

Winter 2019

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Football insolvencies: have the Shakers given the fit and proper test a shakedown? A metaphorical VAR of the Bury FC administration and how the EFL has reacted

The only Brexit certainty?

We need insolvency law reforms

We've known from day one that insolvency and restructuring will change after Brexit: how can the UK make it work?

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From the editor

Howard Morris opines on page 7 that the only Brexit certainty is that we need insolvency law reforms. That they are needed is indeed a certainty, but beneath the headline Howard makes clear that the need is there with or without Brexit. It's just that Brexit makes things worse – the attractiveness of restructurings to investors, the challenges and costs of cross-border restructuring or even, I suggest, the performance of the UK economy. At least we've got a new elephant in the room – what will we have for a government after 12 December?

One Brexit challenge, as Howard points out, is the enforceability of UK schemes of arrangement. That's not why we invited Ruairi Rynn and Niamh Cacciato to examine the use of an Irish scheme in a financial services restructuring. But their article on page 10 does underline the efficacy of common law schemes in international restructurings, as well as reminding us of the competitive threat to what some have described as the UK's restructuring hegemony.

Our corporate insolvency case study on page 13 describes a strengthening of the liquidator's position on s127 claims. To be validated a transaction must benefit the creditors generally, whatever the bona fides of the recipient.

We are indebted to Sarah Rapson for explaining on page 21 the FCA's views on phoenixing, fronting and lifeboating. Consumer protection is a key driver for the FCA and its concern is about deliberate avoidance by directors of liability or personal accountability. It would be good to see a disqualification regime more targeted towards such egregious misconduct.

Duncan Swift highlights, in his president's column on page 4, the progress of and continuing need for R3's crown preference campaign. Matthew Davies of UK Finance spells out on page 26 the regressive nature and questionable logic of the policy and considers how the new government should at least explore how to mitigate some of its negative consequences.

And finally, Frances Coulson reflects on page 34 on a memorable INSOL Europe conference in wonderful Copenhagen. She urges your participation in the pan-European insolvency and restructuring trade association, whatever flavour of Brexit we do or don't end up with! Just to tempt you, the conference next year (from 1 to 4 October) is in Sorrento!

Season's Greetings and best wishes for 2020.



C. Laughton

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

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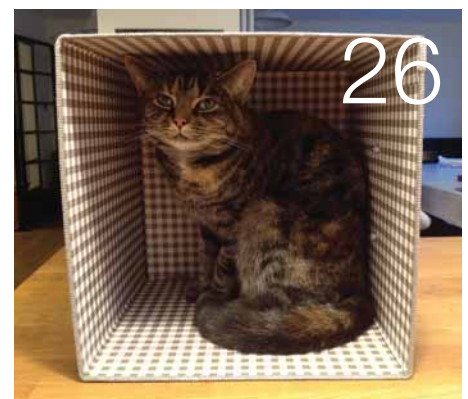
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President's column

Duncan Swift's quickly restructured schedule has allowed for some good returns on Crown preference and airline insolvencies.

As R3 President, you can never completely know what the role will involve. You know there will be representation work, media appearances and much engagement with members, and that you'll do a lot behind the scenes as part of the executive committee, but there will be some things that you don't expect.

Like meeting a lord in his kitchen to talk about Crown preference. Or, needing to be *compos mentis* in a BBC studio at 5.20 am to talk about airline insolvencies. Or giving an interview to *The Times* in a five-minute break between conference sessions. Or, straight after a BBC News 24 interview, being pulled in by a local BBC radio show host to comment on 'Mike in Gosport's' package holiday losses in both Thomas Cook and Monarch.

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We've won a concession: the government has dropped its plans to include tax penalties. But that isn't the end of it.”

All of these have happened to me in the last three months – and were great opportunities for R3 – but they did come from rather left of field. However, I made the most of them, as I have with my other presidential work...

Continuing the 'Crown preference' campaign

Crown preference continues to be a key theme in my meetings in Westminster. The government's plans to move HMRC up the creditor priority list will play havoc with business rescue and access to finance.

That's the message I've been taking to parliamentarians and it seems to be resonating. We've won a concession: the government has dropped its plans to include tax penalties. But that isn't the end of it. We want to see the policy dropped, or, at a minimum, a cap on the age of tax debts eligible for preferential status introduced.

Achieving something like that means we need to ensure Westminster policy-makers understand the proposed policy's potential consequences. That's why we launched a campaign at the end of September asking members to write to

their MPs, and my thanks to all members who have done so.

The nuances of airline insolvencies

Another area that's been a focus of our public affairs work over the last three months has been airline insolvencies. Following Thomas Cook's entry into liquidation, the government announced that it was looking at proposals to keep insolvent airlines' planes flying during an insolvency process.

While we understand people stranded overseas by these events need an orderly means of returning home, keeping planes in the air during an insolvency is potentially much more complex than politicians and journalists appear to think. There would be risks for aircrew, passengers and insolvency practitioners.

A far better solution would be to extend the ATOL package holiday protection scheme to cover flight-only tickets; this would help fund repatriation by an unconnected party, but without the risks that keeping the fleet flying would raise.

Our position appears to have been taken on board by officials – and we'll keep lobbying and campaigning to ensure these issues are fully considered when Parliament returns after the election.

Shaping the review of insolvency regulation

Thank you to everyone who attended the R3 members' workshops in London and Manchester over the summer, and to all who responded to the survey we issued on the government's call for evidence on the regulation of insolvency practitioners. It was great to meet, hear and read your views on what form regulation should take, and to understand more about your views on regulation.

Being able to go to the government with facts, stats and anecdotes like the ones we were able to source from members helps a great deal. The government is open-minded on this issue and being able to provide evidence and input from the profession should help us work with them to develop something that builds on the very effective framework we have already.

Like everything else, we need to wait for the result of the general election to see what the next steps are on this proposed policy, but the work we have done to date will put us in a strong position with whomever forms the next government.

Promoting the profession

Our media work goes hand-in-hand with our policy work – and the press team has been

busy working to secure opportunities for me and colleagues to promote the profession.

High-profile insolvencies provide an opportunity to explain insolvency processes and highlight the work we do as a profession to help those affected by them. Policy proposals like Crown preference or airline insolvency reform, where I've been quoted in the media commenting on draft legislation and putting forward our thoughts on what's been proposed, give R3 a chance to voice the profession's concerns and highlight why any policy proposals and their nuances need to be carefully thought through before being committed to statute through the House of Commons.

Topics like our business distress survey, which was featured in *The Times* at the start of October, enable us to highlight how engaging with members of our profession as early as possible can help save businesses and jobs.

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High-profile insolvencies provide an opportunity to explain insolvency processes and highlight the work we do as a profession to help those affected by them.”

It makes for a busy diary, but it really is worth it when we see the articles, the footage and the response from parliamentarians and the business community.

And, it's very satisfying when the quality and scale of this effort is publicly recognised: R3's Press, Policy and Public Affairs team has been shortlisted for the prestigious PRCA Public Affairs In-House Team of the Year Award! Well done team – I look forward to more of the same, and the unexpected. ▣



DUNCAN SWIFT
is president of R3
and a partner at
Moore UK.

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The only Brexit certainty? We need insolvency law reforms

Howard Morris writes that the UK's attractiveness as a restructuring centre is in jeopardy without change.

The truth is that from day one after the Brexit referendum we knew the technical effect on the restructuring and insolvency industry of exiting the EU. We will lose the European Insolvency Regulation (EIR), which enables liquidators and administrators appointed in the UK to be recognised in the EU and avoids an unseemly scrum among creditors in different countries to gain advantage over each other (for UK-based companies in UK insolvency proceedings). The EIR is reciprocal and so EU members recognise UK insolvency procedures and proceedings.

We also knew that schemes of arrangement would be in jeopardy of no longer being effective in EU member states, and that is still a problem. Even though the UK hasn't left the EU (and possibly won't leave, depending on the election result) and because we've known about the problems for years, now is a good time to survey the landscape.

Brexit means...

We drop out of the EIR. If it's a 'hard Brexit', then the government is likely to exercise its Henry VIII powers under the withdrawal legislation to end recognition of EU member insolvency proceedings in the UK – we can't have them not recognising our proceedings while we continue to recognise theirs. What happens to cases started before Brexit day that would, until that moment, have enjoyed the benefits of the EIR, no one knows. It is not beyond the bounds of possibility that UK judges will discover, under the common law, that recognition continues, and it may be that judges in the EU rule in the same way. In fact, the UK will continue to recognise and support foreign insolvency proceedings (from the EU and the rest of the world) because the UK has enacted the UNCITRAL Model Law on Insolvency, but foreign insolvency office-holders will have to come to the UK courts and apply for a court order.

To state the obvious, domestic insolvencies won't be affected at all, but many businesses have assets and activities in a number of countries. Loss of the EIR will be a blow, although one shouldn't forget that recognition elsewhere in the EU, even with the benefit of the EIR, hasn't always been as straightforward as it ought to have been and, well, we used to manage before the EIR. While undoubtedly we shall face (actually, UK professionals already are facing) more competition for assignments

from EU advisers who make a case for using their own restructuring laws, that does not mean that they and the courts in the EU will put selfish interests before good sense and creditors' interests.

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Whatever happens post-Brexit, the UK must press ahead with its insolvency law reforms.”

Looking beyond the EIR

The UK is a centre for international restructurings. This has nothing whatsoever to do with our insolvency laws but instead a company law mechanism: the scheme of arrangement. Not many years ago, the scheme was considered dull, document-heavy and ponderous; it was used, principally, for reductions of capital and takeovers. But then insolvency professionals started using it to tackle the long-tail liabilities of insurance companies. In the following years, the profession got adept at devising schemes, the courts figured out how to make the procedure run efficiently and computers permitted the necessary mass of paper to be drafted and produced with greater ease. Now we have a tool, born in the 19th century, that attracts restructurings from all over the world to the UK.

The restructuring business, which generates billions of pounds in fees, is gravely concerned that after Brexit we will struggle to persuade the UK courts that schemes are enforceable in the EU, and that the courts won't sanction a scheme if it's not enforceable wherever it needs to be implemented. While there are legal arguments for each EU country that a scheme will still be enforceable, there is another problem that threatens the primacy of the scheme: sentiment.

The UK courts rely on foreign law experts to attest to the enforceability of a scheme in their country. Arguably, with the treaty underpinnings of enforceability severed because of Brexit, plus feelings that the case could be dealt with under their own – often recently reformed – laws, experts may not be so emphatic as they have been that a UK scheme will be enforceable in their country.

Maintaining the UK as a restructuring centre

Here it's worth stepping back and taking a broader view of the UK's future as a restructuring centre. 'Regulatory competition' is a recognised way in which the laws of different countries harmonise. A country has laws on a topic that are more efficient, more appealing, less bureaucratic, less expensive or more practical than others, and so businesses flow to that jurisdiction and other countries follow that lead. Research shows that it is far from the laxest laws or the lightest regulation that has this effect. Companies have come to the UK to restructure because of the scheme of arrangement, the integrity of the courts, the flexibility and predictability of English law, the concentration and excellence of professionals and access to capital. This has prompted other countries to reform. France, Germany and the Netherlands have introduced, or are introducing, new restructuring procedures, and the EU is making a huge, heaving effort to introduce a minimum standards framework for restructuring. All of these new laws look more or less like Chapter 11 for two reasons. First, Chapter 11, for all its flaws, works and addresses companies with complex debt structures – something more and more common. Second, the World Bank, in judging ease of doing business in different countries (and publishing its politician-friendly league tables), uses a Chapter 11(-ish) template for what makes a good insolvency law.

Whatever happens, one certainty remains

Whatever happens post-Brexit, the UK must press ahead with its insolvency law reforms (on the table since 2015) – not because our law is bad or doesn't work, but because debtors and creditors, and, very importantly, the funds that invest in restructurings are comfortable with a Chapter 11-looking system. They're more comfortable about the risks so the pricing of deals is better. If the UK doesn't do this, whatever its other advantages, its attractiveness as a restructuring centre is at risk. □



HOWARD MORRIS is head of restructuring at Morrison & Foerster LLP.

Thanks for being part of R3's events in 2019!

