann's analysis and findings

On the two key issues Mr Justice Mann found as follows:

The appropriate method of valuation

It was held that a going concern valuation was the most appropriate method. In reaching this conclusion, Mr Justice Mann stated that the evidence relied upon by the mezzanine lenders was insufficient to justify their valuation. Furthermore, he was very critical of the mezzanine lenders' Monte Carlo valuation technique, which *'seems not so much to produce a range of values, professionally assessed, but a range of possibilities'*. He went on to state that a proper approach to valuation in a case such as this requires some real world judgment as to what is likely to happen *'...rather than a range to which other ranges are applied in a series of random calculations to come up with some mechanistic probability calculation.'* In short, he concluded that the mezzanine evidence was unconvincing and not good enough to establish their case.

Mr Justice Mann found the approach used by the companies more helpful and relevant. In particular, their approach used assumptions based on professional and expert judgments, including a factor for the current level of market inactivity. He contrasted this to the more 'robotic' mezzanine approach.

On the question of valuation,

therefore, the court concluded that the Monte Carlo model failed to demonstrate that there was a realistic chance that the value of the companies was in excess of the value of the senior debt.

Did the directors breach their duty?

The court noted that under the Companies Act 2006 and the Insolvency Act 1986, where a company was insolvent the duties of directors switched from acting in the best interests of the shareholders of the company to acting in the best interests of the creditors of the company.

“In recent months, notable examples have reaffirmed the use of schemes as a highly effective restructuring tool, building on the success achieved in *McCarthy & Stone plc* and *Crest Nicholson plc*.”

In this instance, the directors of the companies had initially engaged in restructuring discussions with both the senior and mezzanine lenders. When these discussions failed the directors agreed the scheme with the senior lenders as they deemed them to be the only parties with an economic interest in the companies.

The court held that the directors did not have to uphold the rights of the mezzanine lenders in circumstances where the valuations showed that they had no economic interest. Furthermore, it was unrealistic to expect the directors to threaten to continue trading as a means of ensuring a better deal for the mezzanine lenders and, in so doing, risk personal liability for wrongful trading. In reviewing their conduct, Mr Justice Mann held that the directors were not promoting the continuation of the group business as a going concern in the interest of the senior lender and at the expense of the mezzanine lenders.

In reaching his conclusion, Mr Justice Mann confirmed the following key principles.

- A company is free to select the creditors with whom it wishes to enter into a scheme and need not include creditors whose rights are not altered by the scheme.
- It is not necessary for a company to consult with any class of creditor that is not affected, either because the creditor's rights are untouched or because they have no economic interest in the scheme.
- Creditors could still object on the grounds of unfairness if the scheme unfairly affected them in ways other than altering their strict legal rights.

Countrywide Properties plc

Although a number of the well publicised schemes involving debt for equity swaps have been proposed by the debtor, in this case a group of lenders proposed a scheme

to implement a debt for equity swap. Countrywide operates an estate agency and property service business. Acquired in 2007 it was funded by debt, including the issue of loan notes, secured over the assets of the group. The particular impact of the credit crunch and the recession on this sector called into question the ability of Countrywide to service its loan notes. The holders of the loan notes proposed a scheme with two classes of creditor, being (i) the holders of loan notes with a floating rate of return; and (ii) holders of loan notes with a fixed rate of return. Under the

scheme, the fixed-rate note holders would receive, in return, a combination of secured junior debt and 35 per cent of fresh equity, while the holders of the floating notes were set to receive five per cent of the new equity. The requisite majority of both loan note holders approved the scheme and Mr Justice Henderson noted that: *'The court should be slow to differ from the commercial judgment of creditors in a matter of this sort'*, unless there was evidence of manifest irregularity or error in the scheme. He added that creditors are *'better placed than the court to decide where their best interests lie, and where, as in the present case, they have given their overwhelming approval to the proposals, it would require a strong justification for the court to take a different view.'* Mr Justice Henderson applied the legal principles established in *Re National Bank Limited* 1966 1 WLR 819 and was satisfied that the scheme was one that *'an intelligent and honest man, and member of the class concerned and acting in respect of his interests, might reasonably approve.'* Accordingly he approved the scheme.

Schemes of arrangement – where now?

In recent months, notable examples have reaffirmed the use of schemes as a highly effective restructuring tool, building on the success achieved in *McCarthy & Stone plc* and *Crest Nicholson plc*. In terms of conclusions to be drawn, the following are suggested.

- **Valuation:** *IMO Carwash* is the first decision in which the court has applied detailed consideration to the issue of valuation. Although the question of valuation was relevant between the creditors on *My Travel*, the issue remained unresolved. Unlike in the case of *McCarthy & Stone plc* where there was no argument over valuation, Mr Justice Mann was required to apply detailed analysis in light of the different arguments put forward by both sides. The decision clarified valuation by

reference to 'going concern' based on the company's current value rather than some future, imprecise valuation method. By determining that the valuation should be on a going concern basis, as opposed to a lower liquidation or break-up basis, the decision may assist junior creditors in future restructurings where the gulf is not so significant as in *IMO Carwash*.

- **'Out of the money' creditors:** *IMO Carwash* confirms that only those creditors with a genuine economic interest in the distressed company need to be taken into account when seeking to effect a restructuring through a scheme. A break in value in the senior debt leading to the exclusion of the mezzanine lenders really does no more than apply what was intended by typical subordination provisions contained in loan and intercreditor documentation.
- **Disincentive to junior creditor to litigate?** Where an administration is involved, it is always possible for creditors to challenge the administrator if it can be established he or she has failed to achieve the best price reasonably obtainable in selling the business. Where a scheme is involved, an additional opportunity to challenge is afforded where a category of creditor can

establish that the proposed scheme is unfair to them. *IMO Carwash* demonstrates: (i) the importance of appropriate valuation evidence and; (ii) where that evidence shows the value clearly breaks at senior debt level, junior creditors with no economic interest will not be able to thwart the proposed scheme. The result should serve as a significant blow to junior creditors using the threat of litigation to negotiate a better position on a restructuring, which involves a scheme.

- **Schemes and pre-packs:** The *IMO Carwash* decision reaffirms how traditional Companies Act schemes can be used effectively with Insolvency Act administration and the pre-pack technique to preserve value and effect the best overall outcome for creditors.
- **Directors duties:** For future schemes, *IMO Carwash* has clarified that directors have no duty to protect any hypothetical interest of out of the money creditors. Instead, they should focus on those with an economic interest and not be hampered by those who do not.
- **Junior creditors – a lost cause?** Not necessarily, ongoing points to consider include: Is there an option to buy out which a junior creditor is legally and financially able to exercise? *IMO Carwash*

was fact specific, other cases may also allow room for manoeuvre around the going concern definition. A junior creditor may also be able to demonstrate a more credible valuation exercise as opposed to the more hastily put together exercise presented by the junior lenders in *IMO Carwash*.

- **Distressed European groups seeking to migrate and use a scheme to restructure:** Where ordinarily there is no sufficient connection with the UK, we may see further attempts to migrate COMI and effect a restructuring through a scheme. Some commentators are already speculating about such moves for European groups currently facing financial difficulties. Any shift in COMI will require careful consideration, not least because of the inherent complexities and absence of automatic recognition without a contemporaneous insolvency process. □



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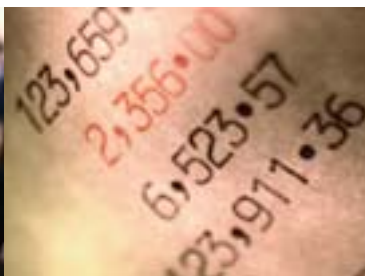
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Recent case summaries

Corporate and personal insolvency update from Stefan Ramel.

Corporate insolvency

Moore Stephens (a firm) v. Stone Rolls Limited (in liquidation) [2009] UKHL 39 (Lord Phillips, Lord Scott, Lord Walker, Lord Brown and Lord Mance)

Facts: SR, a company entirely under the control of Mr S, perpetrated a large scale fraud on various banks as a result of which proceedings were successfully brought against SR and S by those banks for a sum in excess of \$94 million. Provisional liquidators were appointed in respect of SR in November 2002; a winding-up order followed in January 2003. MS were the auditors of SR for the years 1996, 1997 and 1998, and, in respect of each of those financial years, MS signed off on unqualified audit reports. The liquidators of SR brought proceedings against MS alleging negligence and seeking damages. MS applied to strike out the proceedings in reliance on an *ex turpi causa* defence: 'no court will lend its aid to a man who founds his cause of action upon an immoral or illegal act'. For the purposes of the application, MS accepted that it owed a duty of care to SR and that it had breached that duty: had MS properly discharged its duty, the fraud would have been discovered earlier, and the losses sustained by the banks would have been greatly reduced. MS's defence of *ex turpi causa* failed at first instance, but was successful in the Court of Appeal.

Held: By a majority (three to two), the House of Lords dismissed SR's appeal. The *ex turpi causa* defence was a complete answer to the proceedings brought by SR. The fraudulent acts, which were actually perpetrated by S using SR as a vehicle, were to be treated as the fraudulent acts of SR; the proceedings brought by SR by its liquidators were therefore founded on illegal acts of SR, which offended the *ex turpi causa* principle.

Comment: *Stone Rolls* was one of several cases decided by the House of Lords on its very last day as the final appellate court in England and Wales before the new Supreme Court took over on 1 October 2009. The speeches are lengthy: they run to some 277 paragraphs in total. If there is a common thread to be discerned in the decisions of the majority, it is that *Stone Rolls* was an extreme case in which to apply the *ex turpi causa* defence: their Lordships relied to a large extent on the fact that SR appeared to be a 'one man company'. Viewed from the perspective of a corporate insolvency officeholder, *Stone Rolls* is an unwelcome decision. It will mean that, when a liquidator is considering proceedings against a third party, it will be necessary for that liquidator to be satisfied



that, where those proceedings are to some extent based on the fraudulent conduct of a director (even a *de facto* or shadow one), that that fraudulent conduct cannot be attributed to the company so as to open the door for a defendant to rely on the *ex turpi causa* defence.

Personal insolvency

Nationwide Building Society v. Wright [2009] EWCA Civ 811 (Maurice Kay and Lloyd LJJ, Sir John Chadwick)

Facts: On 7 April 2006, N obtained a judgment against W in the sum of £10,000 in relation to credit card debts. N successfully applied for an interim charging order, which was made on 5 May 2006. A bankruptcy petition was presented against W on 17 May 2006 by the supervisor of W's failed IVA. Before the bankruptcy petition was heard, N's interim charging order was made final on 26 June 2006. It was not until 12 July 2006 that W was made bankrupt. W's trustee in bankruptcy applied for an order under section 3(5) of the Charging Orders Act 1979, discharging the interim and final charging orders obtained by N. At first instance, the district judge acceded to the trustee's application. N appealed unsuccessfully to the circuit judge. Thereafter, N applied for and obtained permission for a second appeal to the Court of Appeal. N relied on section 346(1) and (5)(b) of the Insolvency Act 1986. It was common ground that neither N nor the judge at first instance who made the interim and final charging orders was aware of the pending bankruptcy petition.

Held: The appeal was allowed. Pursuant to section 278 of the Insolvency Act 1986, the bankruptcy of an individual commences on the date of the bankruptcy order. The point of principle identified by the Court of Appeal was whether a creditor that has, in good faith and without

knowledge of pending bankruptcy proceedings, obtained a charging order against an individual shortly before that individual was made bankrupt (and thus, for the purposes of section 346 has completed execution) should be vulnerable to a challenge under section 3(5), which gives the court a wide discretion to set aside a charging order. Sir John Chadwick concluded that, although section 346 did not expressly limit the discretion granted to the court by section 3(5), the legislative policy that underlies section 346 meant that there had to be something additional to the making of a bankruptcy order to entitle the court to set aside a charging order in the circumstances that prevailed in *Wright*. No such additional factor being present, the final charging order should have been allowed to stand.

Comment: It is important to bear in mind when considering the Court of Appeal's decision in *Wright* that, for costs reasons, the trustee in bankruptcy was not represented on the appeal, and instead the Court of Appeal relied on the written arguments filed on behalf of the trustee in the courts below. It isn't clear from the Court of Appeal's decision whether any submission was made on behalf of the trustee to the effect that section 284(1) of the Insolvency Act 1986 meant that, after the presentation of the bankruptcy petition, no disposition could be made by the person adjudged bankrupt without the consent of the court. Likewise, it isn't clear whether, under the terms of the IVA in *Wright*, W's interest in the property was held on trust for W's IVA creditors, in which case no charging order could have been made in the first place. From the perspective of an officeholder faced with a charging order obtained by a creditor between the presentation of a bankruptcy petition and the making of an order, the first action point following *Wright* ought to be an enquiry as to whether the creditor or the judge knew of the pending insolvency proceedings prior to the making of a final charging order. If it turns out that neither the creditor nor the judge were aware of the pending insolvency proceedings, in the light of *Wright*, such a charging order may well bind the trustee. □



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Legal Q&A

Jeremy Marshall answers your insolvency queries.

I have recently been appointed as the administrator for a company that was involved in litigation with one of its former suppliers. Two days prior to the administration, the company received a part 36 (without prejudice) offer to settle from its supplier. Can I accept this offer on behalf of the company, or will the other side be able to withdraw it when they learn of the administration?

When a party to litigation makes a without prejudice offer to settle pursuant to rule 36 of the Civil Procedure Rules (CPR), assuming that the offer is made not less than 21 days before the trial, the offer will have to be open for acceptance by the other side for a period of at least 21 days (rule 36(2)(c)). This 21-day period is known as the period for acceptance.

Regardless of whether the offer has been made by the claimant or the defendant to the litigation, the party making the offer (the offeror) will need the court's permission to withdraw or alter the offer during the period for acceptance. In order to withdraw or alter the offer, the offeror will need to make an application to the court for permission in accordance with part 23 CPR (rule 36.3(5)). The offeror will need to state the reasons that have given rise to its desire to withdraw or reduce the offer. Part 36 does not prescribe any particular grounds for reducing or withdrawing, but case law under the old (pre April 2007) part 36 suggests that, in order to obtain permission, the offeror will need to show that there has been some sort of fraud or mistake, or that there has been a change of circumstance since the offer was made, such as the discovery of new evidence for example.

However, it is not the case that every change of circumstance will be sufficient for an offeror to withdraw or reduce its part 36 offer during the period for acceptance. For example, in the case of *Flynn v. Scougall* [2004] EWCA Civ 873 the defendant made a payment into court of £25,000. After making the payment, the defendant received his expert's report, which was favourable to his case, and adverse to the claimant's case. However, the report had also been sent to the claimant, and upon receipt of the report the claimant applied to accept the defendant's offer. The Court of Appeal refused the defendant's application to withdraw the money paid into court, deciding that, because the defendant had known that the report was on its way, and because it was commonplace



“After the petition for recognition is filed, but before recognition is granted, the bankruptcy court may grant you provisional (interim) relief such as staying any execution against the English company's US assets.”

in personal injury litigation for the parties' experts to disagree with each other, there had not been a sufficient change in circumstance which would justify the withdrawal of the offer by the defendant.

In answer to your query, as the administrator of the company you are able to accept the offer on behalf of the company. If you accept the offer within the period for acceptance, the offeror will need to apply to court for permission to withdraw or alter the offer. However, if you do not accept the offer within the period for acceptance, the offeror will be able to withdraw or alter the offer after the expiry of the period for acceptance, without needing the court's permission.

I am a liquidator of an English company, which has assets located in the USA. How can I gain control of those assets in order to bring them into the liquidation?

It is becoming increasingly common in corporate insolvencies for debtors to have assets (and liabilities) located in more than one jurisdiction. In May 1997 the United

Nations Commission on International Trade Law (UNCITRAL) published its Model Law on Cross-Border Insolvency (the Model Law). One of the main aims of the Model Law is to promote fair and efficient administration of cross-border insolvencies, so as to protect the interests of all creditors. In the USA, the Model Law came into effect on 17 October 2005 as a new Chapter 15 of the US Bankruptcy Code.

You would need to obtain legal advice from an American lawyer, but briefly Chapter 15 allows a foreign representative of a debtor in a foreign insolvency proceeding (eg a liquidator) to seek assistance from the US courts in dealing with the foreign debtor's US-based assets. In your case, the English liquidation of an English company is likely to be considered 'main' proceedings. A main proceeding is defined as an insolvency proceeding that is pending in the country where the debtor has the centre of its main interests (COMI). A debtor's COMI is not specifically defined, but is presumed to be the place where it has its registered office. You would need to file a petition of recognition, that must be supported by certain documents, eg copy court orders and notice of your appointment. If you do not apply for, and obtain, recognition, you will not be able to access the US court system.

Once the petition for recognition is filed, the matter must be considered and decided by the US court at the earliest possible time. After the petition for recognition is filed, but before recognition is granted, the bankruptcy court may grant you provisional (interim) relief such as staying any execution against the English company's US assets.

If the US court recognises the liquidation, the English company will be treated as a traditional US bankruptcy debtor in many respects, and you will have the ability to deal with the US-based assets and to realise them for the benefit of the creditors.

In England and Wales, the Model Law has been given effect by the Cross-Border Insolvency Regulations 2006. □



Jeremy Marshall is a partner at Irwin Mitchell.

Technical update

Richard Heis outlines R3's response to The Insolvency Service's consultation document on administrations and CVAs.

Encouraging Company Rescue

In June The Insolvency Service launched its consultation document *Encouraging Company Rescue*. The document sets out proposals for changes to the law relating to administrations and company voluntary arrangements (CVAs) in order, in the words of Pat McFadden, the minister, 'to give struggling, but viable, companies, a greater chance to work their way through difficult times.' The document acknowledges that the current UK insolvency regime is generally robust, effective and well regarded, but sees the proposed changes as enhancements to existing procedures to enable maximum economic value to be rescued from companies that get into difficulties.

This article summarises R3's response to the document, and also notes some of the comments made by other respondents. The R3 response was produced by the General Technical Committee, the Scottish Technical Committee and the recently formed Policy Group. A survey of members' views was also undertaken, which greatly helped in formulating the response.

One fact which emerges from a review of responses is that, although a number of people think that some reform of insolvency law would be helpful, not everyone agrees that it should take the form proposed in the document.