As we near the end of 2019, we can't help but look back and reflect on what a fantastic year of R3 events it's been, with huge numbers of delegates joining us at over 150 events across the UK – from our Annual and Regional Conferences, One- and Half-Day courses and Breakfast Briefings through to our many and varied Regional Events. All excellent opportunities to network, gain

new skills and hear about the latest changes in legislation and best practice. A huge thank you to everyone who has attended, spoken at or helped to organise our 2019 events... and we can't wait to do it all again next year as we continue to deliver exceptional training for the profession by the profession. Especially – of course – our yearly highlight with the 2020 Annual Conference at Beaumont Estate in Windsor! ▣



R3 2020 Courses & Event Highlights



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Agriculture
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Insolvency Professionals**
25 February, London

MARCH

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SPG Technical Review
3 March, Leeds

One Day Course
SPG Technical Review
12 March, London

Breakfast Briefing
Fintech
19 March, London

Half Day Course
Agriculture
26 March, Bristol

APRIL

One Day Course
SPG Technical Review
2 April, Warwick

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**The Return of Crown
Preference**
21 April, London

Breakfast Briefing
**Hotels, Bars &
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21 May, Manchester

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Examining an emerald scheme

Ruairi Rynn and Niamh Cacciato explore the Irish scheme of arrangement via the case of *Ballantyne Re*.

Earlier this year Ballantyne Re plc (Ballantyne), an Irish reinsurance SPV, utilised an Irish law scheme of arrangement to restructure its reinsurance obligations and outstanding New York law-governed indebtedness to facilitate the distribution of the residual value in the company to its senior note-holders (the scheme).

The scheme provided for, among other things: the novation of the company's reinsurance obligations; the restructuring of third-party guaranteed senior debt; the commutation of the largest guarantor's obligations; and the preservation of the second guarantor's obligations until the original maturity of Ballantyne's senior debt in 2036.

The sanction of the scheme by the Irish High Court was opposed by a senior note-holder with a relatively minor holding. Following a contested hearing, Barniville J delivered a detailed judgment rejecting all the grounds of objection and sanctioned the scheme on 6 June 2019. Ballantyne subsequently sought and obtained recognition of the scheme under Chapter 15 of the US Bankruptcy Code on 11 June 2019.

The facts of the case

Ballantyne was an Irish reinsurance SPV incorporated for the purpose of entering into and performing an indemnity reinsurance agreement (the reinsurance agreement) relating to a defined block of US life insurance policies. In order to fund its obligations under the reinsurance agreement, Ballantyne issued senior notes and junior notes in the total amount of c.US\$1.92bn (£1.5bn) and engaged a third party as investment manager (the investment manager) for the funds raised from the issuance of the notes.

The scheduled interest and principal of certain of the senior notes was guaranteed by Ambac Assurance UK Limited (Ambac) (par value \$900m) and Assured Guaranty (UK) plc, and ultimately other Assured Guaranty group entities (Assured) (par value \$500m).

Approximately 95% of these funds were invested in subprime and Alt-A securities which experienced c.\$1bn of losses between May 2006 and October 2008. Following the settlement of litigation against the investment manager and discussions with certain senior note-holders, Ballantyne decided to proceed with a restructuring following a proposal by Ambac.

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The judge noted that it would be extremely rare for a court to refuse to sanction a scheme where it has been approved by the required special majority of correctly constituted classes.”

Proposed restructuring of Ballantyne

The key elements of the proposed restructuring included:

- the novation of the reinsurance agreement to Swiss Re Life and Health America Inc
- the disbursement of residual assets following the novation to pay a dividend to senior noteholders (ultimately \$0.512 per \$1.00 of senior debt)
- the commutation of the guarantee obligations of Ambac in return for a commutation payment

- the releases of any claims of the senior note-holders against the various third parties (including Ambac as financial guarantor)
- the subsequent solvent liquidation of Ballantyne.

The sanction hearing

Resolutions to approve the scheme were passed overwhelmingly by senior noteholders at two scheme meetings in Dublin in May 2019. Ballantyne subsequently issued an application to the Irish High Court for an order sanctioning the scheme. That application was opposed by a single senior noteholder, ESM Fund I, LP (ESM) who held \$5m of the Ambac guaranteed senior notes on the grounds set out below, each of which was rejected by the Irish High Court.

Judgment approving the scheme

In the judgment approving the scheme, Barniville J considered and adopted a number of Irish and international precedents applicable to schemes of arrangement. In particular, he noted that the judgment of Parker J in *Re Ocean Rig UDW Inc* (18 September 2017, Grand Court of the Cayman Islands, Parker J) was of ‘considerable assistance’.

The court also cited, with approval, the leading Irish decision of Kelly J in *Re Colonia Insurance (Ireland) Ltd* [2005] 1 IR 497 (*Colonia*), which set out the criteria to be satisfied when sanctioning a scheme:

- sufficient steps have been taken to identify and notify all interested parties
- the statutory requirements and all directions of the court have been complied with
- the classes of creditors are properly constituted
- no issue of coercion must arise
- the scheme of arrangement is such that an intelligent and honest man, a

member of the class concerned, acting in respect of his interest might reasonably approve it.

The judge noted that it would be extremely rare for a court to refuse to sanction a scheme where it has been approved by the required special majority of correctly constituted classes and there is no suggestion that the majority did not represent the views of the class.

Grounds for Objection

The court found that the real issue in this case concerned the fifth criterion and Barniville J then went on to consider and reject each of the following objections put forward by ESM in that context:

1. Alleged material deficiencies

ESM alleged that the scheme circular was materially deficient, particularly with respect to Ambac's financial position and the consequent appropriateness of the commutation of Ambac's guarantee obligations. While the judge accepted that the financial position of Ambac was clearly of significance to the scheme, he was not satisfied that there was any material deficiency in the information provided in the scheme circular and concluded that Ambac was clearly in a difficult or distressed financial position.

2. Third-party releases

ESM argued that the applicable legislation could not be interpreted to enable the provision of third-party releases in an Irish scheme and that the court had no jurisdiction to sanction a scheme of arrangement providing for the release of claims. ESM argued that strict construction

“

Barniville J accepted Ballantyne's submissions that an Irish scheme could be utilised to restructure New York law governed debt.”

should be given to the relevant statutory provision insofar as it could interfere with an Irish constitutional right.

Barniville J considered the decisions of the Federal Court of Australia in *Re Opes Prime Stockbroking Ltd* [2009] FCA 813 and the English Court of Appeal in *Re Lehman Brothers International (Europe) (In Administration) (No. 1)* [2010] 1 BCLC 496 and noted that third-party releases are 'fairly common' in schemes in other jurisdictions. He accepted that the releases were necessary under the scheme to give effect to the commutation of the Ambac guarantee and bring finality to the affairs of Ballantyne.

What is a scheme of arrangement under Irish law?

A scheme of arrangement under Irish law is effectively equivalent, with extremely similar governing legislation, to an English law scheme of arrangement. Part 9 of the Irish Companies Act 2014 (the 2014 Act) provides for a company to enter into a compromise or arrangement with (a) its creditors or any class of them or (b) its members or any class of them.

In order for a scheme of arrangement under part 9 of the 2014 Act to take effect:

- the scheme of arrangement must be approved by a special majority (a majority in number representing 75% or more in value of the creditors/members of each class present and voting) at the required meetings of classes of creditors/members
- the publication of notices of the passing of such resolutions at the scheme meeting(s) and that an application will be made to the High Court to sanction the scheme of arrangement
- the High Court must sanction the scheme of arrangement.

An Irish law scheme of arrangement can be used by any company incorporated under Irish law or any non-Irish company with a 'sufficient connection' which has the same meaning as that term is understood in Irish law, to Ireland.

As to the constitutional point, the court (while not determining whether ESM as a non-Irish body corporate had the benefit of Irish constitutional rights) concluded that the involvement of the court in sanctioning a scheme of arrangement provided the appropriate protection and balance of any constitutional rights involved.

3. New York Dimension

Barniville J rejected any contention that the restructuring should have been pursued before the US courts and did not accept that fiduciary duties applicable to Ballantyne and its directors were governed by New York law. He accepted Ballantyne's submissions that an Irish scheme could be utilised to restructure New York law-governed debt.

Finally, he concluded that ESM had not demonstrated any good reason for him not to sanction the scheme based on the existence of a recently issued US Federal

Complaint against Ambac by ESM that ESM asserted would have been compromised by the scheme (in particular the third party release).

Decision

Barniville J ultimately sanctioned the scheme on the basis that:

- the pre-conditions set out in section 453 of the 2014 Act were satisfied
- the criterion set out in *Colonia*, that there was no coercion of the minority at the relevant scheme meetings, was met
- an honest and intelligent person acting reasonably in his or her own interest would have supported the scheme.

“

A scheme of arrangement under Irish law is effectively equivalent, with extremely similar governing legislation, to an English law scheme of arrangement.”

Chapter 15

An application was subsequently made to the US Bankruptcy Court to recognise the scheme as a 'foreign main proceedings' under Chapter 15 of the US Bankruptcy Code. While that application was initially contested by ESM, that objection was not pursued at the hearing and an order was made on 11 June 2019 recognising the scheme.

Key Points

This case demonstrates the effectiveness of an Irish law scheme of arrangement as a tool to implement complex international debt restructurings and highlights the effectiveness and robustness of Ireland as a jurisdiction in which to pursue such restructurings. It also demonstrated the willingness of the Irish courts to consider the well-developed jurisprudence of other jurisdictions in evaluating and ultimately sanctioning a scheme of arrangement. ■

The authors' firm acted for Ballantyne Re plc.



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► **LEGAL VOICE** The nature of the advice given is general and neither *RECOVERY* nor the writer is responsible for any consequential loss arising in connection with information given in this publication.

Legal Q&A

Hanh Nguyen and Jessica Williams answer your insolvency queries.

Q I am the director of a company that is now in liquidation. The liquidator has told me that I unlawfully declared a dividend to the company's shareholders prior to the liquidation and that he may look to me to contribute for the company's loss. I am not a shareholder of the company and did not receive any benefit of the dividend payment. Is he able to recover the dividend sum from me personally?

A The liability of a director where a dividend is subsequently found to be unlawful was considered in the case of *Re Burnden Holdings (UK) Limited (in liquidation)* [2019] EWHC 1566 (Ch). This case held that director liability for unlawful dividends is not strict – ie the court considers whether the director was at fault

“Your knowledge at the time you declared the dividend will be of key importance.”

when he declared the dividend. It was held that directors would not be personally liable in respect of an unlawful dividend payment where, at the time that the dividend was declared, they can show that:

1. they were not aware that the declaration of the dividend was unlawful
2. they took reasonable care in preparing the company's accounts and calculating distributable profits.

Therefore, your knowledge at the time you declared the dividend will be of key importance. In this regard, the court will take into account: whether you knew the payment was unlawful; whether you knew of the facts that evidence the unlawful nature of the payments; and whether you ought to have known of these facts (being a reasonably diligent director).

Further, you will not be liable if you can demonstrate that you took care to ensure that the accounts were accurate and demonstrated the availability of sufficient profits from which to make a dividend payment. The court has acknowledged that

a director may rely on professional advice given by others who are carrying out specialist roles. Therefore, it will be relevant whether you employed accountants and/or lawyers to assist you in preparing the company's accounts and declaring a dividend.

This case has made bringing an unlawful dividend claim against a director significantly more difficult for liquidators and administrators. In addition to demonstrating that the declaration of the dividend was unlawful, they must also evidence the director's knowledge of this fact at the time. Therefore, whether the liquidator may be able to recover the dividend from you personally will depend on the specific facts of your case (by reference to the above considerations).

Q A creditor of a bankruptcy estate has threatened to apply to court to have an alternative trustee in bankruptcy appointed (and me removed from office) due to alleged misconduct. What would a creditor need to demonstrate in order to be successful in such an application?

A The removal of a trustee from office is always a difficult topic – not least because the very allegation of misconduct is one that is very personal. A trustee faced with such an allegation will always be concerned that their integrity is being challenged and will (understandably) expend significant time and effort in defending such claims.

The grounds for removal of a trustee has recently been considered in the case of *Birdi, Miles & Others v. Price & Others* [2019] EWHC 291 (Ch). The court in this case

confirmed that the conduct of the trustee will be a material consideration and that it (the court) has very broad powers for removal of a trustee, but ultimately the best interests of the creditors will be key in determining whether the removal of the trustee is appropriate.

The court may therefore look beyond limited instances of misconduct and will instead make reference to the 'real substantial, honest interests of the process,

“The court will not remove you from office lightly.”

and to the purpose for which the office-holder is appointed' (*Doffman & Issacs v. Hellard & Wood* [2011] EWHC 4008 (Ch)). In the *Birdi* case, the court (who considered that the applicants had not demonstrated any evidence of misconduct in any event) noted that it was material that the estate was unlikely to make any distribution to creditors and that, accordingly, creditors were unlikely to see any benefit of the replacement of the trustees.