The proposals in outline

In summary, the proposals set out in the document are:

- Extending to medium and large companies the option of a moratorium against creditor action, which is currently only available to small companies.
- The introduction of a new court-sanctioned moratorium available to all companies.
- Giving super-priority to costs incurred for rescue in administrations by allowing them to rank ahead of other expenses.
- Giving greater ability to create new security in administrations and CVAs in order to encourage the provision of funding.
- Providing for the cessation of certain asset based lending arrangement on administration or CVA.

The document also invites any other comments on ways in which company and business rescue might be made easier.

General observations

The R3 membership survey indicated that the members were broadly in favour of the proposed changes, and this view was



reflected in the R3 response. However, it was emphasised that the proposals should not be seen as artificial life-support to non-viable businesses that ought to be liquidated.

Extending the small company moratorium

The R3 response supported extending the small company moratorium to all companies, but expressed doubt as to how much it would be used. This is broadly in line with the views expressed by other respondents. The existing small company moratorium is little used, and there are differing views as to the reasons for this. Some believe that the role of the nominee is too onerous, carrying a high level of

25 per cent thought that it was because the directors did not want to incur the associated costs, and 22 per cent suggested that it was because the directors did not want details of the moratorium published. However, there can be cases where aggressive creditors can extract an unfair advantage at the expense of other creditors, and the proposed moratorium may help in those situations provided other preconditions for a viable CVA are in place.

It has been noted that comparatively fewer CVAs have been proposed or implemented in Scotland in comparison with the rest of the UK, and without being able to attribute the reason for this, it is difficult to assess the impact of the proposed change.

R3 has also suggested that the opportunity should be taken to amend Schedule A1 to allow the nominee to apply to the court for directions in the same way as is open to other insolvency office holders. When the Bill introducing Schedule A1 was going through parliament, R3 put down an amendment to insert provision to allow the nominee to apply for directions, but the amendment was rejected by the minister at the time for reasons that were, and remain, unconvincing.

Court-sanctioned moratorium

The R3 response supported this proposal in principle, though again there are doubts as to how widely it would be used.

The proposal is that a court-sanctioned moratorium would be available before a formal proposal had been fully worked out. However, satisfying the necessary criteria (demonstrating a reasonable prospect of a CVA being approved and showing that a

“Although a number of people think that some reform of insolvency law would be helpful, not everyone agrees that it should take the form proposed in the document.”

responsibility for matters that are outside his control. Of the respondents to the survey, 55 per cent gave unacceptable risk to the nominee as a reason why the existing moratorium procedure is not used, and 62 per cent said that they thought this would also apply in the case of medium and large companies. Of other reasons given for the limited use of the moratorium procedure, 36 per cent thought that it was because the directors did not deem it necessary as there was no imminent threat from creditors,

moratorium would be in the interests of the creditors as a whole) could only be achieved by drafting at least an outline proposal and considering both the CVA and the alternatives. In this respect it appears in normal circumstances to add little to the first proposal. However, we could see a quick moratorium without a formal proposal being useful where a company encounters an unexpected crisis that threatens its solvency and where a limited period of protection is needed to resolve



the situation. Chapter 11 in the US is sometimes used for this purpose. The other reason for its use would be the much longer moratorium period that would be necessary with large and complex restructurings.

A moratorium with court sanction would also be beneficial in securing cross-border co-operation from foreign judiciaries, which are usually more amenable to recognition where there is court involvement.

Moratoriums, CVAs and Companies Act schemes

The consultation document considers the proposed moratorium only in connection with CVAs. However, in large and complex cases Companies Act schemes are often used in preference to CVAs, because of their greater flexibility. For example in a scheme it is possible to vary the rights of

A number of respondents argued that any new moratorium procedure was more likely to be of use in conjunction with CA schemes than with CVAs.

Super-priority for rescue finance in administrations

The document proposes that costs incurred in rescue should rank in front of other administration expenses. However, it is difficult to see how this would mark any change from the present position. Expenses incurred by the administrator already enjoy a high priority by virtue of rule 2.67. Potential lenders or suppliers to the business during the administration are only likely to support it if they calculate that they will be paid out of the available funds, so this proposal would not in itself increase the level of assets available to fund

- as a subordinate fixed charge on any property, or
- subject to the agreement of existing charge-holders or the court, and only where there is no scope for a new or subordinate charge, as a first charge ahead of prior charges, or an equal first charge on property already charged.

However, an overreaching, or equally ranking, first charge would only be available where the insolvency practitioner is satisfied that:

- the granting of such security is necessary to obtain finance
- the interests of existing charge-holders are adequately protected, and
- obtaining the rescue finance is in the best interests of the creditors.

Legislative provision would be made for the rights of negative pledge-holders to be overridden.

R3 welcomes the objective of extending the availability of rescue finance, but there are a number of technical difficulties that need to be thought through.

As far as unencumbered assets are concerned, administrators already have power to grant security over the property of the company. In practice they rarely do so, because the administrator will normally borrow from the floating charge-holder, who has no need to vary his existing security, and the remaining assets will usually be covered by fixed charges.

We can see some advantages in allowing negative pledges to be overridden, as this could encourage the provision of further finance in some cases. However, it needs to be remembered that negative pledges may be a key protection for existing lenders, and in the desire to facilitate rescue finance it is important not to impair the availability of traditional finance. Indications are that unsurprisingly the banking community is not in favour of this proposal.

However, the proposal for overreaching first charges is altogether more difficult and contentious. R3 >>

“The proposal for overreaching first charges is altogether more difficult and contentious. R3 considers that there are very serious issues relating to the concept of ‘adequate protection’.”

secured creditors, whereas in a CVA it is not. In addition, the recent decision of the High Court in *Re Bluebrook Limited* suggests that the courts will be willing to sanction a scheme that excludes creditors with no financial interest. To put this on some form of statutory footing would remove the scope for out-of-the-money creditors to adopt obstructive tactics in an attempt to extract ransom payments. The R3 response therefore suggested that there is a strong case for allowing a moratorium to be used in conjunction with Companies Act schemes as well as CVAs. In addition, removing the anomaly between CVAs and schemes regarding the rights of secured creditors and the treatment of out-of-the-money creditors may be a way of extending the usefulness of CVAs.

the administration. It is only likely to be relevant if the administration itself becomes insolvent and the order of priority of expenses becomes critical. This seems to have been the view of a number of other respondents.

Furthermore, it is not clear what ‘rescue finance’ means, and it is likely to be difficult to determine which outgoings relate to ‘rescue’ and which do not. Definitions will need to be tightly drawn if disputes are to be avoided.

Greater ability to create charges in administrations and CVAs

The document proposes that rescue finance should be able to be secured:

- against any property not already charged

considers that there are very serious issues relating to the concept of 'adequate protection'. In the event of a shortfall under the security the (original) subordinated lender would have no further recourse, whereas the new lender would enjoy first priority, recourse to all other estate assets (as an administration expense) and would probably earn a higher interest rate than the existing senior creditor. This would effectively force the existing lender to lend new money to protect his position. His only defence is 'adequate protection'.

'Adequate protection' is not defined in the consultation document, and it is understood that it is not intended to provide a statutory definition but to leave it to the discretion of the courts. Nevertheless, the examples of what might constitute

is some authority that receivables collected during an insolvency process cannot be used to set off against prior indebtedness if they result from the office holder's own actions. Many ABL facilities are supported by a debenture, which would catch any shortfall, although this aspect of ABL agreements was not discussed in the document.

Other comments – restriction on exercise of termination rights

R3 believes that there should be a wider form of stay to hold contractual arrangements in place, and this idea was developed in the final section of the R3 response.

For example, computer software plays a pivotal role in business continuity and is

remedied by restricting licensors' ability to exercise their termination rights under the licence agreement, subject to the licensee's obligation to continue to make any ongoing payments under the general terms of the agreement. This could be achieved by amendment to section 233 of the Insolvency Act 1986.

In its response R3 also suggested that the provisions of section 233 should be extended to cover suppliers of telecoms services and equipment who are on-sellers and not original suppliers covered by the definition in section 233(3)(d). Such suppliers are particularly important, for example, in retail businesses where a number of different IT and telecoms services are used to run stores and tills and to accept credit card payments.

There is a strong case for widening the scope of the statutory stay in administration and the proposed moratoriums to preclude the exercise, on grounds of insolvency alone, of contractual termination provisions, in particular the so-called *ipso facto* clauses. This may significantly assist in saving businesses, subject to appropriate safeguards for the creditor or, if a customer, continuing to receive supplies. Generally the principal safeguard will be that he is paid for the continued service. However, by way of additional protection, a contractual counterparty genuinely prejudiced by the stay, could (as with the current stay in administration) request consent to exercise a termination right and, if refused, seek leave to terminate from the court.

Respondents to the R3 members' survey were overwhelmingly in favour of extending protection to include forced continuity of supply (as long as normal contractual payments are made): 75 per cent of respondents were in favour of an extension as compared with 22 per cent who were not.

It is fair to say that the idea of precluding the exercise of termination rights in *ipso facto* clauses is not universally supported. Of the other responses of which we are aware, one organisation put forward a similar suggestion, while others were opposed on the grounds that it would be an unwarranted interference with contractual rights, and could have knock-on effects on the other parties. This is likely to remain a contentious area.

The full text of the R3 response is available on the R3 website at www.r3.org.uk □

“ Respondents to the R3 members' survey were overwhelmingly in favour of extending protection to include forced continuity of supply (as long as normal contractual payments are made). ”

'adequate protection' given in the document seem far from reassuring. The document suggests that in the first instance it will be for the administrator to show that the existing charge-holders are adequately protected. However, it is difficult to see how an administrator could ever give an assurance that a creditor's position is adequately protected with confidence that such an assurance will not be subsequently challenged with the benefit of hindsight.

The concept of adequate protection seems to have been taken from the US Bankruptcy Code. It would appear to offer scope for lengthy and damaging valuation battles, and it is understood that in the US a consensual approach is usually preferred for this reason.

Not surprisingly, this aspect of the proposals has attracted a considerable degree of comment from other respondents, who point out that it would mark a radical departure from established legal principles in the UK.

Of the respondents to the R3 survey, many welcomed the proposal but 36 per cent expressed some concern about super-priority funding. Of these, a majority believed that it would allow unviable plans to be funded against the interests of creditors, that 'leap-frogging' over existing secured creditors would undermine confidence in the bank lending system, and respondents also felt that banks and other lenders may demand greater security or charge higher interest rates on normal business lending.

Cessation of certain ABL arrangements on administration or CVA

R3 is supportive of the idea that receivables generated after an insolvency event should be available to fund the proceedings. There

embedded in an increasing number of devices on which businesses depend. Licensors of software are able to use their position to extract ransom payments to permit continued use of the software or to allow the right to use it to pass to a purchaser. This is not only inimical to business rescue, but acts against the interests of other creditors. The administration moratorium provides no protection against this. This could be

Technical Bulletin

Technical Bulletin 88 was issued in September.

Its contents included:

- Changes to Companies Act Forms from 1 October 2009
- Employment Rights Act – increase in maximum amount of a week's pay from 1 October 2009
- Display of company name – exemptions where company is subject to insolvency proceedings
- The Insolvency (Amendment) (No. 2) Rules 2009
- The Companies (Disqualification Orders) Regulations 2009
- Overseas Companies – new registration and filing regulations
- HMRC – address for notifications of liquidations
- Sales to connected parties – HMRC power to require security for VAT
- Scheme of arrangement – court sanctions scheme opposed by out-of-the-money creditors
- Transfers of undertakings – Court of Appeal decision leaves TUPE unclear
- Pre-packaged sale – court orders removal of administrator to allow independent review
- Bankruptcy order annulled on grounds that debtor's COMI was outside the UK
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Richard Heis is a partner in KPMG Restructuring.

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OFT's role and interaction with the insolvency profession

Ray Watson explains that the OFT will continue to take enforcement action to drive compliance but also wants to work with industry to raise standards.

Since 2008, and the implementation of changes to the Consumer Credit Act 1974, the OFT has operated a risk-based enforcement regime to target the areas that pose the highest risk of harm to vulnerable consumers.

We had identified the debt management sector, including Individual Voluntary Arrangements (IVAs), as a high-risk area well before the beginning of the current economic downturn. Vulnerable consumers can suffer detriment as a result

the OFT's remit rather than that of The Insolvency Service. In assessing applications from IPs, we work closely with The Insolvency Service and the industry, including R3, and other regulators and the regulated professional bodies (RPBs) to ensure that we are aware of all information relevant to an applicant's fitness to be given and/or retain a consumer credit licence. For example, factors that may help us make a faster and positive assessment of an IP's integrity and competence include evidence of compliance with our debt management guidance, membership of relevant trade

entrants to improve their business practices and have not hesitated to refuse applications if they cannot demonstrate to us that they are competent to engage in these high-risk activities.

Given the significant changes that have occurred in the debt management market, and against the background of the current recession and our increased enforcement activity, we have decided to launch a compliance review of the debt management guidance at the end of October 2009.

Review of compliance

This review will assess compliance levels across the industry and help us adjust the OFT's regulatory strategy accordingly. We will also use the compliance review to obtain feedback on the guidance itself. Part of our methodology for completing the review will include issuing questionnaires to licensees and all key stakeholders – we would encourage you to tell us what you think about compliance levels within this industry either directly by completing one of our questionnaires or submit your comments via your trade body, R3, or your RPB. Questionnaires will be made available for download from the OFT's website: www.oft.gov.uk. A report of our findings will be issued in 2010.

The OFT is determined to protect vulnerable consumers from those that may look to take advantage of them. We will

“The need for effective regulation is even greater as the recession has resulted in many more consumers finding themselves in need of debt advice.”

of receiving poor quality debt advice or being subject to aggressive and misleading IVA advertising. The need for effective regulation is even greater as the recession has resulted in many more consumers finding themselves in need of debt advice.

Scrutiny of IPs

Under the new regime, applicants for high-risk debt advice and debt-adjusting activities are being asked to provide additional information to us and may also be subject to an on-site competence visit from Local Authority Trading Standards Services to assess their competence to engage in those activities. We are also using our new information gathering powers proactively to monitor both the competence and integrity of current licensees and to improve standards. For those insolvency practitioners (IPs) more familiar with insolvency regulation this additional scrutiny of new entrants and existing licensees should be welcomed.

Many IPs will need to be licensed by the OFT if they advertise services including the provision of debt advice to consumers prior to the agreement of an IVA – regulation of these activities falling within

associations or professional bodies with codes that promote compliance with consumer credit law and an absence of consumer complaints.

New enforcement toolkit

Those of you familiar with our work will know that our key priority this year has been to use our new enforcement toolkit to enforce compliance with the minimum standards of behaviour set out in our guidance. We have moved quickly to tackle

“The review will assess compliance levels across the industry and help us adjust the OFT's regulatory strategy accordingly.”

bad practice in the market, including taking well publicised action against firms that sent misleading IVA mailings to consumers, used 'look alike' websites to mislead consumers into believing that they were charity-based sources of free debt advice, and engaged in cold calling in a way that breaks the law. We have also used our new requirements' powers against new

continue to take enforcement action to drive compliance but we also want to work with industry to raise standards as this benefits both consumers and legitimate business. □

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Ray Watson is the director of the Consumer Credit Group at the OFT.



Personal insolvency – does it pay?

Mark Sands analyses the pros and cons of the available debt solutions for personal insolvency from the point of view of both the creditor and the IP.

Most people ask if personal insolvency pays from the perspective of either the creditors or the insolvency practitioner (IP). Being asked to address it from the views of *both* camps has allowed me to reflect on the symbiotic relationship between creditors and IPs – both groups need successful outcomes from insolvencies and we should work together to that end. If one wins to the cost of the other the relationship will not be sustainable.

I therefore make no apologies for looking at the impact the recent changes in the personal insolvency market have had on *both* IPs and creditors. For both the question is – does personal insolvency pay?

the current climate one of the most difficult markets they can remember. This suggests that personal insolvency does not pay!

Debt Relief Orders (DROs)

Of the three types of personal insolvency, DROs are perhaps the easiest for me to tackle: they're new, expected to rise to 20,000–30,000 each year, no IP is involved and they pay no dividend. They are only available for debtors with liabilities of less than £15,000, assets of less than £300 and surplus monthly income of less than £50; if there are assets or surplus income then they do not meet the statutory criteria and any DRO is revoked. So on the face of it they benefit neither creditor nor IP.

In the first six months of the operation of DROs an estimated 6,500 people have

of DROs appears to dilute the average dividend return creditors may expect. The counter to this is that many of the DROs would have been bankruptcies, where there were no material assets or surplus income and which therefore already resulted in no IP being appointed as trustee and no dividend being paid to creditors. The effects of DROs on the overall mix will only become clearer once they have been in place for some time; and even then, the recent ructions in the market mean that a proper assessment of their impact, as opposed to the impact of the market changes, will be difficult.

There will, though, be an unknown proportion of new entrants to the personal insolvency market, who would not have formed part of these statistics had DROs not been introduced. So looking purely at those new entrants (no matter how many or how few) creditors are worse off, and IPs no better off, as a result of the introduction of DROs. So – DROs do not pay.

Bankruptcies

Bankruptcies have traditionally been seen to result in little or no return to creditors and to provide the IP and his solicitors with endless fees. That is not a true reflection of the work that most IPs have delivered on bankruptcies in the past, or the dividends generated for creditors. Anyway, surely that no longer matters – the falls in the property market mean that IPs and creditors are gaining little or nothing from bankruptcies? So is that it? Should we all

“There needs to be a symbiotic relationship between creditors and IPs – both groups need successful outcomes from insolvencies and we should work together to that end.”

Personal insolvencies are at record levels¹ so that must mean that creditors are suffering record write offs. And, of course, IPs must be very busy and very profitable – if I were to believe the reaction of everyone who finds out that I specialise in personal insolvency. The latter though is not the case!

Yes, creditors are suffering record levels of write offs. IPs, though, are finding

taken advantage of the new approach. After a slow start we are seeing more than 1,700 DROs each month. This suggests that DROs have already reached an annualised rate of around 20,000 and I expect them to total between 20,000 and 30,000 per annum for the next few years².

Clearly when looking at a portfolio of debt due from individuals, the introduction

focus on corporate assignments and leave bankruptcies to the OR? Should creditors assume (if they have not already done so) that bankruptcy is a waste of time, write off the debt and pay no attention to what happens in bankruptcy cases?