The creditor will therefore need to evidence more than simply an instance of misconduct. They will need to show a real benefit to the creditors in replacing you as trustee. The court will not remove you from office lightly and, further, will take into account (among the issues set out above), the impact that your removal would have on your professional standing and reputation (see *Re Edennote Ltd; Tottenham Hotspur plc & Others v. Ryman & Others* [1996] 2 BCLC 389 in this regard). ▢



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Recent case summaries

The latest insolvency update from **Matthew McGhee** and **Tony Beswetherick**.

PERSONAL INSOLVENCY ▼

Martin v. McLaren Construction Limited [2019] EWHC 2059 (Ch)

The court confirmed that, where liability to make payment under a guarantee is dependent upon demand being made by the creditor, the service by the creditor of a statutory demand cannot fulfil the dual function of (a) triggering liability under the guarantee and (b) establishing the presumption that the debtor is unable to his/her debts. Moreover, an earlier

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ICC Judge Barber rejected McLaren’s argument that an earlier statutory demand could be relied upon as the demand necessary to make the subsequent statutory demand valid.”

statutory demand could not be relied upon by the creditor as a contractual demand for payment and (contrary to earlier *dicta*) the court would be likely to set aside a statutory demand where the creditor had failed to make prior demand.

The facts were that Mr Martin guaranteed certain liabilities of various companies. The guarantee required the creditor to serve a written demand upon him as a condition precedent to his liability. McLaren (as assignee of the original creditor) served a statutory demand upon Mr Martin in respect of sums said to be due and ‘payable immediately’ under the guarantee. Mr Martin applied under rules 10.4 and 10.5(5)(d) Insolvency (England and Wales) Rules 2016 to set aside McLaren’s demand on the basis that the debt was not ‘payable immediately’.

ICC Judge Barber followed earlier authority that establishes that, in the context of an ‘on demand’ guarantee, no cause of action arises until the demand is made. She held, applying the decisions in *TS&S Global Ltd v. Fithian-Franks* [2007] EWHC 1401 and *Wallace LLP v. Yates* [2010] BPIR 1041, that a statutory demand is not a formal demand under a demand guarantee and the debt claimed in the statutory demand must already be due and payable when the statutory demand is

made. On that basis, at the date of service of the statutory demand, the debt was not ‘payable immediately’.

ICC Judge Barber rejected McLaren’s argument that an earlier statutory demand could be relied upon as the demand necessary to make the subsequent statutory demand valid, relying in part on the observation in *TS&S Global* that a statutory demand ‘is not intended as a means of fulfilling contractual pre-conditions of making a debt immediately payable’.

Finally, in rejecting McLaren’s argument that the court should decline to exercise its discretion to set aside the demand, the judge doubted the suggestion in *TS&S Global* that the court should be slow to set aside a demand if satisfied that the guarantee liability would not have been met even had there been a prior demand. Instead, the judge placed emphasis upon McLaren’s failure to have satisfied the pre-requisite under sections 267/268 of the Insolvency Act 1986 that the debt was payable immediately.

CORPORATE INSOLVENCY ▼

Re MKG Convenience Ltd (in liquidation), Abdulali and others v. NISA Retail Ltd [2019] EWHC 1383 (Ch)

In this case, the court considered whether the recipient of payments made in the period between presentation of a winding-up petition and the winding-up order (and so void under section 127 of the Insolvency Act 1986) could establish a defence to a claim by a liquidator to recover those sums. MKG Convenience sold goods purchased from Nisa while trading under the Nisa brand. On starting this arrangement, the company gave Nisa direct debit authority over certain company accounts. Nisa used the direct debit mandate to charge the company for goods and received direct debit payments in the period between presentation of the petition and the making of the winding-up order.

The liquidators of the company applied for a declaration that the payments were void and that they be repaid. Nisa cross-applied for a validation order, alternatively resisting repayment on the basis of a defence of change of position.

HHJ David Cooke held that, first, there would be no validation order. It was insufficient for Nisa to show that the direct debit payments were in the ordinary course of business or that Nisa acted in good faith.

“
It was insufficient for Nisa to show that the direct debit payments were in the ordinary course of business or that Nisa acted in good faith.”

Such matters would be relevant to the exercise of discretion, but there was a threshold requirement that the transactions to be validated were beneficial for creditors generally or otherwise made in exceptional circumstances.

Second, the liquidators were entitled to restitution of the sums paid. The judge accepted that a defence of change of position in good faith was available in principle but held that the defence was the corollary of the court finding it inequitable that the claim in restitution be permitted to proceed and the defence would likely be constrained by requirements similar to those for a validation order. In this instance, the defence was not made out. In particular, Nisa was evasive with the liquidators and was aware that the company’s business had been transferred to a third party. Any difficulties in ascertaining whether Nisa had acted in good faith were due to deficiencies in Nisa’s evidence. □



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The profession misses the... *good old days*



Ben Luxford bounces the argument for out of hours e-filing back and forth across the courts.

When I first started my career in the insolvency and restructuring profession, one of my many duties was to run to the old Rolls Building in London with a 'notice of appointment of an administrator' (NOA) in one hand and a BlackBerry in the other with view to filing the NOA with a court clerk to effect the appointment before 4.30 pm. Sweepstakes would be taken back in the office on whether I would make it in time. It was exciting. A rush. And I never missed a filing!

“

E-filing enables parties to issue proceedings and file documents online 24 hours a day, every day, all year round, including outside of normal court office opening hours.”

Upon the NOA being stamped with the court seal, I would take a photo and email the same to the team in the office who would commence post-appointment formalities. Those times were much simpler. Everyone knew where they stood and when the appointment took effect. Oh, how the profession misses the good old days following the introduction of electronic working (e-filing)...

Electronic working pilot scheme (EWP)

The EWP practice direction came into effect in 2015, initially in the London region. It now applies in all Business and Property Courts in England and Wales from 30 April 2019.

E-filing enables parties to issue proceedings and file documents online 24 hours a day, every day, all year round, including outside of normal court office opening hours, on weekends and on bank holidays. E-filing is a permitted means of electronic delivery of documents to the court for the purposes of rule 1.46 of the Insolvency (England & Wales) Rules 2016.

Although e-filing is available 24 hours a day, some have interpreted paragraph 8.1 of the *Practice Direction – Insolvency Proceedings* to mean that e-filing cannot be used to make any out of hours appointments. R3's General Technical

Committee inclines to this view but others read it to mean that the restriction only applies to qualifying floating charge holders (QFCH) and, as such, directors can file a notice of appointment outside of court hours. This interpretation has been

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Why wait until the court opens when e-filing is available? Just get on with it.”

used by some who seek to gain a timing advantage in terms of appointment – 'why wait until the court opens when e-filing is available? Just get on with it'.

Case law tennis

Prior to the introduction of e-filing, it was common practice as dictated by the insolvency rules that QFCHs were permitted to file an NOA when the court was closed if certain procedural steps were taken and there was no corresponding procedure available to directors or companies. However, the introduction of

e-filing created ambiguity that has led to a series of cases being brought before the courts as IPs seek certainty that their appointment is valid. It is this certainty IPs crave, which is not surprising considering the significant responsibilities that come with appointment as an administrator.

The ball was served in the case *Wright v. HMV Ecommerce Limited*. The court was asked to confirm whether administrators were validly appointed following the directors filing an NOA after the court office was closed. While the judge concluded that there is no question here of

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The introduction of e-filing created ambiguity that has led to a series of cases being brought before the courts as IPs seek certainty that their appointment is valid.”

the administration appointment or any act of the administrators being nullified or automatically rendered a nullity or invalid; he did not confirm definitively that directors can make an out of hours appointment, but neither did he say that they cannot.

There was a lovely forehand return down the line in the cases of *S.J. Henderson & Company Limited* and *Triumph Furniture Limited* (both in administration) whereby ICC Judge Burton concluded that a company or its directors cannot appoint outside the court's usual counter hours, with the exception of applying to a judge for an administrator order, without a legislative power enabling this action.

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It is this certainty IPs crave, which is not surprising considering the significant responsibilities that come with appointment as an administrator.”

At the same time as the above, Marcus Smith J in the case of *Skeggs Beef Limited (in administration)* was invited to consider an identical situation, save that the NOA had been filed via e-filing on behalf a QFCH. Here the judge concluded that the appointment was not invalid because not complying with the prescribed procedure under the insolvency rules, applicable to a QFCH appointment, was a formal defect. The appointment took effect at the time the NOA was filed.

These two cases highlight the previous common practice before e-filing that only a QFCH can file outside of court hours, if certain procedural steps were taken.

The welcomed clarification in the above cases was returned like a Federer backhand cross court to the profession by HHJ Hodge QC in the case of *Keyworker Homes (North West) Limited*. HHJ Hodge QC handed down a decision confirming that directors *can* appoint out of hours via e-filing, taking effect at the time and date of filing (subject to subsequent acceptance). The judgment is awaited at the time of this article; however, the decision only adds to the confusion for IPs.

With the exception of *Wright v. HMV Ecommerce Limited*, the recent back and forth of decisions has taken place over a matter of weeks and leaves us asking 'where will it go next? Will the decision in

Keyworker Homes (North West) Limited remain or will it be returned with interest?'

Playing for clarity

R3 have been listening to the concerns of members on the confusion surrounding e-filing and have been following the flurry of legal cases with interest. Seeking some much-needed clarity, R3's technical team and some members attended an e-filing workshop with the Insolvency Service recently to discuss e-filing and the ambiguity surrounding the filing of an NOA by directors or companies. The Insolvency Service has advised that only legislative change will give absolute certainty for the profession.

If legislative change is what is required,

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The Insolvency Service has advised that only legislative change will give absolute certainty for the profession.”

R3 will working with the Insolvency Service to ensure any changes end the confusion and work for the profession.

The game is on an extended rest... for the moment. ▣



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EBTs and avoidance: a tax-tics primer for IPs

Israr Manawer delves into the murky world of EBTs and beyond to explore what avenues an IP has to make a claim.

In the 1990s and 2000s, employee benefit trusts (EBTs) were a popular way of financially incentivising (normally senior) employees and encouraging loyalty to the company through the distribution of benefits such as company shares. Over time, these discretionary trusts became more complicated, with some seemingly constructed for the sole purpose of avoiding paying income tax or national insurance. This ordinarily involved the company paying an amount into an EBT or an employer financed

These loans would rarely be paid back before they became due.

Since 2010, successive Finance Acts have targeted EBTs used as tax avoidance schemes, including introducing accelerated payment notices (APNs) and follower notices (FNs) in 2014. In 2017, HMRC was permitted to charge tax on all loans, taken under the aegis of an EBT or an EFRBS since 1999, which were outstanding on 5 April 2019. The issuing of APNs, FNs and the imposition of the loan charge (which remains in force despite a government review) have been highlighted as contributory factors in company insolvencies.

Tax avoidance and insolvency

An IP charged with the administration of a company that had created an EBT or an EFRBS will explore if it was a disguised remuneration scheme. If it is, then HMRC will be a principal creditor and the directors' conduct will come under scrutiny. Without sufficient assets to satisfy the company's creditors, IPs will consider what claims they could make against the directors under the Insolvency Act 1986 including misfeasance, fraudulent trading, wrongful trading, transactions at undervalue, and transactions defrauding creditors. Alternatively, they could consider the role of the directors' professional advisers in advising on the structure and implementation of the EBT or EFRBS with a view to launching a professional negligence claim.

Claims against directors

Misfeasance (section 212 Insolvency Act 1986 (IA86)). The purpose of section 212 IA86 is to allow for the litigation of claims by an insolvency practitioner in respect of causes of action that belonged to the company and that the company could have litigated itself before entering liquidation.

A liquidator can bring a misfeasance claim when an officer of a company: misapplied or retained, or became accountable for, any money or other property of the company; is guilty of misfeasance; or has breached their

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Claims alleging, for example, breach of duty in failing to exercise reasonable care, skill and diligence will be statute-barred after six years from the date that the misfeasance or breach of duty occurred.”

retirement benefit scheme (EFRBS), which would then be distributed to employees in the form of a loan at a low interest rate, subject to neither income tax nor national insurance (and, in most circumstances, also subject to a corporation tax deduction).

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If directors can demonstrate that they did everything they could to minimise potential losses to creditors, such as taking advantage of the EBT settlement opportunity, they may be able to avoid liability.”

fiduciary or any other duty in relation to their company. An IP needs to explore if the director's motive in creating an EBT or an EFRBS was to avoid tax. If so, it could be argued that this was a misapplication of

company funds and breach of directors' duties as detailed in the Companies Act 2006, the importance of which was examined in two court cases in 2017: *Ball v. Hughes* [2017] EWHC 3228 (Ch) and *Secretary of State for Business, Innovation and Skills v. Akbar* [2017] EWHC 2856 (Ch).

In *Ball*, the directors of PV Solar Solutions Ltd, which installed solar panels, were reimbursed through the payment of management fees. In 2013, the directors continued to withdraw substantial sums (c.£750,000) from the company into their directors' loan accounts (despite the reduction of preferential tariffs), repackaging withdrawals as tax credits under a scheme in which they were involved, even after PV entered

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HMRC has regularly released 'spotlights' and correspondence to scheme users outlining their views on tax avoidance schemes, over a number of years.”

administration in 2014. The liquidators challenged the loan withdrawals, and the High Court found that the directors had breached their fiduciary duties to the company by not acting in the best interests of the creditors. The directors' behaviour was in breach of their duty to avoid a conflict of interest by advising on their own remuneration through an EBT of which they were trustees,

Akbar examined if a director, exercising reasonable care, skill and diligence, would have implemented a particular scheme based on their knowledge at the time, and whether their actions were those of a reasonable director. This case involved an aggressive EBT scheme, known as a gold bullion scheme, which involved the company putting cash into an EBT used to buy gold to sell to employees on deferred payment terms. The employee sells the gold but does not honour their payment obligations to the company, and avoids any tax on the gain. After the company went into administration, the court found that the directors had failed to act in its best interests when they respectively caused and/or allowed it to enter into the gold bullion arrangement.

In both cases, the courts considered the timing of the schemes, when the payments were made, and the actions of the individual(s) implementing the scheme. However, breach of duty would have been more difficult to prove had those directors acted upon professional advice, unless they acted knowing that the scheme may be challenged in future, or if they had

acted against professional advice and had not put money aside to pay a future tax bill. Nonetheless, it must be remembered that claims alleging, for example, breach of duty in failing to exercise reasonable care, skill and diligence will be statute-barred after six years from the date that the misfeasance or breach of duty occurred.

Fraudulent trading – s213 IA86. If, during a liquidator's investigations, it appears that the company carried on trading with the intent to defraud creditors, then a liquidator can seek a declaration from the court that anyone who was knowingly a party to the fraudulent activity must contribute to the company's assets.

This will therefore catch directors who continue trading intending to defraud the company's creditors. Fraudulent trading also constitutes a criminal offence under section 993 of the Companies Act 2006.

However, it is questionable if entering, or continuing to contribute to, a tax avoidance scheme (as opposed to evasion) while the company is insolvent amounts to defrauding HMRC. In *Jetivia SA & Anor v. Billa (UK) Ltd & Ors* [2015] UKSC 23, the liquidators relied on s213 to bring a claim against a company's former directors and a Swiss company for their involvement in a fraudulent scheme. The directors attempted to appeal the liquidators' claim on the basis of the *ex turpi* principle but their appeal was rejected by the Supreme Court. In *HMRC v. Stephen West* [2018] UKUT 0100 the Upper Tribunal (UT) held that the director of an insolvent company was personally liable for wilfully failing to pay PAYE and NICs due on a bonus paid to clear his loan account before the company went into liquidation.

Wrongful trading – s214 IA86. If, during the course of a liquidation, it appears that a person who is, or was, a director of the company knew, or ought to have concluded, at some point before the start of the liquidation that there was no reasonable prospect that the company would avoid an insolvent liquidation, then the liquidator can seek a declaration from the court that the director contribute to the company's assets.

Wrongful trading is measured by the increase in the company's net deficiency of assets from the time when they realise – or ought to have realised – that the company was not going to avoid an insolvent liquidation. If there has not been an increase in the company's net deficiency in assets, then the court will not make an order; conversely, if there is an increase in the company's net deficiency in assets, the maximum quantum of any liability for wrongful trading will be the amount of that increase.

What is important to bear in mind is that the service of an APN, an FN, or the crystallisation of the loan charge, may make insolvency inevitable.

A liquidator has a high threshold to establish wrongful trading and if directors

can demonstrate that they did everything they could to minimise potential losses to creditors, such as taking advantage of the EBT settlement opportunity (withdrawn on 31 July 2015) or the November 2017 settlement terms, they may be able to avoid liability. However, a liquidator could look at the directors' actions upon receipt of correspondence of HMRC opening enquiries, regulation 80 determinations, and/or section 8 decisions to evidence whether a director ought to have known of the possibility of liquidation.

In *Grant v. Ralls Builders Limited (in liquidation)* the court ruled that the directors should have known, at least six weeks before the company ceased trading, that insolvency was unavoidable. However, no order was made as there was no overall detriment to creditors despite trading while insolvent.

For more on wrongful trading, turn to page 28 to see Stephen Hunt's article on how to calculate loss.

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Traditionally, courts have been cautious when deciding if remuneration payments are reasonable as employees are entitled to receive proper compensation for services rendered.”

Transactions at an undervalue – s238 IA86. If a company has made a gift or entered into a transaction for either no or little consideration and that transaction was entered into during the two years before the onset of insolvency, and the company was unable to pay its debts or became unable to pay them as a result of the transaction, then a liquidator can apply for a court order to restore the position to what it would have been had the transaction not occurred.

To prove that a payment of funds to an employee is a transaction to an undervalue, a liquidator may find it difficult to substantiate the consideration in return of the payment. This was evident in *Ball*, where the judge found that the payments to an employee were not a transaction at an undervalue due to the significant work he did for the company.

Transactions defrauding creditors – s423 IA86. A transaction may be set aside under this section if it was entered into at undervalue and the purpose of the transaction was to put assets beyond the reach of the person making a claim against the company.

A subjective test is applied to proving the relevant purpose. Therefore, if this cause of action is pursued by a liquidator in »

connection with the use of an avoidance scheme, then they must show that the overriding purpose of the transaction was to prejudice HMRC's interest by avoiding certain tax liabilities – the latter objective is, of course, the purpose of these schemes.

Directors are aware of their duty to ensure their company pays tax on behalf of itself and its employees. Contributing funds, which would otherwise be available to pay such tax, to a tax avoidance scheme means that those funds are now out of HMRC's reach.

Therefore, it depends when the scheme was implemented and when the transaction(s) took place as HMRC has regularly released 'spotlights' and correspondence to scheme users outlining their views on tax avoidance schemes, over a number of years.

“Any claim in relation to EBT or EFRBS schemes will depend heavily on the timing and circumstances of when the scheme was entered into.”

In *Toone & Ors v. Ross & Anor* [2019] EWHC 2855, the judge found that the directors breached their duty by sanctioning payments from the company, via an EBT, to shareholders. These payments were not only dividends rather than employee remuneration, they were also subject to tax when made – making the company insolvent at that point and, as funds were no longer available to pay the company's debts, in breach of its duty to its creditors. The judge ordered the directors to account for the loss.

Defences of directors

Quantum meruit/unjust enrichment. To claim unjust enrichment, IPs have to prove the director(s) received payments, to which they were not entitled, to the detriment of the company. Traditionally, courts have been cautious when deciding if remuneration payments are reasonable as employees are entitled to receive proper compensation for services rendered. Therefore, IPs may struggle to recover funds, as shown in *Ball* where the judge commented on *Global Corporate Ltd v. Hale* [2017] EWHC 2277 (Ch):

'Ultimately, however, it will be for other courts to determine the fate of Re Global. For present purposes it suffices to state that the decision is distinguishable from present facts. In Global, the director was already a PAYE employee who had been in receipt of a salary for a number of years prior to the events in question. In the present case, the respondents did not have employment contracts and had consciously decided against the same.'



Acting honestly and reasonably – s1157 CA06. If a director can prove that they relied upon legal advice, acted honestly and reasonably, and had regard to all the circumstances of the case, they may be able to apply for a court order to be relieved from liability under CA 2006.

Likewise, if the director can prove they acted honestly and reasonably, a claim for breach of duty (misfeasance) will be difficult to uphold. In a recent decision by the Supreme Court (*Burnden Holdings (UK) Ltd (In Liquidation) v. Fielding*) the judge commented:

'Directors are not required to be accountants and the comments of Lord Davey and Lord Halsbury LC in Dovey v. Cory [[1901] AC 477] as to directors being entitled to rely on the judgment of others whom they appoint to carry out specialist financial roles within the company are as pertinent today as when they were made in 1901.'

Claims against finance professionals

For those directors who relied on professional advice, IPs could investigate pursuing a negligence claim against those professionals who advised on the tax avoidance scheme. To establish a professional negligence claim, the IP will need to establish the following:

- the professional owed the company a duty of care
- that duty of care was breached
- the breach of duty caused a loss
- the loss complained of was reasonably foreseeable.

First, the IP needs evidence that the relationship between the company and the professional was based on a legal footing, whereby the professional was legally obliged to adhere to a standard of reasonable care when carrying out services on the company's behalf. A contract or retainer between the company and the professional would be sufficient proof.

Second, the IP needs to prove that the professional breached their duty of reasonable care by comparing their actions to those carried out by other reasonable, responsible professionals under the same circumstances; a negligence claim does not automatically arise just because a professional has got something wrong. If the professional provided satisfactory disclaimers and explained the potential

risks involved, and it can be reasonably assumed that other reasonable professionals would have pursued a similar action, then no breach of duty will have occurred.

Summary

Any claim in relation to EBT or EFRBS schemes will depend heavily on the timing and circumstances of when the scheme was entered into, the volume and timing of the payments made and the actions of the director(s). In weighing up whether a claim ought to be made, insolvency practitioners should consider:

- whether the scheme was entered into before or after 5 August 2010
- what advice the director(s) received at the time (if any) and their reliance upon that advice
- whether the monies paid under the scheme represented reasonable remuneration (at least in part)
- what action was taken by the director/s after HMRC intervention.

“The burden of proof will lie with IPs and that is not necessarily an easy process.”

Given HMRC's determination to crack down on tax avoidance schemes, and its efforts to seek further legislative powers to stop directors and shareholders misusing insolvency to side-step their tax liabilities, the pressure on IPs to investigate whether or not they can claw back monies from those schemes is likely to increase. The burden of proof will lie with IPs and, as outlined above, that is not necessarily an easy process. Given the cost of litigation, and the uncertain outcome (potentially leaving an IP open to an adverse costs award) all IPs should seek legal advice from lawyers familiar with EBTs and other tax avoidance schemes before embarking on a particular course of action. To date, case law indicates that each matter will turn on the strength of the evidence available, so it is imperative to carry out thorough due diligence before committing to the courts. ▣



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When lifeboats rescue the wrong people

Sarah Rapson outlines the FCA's fight against phoenixes and 'lifeboating'.

All insolvency practitioners will be familiar with the problem of 'phoenix' firms: companies that collapse leaving a trail of debts and obligations only for their directors to re-emerge in a new firm with a similar business model.

Of course, in any commercial environment companies will fail and the people behind them should be allowed to try again. To suggest otherwise would stifle entrepreneurship. However, no one, surely, would countenance the *deliberate* attempt by directors to avoid their liabilities or their

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The challenge with lifeboating is that the indicators are not as obvious as they might be with classic phoenixing or fronting.”

personal accountability for their conduct. In the financial services sector, we have seen a number of instances of directors who have wound up companies owing significant sums, often in the form of customer redress awarded by the Financial Ombudsman, or who have engaged in financial misconduct, only to reappear at the helm of strikingly similar businesses.

The many forms of the phoenix

Not surprisingly phoenixing has long been on the FCA's radar. Closing one firm only to start another is not in itself a regulatory breach. However, we expect all directors to act in a 'fit and proper' manner and avoid causing harm to customers. Deliberately walking away from liabilities or trying to hide a poor conduct history is clearly at odds with this concept.

Phoenixing can take many forms. Closing down a firm only to emerge subsequently in a different legal entity is called classic phoenixing. Another mechanism is 'fronting', where an individual with a clean regulatory history is put forward to front a firm that is controlled by someone with a history of misconduct – a shadow director.

We also see a pre-emptive version of phoenixing called 'lifeboating'. Here, the firm knows its actions may lead to complaints and redress awards some years down the line. The directors then take pre-emptive action by setting up a new firm (or perhaps acquiring an existing firm) and applying for FCA authorisation. Their intention, were they to gain authorisation, is to close down the existing firm, having first moved its assets to the new firm, and allowing it to sink under the weight of its potential liabilities, leaving the assets to sail on safely in the lifeboat.

The challenge with lifeboating is that the indicators are not as obvious as they might be with classic phoenixing or fronting – complaints or evidence of misconduct may not yet have materialised, for example. This means we have had to change our approach.