No. Bankruptcies are about more than just the property market. Nonetheless, there is no escaping from the fact that most bankrupts have no assets, no issues to be investigated by an IP and no prospect of a dividend being paid to creditors. Latest figures from the IS suggest that a private sector IP is appointed in less than ten per cent of cases³. The OR deals with a further

Bankruptcies offer a broader spectrum than any other personal insolvency procedure. Many cases contain no value, a few offer a little and a minority a real opportunity. So, admittedly in a small proportion of cases, bankruptcies can pay.

IVAs

IVAs were the new kids on the block – that was years ago! Now they are a focused and streamlined procedure with a protocol all of their own. IPs have adapted their systems to strip out costs, ensure advice is appropriate and meet the needs of creditors for a return that reflects the assets and income of the

systems, or practices focused on adding value, this is not the case. So for both creditors and IPs, IVAs do pay.

The future

All forms of personal insolvency will continue to impact on creditors and, in many cases, will need the services of an IP. Other than remaining vigilant of ineligible debtors, little can be done by IPs or creditors as regards DROs. When the recession ends (and by that I mean when the effects on the employment and property markets come to an end) both bankruptcies and IVAs can and will (and indeed must) provide a return to creditors that they recognise as being value delivered by IPs. In return, IPs will earn a return proportionate to the value they add. For a well run IPs' practice that should also mean a fair profit.

Personal insolvency is here to stay. The levels we have and will see may reduce slightly come the upturn. Nonetheless, many more than 100,000 people are likely to need help every year – as are the creditors they owe money to. Creditors see falling dividends. For many IPs, numerous cases no longer fit their business plan. Value, though, remains to be extracted from a portion of personal insolvencies – for both IPs and creditors.

“Across a portfolio of cases, property and income remain the most likely contributors to a dividend payment.”

slice of cases in his Regional Trustee and Liquidators Units (RTLUs). All other cases must be assumed to have no assets or rights of recovery to be pursued; I estimate that a massive four out of five bankruptcies are hopeless cases from day one.

That, though, still leaves between 5,000 and 10,000 cases a year where there is a job to be done. One impact of the economic downturn is that increasingly the opportunity for value arises from dealing with a business or carrying out an investigation. This should not mean that the equity in the family home and income payments, while not likely to generate the highest returns for creditors, may be ignored. Across a portfolio of cases, property and income remain the most likely contributors to a dividend payment. In the long term, when property prices are stable (or modestly rising) and employment levels rise, they will almost certainly return to the fore.

That leaves a minority of cases where there will be something different – a transaction to be pursued, either because an asset has been transferred to a third party (or indeed was registered in their name), or an unusual asset to be realised. This is an opportunity for the IP to demonstrate his or her skills and, when successful, to earn a rewarding fee and pay a dividend that will gain the attention of the creditors.

The focus of creditors has now turned to the fees of trustees in bankruptcy. While bankruptcies are rarely if ever capable of being dealt with in the same manner as IVAs, there are opportunities for IPs to minimise the costs of administering bankruptcies and to focus on the areas where they can add value:

- maximising realisations from the family home through skilled negotiation and investigation;
- dealing with business assets; and
- pursuing investigations thoroughly yet commercially.

Creditors accept the need to recognise added value, while rightly asking that the basic costs of administering a bankruptcy be carefully controlled.

debtors. In many ways they lead the way in demonstrating what IPs can achieve when they focus on the needs of creditors (as well as the often forgotten debtor who remains at the centre of the process).

The introduction of the protocol, while still causing some IPs to complain about how it removes the need for their skills and expertise, is an important and

“Provided the profession continues to develop approaches that provide value then personal insolvencies will pay creditors a return and form a part of many IPs' practices.”

appropriate development in the area of the over-indebted consumer. I am not for one moment suggesting that it is relevant to all IVAs. That was never the intention. There will remain a relatively small number of cases requiring 'old fashioned' IP skills, such as middle market trading cases and professional partnerships.

Nonetheless, the protocol has brought a consistency to a procedure increasingly popular with debtors, allowing creditors to estimate their recoveries with increasing certainty. Interestingly, a recent review of the dividend levels forecast at the outset of an IVA showed a small increase in the sums expected to be paid to creditors⁴. This is a reflection of tightened creditor criteria over many years, a reduction in costs and an increase in professionals and other higher income individuals seeking an IVA as a result of the economic downturn. Against that must be set the increasing variations and failures of IVAs, driven partly by overly constrictive modifications at the outset and more so by the recession.

The actual returns to creditors will only be known in years to come; as a concept they include a welcome commitment to pay a dividend that is absent from the other personal insolvency procedures. While the pressure on IPs' fees may leave many with the feeling that IVAs do not pay them a sufficient return, for those with effective

Provided the profession continues to develop approaches that provide value then personal insolvencies will pay creditors a return and form a part of many IPs' practices. Whether the IP focuses on one aspect of this sector or all, there is a business to be built – on adding value and paying dividends to creditors. On making personal insolvency pay. □

¹ Insolvency Service statistics for the quarter ended 30 June 2009 show that there were a total of 33,073 individual insolvencies in the quarter, more than any other quarter covered by those statistics.

² *Tenon Tracker* recorded just over 6,500 DROs in the period from 6 April 2009 to 30 September 2009. In September 2009, it recorded more than 1,700 DROs. If DROs continue at 1,700 per month annual rates will be around 20,400. The personal view of the author is that rates will rise above those currently being seen.

³ The IS confirm that in the year ended 31 March 2009 there were 5,676 appointments of trustees in bankruptcy.

⁴ Source – *Tenon Debt Solutions* and *Tenon Dividend Watch*.



Mark Sands is director of personal insolvency and head of bankruptcy at Tenon Recovery.

Overview of personal insolvency

The number of options available to deal with personal debt problems has never been larger. Nick Howard examines them and reports on how The Insolvency Service is keeping them, and the system, under review.

Insolvency is very much in the news at present and there is no shortage of initiatives taking place in the personal insolvency world, so I am grateful to R3 for offering me the chance to reflect on where we currently stand. Government is very alive to insolvency issues, with the world of consumer debt the main theme running through the BIS Consumer White Paper. Among other things, the paper proposes measures to help support homeowners, allow a breathing space for those struggling to pay utility bills and set up an NHS credit crunch stress helpline.

In debt? – dealing with your creditors

In keeping with this theme, a major contribution to advice on debt issues has been made recently thanks to the IVA Standing Committee. Committee representatives from all sides of the insolvency world have come together to produce a comprehensive guide to insolvency solutions, entitled *In debt? – dealing with your creditors*. The unique selling point of this guide is that it has the support of the wide range of organisations that were involved in its production, including insolvency practitioners, debt advice agencies and creditor organisations, all of whom agreed the content of each section in the guide. As a result the document is clearly targeted at the needs of those struggling with debt and represents an impartial view of the variety of options available to them. It is already being widely welcomed by those who give debt advice.

The options need to be explained to consumers

The guide attempts to make sense of what is becoming an increasingly complex insolvency world. Given the number of debt solutions on offer, it must feel confusing to those consumers who face debt difficulty and wish to know where to turn to for advice. Bankruptcy has long been seen as the last resort, but there are now numerous other options ranging from formal collective agreements with creditors, such as IVAs, to informal agreements with individual creditors aimed at rescheduling payments. A feature of the system in England and Wales is that individuals are able to choose the solution that best meets their needs, but it is important to ensure that all those who give advice do so impartially, explaining all options and making recommendations

based on the individual's circumstances. Consumers should be encouraged to consider all options fully before making their choice.

Looking in more detail at the insolvency field, the suite of options available may be compared to a family, with the bankruptcy matriarch surrounded by a range of younger family members such as IVAs and DROs. In that context we could

currently contributing to this debate along with other member states. The general movement across Europe is towards a system that more closely resembles our own, with more emphasis being placed on the rehabilitation of those in financial difficulty, enabling them to become economically active once more in the short term. Some European states are still in the position where discharge from debts is not

“The guide has the support of the wide range of organisations that were involved in its production, including insolvency practitioners, debt advice agencies and creditor organisations, all of whom agreed the content of each section in the guide.”

usefully look first at a possible new addition to the family, as the consultation document on Debt Management Plans was launched recently after a protracted gestation period. Insolvency practitioners have frequently made the point that this area was in need of review, due to concerns over the lack of regulation for those involved in offering repayment plans and worries that debtors may end up in such a plan without the benefit of impartial advice. It has been difficult even trying to get accurate figures for the numbers of people entering into such plans each year. Creditors are not currently bound when debtors enter into these plans, and there have been stories of debtors coming out of repayment plans after some years in a worse position than when they entered.

Regulation or voluntary codes?

For all these reasons, it was felt worthwhile to conduct a general consultation to see whether those most involved feel there is a need for regulation in this area, or whether the introduction of voluntary codes of practice would help. I would encourage all those with an interest in this area to respond to the consultation; your views will play an important part in deciding the way forward.

The European dimension

The rise in popularity of debt repayment plans may at least in part be attributed to the supposed stigma attached to other insolvency options, such as bankruptcy and IVAs. The EU is very interested in this issue, and The Insolvency Service is

attainable for individuals and, given the free movement of EU citizens between member states, this disparity between insolvency regimes has led to concerns of floods of foreign nationals coming to the UK to take advantage of our more enlightened procedures.

Research conducted within The Insolvency Service suggests that at present such fears are unfounded, as the numbers that we are finding are relatively small. It must be remembered that EU citizens are entitled to move around the EU, and as such it is likely that their Centre of Main Interest (COMI) will quite legitimately move from time to time. Such cases should be distinguished from the smaller number who present their petition in this country despite their COMI being elsewhere. We are keen to identify these cases and have taken action to annul bankruptcy orders where it was possible to demonstrate that the attempt to claim a UK COMI was a sham. (See 'Bankruptcy tourism' on page 22.)

DROs

The newly born addition to the family of debt solutions is the Debt Relief Order regime. Still linked in to the theme of providing relief to those most in need, the new regime is now functioning well and, at the time of writing, has assisted over 6,000 individuals who would previously have struggled to gain access to debt relief mechanisms. Debtors have to access the regime via an intermediary, a qualified debt adviser, which ensures that appropriate advice is given prior to filing



their application. The procedure is aimed very much at the most needy, with strict eligibility criteria restricting entry to those with relatively low levels of debts which, due to their circumstances, they are finding unmanageable. The automation involved in the process means that costs are kept to a minimum, an important feature as the process must be self-financing.

There are safeguards built in to the system to ensure that it isn't abused, and a number of DROs have already been revoked once information has been provided by creditors showing that the information initially provided was incorrect. We have also identified our first cases where we think Debt Relief Restrictions Orders are warranted, due to identified misconduct on the part of debtors. As with any new arrival, however, teething problems are to be expected, and we will be conducting early discussions with debt advisers and creditors to assess the impact of the new regime.

IVAs

And what about that troublesome youngster, the Individual Voluntary Arrangement? After some turbulent years involving advertising abuse there have been encouraging signs of maturity recently, with numbers showing the first rise for quite a while. The proposed introduction of the simplified IVA legislation has been put on hold while a full assessment is carried out of the IVA protocol. The protocol has been in place for almost two years now, and we hope to publish our initial assessment of its effectiveness by the end of 2009. The IVA Standing Committee meets regularly and carries out vital work behind the scenes

both to improve the wording of the protocol itself and the understanding between all sides of the industry. Without wishing to pre-empt the findings of the review, it is fair to say that misunderstandings and some mistrust still exists between providers and creditors, and the question to be resolved is whether a voluntary code is strong enough to deal with these issues.

Concerns raised by creditors or their agents tend to be around the speed with which dividends are paid, and whether contributions are set at realistic and

increasing the penalties for those whose failure came about due to their own negligence or culpability. We now have in mind some further modernisation work, firstly by way of a make-over of the insolvency rules where we remain on target to implement significant changes in April 2010. The amendments will include proposals to:

- encourage the use of electronic communication and use of websites as a means of communication within insolvency proceedings;
- provide greater flexibility as to the media through which statutory meetings may be conducted; and
- revise the means by which office-holder remuneration and expenses may be approved, providing greater transparency for creditors.

We will also be consulting further on the proposals to take the courts out of the bankruptcy order making process in debtor petition cases. Earlier consultation on these proposals threw up concerns about reducing the gravitas of the proceedings and around the advice that debtors took prior to filing their petition. We hope the latest proposals will deal with these concerns, while at the same time delivering a more efficient and streamlined process for those who have decided that bankruptcy is their best option. It would appear that there is plenty of life left in the old girl yet.

A review of personal insolvency?

There have over recent times been a number of calls for an overall review of the personal insolvency field to ensure that the suite of remedies remains fit for purpose. I have some sympathy for this view, as it is now well over 20 years since the Cork Report, and so much has changed since

“There have been a number of calls for an overall review of the personal insolvency field. For now, it appears to be in reasonable shape to weather the test provided by the current gloomy economic times.”

sustainable levels. From the provider's point of view, the number of modifications, even to protocol compliant IVAs, is a source of irritation, and there are concerns about fee levels having dropped to the point where smaller providers in particular are struggling to remain in the marketplace.

Amendments to the bankruptcy procedure due in the spring

Turning our attention to the grand old dame of insolvency procedures, the bankruptcy regime, you might think that she was sufficiently advanced in years to be left well alone. However, the Enterprise Act sought to drag her kicking and screaming into the modern era, aiming to reduce the stigma attached to bankruptcy while

then. However, all will depend on the views of an incoming government of whatever flavour. As ever, we will keep things under review and will look to get the views of practitioners whenever significant changes are proposed. For now, it appears that the family is in reasonable shape to weather the test provided by the current gloomy economic times.



**Nick Howard is
director of policy
at The Insolvency
Service.**

Bankruptcy tourism

Bankruptcy tourism is on the increase. Annerose Tashiro explains the reasons for German nationals seeking new abodes and two UK practitioners respond.

English tourists in sunny destinations have long complained about their German counterparts rising early in the morning and reserving deck chairs with bath towels. Now the German version of 'bankruptcy tourism' is raising a few eyebrows. Recently an influential national German newspaper, *Frankfurter Allgemeine Zeitung*, looked most unfavourably at the matter with a half-page spread: 'Auf der Flucht vor dem Gläubiger' (fleeing the creditor), page 11, 22 July 2009.

The scale of the problem

Even if only some 1,000 German nationals do cross the channel each year to file a bankruptcy petition with the English courts, there must be some positive benefit beyond the beauty of the Kent countryside. For these tourists plan on staying around some time and, apparently, often relocate for the longer term. The benefit must be of some monetary and personal gain to the insolvent. While the proportion of German nationals that is ripe for bankruptcy before a German court makes the trip to an English bankruptcy court may seem relatively small (estimated at 1,000 individuals out of 100,000 who file for



present. This is a period of time when the bankrupt has to survive on the statutory level of subsistence, which is capped around €1,700 at an income of circa €3,000, and without kids. The bankrupt's personal circumstances and needs are irrelevant. The rest of any income is distributed among creditors as a matter of course. During this 'good behaviour' period statutory rules also

upheld a decision to recognise a French bankruptcy court's ruling on discharge. A German national moved to France and was made subject to a bankruptcy order under French law, yet could take advantage of a discharge after a period of three years. Following the German court's recognition of the foreign discharge, the German national could not be pursued on German soil for debts incurred in Germany before the bankruptcy order. This meant that third-party attachment orders and entries on debt registers in Germany such as SCHUFA could be annulled. A green light for rehabilitation in three years rather than seven!

InsO, sections 304 to 314

Although there is no fast track to discharge under InsO, sections 304 to 314 do offer provisions for simplified proceedings in the case of some personal insolvencies such as so-called consumer insolvencies (Verbraucherinsolvenzverfahren). In these cases there are no provisions for a report meeting, none for a scheme of arrangement after the bankruptcy order, none for self-administration; a trustee, usually a lawyer, is appointed by the court. It is a particular feature of such proceedings that the bankrupt may apply to court to retain his assets by making a payment by some fixed date. The court will set the amount for distribution and the deadline for payment.

Yet the simplified provisions of sections 304-314 of InsO do not automatically apply to self-employed individuals such as doctors and dentists, accountants and lawyers, who count high among the German version of 'bankruptcy tourism'. To qualify for the simplified proceedings, the self-employed

“It is reasonable to conclude that those self-employed professionals who seek some refuge in English bankruptcy law wish to escape full-blown insolvency proceedings in Germany. For they often would not qualify for the simplified provisions.”

personal insolvency in Germany, ie one per cent), this minority is likely to have a high average level of debt and a potential to make a living after rehabilitation.

A glance at a website of what might be coined a bankruptcy tourism agent shows how such trips to England are marketed (eg www.insolvenz-agentur.de). The benefits are spelt out for the seeker. Some agencies assist insolvent individuals residing in Germany to set up shop or COMI in England: secure accommodation, open a bank account, apply for a land line, utilities, National Insurance number and so on.

The benefits in England

So what are the benefits? The key benefit lies in the period of discharge under the English rules. A personal insolvency in Germany lasts, as a rule, six years at

govern the distribution of property acquired after the bankruptcy order. Moreover, discharge is not automatic under German law. The bankrupt has to submit an application to the court and make a case for discharge. Any creditor has the right to disagree. As section 1 of the German Insolvency Code (InsO) puts it (in translation): 'Honest debtors shall be given the opportunity to achieve discharge of residual debt' (emphasis added).

France has its attractions

To convince the willing 'bankruptcy tourist' that the trip from Germany to England is worthwhile for swift rehabilitation, the highest German court, Bundesgerichtshof, has recognised another member state's short track to discharge. In a ruling of 18 September 2001 (IX ZB 51/00), this court

debtor has to demonstrate that his assets are 'manageable' (überschaubar) and that there is no outstanding debt from employees' contracts of employment. It is reasonable to conclude that those self-employed professionals who seek some refuge in English bankruptcy law wish to escape full-blown insolvency proceedings in Germany. For they often would not qualify for the simplified provisions. Outside of these provisions and with just few exceptions, the remainder of the German Insolvency Code applies equally to both corporate and personal insolvencies without distinction.