Holding the lifeboats

When considering authorisation applications, we now focus increasingly on the rationale given for setting up a new firm. We scrutinise connections, direct or indirect, between the individuals behind it and existing, or previously authorised, firms. We ask 'Is there a "parent vessel" for which the applicant firm is providing a lifeboat?'.

We have already had success in preventing would-be lifeboats from being launched. Following discussions with certain firms applying for authorisation, they have decided to withdraw their applications rather than risk refusal. Our aim then is to work with the 'parent vessel' to ensure that consumers' interests are at the forefront of any actions it may take to protect its assets.

The work we have been doing initially focused on the financial advice sector. The particular challenge here is that the nature of investment products means a customer given inappropriate advice, for example, is unlikely to realise they have a problem for some years. By that time, the people that advised them – and against which they could seek redress – may have ceased trading in that legal entity, even though, frustratingly, they may still be offering advice under a different guise.

Customers do have recourse to the Financial Services Compensation Scheme (FSCS) but the FSCS compensation cap means they may not recover all their losses.

Meanwhile, it is the wider industry, rather than the firm that gave the poor advice that picks up the FSCS tab.

Prevention and protection

So, it is in everyone's interests to minimise the opportunities for phoenixing. Our approach relies on up-to-date intelligence, so we are strengthening our links with other organisations. In April, we launched the Financial Services Regulatory Family Phoenixing Working Group, through which the FCA, Financial Ombudsman, FSCS,

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Data from the Ombudsman and FSCS has already proved critical in building cases against firms we suspect of phoenixing.”

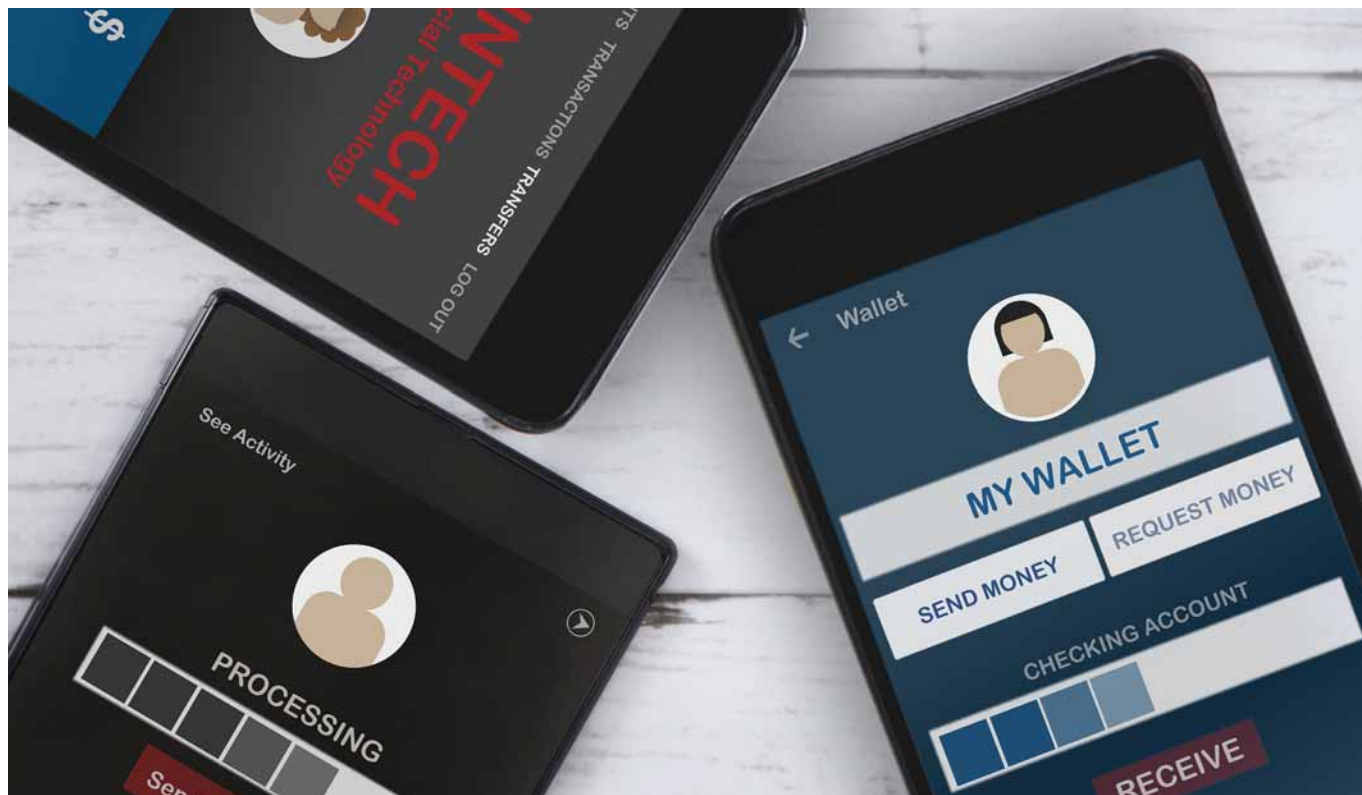
Insolvency Service and Scotland's Accountant in Bankruptcy share ideas on how we can combine our data to improve our ability to detect and prevent phoenixing.

Data from the Ombudsman and FSCS has already proved critical in building cases against firms we suspect of phoenixing, and we are keen to explore the extent to which intelligence from the insolvency world could prove similarly useful (practitioners may report any suspicions to firm.queries@fca.org.uk).

As with all aspects of consumer protection, prevention is better than cure and we hope to continue to develop fruitful relationships with professional bodies such as R3 so that together we can stamp out this unacceptable practice. □



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Peer-to-peer pressure

Tim Bignell explores some of the major recent setbacks for P2P lending and the regulation that allowed them to get there.

On 23 October 2019, FundingSecure Limited, the asset-based peer-to-peer (P2P) lender, entered administration with £80m of loans belonging to its 3,500 customers at risk.

In doing so Funding Secure became the latest in a growing list of high-profile failures in the P2P sector. Its demise provides yet another cautionary tale for investors and regulators.

Background to P2P lending

The arrival of Zopa's platform in 2005 is commonly viewed as the origin of today's £9.5bn P2P sector in the UK. It was not until the recession of 2007/2008, however, that its growth really took off.

The combination of low interest rates and a generally reduced appetite for traditional lending in the wake of the 2008 banking crisis provided fertile ground for Zopa and other new entrants into the P2P market, such as Funding Circle and RateSetter, to expand.

These platforms offered a technologically innovative and efficient method of linking needy borrowers with willing lenders. The loans were often unsecured, which meant they could be quickly arranged, and, because such platforms offered their services solely online, overheads were lower than usual and the loans could be provided more cheaply. The credit-worthiness of the borrowers was not necessarily scrutinised in

the same way as it traditionally would have been by a high street bank. The result was that both borrowers and lenders benefitted, with lower costs and attractive, almost fixed, rates of return, over the term of the loans.

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The credit-worthiness of the borrowers was not necessarily scrutinised in the same way as it traditionally would have been by a high street bank.”

The P2P market diversified over the years and the platforms developed an increasingly wider range of business models. In addition to simply acting as a facilitator, some now structure the loans according to the profile of the lender, while others split the loans between a variety of borrowers, thus spreading the risk but adding to the administrative complexity of the platform. In a number of instances, the results obtained by the lender have become directly linked to the performance of the platform they lend on.

The risk and return that the lender might expect now also varies hugely on the

nature of the underlying loan. The type of loan (for example, SME finance, consumer credit or property finance), the term of the loan and the loan's repayment schedule each impact the lender's exposure.

Regulation

Prior to 2014, P2P platforms usually operated under the auspices of the Office of Fair Trading and would be licensed for activities such as debt administration. With the introduction of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, P2P platforms fell within the regulated activity of 'operating an electronic system in relation to lending', and so came to be regulated by the Financial Conduct Authority (FCA).

This meant that P2P platforms were required to comply with the Systems and Controls Rules, the Conduct of Business Rules and the Principles for Businesses. Some aspects of the Consumer Credit sourcebook would also apply to the platforms.

In October 2017 the FCA published a consultation paper in relation to the Financial Services Compensation Scheme (FSCS) in which it confirmed that bringing P2P lending under the FSCS regime was not justifiable. Lenders on P2P platforms were therefore not protected by the FSCS in the event their loans were not repaid, either partially or in full. In a small number of cases, however, compensation might be available if the FSCS deems the investor to have received unsuitable advice on the merits of P2P lending.

London Capital & Finance

Instead of borrowing via a P2P platform, some corporate borrowers seek P2P finance directly from the lenders themselves. In some instances, this was in the form of mini-bonds – in other words, unlisted debt securities marketed to retail investors.

The FSCS provides no protection for holders of mini-bonds and the issuing of mini-bonds is not a regulated activity under the Financial Services and Markets Act 2000, meaning the firms issuing them do not need to be FCA-authorised. Firms that promote the mini-bonds do fall within the regulatory regime, however.

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In March 2019 the SFO made four arrests in connection with LC&F's collapse, and the FCA has since referred itself for an independent investigation into its conduct of the matter.”

While mini-bonds can offer higher than average yields, this ultimately reflects the higher risks involved. The issuers are frequently small, nascent business and the mini-bonds are highly illiquid.

Mini-bonds were the debt security of choice for London Capital & Finance (LC&F). It raised £236m following a marketing campaign ran on its behalf by Surge PLC, which attracted investors with fixed returns of up to 8% from the mini-bonds that could purportedly be held in the tax-free, innovative finance ISA.

LC&F advertised itself to potential investors as FCA-authorised, although did not draw attention to the authorisation being in respect of its promotion of the mini-bonds only.

The FCA was first warned about LC&F in 2015 by an independent financial advisor who, having been shown the scheme by a client, had investigated and seen ‘a lot of interconnection between the people they were lending to and the management of LCF themselves’.

The FCA only took action on 10 December 2018, when it ordered LC&F to stop promoting the mini-bonds as it deemed them ineligible to be held in the ISAs, as advertised.

Three days later, the FCA froze LC&F's assets.

On 30 January 2019, administrators were appointed. In the course of their investigations, they discovered that LC&F had paid its marketing agent, Surge, £60m in commission and, instead of the funds being applied across a large number of companies, LC&F only loaned the money

to 12, with a number of instances of the money being sub-loaned.

The administrators have warned the 11,600 LC&F investors to expect as little as 20% of their money back. In March 2019 the SFO made four arrests in connection with LC&F's collapse, and the FCA has since referred itself for an independent investigation into its conduct of the matter and the existing regulatory regime surrounding the protection of retail investors of mini-bonds.

Lendy

In some instances, P2P financing is backed by property. Lenders are drawn to this not only because of the high rates of return, but also the perceived security they get from the nature of the asset they are lending against.

Lendy offered retail investors just this. In its marketing material it informed potential investors of its ‘four-step due diligence process’ and its ‘five-phase credit assessment’, and returns of up to 12% in exchange for lending their money against property.

While it started life providing 12-month bridging loans on property purchases, its downfall was triggered when it began lending to property developers. The risk profile changed, and its rate of defaults began to grow. Investors lost confidence and money dried up. Developers found they could no longer draw down and their developments came to a halt.

This cycle continued and the FCA was forced to intervene in Lendy in late 2017. Notwithstanding that, it then proceeded to grant Lendy full FCA authorisation in July 2018.

In May 2019, ten months after receiving authorisation, the platform failed. 9,000 investors had invested a total of £152m into the P2P lender at the time of its collapse. The sum of £600,000 was still owing to lenders following the FCA intervention in 2017. The administrators subsequently discovered that out of Lendy's 54 corporate borrowers, 35 were either in, or entering, administration. They estimate the investors' recovery will be 58 pence in the pound before costs.

FundingSecure

Some P2P platforms provide financing against other types of asset. In the case of FundingSecure, this was against items such as art, vintage cars and watches.

On its website, FundingSecure stated that it did not use borrowers' credit scores to determine who to lend to; instead it based its decisions on the value of the assets that were being put up as security. It advertised that lenders could achieve annual returns of up to 16%.

A series of defaults ultimately led to the platform's collapse. In one high-profile case, Matthew Green of Mayfair Fine Art Limited was able to sell paintings by Picasso, Chagall and Bonnard which he had provided as security against a loan of £2.32m, before he defaulted.

Administrators were appointed at the end of October this year, and 3,500 investors are potentially exposed to the losses of their loans totalling £80m.

FCA criticism and new requirements

The worrying frequency of P2P lenders failing has led to calls for the increased regulation of the sector. The fact that many of those who suffer as a result of the lenders collapsing are ordinary people – investing their inheritance or their pensions, or who are self-employed – has strengthened these calls.

The FCA's perceived inaction in relation to the recent collapses of LC&F and Lendy, despite being warned of the lenders' respective conduct, has placed the FCA itself in the spotlight. Lord Myners, the former City minister, has called for an independent review of the FCA's supervision of Lendy – in addition to the review currently being undertaken into its response to LC&F's business.

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The worrying frequency of P2P lenders failing has led to calls for the increased regulation of the sector.”

In June 2019 the FCA unveiled its much-anticipated plans for updated rules for the P2P sector. These aim to ‘prevent harm to investors, without stifling innovation’, and come into force on 9 December 2019. Among other matters, the new rules cover requirements in relation to the platforms' governance systems, the platforms' assessment of investors' knowledge and experience of P2P lending, and the provision of a minimum level of information to the investors. The lack of protection from the FSCS will also need to be highlighted. Perhaps most strikingly of all, the FCA is placing a limit on investments made by new investors to the P2P sector of 10% of their investable assets. This limit is disapplied if the investor has received regulated advice.

The new rules should force a number of smaller or badly-run P2P lenders out of the industry, which is largely positive. There are currently fears that over ten lenders are close to collapse, and for the investors in those, the new rules will likely accelerate their losses. ■



TIM BIGNELL is a partner at Howard Kennedy LLP.

Planning to protect pensions

Mike Ridley offers a reminder that early engagement with the Pension Protection Fund can make all the difference.

Economic downturns or periods of uncertainty, such as we're experiencing now, often act as a prompt for businesses to review their contingency plans. In fact, any company that wants to deliver on its strategic objectives, whether it's perfectly healthy or in distress, needs to have a plan. In the past few years we have seen a significant rise in the number of high-profile company insolvencies and restructurings, which indicates that contingency planning is more important than ever.

Each year, the Pension Protection Fund (PPF) is involved in two to three restructuring or rescue transactions affecting employers sponsoring defined benefit (DB) pension schemes that would otherwise face certain insolvency. These companies run into difficulties for a number of reasons. It's largely not the fault of the pension scheme and pensions are often side-lined by employers in the process of an insolvency or restructure.

Early engagement

The more time anyone has to think about a problem and the appropriate solution, the better the outcome is likely to be for all stakeholders, including DB pension scheme members. Employers and trustees both need to ask themselves questions when thinking about contingency planning.

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Any company that wants to deliver on its strategic objectives, whether it's perfectly healthy or in distress, needs to have a plan.”

Looking at the employer first: what is it doing to meet the company objectives? Identifying this can help employers foresee any obstacles that could act as roadblocks on the way. These roadblocks could come from a variety of factors, so involving all senior leaders is crucial to making a robust and comprehensive plan, with an alternative if it fails.

Turning to trustees: what are they doing to oversee best interests of the pension scheme members? The trustees of a DB pension scheme have a responsibility

to ensure there is enough money in the scheme to pay members' pensions as and when they need to be paid, which involves monitoring scheme investments and keeping an eye on the financial strength of the employer standing behind the scheme.

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A company's DB pension scheme is often one of its most significant financial liabilities.”

They should also ensure that there is a plan to minimise risk of disruption and effective mechanisms to communicate with members in the event of insolvency.

Identifying real or potential risks that might arise further down the line should be undertaken by every business. As soon as management is aware of a problem, they should be reaching out to their advisers and other stakeholders, of which the PPF is often one, to keep them informed at an early stage.

Protecting pensions in insolvency cases

A strong sponsoring employer that has effectively planned against all potential headwinds is the best protection for DB pension schemes, but in extreme circumstances where an organisation faces a serious risk of insolvency, this support may no longer be available.

A company's DB pension scheme is often one of its most significant financial liabilities. It is also volatile in its value, which means management teams should have a clear plan to reduce this movement to minimise the potential threat. This is tackled by increasing contributions into the scheme coupled with a change in its risk profile.

If a business is inevitably going to fail, what does this mean for the sponsoring employer of the DB pension scheme? Initially, their pension scheme will move into a PPF assessment period. During this period the PPF will decide if the scheme has sufficient assets to 'buy out' pension benefits with an insurance company at levels greater than the PPF pays. If the scheme has insufficient assets to do this, it will transfer into the PPF who will become responsible for paying scheme members compensation at levels set by government. ■

What is the PPF?

The PPF, which was set up to protect millions of people who belong to final salary (DB), pension schemes in the United Kingdom, will compensate scheme members for any lost pensions if their employers fail, and their pension schemes cannot afford to pay what they were promised. The PPF works closely with The Pensions Regulator (TPR) to share intelligence and understand the risks posed by employers in financial distress and will participate in restructuring where it's clear that doing so will result in a better outcome for the PPF and its levy payers.

The PPF's role for IPs

In insolvency and company restructuring cases, the PPF's in-house team works closely with tPR to negotiate the best outcome for the PPF. The PPF plays a statutory role in these negotiations, as set out by the Pensions Act 2004, where it assumes creditor rights for the troubled DB pension scheme. Usually, the scheme is one of many unsecured creditors and has no special advantages throughout these negotiations. Restructuring proposals must satisfy all of our seven published principles, which include a requirement that employer insolvency is inevitable and that the restructuring provides a significantly better return for the pension scheme than it would receive through the normal insolvency process.

Minimising the chance of insolvency is the best protection for the 11 million members of UK DB schemes and the levy paying businesses. This involves having a plan in mind, having clearly articulated objectives against this plan, and for those objectives that can't be met, having a fall-back and being prepared to execute this fallback plan earlier than you might expect.



MIKE RIDLEY is the head of restructuring in the Pension Protection Fund's (PPF) Restructuring & Insolvency team.

Pursuing litigation is risky and expensive. But for whom?

Mark Beaumont explains how a common-sense approach and the right insurance can lead to a better outcome.

The products Annecto Legal broker allow IPs to transfer risk to an insurer or funder's balance sheet. There is a cost to these products, albeit usually deferred until settlement, but the question is: do these products add more value than they cost?

The headline figures thrown around for litigation funding can be quite off-putting. Few clients would want to give away large chunks of a settlement – especially if the deal had been reached quickly and funders had taken little risk up to that point.

“The headline figures thrown around for litigation funding can be quite off-putting.”

Thankfully, the figures bandied around of ‘giving away a third of damages’ or providing funders with up to a 300% return on their investment are more talked about than utilised. With scores of funders and insurers in the market, this is a competitive environment whereby those wishing to pursue disputes are well placed to secure attractive terms for multiple funders. It would be difficult for an IP to justify giving large returns to funders in this market.

An abundance of opportunities

There are more funders than ever, and that's impacting on price. As well as using the present market conditions to negotiate on price, there are an abundance of opportunities to consider hybrid approaches that reduce cost overall.

Hybrid arrangements consist of a mix of risk sharing to minimise the amount of money that flows from successful settlements into the bank accounts of the funders. Typically, partial conditional-fee agreements (CFAs) will be utilised along with a mix of after-the-event (ATE) legal expenses insurance, to protect the adverse costs position, and own costs insurance, to protect disbursements incurred, and even your own solicitor's fees.

Insuring the risk

Using retainers and insurance can both reduce the amount of cash required and have a significant impact on the cost of

those funds that are needed to cash flow the case. Let's use a relatively straightforward, smaller case as an example: it requires £100,000 of ATE for adverse costs and £50,000 of own costs insurance, with perhaps £35,000 of actual cash needed for court fees, experts and counsel.

As the £35,000 is insured, it means that whoever funds that £35,000 is not taking the litigation risk: if the case loses, the insurer will pay back the £35,000. The consequence of this is that a creditor might be more willing to provide cash if they are not taking the risk of losing said cash if the case fails. Alternatively, the solicitor or barrister might be more inclined to work on contingency if some of the work in progress (WIP) is insured and so will be paid at the end, *win or lose*. Of course, by insuring the risk, you can even negotiate far better terms with third-party litigation funders should it be necessary.

When own costs insurance is in place, we see funders providing cash for between 20% per annum and 50% per annum. The cost of the insurance is usually between 10p and 40p in the pound, depending on when the case settles, so as an overall package it is significantly less than taking cash (without insurance) for up to a 300% return to the funder. So £100,000 of ATE, £50,000 of own costs insurance and £35,000 of funding could cost *under £50,000* if the case settles within 12 months.

So, do these products add more value than they cost? The first thing to consider is what is the goal, and what are the obstacles to getting there...

- Do you need to issue a claim to have a serious settlement discussion? Would having ATE and disbursement funding be enough to encourage settlement discussions, and would they improve the net outcome for stakeholders?
- Could the funding and insurance be staged, to favour the creditors should settlement be reached quickly?

- Will security for costs be an issue, and could insurance be a cost-effective solution?
- Would funding and insurance allow the case to be properly pursued, and therefore lead to a better net outcome overall, even after the costs of funding are factored in?

There are lots of issues and factors to consider pre-litigation, but what combination of retainers, funding, insurance etc would maximise returns is certainly one of them.

“There should be no increase in the costs of funding a case when a broker is involved.”

Value outweighs cost

There should be no increase in the costs of funding a case when a broker is involved. Annecto Legal assists clients in securing the right funding and insurance by understanding your aims and objectives, preparing the case for underwriting, having access to a wide range of different funding and insurance markets and products, negotiating terms and ensuring the project is delivered in as timely fashion as possible.

Using a broker adds a further cost to be factored in too of course, and so our service should also be considered in the round: are we adding value over and above our cost?

The funder/insurer will need to pay a brokerage fee, but they will also be saving time and money on marketing, case assessment and client management. Some markets will only work with brokers, as they don't have the resources to market their services and handle a volume of enquires from IPs. However, the broker should save both the lawyers and IPs time in getting their case prepared, out to the appropriate markets and, ultimately, funded and insured. Overall, the net impact of a broker should be significantly positive in both time and monetary terms. ■



MARK BEAUMONT is co-founder of Annecto Legal Ltd, a national broker of after-the-event (ATE) legal expenses insurance and a wide range of funding for litigation and arbitration claims. Annecto is happy to assist with smaller claims under £100k as well as mid-market, large-scale and complex cases. Contact Annecto Legal on 0800 612 6587 or Mark Beaumont directly on mark.beaumont@annectolegal.co.uk or 07730 217 643.



Belle the cat, courtesy of Matthew Davies

Schrödinger's VAT

Matthew Davies argues that UK businesses have thrived while the funds are in the box but that is likely to be changing.

The 2018 autumn budget statement included a relatively minor reference to a measure to extend the little used secondary preferential creditor status to include HMRC's claims for certain taxes, including PAYE income tax, VAT and Employee NICs.

These are taxes that have been paid over by the end-user and are held 'in trust' by the receiving business on behalf of the Crown (although not formally *in trust*, of course). This status sits in the creditor hierarchy underneath fixed security, with significant impacts for unsecured creditors and lending against floating charge (FC) security.

One year on, this article considers where we have got to and the likely impact on lending to UK businesses.

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As a creditor HMRC is certainly not helpless; it has significant (unique) powers to intervene pre- and post-insolvency and is intent on taking more.”

The (more than slight) return of Crown preference

While not branded as such, this is a partial return of the concept of Crown preference (CP), which afforded preferential status to debts owed to the Crown in insolvency. CP was removed by the Enterprise Act 2002 (EA2002) to release working capital,

increase and diversify access to finance, and support business rescue; objectives on which it is seen to have been broadly successful.

Indeed, since 2002 we have seen a steady parade of policy interventions to support access to finance for UK businesses. Prominent among these has been establishing the British Business Bank and the schemes it oversees, some of which are intended to bolster the security available to SMEs in accessing finance. The practical effect of this measure is precisely the opposite.

To balance the removal of CP, the EA2002 also introduced the 'prescribed part', which reserved for unsecured creditors a portion of the realisations that the Crown had released. But as part of its separate corporate governance policy package, the Insolvency Service is now proposing to *increase* the prescribed part. Paula Laird, partner at Squire Patton Boggs, highlights the cumulative impact of this:

'The re-introduction of a significant proportion of such Crown preference claims, combined with an increase to the prescribed part results in a double whammy for lenders, increasing their exposure as floating charge holders.'

Of course, this is not a full restoration of CP as it does not include all taxes. But it covers a significant majority of those sums that would be due as a business enters insolvency. And, regardless, HMRC retains the right to participate in the increased prescribed part for any outstanding tax liabilities.

In justification, HMRC notes that it is an involuntary creditor. But at insolvency, *all* creditors will be involuntary. As a creditor HMRC is certainly not helpless; it has significant (unique) powers to intervene pre- and post-insolvency and is

intent on taking more. It also has insight into the tax position of all businesses to inform its decisions that other creditors will not have.