Those German nationals who reap benefit from English insolvency law perhaps look beyond the two goals of InsO. Even a superficial reading of section 1 of InsO does not miss these: satisfaction of creditors' claims and punishment of the debtor. Perhaps the tourists searched in vain for a third goal: that much vaunted rehabilitation, which also guided the 1999 reform of German insolvency law, but seems to have got lost in the drafting. On any analysis, seven years of good behaviour and living at subsistence level is a mighty long time for, say, a forty- or fifty-year-old

professional such as a doctor to clear or rehabilitate his name. (Even sick Germans in retirement cross the channel!) Often that same professional will have made a poor business judgment and have got into financial difficulties trying to honour repayments on loans (whether on loans raised for setting up a practice, for exploiting generous tax breaks in the 1990s or the like). And in a nation of renowned savers, we surely need some risk takers and their reasonably swift rehabilitation when they make errors of judgment.

German law needs reform

Some reform of German insolvency law thus seems necessary. Section 1 of InsO sets out how goals of bankruptcy laws are to be achieved at present: disposal of a debtor's estate and division of the proceeds is the norm, whereas a scheme of arrangement or similar is regarded as a deviation from that norm. For the time being bankruptcy in Germany is still stigmatised. It is seen as the beginning of the end rather than as the opportunity for a new beginning. And herein lies the need for change.

There is, of course, a case for rejecting

bankruptcy tourism even when the provisions and spirit of Council Regulation (EC) No 1346/2000 are respected. There will often be a suspicion of misuse, but the border while crossing from use to misuse is still to be found. But poor knowledge of English law and poor access to information probably scare the average German creditor most. And poor knowledge of a foreign language probably scares the average insolvency practitioner. Both are bound to feel uncomfortable and will rely on the services of lawyers in the jurisdiction in which a bankrupt holds assets. Although engagement of local German lawyers is bound to drive up the costs of proceedings, those up for bankruptcy tourism may have left behind assets worth looking into and selling. □



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and insolvencies at
Schultze & Braun.

Two UK insolvency practitioners give their views

Chris Laughton is a partner at Mercer & Hole.

Two of my experiences take bankruptcy tourism from the sublime to the ridiculous. Firstly I was approached by a senior adviser to an individual and the German company of which he was a director. The German tax authorities had made the individual personally liable for a multi-million euro corporate tax debt (which is possible under German law if the individual is the managing director). His duties in the company largely comprised managing an English subsidiary so establishing a personal COMI in England would not have been difficult. His concern was whether by doing so, and by going through English bankruptcy proceedings, he would extinguish his liability to the German tax authorities. His tax debt would, under German law, survive a German bankruptcy.

Government of India

On the face of it the German tax debt would be extinguished because the European Insolvency Regulation (Article 39) specifies that tax authorities of member states shall have the right to lodge claims in insolvency proceedings subject to the regulation. However, careful analysis of a 1955 House of Lords case, *Government of India v. Taylor*, cast doubt over the efficacy of the plan. Although that case has often been taken to mean that, under English law, foreign tax debts are not provable in insolvency proceedings (which would have been overturned by Article 39 of the European Insolvency Regulation), in fact

the point of the case is that foreign tax debts are not debts under English law. Therefore, although foreign tax debts may be proved in English insolvency proceedings, they are not bankruptcy debts (defined in Section 382 IA 86) that would be released pursuant to Section 281 on the bankrupt's discharge.

Commentators have suggested that *Government of India* may no longer be applied in this way, but the cost and risk of having to take the matter to the House of Lords was not something that the debtor was prepared to take on.

Follow your own advice

Somewhat more prosaically, I was instructed by a German trustee to arrange the annulment of an English bankruptcy on the ground that a bankruptcy order had already been made in Germany. The amusing point is that the bankrupt had operated a website advising German debtors how to shift their COMI and go bankrupt in England. Unfortunately, he had failed to follow his own advice and his German creditors had caught up with him just in time!

Bankruptcy tourism is a natural consequence of the European Insolvency Regulation. If an individual's COMI has genuinely moved from one member state to another by the time the request to open insolvency proceedings has been filed, the debtor should be able to use the insolvency law of his 'new' member state. This may give the English courts and the OR some interesting cases, but there may well be a spin-off for IPs if there are assets in the estate.

Peter Sargent is a partner at Begbies Traynor.

Bankruptcy tourism is not a big issue at present. The number of foreign bankrupts is probably in the hundreds, and only nine cases have been annulled as a result of appeals by The Insolvency Service (IS) over the Centre of Main Interest (COMI).

The worry is that a trickle could turn into a flood and, given EU rules on the free movement of labour, there is probably little they can do about it as long as the COMI is properly established. The view is that the definition of COMI is poor and easy to abuse; as a result it may be easy for the debtor to persuade a judge to grant a bankruptcy order. It may also be the case that some district judges have limited experience of the European Insolvency Regulation. IS action to obtain an annulment is expensive and time consuming as the court has to be persuaded they have got it wrong.

A review of EU regulation is being carried out and the COMI situation may change. There seems to be a culture clash: in the UK we have a 'second chance' culture, where we try to rehabilitate the debtor, while in Europe it is about punishment. What the UK system has in addition is the ability to deal with the rogue debtor through bankruptcy restriction orders (BROs) etc. What we are missing to complete the rehabilitation of debtors is an education process, which I understand they have in Canada. To me, that would be the final piece in the jigsaw.

What is MALG all about?

Anthony Sharp explains that MALG aims to bring all parties involved in difficult financial situations together in a spirit of willing co-operation and impartiality.

The Money Advice Liaison Group of the United Kingdom is an unincorporated association, more commonly known as MALG. The aims and objectives of MALG are to facilitate and organise a non-policy making discussion forum to promote better communications, best practices, understanding and professionalism among national organisations concerned with consumer credit and personal debt, debt advice, debt collection and all related ancillary matters within the United Kingdom.

“MALG believes in liaison, communication, impartiality, understanding, knowledge and working together for the common good.”

The formation of MALG

It was formed in 1987 at the time of another consumer credit boom, prior to the recession of the early 1990s. At that time, money advisers were very much new folk on the block as far as creditors and debt collection companies were concerned. Their view of creditors was that they were probably devils with horns and creditors' view of money advisers was that they were left wing loonies: I believe there was a little bit of truth in both these definitions. In the middle was the creditor's customer, the debt collection company's debtor, and the insolvency practitioner's or adviser's client. Nobody communicated with each other and the individual suffered as a result.

At the time I was deputy director of the Consumer Credit Trade Association and, together with a colleague from Citizens Advice and two industry visionaries, we met in Birmingham and discussed how we could improve this dire situation. We believed that

if we could bring all sides together in a spirit of willing co-operation and impartiality, the benefit to all sides, and in particular to the debtor who was in serious financial difficulties, would be enormous.

Thus was born the Money Advice Liaison Group. I was appointed chair and am indeed proud that some 22 years later I still hold that position. Today we have 47 national organisations in membership.

How MALG operates

Towards the end of the 1990s we started forming autonomous regional fora throughout the UK. Their objectives are

the same as those of National MALG, but their membership tends to be more local to their geographical area. There are now six such fora in existence.

National MALG meets once every two months in London and current attendance tends to reach about 40. It was to this diverse group of organisations that we were delighted to welcome R3 as full members well over a year ago.

Although we are unable to make any policies, since its existence MALG has played an important and influential part in the improvement of relations between all sides within the industry. Naming and shaming is strictly forbidden.

We hold an annual conference in London and this year is our 21st. This one-day event attracts well over 250 attendees, including academics and members of government. It is the uniqueness and impartiality of the event that people find attractive and beneficial.

Over the last year some of the subjects that MALG has tackled at its meetings have included: claims' management companies; the limitation issue; data quality; vulnerable customers and the utilities; debt and the older person; the Home Owners Mortgage Support Scheme; Debt Relief Orders, sale and lease back, and bills of sale.

The MALG Mental Health Awareness Guidelines

In November 2007 MALG produced *The MALG Mental Health Awareness Guidelines* and, in July 2008, the Debt & Mental Health Evidence Form, an integral part of these voluntary guidelines. As hoped, these unique documents have been adopted by a number of trade associations within the industry either by reference or inclusion in their codes of practice. This is very gratifying and we believe they have had a very beneficial effect on how the industry, including money advice, works with individuals who have serious mental health conditions.

The guidelines have recently been promoted in the White Paper issued by the Department for Business, Innovations & Skills entitled *A Better Deal for Consumers – delivering real help now and change for the future*. Also the Office of Fair Trading's guidance on irresponsible lending, due to be published in the spring of 2010, strongly recommends the use of the Debt & Mental Health Evidence Form.

This work on mental health would not have been possible without the strong support of many mental health organisations who have given of their time and expertise and, in particular, the Royal College of Psychiatrists.

The funding of the administration costs of MALG is undertaken by the generous contributions of the creditor members of MALG.

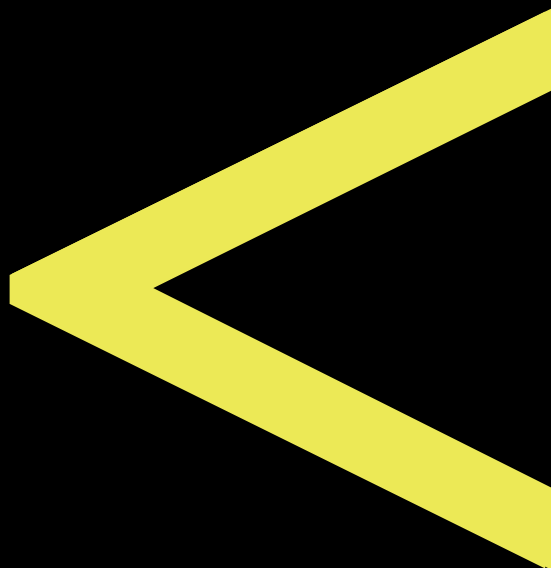
MALG believes in liaison, communication, impartiality, understanding, knowledge and working together for the common good. I believe that the organisation has proved, over many years, how close we are able to get to achieving this. Long may this continue. □



Anthony Sharp is chair of the Money Advice Liaison Group.

Corporate members of MALG

The Association of British Credit Unions Ltd	The County Court Issues Group	The Legal Services Commission
The Accountant in Bankruptcy	The Credit Services Association	The Local Authority Civil Enforcement Forum
The Advice Services Alliance	The Department of Business	The Ministry of Justice
Advice UK	Innovation and Skills	Money Advice Scotland
The Association of British Insurers	The Energy Retail Association	The Money Advice Trust
The Association of Civil Enforcement Agencies	The Enforcement Services Association	National Debtline
The British Cheque Cashers Association	Equifax PLC	Northern Ireland Association of Citizens
The British Bankers Association	Experian Ltd	Advice Bureau
The British Retail Consortium (The Mail Order Traders Association)	The Financial Services Authority	The Office of Fair Trading
The Building Societies Association	The Finance & Leasing Association	PayPlan
CallCredit PLC	The Foundation for Credit Counselling	R3 (The Association of Business Recovery Professionals)
Citizens Advice	Her Majesty's Revenue & Customs	The Society of Messengers-at-Arms and Sheriff Officers
Citizens Advice Scotland	The High Court Enforcement Officers Association	The Trading Standards Institute
The Civil Court Users Association	The Insolvency Service	The UK Cards Association
The Consumer Credit Association (UK)	The Institute of Credit Management	Water UK
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Review of the MG Rover report

Kevin Murphy reviews the long-awaited MG Rover report and finds it a surprisingly good read.

It took four years in the writing, with an advance to make JK Rowling blush. But the long-awaited report on the demise of MG Rover was finally released in September. The *Report on the affairs of Phoenix Venture Holdings Limited, MG Rover Group Limited and 33 other companies* runs to two volumes and 830 pages and can be downloaded for free at www.bis.gov.uk/mgrover-report.

So for the £16 million (inc VAT) question: is it worth reading? The answer is a qualified 'yes'.

A user-friendly report

The report is much more user friendly than I had ever expected. It is written in an easy-going, almost chatty style, with good referencing and clearly defined chapters. The authors are also not afraid to be controversial – for example in stating that witnesses were untruthful or that excessive remuneration was earned.

The most interesting issue is whether there was ever any prospect of the company avoiding formal insolvency, following the sale by BMW to the Phoenix consortium in 2000. The report makes it clear that while the £427 million dowry from BMW meant there was no risk of immediate insolvency, the ongoing losses and investment requirements meant that it could not survive without a joint venture partner. The fact that BMW had retained MG Rover's best brands (Mini and Land Rover) did not



legal issues such as those surrounding directors' duties in the 'zone of insolvency'. It also gives a thorough overview of the obligations of the auditors in assessing going concern.

The text is also noteworthy from the perspective of professional voyeurism, giving an insight into advice given by solicitors and accountants and quoting

inspectors when he said: 'I did not like the allegation of the reason I am not treating them well is the five per cent equity, which was merely £250-300,000. If I ever allowed my professional opinion to be influenced by that size of money, I will be disappointed with myself'.

On the negative side, reading the report feels a bit like reading an old newspaper. This is not just because of the four years it's taken to investigate but also because events have moved on (including the near collapse of the global financial system). And while the report identifies a number of transactions that may be susceptible to challenge by the liquidators, one does get the impression that there was little of substance identified by the inspectors that would not have been revealed by the liquidators' own investigations – and probably in less time and at less cost to the public purse.

Indeed, the, then, DTI's decision to commission the report has parallels with the decision of the Phoenix 4 to 'rescue' MG Rover. Seemed to be the right thing to do at the time, but nobody is surprised at how it turned out. □

“The most interesting issue is whether there was ever any prospect of the company avoiding formal insolvency, following the sale by BMW to the Phoenix consortium in 2000.”

help MG Rover's prospects. Efforts were made to negotiate a JV, most notably with SAIC from China – but these ultimately came to nothing.

Interestingly the report mentions that had the Phoenix 4 not taken on the challenge, BMW had made contingency plans to place the company into members' voluntary liquidation. This option would certainly have been beneficial to the pension scheme (which was ultimately the largest creditor in the liquidation), given that there was no Pensions Regulator to protect it from an (arguably) detrimental transaction.

Searching and searing insights

The report, which was co-written by Guy Newey QC and Gervase Macgregor of BDO, contains good analysis of various

extracts from e-mails and internal documents. It contains yet another example of an e-mail that might (on reflection) have been better not sent. (The partner in the law firm advising the Phoenix consortium on the purchase from BMW e-mailed his team: 'Congratulations and thanks to everyone for a great job in completing Phoenix within an impossible timetable – even if we don't know what we have bought or what any of the agreements say!')

There is also a cast of insolvency professionals known to many readers of *RECOVERY* who make appearances at different times.

By far the most fascinating character is the brilliant Maghsoud Einollahi, a corporate finance partner from Deloitte, who was a close adviser to MG Rover. He also gave my favourite quote to the DTI



Kevin Murphy is a partner in the Business Recovery Division of Chantrey Vellacott DFK.

SIP 16 – does it do what it says on the tin or is it a can of worms?

Robert Smailes recounts the sorry tale of a pit into which he fell.

Much has been written about pre-pack sales of businesses out of an administration process to both connected and non-connected parties and the use and sometimes abuse of SIP 16. Now nearly a year after SIP 16 was introduced what practical implications are there for practitioner and the rescue culture in general?

Clydesdale v. Smailes

A lot of recent industry comments centre around the recently reported case of *Clydesdale v. Smailes*. As the insolvency practitioner involved I am very much aware that in this case, like many others, some of the salient points raised have either been taken out of context or indeed have been badly reported. However, there are real implications and indeed might make even the most thick skinned practitioner think twice before undertaking the next pre-pack.

Clydesdale v. Smailes centred around Alexander Samuel LLP (LLP), a firm of solicitors. My advice was sought and, at the first meeting, I was informed that the LLP was a firm of solicitors who were in extreme financial difficulties and could not continue to trade. The nature of their business was explained to me and, in particular, that the LLP practised exclusively in the field of personal injury work undertaking a significant volume of cases all of which were conducted under conditional fee agreements. I was also advised that the overwhelming bulk of the work related to road traffic accident cases. The value of any particular file was relatively small, if indeed it held any value at all.

I was also made aware, at the outset, that the LLP had very substantial borrowings and that relationships with its funders were poor. I was informed that there was a real risk of one or more funder taking hostile steps in the immediate future and the position looked bleak.

From the information provided to me by the LLP it seemed clear that the business was not solvent and could therefore not continue trading. An additional complication was that once the principals of the LLP formed the view that they could no longer legitimately trade I was informed that they would have a



professional obligation to inform the Solicitors Regulation Authority of this fact and there was a significant risk that this would trigger an intervention into the practice that was likely to have disastrous consequences, not least for creditors.

What were the options?

Time was of the essence and there appeared to be very limited options. Trading out in administration did not seem to me to be a viable option. To run the LLP would mean continuing to employ a large number of staff (the firm was operating on something like 100 or more fee earners) and there would be substantial cash flow requirements in view of the firm's

overheads. Funding was unlikely to be available and retaining staff in what would be no more than a run-off process would have been very difficult.

I did not consider that an open market sale was possible for a practice of this nature. Even if there were a relevant market for such businesses it was very unlikely that any purchaser could be found who would be prepared to purchase the business in a short timescale, and there was a real risk that in seeking to market the business news of the situation would leak out with likely adverse consequences in the loss of clients and staff and possible pre-emptive action by one of the creditors as well as possible regulatory issues. It seemed to me unlikely that there would be a ready market for such a large niche firm in any event.

The LLP advised me that they had been in contact with a third party who was interested in buying the business as a going concern and was willing to do so in a short time span. In all the circumstances, this seemed to me to offer the best solution provided that the sale was at an appropriate price and it was therefore agreed to proceed by means of a pre-pack sale to that purchaser subject to reaching agreement on price.

To ensure that a proper price was to be paid for the business a wholly independent large firm of accountants was instructed to carry out a valuation of the business.

In accordance with the stance taken in both the *Transbus* and *Kayley Vending* cases where creditors had been deprived of the opportunity to influence a sale, I invited an offer from the only known interested party and a sale figure was negotiated and agreed; this figure being substantially higher than the expert valuation that I had obtained.

That a pre-pack sale of a firm of solicitors was undertaken in itself was not worthy of any particular mention or debate. In the current climate a number of professional practices had gone into administration and indeed in the majority, if not all of these cases, a pre-pack was not only the route utilised but indeed, the sale to the current management.

Why the concern?