The split in taxes this measure is intended to recover is also relevant. In combination with the introduction of significant – and not uncontroversial – new powers to make directors and other parties liable for unpaid tax, the government hopes the measure will recover up to £185m p/a. VAT is expected to account for the lion's share, around £140m. More on this below.

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Businesses, particularly SMEs and high-growth firms, are less likely to be fixed-asset rich and their requirements will be more around working capital, intangible assets and working assets.”

Proving a negative

In its consultation HMRC correctly points out that most secured funding to businesses is against fixed charge. However, the conclusion drawn from this – that this measure will thus have minimal impact on lending – is mistaken. Yes, the bulk of secured lending to UK businesses is for and secured against commercial property. However, businesses, particularly SMEs and high-growth firms, are less likely to be fixed-asset rich and their requirements will

Reflections on Asset-based lending (ABL) and the return of Crown preference

'The growth of asset-based lending over the last 15 years has been a good news story for the UK – this has been driven by the quantum of lending available against FC assets such as finished goods, stock, work in progress and raw materials. It is a cost-effective and flexible form of finance that supports businesses across the economy and is particularly important for manufacturing, distribution, wholesale, retail and equipment rental businesses.'

This type of financing, secured against these FC assets, has always been flexible. However, this step by HMRC effectively reduces the amount available for lending against these assets, which will have a significant effect on the borrowing capacity for UK Plc.'

STEVEN CHAIT of
Wells Fargo Capital Finance.

'This may well disproportionately impact sectors of the economy that are already feeling challenged. It is going to impact those businesses that may be stressed but which could currently be turned around with ABL. It's also going to impact those high potential growth businesses which may not have the short-term financials to enable traditional forms of finance but could currently use the value in their intellectual property and other FC assets to unlock the working capital they need. It will, in fact, prove to be restrictive to both businesses looking to survive and thrive.'

JEREMY HARRISON of
ABN AMRO Asset Based Finance.

'There has been a move away from preferential categories in the significant jurisdictions around the world. The UK led the way in 2002 in seeking to create a business-friendly rescue culture. It is a real concern that we are going back on this now when we should be emphasising that the UK is open for business.'

PAULA LAIRD of
Squire Patton Boggs.

'What was a policy priority in 2002 – releasing working capital and supporting business rescue – is even more pressing in 2019 with the economic uncertainty around the UK's exit from the EU. The abolition of Crown preference has been a policy success, unlocking millions of pounds of finance and likely saving thousands of businesses in the UK. To unwind it at any time wouldn't make economic sense; to do it now is verging on madness.'

RICHARD HAWKINS of advisory firm
Atlantic Risk Management.

be more around working capital, intangible assets and working assets.

It is these businesses where the impact of this measure will be felt. In some instances the value of these assets for borrowing will be significantly degraded, in others it will effectively be extinguished altogether. Due to the uncertainties outlined below, these impacts will be felt far wider than just those businesses approaching or in insolvency, or in distress.

It is partly the success of the abolition of CP as a policy that has made it inherently challenging to quantify the likely impact of its reprise. Across many business lending products, the value of funding against FC assets – which will include raw materials, work in progress, stock, intellectual property, cash and book debts (in a non-invoice discounting facility) – will not be defined but will still be key in enabling flexibility and maximising funding.

So, within a business overdraft, for instance, there will not be £X secured against FC assets, but the headroom provided by those assets will allow a bank to take a more holistic view and provide a larger overdraft than otherwise possible. This practical reality means that it is difficult to arrive at a single isolated figure of the value of finance currently provided against these assets and that, combined with limited visibility for lenders of Crown arrears, makes it almost impossible to quantify the increased risk.

While it will represent only part of the total impact, one area where the value of funding secured against FC security can be quantified is in asset-based lending (ABL). UK Finance's Invoice Finance and ABL (IFABL) members break down advances against stock alongside other assets and this data provides the clearest indication of impact. After years of continuous growth – almost 50% in the three years to 2018 – advances against this asset class have fallen since HMRC's announcement.

Of course, supporting a business through turnaround reduces losses to HMRC; if creditors are less able to support then HMRC is going to be more often put at risk. Based on data provided by its IFABL members, UK Finance estimates that the impact on current lending could be up to £1.5bn. This takes no account of the larger but less quantifiable impact on other types of lending. It also takes no account of the economic growth – and hence additional tax revenues and employment – that this lending enables. Even a conservative estimate of impact on lending will find it to be a significant multiple of the amount of additional tax HMRC is hoping to collect.

The way ahead

Conceptually, this measure turns on a single unresolved point: whether funds that have been paid over but which are not yet payable to HMRC are properly part of that business' working capital. Of course, as

the EA2002 implicitly recognised, in the absence of insolvency, the reality is akin to Schrödinger's cat: such funds are simultaneously due *and* part of the working capital. This has enabled millions of pounds of additional finance to be provided to UK businesses.

Maximising the recovery of tax receipts is, self-evidently, an extremely important policy objective. But the impact of this measure on lending will likely dwarf the returns it is hoped it will bring to the Exchequer. A proper impact assessment is required to consider the cumulative impact of this measure alongside the increase in the prescribed part and other proposed changes to insolvency legislation. Collectively these constitute the most significant recasting of the business rescue landscape for a generation and they must be assessed as such, not in isolation by different government departments.

In addition – and broader still in impact – split VAT looms on the horizon. This is a significant policy change that will bring massive challenges for businesses and the finance providers that seek to support them. Given that the majority of the revenue hoped for from CP will be VAT,

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The reality is akin to Schrödinger's cat; such funds are simultaneously due *and* part of the working capital. This has enabled millions of pounds of additional finance to be provided to UK businesses.”

it appears even more important to pause for a comprehensive review of the potentially contradictory measures in train than damage access to finance at an already uncertain time.

If, following a comprehensive assessment, the next government decides to persist with this measure, UK Finance urges proper consideration of the ways that the negative consequences could at least be mitigated, as we have set out in our representations. □



MATTHEW DAVIES
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invoice finance and
asset-based lending
team at UK Finance.



Calculating the bill for wrongful trading

Stephen Hunt examines awards made in instances of wrongful trading and proposes a calculation method for IPs to put before the court.

Over the last 30 years there has been some discussion regarding the proper approach for the court to take when considering how much a director ought to contribute to the assets of the company where they are guilty of wrongful trading. The most common approach has been to calculate the increase in net deficiency (IND) from the critical date to the date of liquidation. Park J in *Re Continental Assurance Co of London plc* [2007] 2 BCLC 287 said:

'(5). In my judgment, under a section 214 claim the starting point for measuring the directors' contribution to the assets of the company is, or at the very least is likely to be, the loss to the company caused by the wrongful trading. Mr Atherton said that there are a range of possible starting points, of which the loss to the company is only one. Alternatively, it might be fairer to say that he said that of the range of possible starting points the increase in net deficiency is only one. Perhaps there is a range of possible starting points, but if the loss to the company from the continued wrongful trading can be ascertained, I believe that either that is the only possible starting point or, at least, it is the normal starting point...'

The new creditor approach

An alternative (new creditor) approach was set out by Gabriel Moss QC in a 2017 article in *Insolvency Intelligence*. In the article he argues that almost all of the first instance

decisions, including *Grant & Anor v. Ralls & Ors (re Ralls Builders Ltd)* [2016] EWHC 243 (Ch), had been wrong to consider that s214 created a specific basis for awarding compensation. He examined the leading cases from 1989 to the present day and noted that not all relied on the IND approach. He also reminded us that as exercises in discretion they were not binding on future cases. In particular he examined the first decision on s214 by Knox J in *Produce Marketing Consortium (in liquidation) Ltd, Re* (No.2) (1989) 5 BCC 569.

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It [the IND approach] gave a perverse incentive to directors to rob Peter to pay Paul.”

Moss argued that in *Produce*, Knox J treated wrongful trading as a tort to compensate the creditors as a whole, which was not the purpose of the section. His argument was that the Cork Committee and subsequent legislation contemplated that the 'wrong' in wrongful trading is not trading while insolvent but the wrongful taking on of liabilities for which there is no reasonable prospect of payment.

Accordingly, the amount awarded ought to be measured by the size of the unpaid liabilities taken on after the critical date. He pointed out that Vinelott J in *Re Purpoint Ltd* [1991] BCC 121 based his calculation on a list prepared by the liquidator of creditors whose debts were incurred after the critical date but which remained unpaid when the company ceased to trade. Despite that calculation Vinelott J said:

'The court has no jurisdiction to direct payment to creditors or to direct that money paid to the company should be applied in payment at one class of creditors' preference to another. Moreover, creditors whose debts are incurred after the critical date in fact have no stronger a claim than those whose debts were incurred before that date. The former class also suffers to the extent that the assets of the company are depleted by wrongful trading.'

The source for this argument probably came from the decision of Maugham J in *Re William C Leitch Brothers Ltd* [1932] 2 Ch 71. The *Leitch* case considered the language of what was then the new section 275 of the Companies Act 1929 (CA29). That section provided that where fraudulent trading was found the director would be ordered to become jointly liable for 'the amount of the debts of those creditors proved to have been defrauded by the acts of the director in question...'. A key question arising was whether s275 created a new approach that enabled the victims of the fraud to be paid

outside of the *pari passu* rule. Maugham J held that it did not, and he could easily distinguish between the method of calculation of the amount to be awarded and to whom that payment should be made. This decision is important because the language of s275 CA29 is much more readily amenable to that direct award interpretation compared with s214(1) of the Insolvency Act 1986 (IA86).

In his article, Gabriel Moss considered a simple example to point out the problems with the IND-based approach. He set out a wrongful trading scenario where the directors acted properly once insolvent trading had become unavoidable, then trading only in cash and taking on no new liabilities and not increasing the net liabilities. In such a case he considered that the directors had a complete defence under s214(3).

In a second scenario he considered an identical situation except that instead of trading in cash the company took on £1m of new creditors to replace £1m of the old. He criticised as unjust and absurd the outcome that there may have been no increase in net liabilities yet the new creditors who ought not have been taken on had suffered individual losses after the point when the directors ought to have ceased trading. It gave a perverse incentive to directors to rob Peter to pay Paul.

Calculating, come rain or shine?

I agree with Gabriel Moss in his criticism of the IND for these reasons and more. I have been a little uncomfortable with how such calculations are arrived at and the other factors case law suggests ought to come into the calculation. One decision allowed a deduction because the ultimate loss was affected by a period of unusually bad weather at a golf course. I think it is mistaken to consider abnormal adverse events in the calculation. The reason why is because the company could just as easily receive an unexpected windfall in the same period, eg winning an unexpected new client or a bad debt that was repaid. Would the director be any less wrong to have continued trading?

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The consequences of a failure to cease trading must be what they are, and the IND is what it is.”

Should a court exclude windfalls from the IND calculation and make the director pay more? No, the consequences of a failure to cease trading must be what they are, and the IND is what it is.

However, there are issues with the new creditor approach too. The Moss scenario of cash trading is very unlikely to occur, and he does not set out what the taking on of new liabilities actually means. In reality, and if nothing else a wrongful trading claim should be anchored deep in reality, the new liabilities being incurred after the wrongful trading point will be mainly new supplies from existing creditors. The positions of individual creditors may differ greatly and the favouring of existing creditors may give rise to triggering other sections of IA86. Lastly, what if one of the new creditors is the director being pursued? Should that be left out of the calculation?

Moss' new creditor argument also fails to take into account the level of dividend available from the other assets that the IND method builds in. If there are other assets, then the wrong is not that the new creditors will not be paid at all but that in *pari passu* terms they will not receive their entire amount. This must be a factor for the court.

My conclusion is that the solution to the problem lies in realising that there are in fact two wrongs in wrongful trading that need to be compensated:

- Wrong 1 – trading on and making the position worse for existing creditors.
- Wrong 2 – taking on new liabilities when there is no reasonable prospect of paying them.

The solution

The solution also lies in realising that the two approaches to calculating loss are in

fact the flip sides of the same coin. If there is an increase in net deficiency then often that is as a result of an increase in creditors, be they existing or new.

Ultimately this is an exercise in discretion and equity and so I believe that the purpose of the evidence should be to provide the numbers from which the court can exercise its functions. Having collected together the basic information then the task for the liquidator will be to calculate the consequences of the IND and new creditor approaches. I would argue that the calculation of loss should be as set out in the table below.