So why did this particular LLP sale cause so much concern? Well firstly, in over 30 years

in the profession I have seldom seen the level of anger shown by the larger creditors. What was clear very early on was that trust had broken down and a variety of serious, and in my view, totally improper allegations were made by the creditors not least of all against me personally. Injunctive proceedings were commenced by two funders and an insurer (who among

for consultation. I have already explained the risks that were perceived and, at least at that stage, the main creditors were not working as one as became the case in the subsequent proceedings. Mr Justice Richards, in part of his summing up of the case, accepted that, provided an administrator was reasonably confident that the best available deal was done,

“To ensure that a proper price was to be paid for the business a wholly independent large firm of accountants was instructed to carry out a valuation of the business.”

other things, had provided credit insurance). These proceedings initially sought to effectively unwind the sale although, subsequently, the claimants recognised that that was not practically possible.

The claimants' allegations were continued into their proceedings (somewhat surprisingly given that, by then, they had had the opportunity to reflect on matters) and ultimately a lengthy hearing took place over several days in the Chancery Division before Mr Justice Richards. At that hearing, Mr Justice Richards made it clear that he rejected all allegations of deliberate wrongdoing that were made.

Perhaps the main reason why the case has received such publicity is that it is an unusual situation where the court ordered the removal of myself and my partner as administrators and appointed a replacement administrator.

A significant feature in the case was the complaint by the claimants that I had not complied with SIP 16, though the real industry issue is what precisely does SIP 16 require an insolvency practitioner to do in these circumstances.

Was it necessary to consult the creditors?

At the time of this transaction, SIP 16 had only just been issued and its practical effect had not been tested. My understanding of the spirit, if not the letter, of SIP 16 was that an administrator dealing with a pre-pack sale should notify creditors of the position at the earliest opportunity but that there was no duty to consult with them to agree any sale figure. As I had been advised that the main creditors were likely to prove hostile (as appears to be borne out by their subsequent actions) I did not feel it was appropriate to notify them at an early stage. I did, however, e-mail the largest creditor immediately prior to the sale proceeding but, admittedly, too late for that creditor to be able to influence the position.

The contention made by the creditors was that I should have consulted with the main creditors before proceeding but in my view, given the circumstances of this particular job, there was simply no room

keeping creditors uninformed for fear that someone might intervene in a way that might ruin the one and only practical opportunity of securing a real value for the creditors as a whole was not a ground for removing an administrator.

Creditors clearly are in a unique position as stakeholders in any insolvent business often having not only provided substantial funding but also time and effort. However, a surprising feature of this

“The contention made by the creditors was that I should have consulted with the main creditors before proceeding but in my view, given the circumstances of this particular job, there was simply no room for consultation.”

case was how the creditors had been persuaded to provide the LLP with vast amounts of funding without ensuring that adequate security was provided and it does call into question what processes they had in place to verify the balance sheet and accounts and any information provided to them by the former members.

The messages for the future

So what are the messages that come out of the case? Is it that administrators need to be more careful when selling businesses as part of a pre-pack scenario. Hopefully not. I think most practitioners value not only their licences but indeed their sanity and would do anything to be beyond criticism and retain both. I can vouch that being threatened with an injunction on a Saturday and spending most of the weekend liaising with your solicitor is no laughing matter. Being accused of collusion is neither good for myself nor the industry.

I have undertaken a number of high profile jobs throughout my career and my first partner, who was a president of R3 in his time, often reminded me when I was taking early steps that getting experienced solicitors and agents was key. My own solicitors were highly experienced and well known in the industry in which the LLP was acting so one box was immediately ticked.

The valuation agent employed had real experience of valuing business and was fully independent.

What was clear from Mr Justice Richards' summing up was that due to the high profile of the case and indeed the concerns of the largest creditor some form of independent view was needed. What was not so clear was why that could not have been done by the appointment of a liquidator of the creditor's choice that I agreed to convene at short notice rather than having another administrator appointed. As most, if not all, of the day-to-day matters of dealing with client's funds had been reconciled and dealt with by my office there was little or nothing to 'administer' and any appointed liquidator would have the same powers if not greater in reviewing the sale. Indeed, shortly after his appointment as administrator the LLP was put into liquidation and the administrator became the liquidator.

Vast amounts of time and money have been wasted. The estimate of legal costs just to deal with the interim application was in excess of £1.5 million. The claimants have been ordered to bear the vast majority of this. It is hard to see how this can have

been a worthwhile exercise given that all that has been achieved is the replacement of the administrators, which would have happened in any event once the liquidation was proposed.

So what of the future? If the largest creditor in your next job tells you not to sell a business but you believe that you have been offered the best possible price and there is a real risk of losing the sale do you make a decision based on your vast experience and go ahead and risk the knock on the door on Saturday with the injunction, or do you not sell and risk other creditors wondering why you did not 'snap their hands off', preserve jobs, save redundancy costs and yes, pay a dividend to unsecured creditors. I think this course of action used to be called the rescue culture but will any practitioner feel in the future that the costs and the stakes are too high. Only time and possible case law will tell. □



Robert Smailes
is a partner at
Shipleys LLP.

Conclusion on pre-packs: part 1

Sandra Frisby gives an initial overview of her findings that have resulted from her research into pre-packs, as outlined in previous issues of *RECOVERY*¹.

The research comprises an evaluation of the pre-pack strategy and draws on an analysis of actual pre-pack cases (taken from a five-year period from September 2001 to September 2006) and interview data from a wide range of perspectives. It was prompted, in part, by the disquiet expressed in some quarters about the pre-pack strategy. While the debate was originally confined to the practitioner and financier sector, with a few academic contributions, it reached the pages of the press towards the end of 2008 and has continued to feature there since. It is hoped that this research may be useful, at least in exploding a few of the pre-pack myths and presenting a more balanced picture of the strategy.

Use of pre-packs

The period following the coming into force of the Enterprise Act 2002 (ie from 15 September 2003) saw a notable rise in the use of pre-packs in administration. As a method of selling the business of a company it had surpassed, in numbers, the 'business sale' method by May 2005, and by September 2006 it continues to be used slightly more often than other methods of sale. However, both forms of sale are commonly used during the period in question, and there is no indication during that period of a pre-pack explosion.

More recent data collected by The Insolvency Service records that around 100 pre-packs a month were carried out between January and June of 2009, but it should be noted that the number of administrations during that period has risen considerably since the period under investigation here. The Insolvency Service estimates that roughly half of all administrations between January and June 2009 resulted in a pre-pack sale. This appears proportionately higher than at any time during the research period, but is very likely explained by the fact that economic conditions during the first half of 2009 meant that funding for the continuance of a business during an insolvency procedure is more difficult to obtain, making the pre-pack sale the most viable, if not the only viable option.

Business sectors and characteristics

The pre-pack is most commonly used to sell service-related businesses, with well over a third of the sample falling into this category. Professional service businesses, such as those providing accountancy and legal services, management consultancy services and recruitment services are more



frequently sold by the use of a pre-pack than any other method of sale. During the later part of the research period, the use of pre-packs to sell construction-related businesses became noticeably more common, as did the use of the strategy in relation to distribution businesses and those operating in the hospitality sector.

An interesting distinction between the use of pre-packs and business sales emerges in relation to the size of the companies in the sample. In general terms, pre-packs are used far more commonly where the company in question is small. Although pre-

“The pre-pack is most commonly used to sell service-related businesses, with well over a third of the sample falling into this category.”

packs can be, and have been, used in relation to large businesses, it is far more common to find such businesses sold by an alternative method. Pre-pack sales are most often used in relation to owner-managed businesses with a turnover of less than £300,000 per annum, no more than four directors and operating from a single location.

Importantly, a common characteristic of such companies is that the vast majority of value is found in two sources, these being debts owed to the company and the future value of any contracts to be performed by the company. In short, pre-pack sales are

used significantly more often in relation to 'tangible asset-light' companies than other forms of sale. In over 40 per cent of the pre-packs in the sample, the *only* free asset that could be offered for sale was goodwill: the companies in question owned no tangible or intangible assets, having hired or licensed them under agreements that would terminate on the insolvency and under which the company had no equity.

Firms and purchasers

A wide variety of firms have carried out pre-packs during the period under investigation, and no particular trends stand out. The post-Enterprise Act period saw a number of smaller firms begin to carry out pre-packs, but this is almost certainly due to the relaxation of entry routes into administration under that Act, and a larger number of small firms carrying out business sales is also evident from the analysis.

Pre-pack sales far more commonly involve a connected purchaser than do other sales, and across the entire sample just under two-thirds of pre-packs fell into this category, with the corresponding figure for business sales being just under half of the sample. However, sales to connected purchasers appear to be an increasing trend in the pre-pack sample, particularly during the last 18 months of the research period. The Insolvency Service's survey of pre-packs from the first six months of 2009 puts the proportion of connected party sales at 81 per cent, although there is no comparative figure for other forms of sale.

The pre-pack process: transparency, justification and conscientiousness

The disclosure requirements of SIP 16 now

apply to pre-packaged administrations, and are to be warmly welcomed. However, a notable improvement in the quality and quantity of information delivered by practitioners is evident from the analysis, and the majority of reports from the latter

administration without funding to continue trading, which was simply not forthcoming from existing funders or any other source; and

- that it was considered that there was a strong likelihood that the value of any

“SIP 16 now requires practitioners to justify their choice of the pre-pack strategy, and this represents best practice from the period under investigation.”

part of the period under investigation were highly informative in terms of disclosing critical information. A small minority, on the other hand, were very poor in this respect. It bears repeating that cases involving pre-packs were overall much better explained and described by practitioners than those involving business sales.

SIP 16 now requires practitioners to justify their choice of the pre-pack strategy, and this in fact represents best practice from the period under investigation, as over three-quarters of the cases in the sample contained an explanation as to why the pre-pack strategy was adopted. Two reasons for choosing to pre-pack were most commonly offered. These were:

- that the business could not realistically be marketed for sale during an

goodwill in the business would deteriorate once the insolvency of the company was publicised, as would the value of the company's debtor-ledger.

A further positive finding in this respect is that practitioners have, over time, devised means of investigating the market for the business in question *before*

agreeing the eventual pre-pack sale. Marketing was initially uncommon (or not referred to) in the earlier cases from the sample, but for those taking place in the last 18 months of the research period practitioners had carried out some form of marketing in just over half of cases. Such marketing as there was would not, of course, be as wide scale as that seen in the business sale sample, but increased and better efforts were clearly being made. Finally, it is clearly now routine for practitioners to obtain some form of valuation of the business before agreeing the pre-pack deal, and references to valuation were made in the vast majority of cases in the sample. □

¹ Previous articles in this series:

Unpacking pre-packs, Sandra Frisby, *RECOVERY* spring 2007

Unpacking pre-packs: the story so far, Sandra Frisby, *RECOVERY* autumn 2007

Coming in spring 2010

Further findings and conclusions will be offered in the next edition of *RECOVERY*. In particular, the next piece will address the question of how various classes of creditors fare from pre-packs and, perhaps most significantly, whether or not the most common criticisms of the strategy are in fact borne out by the research.



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Football League clubs face the recession

Brendan Guilfoyle explains the challenges ahead for football clubs and how best to undertake the administration of a club.

Warning bells are sounding in the world of football as Football League clubs face up to the harsh realities of recession and the credit crunch. It is inevitable that more clubs are going to face financial stress and possibly administration, failing as a result of declining revenues, fixed costs and players' wages that cannot be reduced in the short term. Income generated from fans is reasonably constant but commercial income is dropping in a recession. Some clubs do not currently have a paying shirt sponsor.

The challenges football clubs play against

What differentiates football clubs from other businesses is that they have the substantial fixed overhead of the wages of their players, who are on long-term contracts. If clubs have budgeted for levels of income that cannot be achieved due to recession, then while their income drops they cannot readily reduce their costs. They will gradually build up debts and eventually fail.

Approximately 70 per cent of football clubs bridge the income gap with a benefactor, but if the benefactor has financial, health or marital difficulties then it could impact on the club. Many benefactors have made their fortunes in property, but with the decline in property values and the lack of liquidity it may prove difficult for them to keep pumping money into a club.

Many businessmen (and to a lesser extent business women) have bought football clubs in the belief that they could impose their successful business methods on the club and change the way the club is run. They soon find that it is like trying to turn a super-tanker and become disenchanted. The lucky ones sell their interest in the club on, but others have been forced to retain ownership, hoping

“More clubs are going to face financial stress and possibly administration, failing as a result of declining revenues, fixed costs and players' wages.”

The temptation to pay players an otherwise unsustainable level of wages is always there for football club directors. They want to live the dream and strive for success on the football pitch. If that success is not achieved then the consequences are predictable. It is a truism that there is a direct correlation between a club's position in the league and the level of the club's player wages.

for a successful sale in the future while still having to pump money into the club.

One of the first areas of expenditure to suffer in a downturn is the academy, thereby eradicating the opportunity for a football club to profit from the development and sale of young players. The preference of clubs in the Premier League to acquire experienced foreign players has also reduced the number of potential sales.

Many football clubs have been bought out of administration by supporters' trusts, determined to run the club on a sustainable basis by balancing income and expenditure. They have often been unsuccessful and forced to hand over control of their club to wealthy benefactors. Fans demand success on the football pitch and if it is not forthcoming attendances at games can drop and income declines, creating a downward spiral that is difficult to reverse.

“Don't accept an administration of a Football League club unless you have secured funding and have a clear idea of how the club will exit administration.”

The decline in government revenues is sure to stiffen HM Revenue & Customs' (HMRC) resolve to collect taxes owed by football clubs or, in extreme situations, to wind them up so as to limit ever-increasing levels of Crown debt. In my experience there is little love for football clubs at Worthing!

When will clubs fail?

This is the big question. So far this season there have been no administrations of Football League clubs, although clubs have failed in the lower leagues. Strategically, clubs seek the protection of administration later in the season when they are better able to evaluate the effect of the sanctions imposed by the Football League.

Since 2002 there have been 45 Football League club insolvencies. History shows that it can be a drawn-out process; when ITV Digital went bust it had a major affect on football clubs, but not necessarily at that time, with many clubs surviving for a number of years before entering into insolvency.

The administration process

Don't accept an administration of a Football League club unless you have

secured funding and have a clear idea of how the club will exit administration.

So, the inevitable has happened and you have been approached to undertake the administration of a football club, possibly as a result of an HMRC winding up petition. Time is of the essence and fans are clamouring for news of developments at their club – yes, their club! You need time to produce a cash flow forecast through to the beginning of next season, including the lean closed season. This will probably throw

up the need for substantial funding, especially if the club has recently been in a higher division with high wage costs.

You must secure at least sufficient monies to enable the football club to trade for the three months that it will take to find a purchaser who, once identified, should be prepared to fund continued trading. Traditionally administrators have been inundated with interest from potential purchasers of football clubs, but in recent administrations there have only been one or two people seriously looking at purchasing the club.

If your cash flow shows income from transfers or the proceeds from player sales in the transfer window then you might want to consider employing a football agency to liaise with the club's manager on potential sales and to negotiate accelerated payment of any deferred payments due to the club from earlier player sales.

Your inability to pay the players' wages on time will impact on relations with the Professional Footballers Association and club manager, the team spirit, and generate huge amounts of airtime on radio and TV and copy in the local press, who will normally run a daily article on their local football club. Any attempt to

cancel or vary players' contracts is, in my experience, naive.

The Football League, in maintaining the integrity of their competition, will apply sanctions to the club upon entering administration – normally a minimum deduction of 10 points. The Football League will require the club to exit administration through an agreed Company Voluntary Arrangement (CVA) if the so-called 'golden share' is to be transferred to a new company.

I say a new company because the Football League will require all football creditors to be paid in full. This leads to direct payment by a purchaser and implacable opposition to a CVA by HMRC, who are often the major creditor for unpaid VAT and PAYE/NIC on wages. Detailed consideration must therefore be given to how a CVA can be agreed in the face of HMRC opposition as there are always football creditors to be paid in full. It remains to be seen if the Football League's monitoring of HMRC debt owed by its clubs will result in lower HMRC debt and more successful CVAs. The Football League certainly hopes so.

Last but not least, make sure you secure funds to pay your firm's fees. During the season football is conducted in the media spotlight 24/7. You will receive calls at all times of the day and night and will be expected to be on call to the media which, after all, is a very effective way of communicating with the fans. Your firm's time costs will escalate very quickly, especially in the early stages of the administration as you stabilise the club and seek a purchaser.

Transparency is key

As with all administrations, clear communication and transparency are more important than ever. There will be a small hardcore group of supporters watching your every move and swapping information on the internet. They are not all archetypal football fans; at my last football club administration I had a fans' group who counted among their members a partner in a Big Four accountancy firm, a leading TV presenter and a hedge fund manager – all local lads who had made good.

While it is easy to see how running a football club can become addictive, it is important not to let vanity get in the way, to remain detached, to make the difficult decisions decisively and get new owners into the club. □

Brendan Guilfoyle wishes to acknowledge the assistance of David Hinchliffe of Walker Morris solicitors and Ben Mansford of the Wasserman Media Group agency in writing this article.



Brendan Guilfoyle is a former president of R3 and a partner in the P & A Partnership.





JJB Sports & Focus CVAs: formidable rescue tools

Kevin Pullen argues that the CVA is a formidable rescue tool in the right circumstances.

The BBC2 website defines its television series *Grumpy Old Men* as a 'series giving a voice to 35- to 54-year-old men, very probably the grumpiest sector of our society'. Well the writer certainly falls within the age range and certainly found himself with an attack of the grumps when reading the autumn 2009 edition of *RECOVERY*. As I commenced my daily commute, crammed sardine-like on the train, I reached for *RECOVERY* and I nestled in for a pleasant read about what a wonderful device the JJB CVA was. Jeremy Goldring's article entitled JJB Sports CVA, started well, with comments such as 'fair enough' and '...on the face of it, JJB's CVA is a

particularly the suggestions that CVAs, such as that used by JJB Sports and more recently Focus DIY, may be capable of being challenged by creditors on the grounds of material irregularity or unfair prejudice.

Is there any basis for such challenge?

In simple terms, both the JJB Sports CVA and the Focus CVA achieved two things. First, they enabled both companies to exit from their lease payment obligations in relation to closed stores (closed premises) in return for the closed premises landlord having the right to claim a set payment from a designated fund. Secondly, in relation to stores from which they wished to continue to trade (open premises) the rents

mechanism that allows an agreed vote by reference to a discounted rent formula constitute a material irregularity? Secondly, does a change in the payment terms under the lease either to terminate those payments (in the case of closed premises) or to move them to monthly payments (in the case of open premises) amount to unfair prejudice?

An important point to note is that the JJB CVA received overwhelming support from its landlords. It was regarded as both a commercial success and it set a precedent for CVAs in the market. The precedent has since been adopted in the Focus CVA.

Material irregularity

Is it a material irregularity to prescribe, in the terms of a CVA, the voting rights that creditors will have if that prescribed mechanism alters rights that creditors would ordinarily have at law? The first thing to note is that neither the JJB Sports CVA nor the Focus CVA operate to prescribe a voting mechanism. In each case, the terms of the CVA make it clear that the chairman of the CVA creditors' meeting has the power to ascertain the entitlement of persons wishing to vote in accordance with rule 1.17A of the Insolvency Rules 1986. Both CVAs then make it clear that claims were likely to be allowed for voting purposes if the claim was calculated in accordance with the discounted rent formula. In essence creditors had the right to provide evidence as to why their claim should be greater than the result of the calculation of the

“An important point to note is that the JJB CVA received overwhelming support from its landlords.”

formidable rescue tool'. It even, to misquote Mr Goldring, ended well '...the JJB CVA represents a remarkable rescue tool. A debtor may devise a business plan that produces a decent return for its investors, re-write its contractual obligations to its financial creditors, suppliers and customers including those with proprietary (though not security) rights and force these changes through with the requisite majorities ... it can even dictate how claims which are difficult to assess should be calculated for voting purposes'. It was the bit in the middle of the article that induced the grumpiness –

were converted from quarterly rents to monthly rents. In each case a formula was used in order to work out a discounted rent for the remaining life of the lease (the discounted rent formula). If a landlord submitted his claim on the basis of the discounted rent formula then that claim would automatically be allowed for the purpose of both voting on the CVA and, in the case of a closed premises landlord, receiving payment under the CVA.

Two questions are raised by Mr Goldring's article: first, does a voting

discounted rent formula. What the discounted rent formula essentially did was create a simple mechanism for determining an unliquidated amount. Rather than finding it 'irregular', creditors found the use of a formula helpful. Indeed, in the case of the JJB Sports CVA, the landlords availed themselves of the use of the formula.

Rule 1.17(2) of the Insolvency Rules 1986 provides: 'Votes are calculated according to the amount of the creditor's debt at the date of the meeting ...'. Rule 1.17(3) provides: 'A creditor may vote in respect of a debt for an unliquidated amount or any debt whose value is

whether something is prejudicial, but whether it is unfairly prejudicial.

Can a CVA operate to alter the contractual arrangements between a debtor and its unsecured creditors? If it could not, it would be a fairly pointless process.

It has been long established that, within the terms of a CVA, it is not unfair to differentiate between members of a class of creditors with future claims on the basis that some creditors would be paid in full (because their asset is required by the company to earn future profits) and some creditors would only be paid in part

to me, expect to pay the full rent to which the landlord is contractually entitled'.

However, Neuberger L J in the *Thomas* case then goes on to make it clear that, pursuant to the statutory scheme, it is only secured and preferential creditors who cannot be bound by a CVA without their consent and that the right of a landlord to receive rent under a lease is not a secured claim: '...While it is true that it was at one time thought that a landlord with a right to forfeiture was to be treated for these purposes as a secured creditor, that is now seen to be wrong: see *Razzaq v. Pala* [1997] 1 WLR 1336, 1341e - 1343d and *In re Lomax Leisure Ltd* [2000] Ch 502, 510 b - 517 d. It does not seem as if the legislature intended a creditor with a right to forfeit should be treated in a different or better position under a CVA than any other sort of unsecured creditor'.

In essence, a CVA can alter the rent payable under a lease. The open premises landlord's proprietary rights are preserved because he retains the right to forfeit the lease if the CVA adjusted rent remains unpaid. Neuberger L J concluded in the *Thomas* case that '... Therefore the landlord is being treated like any other unsecured creditor. He is not being deprived of his right to forfeit: he is merely unable to forfeit for rent which he can no longer claim for, because it has been replaced by debt under and pursuant to the terms of the CVA. In any event the landlord is not deprived of his right to forfeit the lease if, as in this case as under any well-drafted lease, he has the right to

“What the discounted rent formula essentially did was create a simple mechanism for determining an unliquidated amount.”

not ascertained and for the purposes of voting (but not otherwise) his debt shall be valued at £1 unless the chairman agrees to put a higher value on it.' Claims for future rent are unliquidated and unascertained. Therefore, rule 1.17(3) applies. In relation to the operation of that provision, the court in *Chittenden v. Pepper* [2006] BPIR 1230 decided that for the purpose of determining the amount of an unliquidated claim '...the chairman should not speculate. Nor is he obliged to investigate the creditor's claim. But he must examine such evidence, and I do not use that word in any technical sense, as the creditor puts forward and any relevant evidence provided by any other creditor or the debtor. If the totality of that evidence leads him to the conclusion that he can safely attribute to the claim a minimum value higher than £1 then he should do so.'

In that case, the court determined that it was acceptable for voting purposes to value future rent at £1. Therefore, it is doubtful that a 'material irregularity' challenge could ever succeed in relation to a formula, which enables a creditor to easily establish the level of its voting entitlement for an unliquidated and unascertained claim at an amount in excess of £1. It should also be noted that the discounted rent formula used in both the JJB and Focus CVAs would achieve a result not totally dissimilar to the claim that a creditor would have had if JJB Sports or Focus had been placed into liquidation and the leases disclaimed. On that basis it would be difficult to challenge the fairness of the approach.

Unfair prejudice

On one analysis, anything done in a CVA is prejudicial. The whole point of the statutory CVA scheme is that one or more creditors will receive less than they were originally entitled to receive. It is the essence of a compromise or an arrangement that rights are altered to enable a company to survive into the future. The question, therefore, is not

(because their assets are no longer required by the company): *Re Cancel Ltd* [1995] B.C.C. 1133. Differentiating between closed premises landlords and open premises landlords was, therefore, perfectly acceptable. It should also be remembered that the JJB Sports CVA almost certainly represented a better return to closed premises landlords than would have been the case if the company had been placed into liquidation and the

“It does not seem as if the legislature intended a creditor with a right to forfeit should be treated in a different or better position under a CVA than any other sort of unsecured creditor'.”

same position appears to have applied in the Focus DIY CVA. On that basis, it would have been difficult to establish any prejudice at all.

So what about open premises landlords; are they unfairly prejudiced as a result of their contractual rent terms being altered from quarterly to monthly payment terms? Can you use a CVA to change what you pay to a landlord and still use his property? The landlords obviously thought so as there was no challenge to the JJB Sports CVA.

Looking at it at a slightly more legalistic level, a landlord is undoubtedly a creditor for future rent: *Re Cancel Ltd*. Future rent is undoubtedly capable of being compromised under a CVA: *Re Cancel Ltd* and *Re Sweetfield* [1997] B.C.C. 744. It is correct to say that Neuberger L J said in *Thomas v. Ken Thomas Ltd* [2006] EWCA Civ 1504 that: '...It strikes me that, at least normally, it would seem wrong in principle that a tenant should be able to trade under a CVA for the benefit of its past creditors, at the present and future expense of its landlord. If the tenant is to continue occupying the landlord's property for the purposes of trading under the CVA (and hopefully trading out of the CVA) he should normally, as it currently appears

forfeit in the event of insolvency including the proposing of the CVA, or any other act of insolvency, and he does not waive it. Furthermore, although the landlord like any other creditor might feel prejudiced by the CVA, particularly, as in this case, if it is one which he has opposed, that is a problem faced by any creditor on the company of the CVA and it is part of the price of the rescue culture'.

Therefore a CVA can be used to adjust the rent payable to a landlord.

So, in conclusion, it has to be said that the CVA is, indeed, a formidable rescue tool when used in the right circumstances as in the case of JJB Sports, which has, indeed, set a precedent for the market. □

Herbert Smith LLP acted for JJB and acts for creditors on Focus.



Kevin Pullen is a partner at Herbert Smith LLP.



The bluffer's guide to Chapter 11 of the US Bankruptcy Code

Michael Rutstein provides a brief overview of Chapter 11 to replace your mid-Atlantic drift.

Here is everything you wanted to know, in pocket-size form, about the Chapter 11 process. Please cut out the guide and keep it in your wallet or purse at all times so you have easy access to it in cases of emergency. I hope, after reading the guide, you will be able to litter your conversation with your US opposite number with Chapter 11 jargon and dazzle them with your expertise.

What is Chapter 11?

Chapter 11 of the Bankruptcy Code has the aim of preserving a company's going concern value compared with the alternative: a liquidation conducted under Chapter 7 of the Code. Chapter 11 contains aspects of UK administrations, CVAs, schemes of arrangement and UK liquidation all wrapped up together.

A Chapter 11 process will usually aim to implement a plan of reorganisation containing one or more of the following elements:

- a stand-alone plan where the creditors, the

company and possibly the shareholders agree on a reorganisation without the involvement of third party investors;

- a sale of all, or substantially all, of the assets as a going concern and a subsequent distribution of the proceeds to creditors;
- a capital injection from a third party investor;
- a debt for equity swap; or
- setting up a litigation trust to pursue claims.

Why is Chapter 11 called a debtor in possession procedure?

Usually in a Chapter 11 case, the management remains in control of the company and there is no involvement of the equivalent to the UK insolvency practitioner. Hence, the company remains in possession of (or rather, in control of) its assets. However, the management's powers are circumscribed. For example:

- the company may not enter into transactions outside the ordinary course of business without approval of the bankruptcy court.
- creditors may require, as a condition for

their co-operation in the process, the appointment of a specialist restructuring officer.

- creditor committees will be formed (representing interest groups such as unsecured creditors, bondholders and tort claimants) and they are likely to take an active role in the conduct of the bankruptcy. They have the right to be heard on court applications and to appoint lawyers and sometimes financial advisers. As the professionals advisers' fees are paid out of the debtor's estate, the Chapter 11 process can be a very expensive process for the company.

How is a Chapter 11 process commenced?

Interestingly, there is no requirement for a debtor to be insolvent before it can 'file' under Chapter 11.

Nearly all Chapter 11 cases begin voluntarily (ie it is the company that files). It does so by lodging with the bankruptcy court a petition accompanied by a list of creditors and a summary of assets and liabilities. Filing takes place electronically and can be done at any time of day or night.

Filing applications must be made in good faith, which means the company must have the intention of bringing about a reorganisation, a realisation of assets or its sale to a third party. Filings that are not made with one of these objectives can be dismissed as a 'bad faith filing'.

company has the exclusive right to propose a plan. In practice, the company will negotiate the terms of the plan in advance with the creditors' committees and other interested parties. The company must provide creditors with a disclosure statement containing information about

confirmation, which can sometimes be obtained within 4 to 6 weeks. The advantage of a pre-packaged case is that the outcome of the Chapter 11 process is certain and the relative speed of the procedure means that costs are saved.

One notch down is the pre-negotiated bankruptcy case where the company has reached agreement with major creditors before filing but there has been no vote by the general creditor body. Once again, the company will hope to save costs and emerge out of bankruptcy earlier than would otherwise be the case.

What is a DIP loan?

Funding of a company in bankruptcy while it puts together a plan of reorganisation is an issue of utmost importance. The US Bankruptcy Code has sophisticated rules for allowing lenders (existing or new) to provide finance to the company after filing (known as DIP lending). The bankruptcy court may authorise super priority liens (or security interests) to the DIP lenders in priority to any existing security lenders although the court has to be satisfied that the existing security holders have adequate protection for the value of their security.

What are section 363 sales?

A section 363 sale has become the favoured method of selling a distressed business. It is relatively quick and only needs the approval of the bankruptcy court rather than the class consents required for a plan. Other advantages are that the management can

“The Chapter 11 process gives the company a discretion to reject or continue with its contracts (and is a much more powerful tool than the paltry right of disclaimer only available to English liquidators).”

What is the automatic stay?

As soon as a filing takes place, the company has the benefit of an automatic stay under which all actions against the company or its assets anywhere in the world are prohibited without the consent of the bankruptcy court. A creditor who takes action in breach of the automatic stay may be guilty of contempt of court and subject to financial penalties. If a creditor wishes to enforce security, it must first apply to the court for the stay to be lifted.

The automatic stay tends to be wider than the UK administration moratorium. The automatic stay prevents exercise of contractual termination and set-off rights (neither of which are prohibited by the moratorium). Furthermore, our moratorium does not purport to bind foreign creditors to the same extent as the automatic stay.

What happens to the debtor's contracts after filing?

The Chapter 11 process gives the company a discretion to reject or continue with its contracts (and is a much more powerful tool than the paltry right of disclaimer only available to English liquidators). If the company rejects any executory contract, the counterparty will be left with an unsecured claim for damages. The company can require a contract to continue (even if the counterparty has the contractual right to terminate it) provided that the company remedies any breach and if a breach has occurred, it has given adequate assurances about future performance. The company also has the right to assign a contract, which it elects to continue even if the contract prohibits assignment. The company may wish to do this in return for a payment from the assignee.

What is the typical exit route for a Chapter 11 case?

The usual process by which a Chapter 11 process ends is by the approval and confirmation of a plan of reorganisation, the equivalent of our CVA or scheme (incidentally the word scheme to an American does not have the same connotation as it does to us; it means some dishonest play).

In the first 120 days after filing, the

the company and the plan (very much like the UK scheme explanatory statement).

To obtain approval of the plan, each class of impaired creditor (one whose rights are to be affected) has to vote on the plan. A plan will be approved by a class if a majority in number and two-thirds by value who vote, vote in favour. A dissentient minority will be bound by the class vote provided that the plan provides for each creditor to receive at least what it would have received in a liquidation (the best interests test) and each creditor in the class is offered the same return. The bankruptcy court must confirm the plan and it has the power to confirm even if a class of creditors has voted down the plan. The court must, before doing this, be satisfied that the plan is fair and equitable.

“The bankruptcy court may authorise super priority liens (or security interests) to the DIP lenders in priority to any existing security lenders.”

As a general principle, the plan must offer secured creditors the full value of their secured claims although payments to them can be spread in instalments subject to a right to receive interest.

A plan must generally provide for unsecured priority claims to be paid in full once the plan takes effect. Priority claims include the company's post-filing obligations and certain pre-bankruptcy wages and employee benefits.

Typically, the plan will offer to unsecured creditors a combination of a cash payment (either payable immediately or in instalments over a period of time or payments linked to future profits) and new shares, loan notes or other securities.

What is a pre-packaged/pre-negotiated bankruptcy case?

It is possible for a company to file a pre-packaged case. Here, the plan has been negotiated and the class votes obtained before filing. All that remains to be done is to obtain the bankruptcy court

sell without exposure to creditors' claims and the buyer acquires the assets free of third party claims. The usual procedure is that the company agrees the terms of a sale with a bidder (known as a stalking horse) but once the deal is agreed, the company must engage in an auction process. If it accepts a higher offer made by a new bidder, it must make a compensating payment to the stalking horse, which is usually fixed between 1 to 5 per cent of the sale price.

So there you have it. *RECOVERY* asked me to pose for a photograph to accompany this guide, clad in an orange prison suit with handcuffs, Madoff style. I declined. Sorry to disappoint. □



Michael Rutstein
is a partner at
Jones Day.

The Spanish construction sector: miracle or mirage?

Agustín Bou discusses how a decade of pursuing an ill-advised economic policy has had a detrimental effect on the whole Spanish economy.

When something can go wrong, it does go wrong. Unfortunately this proverb is fully applicable to the present situation of the Spanish construction sector. When one analyses the present economic situation in Spain, one tends to think that the situation is equivalent to that in other jurisdictions. This approach stems from a false premise, for the present crisis has had some special features in its impact on the Spanish economy.

A crisis in construction

On the one hand, the financial crisis has so far affected the Spanish banks less severely than banks in other jurisdictions. Fortunately, Spanish banks did not take on exposure to the subprime market. On the other hand, the Spanish economy as a whole was too deeply and too riskily based on the construction sector; and thus the impact of the construction crisis has been much higher than in other Western economies.

Spain has been incubating its present crisis over the past ten years under the cover of the boom in the construction sector. Ten years ago, the percentage of Spain's GDP attributable to the construction sector was not different from that of other developed economies. Each year, the degree of dependence became progressively greater; to the point of a dependence of more than 16 per cent of



to the shortage of it; the complex financial structure of Spanish regional and municipal governments, which makes them highly dependent on real-estate development and pushed them into a headlong race to incessant development of building land, etc.

All these factors were inevitably dragging the country into an unsustainable situation, although the operators hoped that they would have a soft landing.

in general, and so wasted precious time in adopting measures to reduce its impact. To this must be added the government's economic policies of a clearly populist nature, which will unfortunately greatly lengthen the time needed by Spain to come out of the recession.

Banking losses

We should also bear in mind that Spanish banks have not yet taken stock of the huge losses that the real-estate crisis is causing in their balances. In many recent cases they have granted refinancing to businesses of doubtful future solvency, and in other cases have assigned mortgaged property to real-estate subsidiaries so as not to have to incorporate them as losses in their own balances. When these properties come to be sold at the real market price, the banks will have to record in their books the loss that they represent; so one can foresee that their results in the coming two years are going to register a serious negative impact.

It is difficult to predict how much time the construction sector is going to need to recover from this crisis, but our impression is that the worst is yet to come. Building companies will soon have to address the enormous financial commitments they have entered into with the banks, without having the resources to do so. That will inevitably provoke in Spain a financial crisis that will involve a merger of banking institutions and even the disappearance of some of them.

The mirage disappears

It is clear that Spain has exhausted an economic model on which it should never have relied so much, and will need to take alternative approaches to the future based on other sectors of the productive economy. This will be extremely difficult. After years of thinking we were living in a miracle, we have suddenly discovered that we were living in a mirage, and we now have ahead of us a tough trek through the desert of reality. □

“Building companies will soon have to address the enormous financial commitments they have entered into with the banks, without having the resources to do so.”

our GDP on the construction sector in 2007. That is an excessively high level for a sector of these characteristics, especially if we bear in mind that its rise was due to a steady fall of industrial sector GDP. The elements for a perfect storm had been attained.

Historical factors

Historically, many factors have contributed to producing this situation: cheap money; mistaken policies to enlarge the area of available urban building land, for it was assumed that high housing prices were due

Unfortunately that has not happened, largely – as the real-estate crisis in other economies such as Ireland's shows – on account of the world recession. However, there have also been many specifically local features that contributed and are still contributing to make the situation in Spain worse. One of the main problems is the bad management of the crisis by the Spanish government, which throughout late 2007 and much of 2008 repeatedly refused to acknowledge the existence of the economic crisis. This denial applied to both the real-estate sector and to the Spanish economy



Agustín Bou is a partner at Jausas.

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Economic snapshot: Southern Region

2009 might well be remembered as the year of the false dawn according to Andy Beckingham as the leisure industry in the South continues to battle against the recession.

This year has seen the economy almost grind to a halt after years of boom and many business leaders have had to make tough decisions just to survive.

Leisure industry kicked into touch

Traditionally, the South has been strong in leisure and tourism as well as technology and manufacturing, but all of these sectors have been hit hard by a sharp decline in consumer spending, the difficulty in securing finance and the general uncertainty in the market.

Of course, particularly on the South coast, our football clubs play a significant role in the leisure industry and so peoples' perceptions of how well the region is performing could well be very closely



about the longer-term outlook, many businesses appear to have resorted to short-term decision making and planning and, in some cases, simply to fire fighting

poor 2008 and a rather wet summer this year, large parts of the leisure and tourism sectors in the South have already been faced with a particularly unwelcome squeeze. Statistically, visitor numbers are up (coinciding with the word 'staycation' entering our lexicon), but late bookings at reduced margins have caused uncertainty and domestic tourists have spent less cash on food, drink and ancillary leisure activities than industry bosses had hoped. The burden will be increased further on employers in the South and elsewhere by the recent increase in the minimum wage and the ruling that tips can no longer be used to top up wages to minimum wage level. This will inevitably drive up business costs and will particularly impact on hotels, guest houses, restaurants and bars across the region. For most, the summer months business boom just hasn't happened.

“Time to Pay liabilities will need to be unwound, and the way in which this is managed, and over what time period, will impact hugely upon business failure rates.”

linked to the health and wealth of their favourite club. With AFC Bournemouth going in and out of administration and Southampton FC doing likewise and currently sitting at the bottom of League One (at the time of writing), the message to the public is only too clear. Even Premiership outfit Portsmouth, currently languishing at the bottom of the division, has been struggling to fund its wage bill, let alone the new players it will need to purchase come the January transfer window, if it is to prosper.

The shape of the recession

In line with the rest of the country, the South entered the downturn with a cyclically weaker balance sheet than might have been expected 15 years after the last recession. We have seen significant over-gearing within both companies and individuals and this has been compounded by unprecedented levels of government borrowing and a banking sector facing its own challenges.

Businesses and politicians alike have been unable to call the shape of the recession with any confidence. Are we headed for a double-dip or will it be conveniently V-shaped as some would have us believe? Hindered by a lack of clarity

as funding sources have dried up. This combination of factors has further reduced business optimism.

For the moment, however, government-generated stimuli have proved a strong anaesthetic against the pain of a deep recession; but we should not be lulled into a false sense of security – when the stimuli wear off, a more reliable picture of whether the recovery is robust and sustainable will emerge.

We are not yet spending our way out of the recession

Previous recessions have come to an end at some pace through a consumer-driven recovery. With household consumption effectively making up the largest part of GDP, the government will hope that, in the right environment, individuals will spend their way out of trouble. The last quarter of this year could well demonstrate just how damaged the consumer wallet is. This year has seen a decline in consumer credit, credit card limits stripped back and the unavailability of equity release, all of which will potentially strip the economy of £50 billion of consumer spending.

For the time being, economic recovery seems to have stalled. What's more, after a

Time to pay liabilities

On top of these recessionary pressures there is a much bigger ticking time bomb. Many businesses unable to manage their working capital through conventional means have turned to the Crown for support in the deferral of (often huge) PAYE and VAT liabilities. These Time to Pay liabilities will need, at some point, to be unwound and the way in which this is managed, and over what time period, will impact hugely upon business failure rates. Whether as a means of emergency cost-cutting, or in response to insolvency, jobs will be lost.

If businesses fail, then the opportunists will, understandably, swoop to pick up their turnover. However, with surplus capacity across all sectors, 15 years since the last recession, it will be order books in demand rather than the people and capacity to service them. Although the green shoots of recovery have been widely reported, 2009 could yet be remembered as the year of the false dawn. □

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Andy Beckingham
is chair of the
Southern Region
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restructuring partner
at BDO LLP.

Financial education initiative

Rod McKee outlines a new initiative, which draws on IPs' expertise, to help educate children about financial matters and start to tackle the root of the problem of personal debt.

In the continuing wake of last year's financial meltdown, no-one can doubt the importance of financial management. This is why the *ifs School of Finance* has been working with R3 on a financial education initiative aimed at increasing financial capability among young people.

IPs visiting schools

IPs across the UK have been visiting secondary schools in their local areas to talk about personal debt and insolvency. Their short talks focus on managing money, keeping track of finances, choosing financial products and 'what can happen when things go wrong'. The aim is to help students knock bad habits on the head at an early stage so that they don't rack up unmanageable debt in later life.

It's a mutually beneficial initiative – a chance to draw on IPs' expertise to help prevent a repeat of the financial chaos of the last year, as well as a great opportunity to enhance the reputation of IPs. Peter Sargent, president of R3, has been instrumental in promoting the initiative: 'I've visited a school in Leeds on a few occasions now and have really enjoyed the experience. The pupils seemed to really respect what I was saying and asked lots of questions. It's a great opportunity to 'give something back' and it's nice to think that



Children are curious about financial matters

Unlikely as it might sound, young people really want to hear about IPs' experiences. We're living in an age where children are genuinely curious about financial matters. According to recent research conducted by the Co-operative Child Trust Funds, half of the parents interviewed say that their

the government to put them on an equal footing with other more traditional subjects. In the meantime, though, initiatives like this one undertaken with R3 are doing a great job of plugging the gap!

Volunteers required

This joint initiative has been running for a few months now and we've had a very positive response from IPs – but we're always on the look-out for more volunteers. If you're interested in speaking directly to 14- to 19-year-olds about the dangers and consequences of getting into too much debt, or if you would just like to find out more about the initiative, I'd love to hear from you.

If you would like to take part, the process is very straightforward:

- E-mail me at the *ifs School of Finance* on rmckee@ifslearning.ac.uk to express interest and state your location.
- I'll then contact an *ifs* local customer relationship manager who will contact you and have a quick chat about how you'd like to be involved.
- The local customer relationship manager then contacts the school to make arrangements for the visit, at a time that works for you, and they help you to prepare your short talk.
- You visit the school to deliver your talk and, following that, R3 sends you an online questionnaire to see how you got on, and to ask if you might be interested in doing it again.

If you would just like to hear more about the initiative, please don't hesitate to e-mail me.

Independent Safeguarding Authority

You might have heard press reports recently about the government's new vetting and barring scheme, whereby people working with children on a regular basis have to be on a suitability register. We understand from the Independent Safeguarding Authority that IPs involved in our financial education initiative will not have to register, unless they want to go into a school every month. For more information on this scheme, please go to www.police.homeoffice.gov.uk or www.isa.gov.uk. □



Rod McKee is head of financial capability at the *ifs School of Finance*.

“It's a mutually beneficial initiative – a chance to draw on IPs' expertise to help prevent a repeat of the financial chaos of the last year, as well as a great opportunity to enhance the reputation of IPs.”

sharing my experiences now might stop students developing bad habits and walking through the door of my office with financial problems in a few years' time!

Some IPs like to build up a long-term relationship with their local school, while others prefer a shorter one-off visit. However much time an IP can spare is entirely up to them. At the *ifs School of Finance*, we make sure that volunteers have the support they need to take part. Each IP's visit takes place at a time convenient to them, and we're always on hand to help them work out what students would be most interested in hearing. Mostly, students just want to know about the cases IPs have seen and to gather some sensible 'top tips' for avoiding situations like that themselves! The commitment is by no means huge, but the value the talks give to pupils is enormous.

children have actively asked them about the economic situation. As many as one in three six- to nine-year-olds have asked their parents about the credit crunch – and that curiosity increases among older age groups. If we're really to learn the lessons of the recession, we'd be foolish not to make the most of the evident thirst for knowledge among the lenders and borrowers of the future.

What's more, financial education can have a long-lasting effect. Research published by the University of Manchester earlier this year confirmed that standalone financial education qualifications can dramatically improve individuals' confidence and skills in financial matters for years to come. The *ifs School of Finance* is currently the only provider of accredited qualifications like these and we're urging

R3 events, courses and conferences

Date	Event title	Venue
December		
1	Practical Pensions & Employment Issues	The Midland Hotel, Manchester
1	Partnership Insolvency	The Midland Hotel, Manchester
1	South West and Wales AGM/Dinner	The Bristol Golf Club
3	Southern Christmas Meeting	TBC
7	North West Regional Meeting	Trafford, Lancashire County Cricket Club
8	Introductory Programme: Partnership Insolvency	etc Venues, London
8	Introductory Programme: Partnership Insolvency	Deloitte, Birmingham
10	Introductory Programme: Partnership Insolvency	Irwin Mitchell, Leeds
10	Practical Pensions & Employment Issues	Novotel St Pancras, London
10	Partnership Insolvency London	Novotel St Pancras, London
10	Yorkshire Women's Group Wine Tasting Event	The Raddison, Leeds
January		
28	Midlands Regional Meeting	TBC
30	Yorkshire Annual Dinner	Yorkshire Railway Museum
February		
2	Introductory Programme: Introduction to Insolvency	etc Venues, London
2	Introductory Programme: Introduction to Insolvency	Deloitte, Birmingham
4	Introductory Programme: Introduction to Insolvency	Irwin Mitchell, Leeds
4	Liquidations	Cheltenham
9	Property, Construction and Health & Safety Issues	London

For further information on R3 courses and conferences, please visit the R3 website www.r3.org.uk, where you can download the full 2010 programme. Alternatively, call the Courses team on 020 7566 4234 to request a programme by post.

■ regional events ■ R3 events

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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.

New Professional (Student) members are individuals preparing to take the examination of the Joint Insolvency Examination Board (JIEB) or Certificate of Proficiency in Insolvency (CPI). Pass students of these exams are eligible to apply for full R3 membership.

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Victoria Smith 020 7087 5589

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Victoria Beach 0121 200 8564

South West & Wales

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Daniel Martin 0113 235 5222
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For a comprehensive summary of the changes introduced in April, see our website at www.tmpreynell.co.uk

Please get in touch for any advice on the new rules or help with your advertising.

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For a confidential conversation on career opportunities across the UK please call **Scott Lavery** on 020 7429 5371 or email scott.lavery@badenochandclark.com

Opportunities currently available:

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Recovery Manager / Top tier firm
Leeds – £40-45k

Recovery Senior Manager / Top tier firm
Manchester – £50-60k

Senior Insolvency Administrator / Boutique
Birmingham – £30-32k

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FTI Consulting is a leading corporate finance and restructuring practice, providing solutions to stakeholders and corporates where value is at risk.

FTI's European practice has grown rapidly over the last 2 years, benefiting from the market leading position FTI holds in the US and its enviable client relationships in both the US and Europe. It has attracted some of the leading talent from the top tier restructuring practices. The European practice is headquartered in London with offices in Munich and Madrid and currently consists of over 60 professionals who provide advice and solutions on strategic, operational, financial and capital needs of businesses.

Due to continued expansion and ongoing success, FTI is now looking to recruit ambitious Directors and Managing Directors with recovery and restructuring experience to its London based team. The individuals will provide technical expertise and experience at an advanced level, lead the delivery of assignments, participate in managing client relationships and develop the practice.

The right individuals will have:

- An exceptional track record within a top tier Restructuring / Recovery practice or special situations team, with a blend of restructuring advisory, transactional and insolvency experience.
- Technical expertise and experience at an advanced level, ability to lead assignments, supervise and guide consultants, manage client relationships and develop the practice
- A passion for the strategic element of their work.
- The desire and ability to lead a wide range of restructuring assignments – financial restructuring advisory, contingency planning, strategic insolvency, pension restructurings, accelerated M&A.
- Individuality and ambition. Apart from the quality of clients and assignments, what stands FTI out is the entrepreneurial, innovative and ambitious team.
- A network of client relationships within the distressed and special situations community.
- JIEB qualification is highly desirable.

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Our client, a worldwide professional services firm and a leader in the provision of global Restructuring and Recovery Services, is currently seeking to recruit at Assistant Manager, Manager and Senior Manager levels in their Grand Cayman office. As local work is largely based on UK Law you should find no problem in adapting providing that you can cope with the unfamiliar situation of year-round sunshine. Suitable candidates must hold a professional accounting qualification and / or JIEB and must have relevant experience gained in the Restructuring / Recovery department of an accounting firm or in a specialist Insolvency practice. In addition to strong technical ability you should also possess the interpersonal skills prerequisite to living, working and developing business relationships in the close-knit and finite community of a small island. You should also be willing to commit to a minimum 2 year 'tour of duty'.

Contact:
chris@davies-kidd.co.uk or on 020 7812 6688

Corporate Restructuring Manager / AD

Leeds £ Negotiable

A first class career opportunity in the Leeds office of an international firm awaits a qualified ACA / ACCA and / or JIEB. Ideal candidates will be currently working at Manager or Senior Manager level with between 3-10 years post qualification experience gained in a medium to large firm or boutique. Your experience will benefit from exposure to a full mix of Restructuring, Recovery and Corporate Insolvency work and will fully exercise your technical, commercial and softer skills in project and case management, staff mentoring, marketing, networking and identification of potential new business opportunities.

Contact:
jeff@davies-kidd.co.uk or on 020 7812 6688

Senior Manager / Director

Sussex £ Negotiable

Great opportunity for a qualified Accountant and / or JIEB to join a leading national and international Recovery and Restructuring team. Ideally you will have at least 5 years post qualification experience, preferably gained in a Top 10, Big 4 or Boutique firm with exposure to a broad range of corporate Insolvency and Restructuring situations. You will be encouraged to push towards becoming an Appointment-taking Director.

Contact:
chris@davies-kidd.co.uk or on 020 7812 6688

Restructuring & Recovery Specialists

London £50,000 – 100,000 +

This leading international Consulting firm has a thriving Restructuring team and is looking to further strengthen its growing London presence by hiring high performing specialists at Consultant, Manager, Associate Director and Director levels. Ideal applicants will be qualified Chartered Accountants, or equivalent, who are able to demonstrate a strong record of achievement working on major Corporate assignments in a Restructuring or Recovery capacity. In all probability you will be a high-performing team player currently working within the Restructuring team of a 'Big 4' large firm or leading boutique. You will be offered a highly rewarding career path, not only financially, but also in terms of richness of experience and personal and professional development.

Contact:
jeff@davies-kidd.co.uk or on 020 7812 6688

Corporate Recovery Senior Manager

Sydney \$AUS Competitive

Great opportunity for an experienced Corporate Recovery specialist to join a leading international boutique in their Sydney office. You are likely to be a qualified ACA or ACCA and / or JIEB with at least 5 years post qualification experience gained in a Big 4, Top 20 or boutique Recovery / Restructuring practice and you should be looking at committing to a minimum 2 year placement, ideally longer.

Contact:
chris@davies-kidd.co.uk or on 020 7812 6688

Director & Head of Fraud

London £ Negotiable

Our client is an established international professional services boutique, which is now seeking to add a fraud specialist to their team to build and develop a service offering in this area. The role will require the successful candidate to carry out fraud investigations, prepare legal reports, participate in legal conferences with lawyers and their clients and act as an expert witness. The position will involve travel locally and world-wide to carry out investigations. The successful candidate is likely to be a qualified Chartered Accountant with several years post qualification experience in Fraud Investigations, currently working for the Forensic Accounting department of a leading professional services firm at Senior Manager or Director level. They will need an established contact base of work referrers with the ability to develop new and existing clients along with the ability to train staff and mould a team.

Contact:
jeff@davies-kidd.co.uk or on 020 7812 6688

Recruiting For Staff?

If you are recruiting for staff at any level in the Restructuring, Recovery and Insolvency fields why not register your vacancy with us to see if we can help. We will happily advertise it for free on our own recruitment website www.big4careers.com which attracts candidates looking for career moves both to and from the 'big 4' as well as among non 'Big 4' firms. With nearly 20 years Senior level recruitment experience behind us we are also highly skilled and discrete in handling opportunities at Senior Manager, Director and Partner level.

Corporate Restructuring & Recovery Managers, Senior Managers, Directors

Australia \$AUS Competitive

Excellent opportunities for qualified Chartered Accountants or equivalent with Corporate Recovery / Restructuring experience to join a leading international Restructuring practice in Australia. Openings exist from Manager through to Director level throughout their Australian network including Sydney, Melbourne, Brisbane, Perth and other locations. Previous Recovery / Restructuring experience in an internationally recognised professional services firm will be desirable.

Contact:
chris@davies-kidd.co.uk or on 020 7812 6688

Corporate Recovery Manager

Midlands £ Competitive

Excellent career opportunity for an established Manager to join a leading Recovery team. Covering the Midlands region between Birmingham and Milton Keynes, you will benefit from exposure to a wide range of Corporate Recovery assignments and a busy, friendly professional environment. The ideal candidate will be a qualified accountant or JIEB with good all-round Recovery skills including previous exposure to Bank work and marketing activities.

Contact:
jeff@davies-kidd.co.uk or on 020 7812 6688

Corporate Recovery Manager

Birmingham £45-60,000

Great opportunity for a qualified accountant and / or JIEB to join a growing independent firm. The role is likely to suit a self-starter with a shirt-sleeves approach who is looking for a busy all-round role with a largely corporate focus.

Contact:
chris@davies-kidd.co.uk or on 020 7812 6688

For a confidential discussion on the market or any of these positions contact:

Jeff Davies on 020 7812 6688 or email jeff@davies-kidd.co.uk

Christopher Kidd on 020 7812 6688 or email chris@davies-kidd.co.uk

All enquiries will be treated in the strictest of confidence.

'Big 4' London Managers & Directors

£ Competitive

Outstanding career opportunities for dedicated Recovery specialists in the London City office of this 'Big 4' firm. There has rarely been a better time to gain exposure to a fascinating range of distressed situations, some often well-publicised and high profile. Despite the demand for services entry criteria are strict – you will need a strong profile of academic and professional achievement with a proven track record of handling Corporate Recovery assignments.

Ideal candidates will be ACA, ACCA and / or JIEB qualified with at least 1-3 years (Managers) and 5-10 years+ (Assistant Directors and Directors) relevant experience, gained in a leading professional services firm or boutique. Your skills should encompass case management, project management, staff management and marketing. Successful applicants will be heavily involved in providing an extremely varied range of services to stakeholders of underperforming businesses including investigations, reviews, restructuring / turnaround planning and insolvency procedures.

Contact:

jeff@davies-kidd.co.uk or on 020 7812 6688

Corporate Restructuring Manager / AD

Manchester £ Competitive

Exciting and challenging career opportunity to join the Manchester office of a multinational firm and market leader in the field of Corporate Restructuring and Recovery work. The role is multifunctional and is likely to cover all facets of casework and advisory work relating to distressed companies in Restructuring, Recovery and Insolvency situations.

To apply you will need to be a qualified Chartered Accountant / ACCA and or JIEB with between 3-10 years post qualification experience, preferably gained in the Restructuring or Recovery team of a medium to large firm or in a specialist Restructuring or Recovery practice.

Contact:

chris@davies-kidd.co.uk or on 020 7812 6688

Working Capital Management Assistant Directors and Directors

London £6 Figure Packages

Outstanding career opportunities in a growth area of a 'Big 4' firm for experienced professionals with Senior Manager or Director level experience in leading Working Capital and Cash Management initiatives for multinational companies. You will need previous relevant experience gained in a leading Financial Consulting or Strategy House or from within a large professional services Restructuring team. With a strong international emphasis fluency in other major European languages would also be a considerable asset.

Contact:

jeff@davies-kidd.co.uk or on 020 7812 6688

Corporate Restructuring Director

Scotland £ Negotiable

Outstanding career opportunity in an international firm awaits a qualified Chartered Accountant / ACCA and / or JIEB with several years' deep and broad experience of aiding and advising distressed companies. The role will offer you the chance to become a key and influential member in a leading international Recovery and Restructuring practice with exposure to a wide variety of work situations including investigating the causes of underperformance through preparing independent commercial and financial reviews, advising and supporting in the design of restructuring solutions, preparing financial turnaround plans, and managing trading administrations.

You will also be instrumental in practice development via staff leadership, marketing, management and identification of potential business opportunities through contacts and networking. Based in Glasgow or Edinburgh you will be offered a competitive market package, career-enhancing experience and a first class environment in which to exercise your technical, commercial and business development skills.

Contact:

chris@davies-kidd.co.uk or on 020 7812 6688

Corporate Restructuring Manager

Central London £55-65,000

This career-enhancing role will suit a qualified accountant and / or JIEB who is receptive to both learning from senior colleagues and mentoring / knowledge-sharing with junior colleagues.

You'll need at least 2 years post qualification experience specialising in Corporate Recovery and Restructuring assignments and should be at a stage of your career where you can plan, monitor and review all types of corporate case work, manage relationships with clients, develop contacts with work referrers.

Contact:

jeff@davies-kidd.co.uk or on 020 7812 6688

CR Senior Manager / Director

Thames Valley £ Negotiable

International firm seeks a qualified accountant and JIEB with several years experience in all aspects of Corporate Recovery, Restructuring and Insolvency work including Review work. This is a great opportunity to become a key player in the firm's local and national Recovery function, development and strategy. You will need strong practice management and people management skills together with proven marketing and business development ability.

Contact:

chris@davies-kidd.co.uk or on 020 7812 6688

Corporate Recovery Assistant Managers

Melbourne \$AUS Competitive

Exciting career opportunities for qualified Chartered Accountants with 1-2 years ppe in Corporate Recovery and Restructuring to join a leading international boutique in Melbourne. You are likely to need a strong academic background and will currently be working for a Big 4, Top 10 or Boutique Recovery / Restructuring practice.

Contact:

jeff@davies-kidd.co.uk or on 020 7812 6688

Partner and Director Search

If you are a Partner or Director or a Team considering a career move then feel free to consult us for advice. With more than 15 years senior level recruitment experience in the Restructuring, Recovery and Insolvency markets we fully understand the 'close' nature of the market and the need for tact and discretion.

We currently have Director and Partner search assignments throughout the UK and are in regular contact with a number of firms who are keen to talk to senior professionals with proven business generation skills who can add value to a Recovery practice.

Practice Mergers and Acquisitions

Looking to merge or acquire a Restructuring or Recovery team? Whether you are a sole practitioner or a team seeking a move or a firm looking to acquire a practice call us for a confidential discussion. Contact Jeff Davies or Chris Kidd on 020 7812 6688 for a confidential discussion.

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CORPORATE RECOVERY MANAGER

Our client is looking to recruit into their growing insolvency/corporate recovery team based in Leeds. You will be part of a market leading team, working with exceptional people and with access to an excellent support network to springboard your career. You will work on high profile mixed assignments for advisory and insolvency with some of the best in the corporate recovery field, gaining wide exposure to a variety of projects within a highly commercial client focused environment. Successful candidates will be currently working at another firm within a corporate recovery/insolvency department and be looking to make their mark within one of the best teams in the North.

Leeds – £ Excellent

Contact Peter Macdonald ACA on 0113 243 7708
petermacdonald@uk.michaelpage.com | Ref: MPRV13040475

CORPORATE RECOVERY SENIOR MANAGER

With a strong presence in the Midlands, this leading firm is looking to recruit a Senior Corporate Recovery Manager for their Birmingham office. You will be responsible for managing a large corporate insolvency caseload as well as driving a well established team. Candidates will ideally be ACA/ACCA or JIEB qualified or an overseas equivalent.

Birmingham – Up to Mid £70,000 + Car + Benefits

Contact Lucy Williams on 0121 634 6920
lucywilliams@uk.michaelpage.com | Ref: MPRV13078151

RESTRUCTURING EXECUTIVE - LIQUIDATIONS & STRATEGIC EXIT ROUTES

Our client, a Big 4 firm in London is currently looking for executive level people with liquidations experience. The role will involve administering a caseload of complex solvent and insolvent liquidations, legal entity rationalisation projects and assisting clients with pre-liquidation planning and business wind-down support. You will ideally have corporate restructuring/insolvency experience with a strong working knowledge of liquidation procedures and will be ACA/ACCA qualified or an overseas equivalent.

London – £ Excellent

Contact Colin Hawkins on 020 7269 2249
colinhawkins@uk.michaelpage.com | Ref: MPRV13027649

REORGANISATION SERVICES MANAGER

This fast paced and highly successful recovery business in the Thames Valley region requires an experienced manager to strengthen their position in the market. Offering a stimulating and challenging environment and with a focus on teamwork, the nature of work on offer is extremely varied; specialising from personal bankruptcy to business turnaround. This is a truly exciting time to be a part of this group and work within an expanding and high profile area of the firm.

Reading – Up to £55,000

Contact Matthew Duqueno on 0118 955 9034
matthewduqueno@uk.michaelpage.com | Ref: MPRV13073189

CORPORATE RECOVERY MANAGER

A national accountancy practice in Bristol has created a new position for a Corporate Recovery Manager to join its team. This is an excellent opportunity for an experienced Senior to step up into a pivotal role. Duties will include: reviewing the case work of the team to ensure it is accurate; assisting with administrations and liquidations and supporting the Recovery Director in the development of new processes and procedures. You will possess experience of administrations and liquidations, be looking to progress your career towards management, work efficiently as part of a team and have outstanding interpersonal/communications skills.

Bristol – £55,000 + Benefits

Contact Nick Jones on 0117 927 6509
nickjones@uk.michaelpage.com | Ref: MPRV13032348

INSOLVENCY MANAGER

An exciting opportunity has arisen within a rapidly expanding national insolvency firm in their Southampton based office. The firm focuses on both personal and corporate work. Working as part of a small, but expanding team, you will be given the opportunity to gain detailed exposure to both areas. Reporting to the Director, you will have responsibility for the day-to-day management of a large insolvency caseload and will be the main point of contact on the majority of your clients' cases. Ideal candidates will certainly be CPI qualified and ideally JIEB qualified or an overseas equivalent.

Southampton – £ Highly Competitive

Contact Stephen Howes on 02380 206440
stephenhowes@uk.michaelpage.com | Ref: MPRV13074961

Interview with Tony Lomas

Lehman Brothers is the largest corporate bankruptcy ever. Tony Lomas is the administrator of the UK entities. His approach is surgical: totally focused on recovering assets and maximising revenue for creditors. Sarah Houghton went to meet him in his operating theatre.

When did you first learn that Lehman Brothers was likely to fail?

In the two weeks leading up to the weekend of the 13–14 September 2008 my team at PricewaterhouseCooper (PwC) looked very carefully at what existing relationship we had with Lehman. On the Friday night I talked to our Lehman relationships' partner to get an update and make sure that I understood our position. During Saturday there were discussions going on in New York but, like everyone else, I imagined they would be successful. So when I was called on Saturday night it came as a complete surprise. The Lehman's counsel explained the situation and asked me to a meeting the next day. I contacted PwC senior partners around the world to get them to begin to think through how they would manage the fall out in their jurisdictions.

How did you feel when you found out you had been appointed as the administrator for Lehman Brothers International (Europe) (LBIE)?

We were appointed at 7.56 am on the Monday morning, before the markets opened, having worked through the night to prepare the documentation for the judge. Because of the urgency of the situation and the impact on not just the UK but the world, there wasn't much time for *feeling*; we had to analyse clinically the issues that needed to be dealt with. There were 5,000 employees who would want to know if they were going to get paid. To do this we needed \$100 million. Our first priorities were to find that money and develop a communications programme for those employees, for whom we were now responsible. Critically, we had to ensure that their dealings with counterparties conformed to our rules. The appointment of an administrator is a personal one so we needed to make sure we did in fact take control and that our team was interacting with the Lehman's team in all critical areas.

How big and complex is the administration?

On 15 September 2008 the vital statistics we were faced with were:

- **\$1.2 trillion balance sheet** – comprising \$600 billion assets (ten times those of Enron) and \$600 billion liabilities.
- **1 million failed derivative contracts** – as we'd lost all our licences to trade and seats on exchanges.



Tony Lomas

2005	Chairman of Business Recovery Services at PricewaterhouseCoopers. Key insolvency appointments: MG Rover, Lehman UK, Baur Group, Enron Europe, BoxClever TV rentals. Advisory roles: Northern Rock, London Underground
1990	made a partner of Price Waterhouse
1986	transferred to the Corporate Recovery division at Price Waterhouse following 18-month secondment to SSU at National Westminster bank
1981	qualified as a chartered accountant (ICAEW)
1978	joined Price Waterhouse

US sub-prime casualties

17.3.2008	Bear Stearns taken over by JP Morgan Chase
8.9.2008	Fannie Mae and Freddie Mac bailed out by US government
14.9.2008	Merrill Lynch bought by Bank of America for \$50bn
15.9.2008	LBHI filed for bankruptcy
16.9.2008	AIG received \$85bn bailed out by US government

- **6,000 live counterparties** – they all had a position with us and many had hundreds of different positions.
- **97 sub-custodians** – with whom counterparties' securities were lodged around the world.
- **5,000 Lehman employees** – we transferred 2,500 of them over to Nomura, had to deal with the remaining 2,500 and we still have about 450 employees working with us.
- **16 overseas branches** – that we had to take control of. The whole of the asset base and the creditor population of the company are represented by data entries on the computer system only so the IT infrastructure has been critical to us. There were more than 5,000 servers and 2,000 separate operating systems – many of which didn't talk to each other.

One year on:

- **\$50 billion claims** – filed in Japan, Germany and LB Inc (LBI).
- **\$150 billion claims** – filed against LB Holdings Inc (LBHI – parent company) and other Chapter 11 estates by the UK parent company and more than 100 others under our control in the UK.

How did you get to grips with things on Day 1?

It was not so daunting because we are realistic, pragmatic and practical. We are experienced in short-notice, crisis project management and have a proven approach to these projects – albeit not one as big as this. We have a procedure that we follow, and used it on Enron, MG Rover and BoxClever.

We set up a programme management office and quickly established work plans, procedures and IT tools that enabled us to fragment the process into component parts and develop the work streams in tandem with each other. For each principal work stream we aligned the relevant PwC, Lehman and Linklaters teams: a trio of inputs. IT was absolutely key, as were our banking and financial markets, forensics, and HR specialists. By the end of the day we had 100 of our specialist people on site.

What were the main tasks?

The administrator's primary function is to protect the value of assets for the creditors, but it was extremely difficult to identify, value and take control of the assets. They are: >>

a) House assets

These we can convert into cash and share between creditors. We currently have \$9 billion that we have recovered and we expect to recover some billions more.

b) Creditors' assets

We have to adjudicate the claims of creditors as they will share in the payout. But we are some significant way off doing this as the claims from counterparties are extremely complicated, with different types of trade requiring a different valuation approach. Setting a date for the valuation, deciding if we are able to set off, looking at the proprietary interest that they might have in certain assets lodged with us and deciding whether we have the right to use those as collateral can be very complicated.

c) Clients' assets

These are assets that are in our possession but which don't belong to the house – and we need to hand them back. The value of the assets has fluctuated over time but, as values have come back somewhat, we don't think there are massive shortfalls in the European securities, as we have visibility on these. There are American and Asian securities (\$7 billion) with less visibility.

Have you managed to unwind the convoluted derivatives contracts?

There are some peculiarities here. The majority of derivatives are governed by an ISDA (International Swaps and Derivatives Association) master agreement – an industry standard. Among the terms it says: in the event of a default by one party the non-defaulting party has the right to close the trade if they wish. So counterparties tend to close out the individual contracts that are in the money for them, and that crystallises the claim they have against us.

However, they don't want to crystallise and pay out on the contracts that are out of the money for them. So we have to persuade them to settle or manoeuvre our position so that we can come to a nett position overall and close the book.

We are working at a strategy to encourage these organisations to close these claims. This is a very technical exercise and requires knowledge of the total relationship with Lehman. So our continuing Lehman staff have been extremely valuable in helping us close out hundreds of these claims in order to reconcile the account and achieve settlement. 'Settlement' can mean either that they pay us the balance owed or that we agree the claim that they have against the estate.

Do you think you have come to the bottom of all the complexities of the administration?

We believe we have the critical issues in sight. We haven't worked through them all and some may take a long time to resolve. It would be helpful to have a common approach to the reconciliation of inter-company claims, because all affiliates are

working from the same global base accounting systems and data. In the early weeks, we worked with the American and UK Lehman staff to close out the Lehman books. A number of jurisdictions co-operated in that exercise to rule off the nominal ledgers at a common date, so there was lock-down on numbers that could then be used as a base for reconciliation of claims between each of them. That base data is now available to the claims' adjudication process among the affiliates. We have proposed a methodology for accepting or rejecting claims that we have developed, together with Lehman staff, and we have suggested to counterparties that this be used as a common approach among the affiliates for claims among each other. We have told them that this is the approach we intend to use for claims coming into us where we have jurisdiction on the matter.

At present, the scheme of arrangement has not been accepted by the court. Our appeal started on 26 October and we await the outcome. We are brokering an alternative approach, and Steve Pearson went to the States to roadshow this early in October. This adapted scheme puts the same resolution framework to creditors and asks them to enter into a bilateral, contractual arrangement with the administrator and agree that their account would be resolved using the framework of rules that are embedded in the scheme.

Why did PwC decline to join the protocol to share information with Alvarez & Marsal and the 13 other liquidators of Lehman's worldwide?

Principally because we believe it was aspirational in its expectation of co-operation and co-ordination, and even though it created no legal obligation, it created a moral one. We were the only entity in the group that substantially kept control of their data. In the States, Barclays took this over. In part due to that, Alvarez & Marsal started to talk to us about having access to our people and our systems and we signed our own protocol with them in November 2008. This gives them, and all the companies under the control of Alvarez, access to London – for which they've paid us nearly £60 million so far.

We also have a separate protocol with the trustee in LBI, which was signed in January; and separate co-operation arrangements with the German, Japanese and certain other trustees who are in affiliates that have a material interface with LBIE.

The global protocol also seeks the co-ordination of exit from these processes. We think that may be impractical. Also, we have filed more than \$200 billion worth of claims against other estates and it is inevitable that there will be some dispute. If it comes to litigation, I don't want to be fettered in any way by having signed a global protocol agreement.

Do you think a debtor in possession regime is more appropriate to this size of administration?

When a company embarks on the process of winding down its affairs, rather than reorganising them, I think it is irrelevant whether the debtor is in possession or not. Some but not all the companies in the US are in Chapter 11. LBI, which is the closest analogy to LBIE in the UK is in an SIPA trusteeship. The debtor is not in possession of this company; it is in the hands of the trustee, a lawyer called Jim Giddens.

The winding down objective is common to all Lehman estates. The only major difference I am aware of is that some have valuable real estate assets – and we don't. Having real estate gives you other exit options, which we don't have.

Under the US bankruptcy process, all creditors had to file their claims against the parent company on 22 September 2009. What does this mean for LBIE?

We have claims totalling more than \$150 billion against the US companies, and these are being addressed on three dates: 22 September – vanilla claims; 22 October – guarantee claims; early November – Lehman paper claims.

Having filed those claims we now wait to hear as to the admissibility of them. I've no doubt they will have 101 questions before they are prepared to accept them into their process and rank them for payment. It's like a massive claims reconciliation exercise – and this is of common interest to us all.

How long will it take to unwind Lehman's?

Initially I had hoped we would break the back of it within 24 months. If we are successful in getting our amended scheme of arrangement approved then this will add another six months on top of that. If not, then it could be twelve more. But there is a lot to be resolved and the final pieces could take ten years or so.

How might we be better prepared for dealing with the insolvency of such a major financial group in future?

Banks could be required to prepare for their own failure by drawing up a 'living will'. They could be reorganised so there are less interdependencies – to enable an administrator to gain control more easily. It would help if banks were more self-sufficient, transparent and had operating systems that talk to each other. More than all of this, a clearer understanding of the risks that exist in the contractual dealings with counterparties, and plans to deal with these, would assist enormously. □

Sarah Houghton is publishing manager of RECOVERY.



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