Existing creditors

- +/- Change in assets post-WT point
- +/- Change in existing creditors post-WT point
- + Dividend to new creditors (dilution)
- = WT loss (existing creditors)

New creditors

- Total new creditors
- – Dividend to new creditors
- = WT loss (new creditors)

The result of this approach leads to numbers that look remarkably like the IND calculation but avoids the defects that Gabriel Moss identified. If the assets reduce after the critical time then the existing creditors have suffered. If new creditors are incurred, then they lose whatever is not covered by their dividend. Existing creditors suffer further as their dividend is diluted by what is paid to new creditors. The combination of the two is a much more refined version of the IND.

The forensic exercise involved in these calculations is not exceptional and it would be of great comfort to the court to know that the liquidator has undertaken this work. The product of it would be to enable the court to understand the effect of wrongful trading on each and every creditor. We are fortunate that most of the necessary data is available in accounting packages and I am told that the profession's main case management software may soon be able to perform much of this calculation in a standard report.

The liquidator can put forward three options for the court: the standard IND, the new creditor calculation and the effect of combining the two. An exercise of discretion based on these calculations ought to be comprehensible and fair to all parties. The concepts are also capable of being set out simply in advice to directors worried about possible future wrongful trading. □



STEPHEN HUNT is a partner at Griffins.

Example of proposed wrongful trading calculation

At the wrongful trading point (WTP) the assets are £50 and liabilities £100, a notional 50% dividend. At liquidation the assets are now £30 and creditors have increased to £150, a notional 20% dividend. The individual positions are as follows;

	WTP	LIQ
Creditor A.....	50	10
Creditor B.....	30	40
Creditor C.....	20	70
Creditor D		30

Creditor B

Dividend on £30 worsens from £15 to £6; a loss of £9. Add additional claim of £10, less dividend of £2; a loss of £8. **Total loss £17**

(the opportunity loss is the difference between the original dividend of £15 to £6, which is £9)

Creditor C

Dividend on £20 worsens from £10 to £4; a loss of £6. Add additional claim of £50, less dividend of £10; a loss of £40. **Total loss £46**

(the opportunity loss is the difference between the original dividend of £10 to £4, which is £6)

Creditor D

Claim of £30 less dividend of £6: **a loss of £24**

**£17 + £46 + £24
= £87 overall loss**



With thanks to Matthew Breach

Football insolvencies: have the Shakers given the fit and proper test a shakedown?

Rebecca Andrews-Walker conducts a metaphorical VAR of the Bury FC administration and the EFL's response.

This year has seen a depressing rise in the number of football clubs struggling financially, and a number of dramatic falls from grace have followed. The sports news has been dominated by the high-profile survival battles of Bolton Wanderers FC and Bury FC, with an emphasis on the impact felt by the local communities and surrounding small businesses whose fortunes were tied to the clubs' success. The resulting empathy for those who have suffered from the fallout has focused the industry floodlights on how and between whom to apportion blame for the clubs' financial failure.

Inevitably, club owners and managers face the brunt of such criticism, for clear failures in how the clubs have been managed. However, some blame must also be apportioned to the governance and regulatory framework that allowed those people to stand at the helm in the first place.

Bury: shaken apart

Bury FC, also known as the Shakers, was the victim of an unfortunate series of events, culminating in a common problem suffered by a club in decline: petition after petition from creditors seeking to wind-up the club on the basis of sums owed. This is a downward spiral that is hard to break, as when the club pays one creditor in the

hope of removing the risk of winding-up, another steps in and repeats the process; Groundhog Day. From there, it is very difficult to prevent the vultures from circling and, as a result, the Shakers' situation only worsened.

But how did Bury get to this point and who is to be held accountable for the collapse?

In December 2018, Steve Dale purchased Bury from Stewart Day for £1. Dale subsequently alleged that several loans had been taken out during Day's ownership of the club with high interest rates. In January 2019, the Shakers fell into administration.

Despite entering administration (and incurring the 12-point penalty for doing

so), Bury somehow secured promotion to League One. In July 2019, payment of 25% of monies owed to unsecured creditors was approved under a company voluntary arrangement. Following several demands for information, a transfer embargo and deadline extensions, the club became the first club to be expelled from the English Football League (EFL) in over two decades.

The fit and proper test: fit for purpose?

The EFL must normally check that the prospective owner meets the owners' and directors' test. The test is more commonly known as the 'fit and proper test' and is intended to be a key protective mechanism for clubs.

The assessment, which applies to teams in the Championship, League One and League Two, is found in appendix 3 of the EFL Regulations. Premier League teams are subject to similar rules, which are set out in section F of the league's handbook.

The aims of the test are to shield the image and integrity of the leagues, to ensure the viability of the football clubs and to protect the interests of all the stakeholders in the clubs. These aims are achieved by precluding certain people from participating in or exerting influence on a club.

The prohibition applies to a 'relevant person'. The broad definition of 'relevant person' includes directors, people in

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This is a downward spiral that is hard to break, as when the club pays one creditor in the hope of removing the risk of winding-up, another steps in and repeats the process; Groundhog Day.”

equivalent management roles, those who have control over a club, as well as any person appointed to represent them.

A person will be prohibited if they are subject to a 'disqualifying condition'. These conditions include disqualifications orders for directors, certain criminal convictions, circumstances relating to insolvency, sports bans, betting offences, situations involving player agencies and bans on entering the UK.

The EFL must check whether the 'relevant person' meets the fit and proper person test *before* any takeover. Clubs must also confirm compliance with the test before the start of each season.

In addition to this test, the EFL should assess whether a buyer has the sufficient money from a legitimate source to fund the club. The regulations require that this information be provided as soon as possible and, in any case, no later than ten days after the takeover. Clearly, the survival of the club will be entirely dependent upon the correct funding. The potential for problems here is clear; if funding

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The club became the first club to be expelled from the English Football League (EFL) in over two decades.”

information was required to be provided prior to the takeover, the risk of funding issues post-transaction would be significantly reduced. Indeed, the structure of the funding regulations as they stand mean that the EFL is left trying to rectify problems that could have been prevented.

Or purposefully ignored?

It has since been revealed that Steve Dale's takeover of Bury in December 2018 was completed without approval from the EFL. Indeed, Steve Dale was not subject to any part of the above process before his takeover. The EFL admitted that it did not commence its checks until after it had been notified that Dale had been transferred the shares in Bury. The EFL also confirmed that it had not received the requisite financial information as late as August 2019.

Bury's expulsion was subsequently sealed after the collapse of a proposed takeover bid, because the collapse meant that the club was not able to meet the extended deadline to send the financial information to the EFL as required by the regulations. The EFL had provided the club with extensions to the original deadlines, but without a lifeline (which the proposed takeover would have provided) – the club could not provide the information. The club is left considering legal action over the handling of the affair as two other prospective buyers were inexplicably



With thanks to Matthew Breach



With thanks to Matthew Breach

excluded from the aforementioned deadline extension. The club has also written to the EFL asking for an explanation on how Dale passed the fit and proper test.

The EFL has come under significant fire on all fronts for the way in which the Bury situation was handled. The EFL has been accused of failing to manage the processes properly, leaving the club doomed to fail.

Game plan

Bury's expulsion has led to severe criticism of the fit and proper test and its application. It has shown the current rules to be wholly inadequate and easily evaded. A change to the rules had been agreed at the EFL's summer 2018 conference. However, interestingly, there was no agreement as to how it would be implemented.

The change would empower the EFL to deal with a 'very serious single act or persistent acts where the individual's conduct is clearly damaging to the standing and reputation of the wider profession and the game of football'. A noble sentiment, but only if it is given the teeth with which to bite. It was also noted at the conference that the tests needed to be strengthened, and compliance periodically reviewed.

There has also been criticism of the EFL's inconsistent application of punishments. Bolton Wanderers faced down the barrel of expulsion simultaneously with the Shakers. Why was Bolton able to play their youth team while Bury was banned from playing altogether?

The obvious effect of this on-goal difference could have a huge impact on who gets relegated or promoted at the end of the season.

Concluding thoughts

It is clear from the aftermath of Bury, and the number of clubs falling into similar difficulties, that the EFL has a considerable amount of work to do – fast – to make the regime truly fit for purpose. Hopefully the very public criticism of the test and its application, and the imposition of

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It is clear from the aftermath of Bury, and the number of clubs falling into similar difficulties, that the EFL has a considerable amount of work to do.”

punishments by the EFL, will force the necessary changes into effect and impact positively on the way in which future club problems are approached by the body.

The EFL have commissioned a 'governance review', to be conducted by Jonathan Taylor QC, who is expected to complete his report by late spring in time for rules to be recommended and voted on at the EFL's 2020 summer meeting.

However, that will come as no comfort to Bury, its fans, or the community and businesses that must now rebuild. □



REBECCA ANDREWS-WALKER is a senior associate at Penningtons Manches Cooper LLP.

Risky businesses: are special managers the new administrators?



David Kelly and **Mike Jervis** offer their unique insights as special managers into the increased use of compulsory liquidation.

Over the last two years there has been an increased use of compulsory liquidation with support from special managers to deal with complex insolvencies, often with material operational challenges; this has led to questions as to whether the administration regime remains fit for purpose and whether this trend for special manager appointments is likely to continue at the expense of the administration process?

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We would expect administrations should remain the procedure of choice, particularly as administration remains one of the most flexible insolvency processes available to directors and creditors.”

We have been involved in all the recent cases where the special manager regime has been used to support the Official Receiver: SSI, Carillion, British Steel and, most recently, Thomas Cook. We believe

that there will be an increased use of compulsory liquidation and special manager appointments; however this process and approach should be considered only as an absolute last resort when there are no other options available. We would expect administrations should remain the procedure of choice, particularly as administration remains one of the most flexible insolvency processes available to directors and creditors when a solvent solution is not available.

Non-financial objectives

The circumstances of each recent use of the partnership between the Official Receiver and special manager have been unique; however, they all have a number of common features. These include the structure of those companies, the nature of the external debt in those businesses and the underlying operational risk. These factors, when combined, meant that when these companies could not continue as going concerns there was no appetite for the external debt-holders or shareholders to step in and fund a solution.

The operational risks facing the prospective insolvency practitioners in all of these cases had a further complication – the importance of non-financial objectives driving the liquidations. This was most stark in Carillion where continuity of public services was of paramount importance – in fact, on that continuity

hinged matters of life or death and matters of national security. In a different, but very important way, the repatriation of the 150,000 Thomas Cook passengers was *de facto* the main reason for and objective of that liquidation.

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Where continuity objectives are deemed more important than financial objectives, there is a case for that industry to have the benefit of a special administration regime.”

One point on non-financial objectives is worth making, if only to highlight the debate. We have undertaken a number of special administrations, especially in the financial services sector. Where continuity objectives are deemed more important than financial objectives, there is a case for that industry to have the benefit of a special administration regime. We think there will be more special administration regimes in the future and clearly the government's airline insolvency review is one current example of that trend.

Legal and operational complexity

The operational complexity attached to the businesses that have made use of the special manager process would have made them extremely risky for insolvency practitioners to take on as administrators. SSI and British Steel were in the steel sector, which has significant production and environmental risks and material working capital requirements; Carillion operated across construction, facilities

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When that lack of choice is combined with the lack of free cash the financial risks for the insolvency practitioner would have been too great to take an administration appointment.”

management, legal services, fleet management and had a significant international business which brought its own complexities; and Thomas Cook with its airline operations had some obvious challenges.

While operational complexities and risk go hand in hand with what insolvency practitioners deal with on a daily basis, these cases were different – ‘switching off’ operations was not an option, with Carillion being the most prominent example of that. When that lack of choice is combined with the lack of free cash the financial risks for the insolvency practitioner would have been too great to take an administration appointment.

Aligned with the operational complexity, we have found that the legal entity structure of some groups are also overly complex (in the case of Carillion there were in excess of 375 legal entities in its structure) or too conjoined, making it difficult for stakeholders to assess or access the underlying value of the businesses in a relatively straightforward manner. We consistently find that management teams in distressed groups often only consider the legal entity structure of their groups (and whether the intrinsic value of the businesses within the group can be accessed in that structure) when it is too late.

Missing financial incentives

A further reason for the trend for compulsory liquidation is a lack of funding. There has been much debate in the financial and restructuring press about the consequences of ‘cov lite’ on restructuring processes. In the past, when lenders had fixed and floating charges, the economic benefit of the assets of a company rested with them, and as such they had a clear



imperative to support and fund the execution of a coherent contingency plan. With the emergence of cov lite many lenders are finding themselves in scenarios where they are unsecured creditors with limited financial incentive to fund an insolvency process. In such a case the directors are left with no alternative but to

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The fact that there have been a number of high-profile uses of the special manager regime does not mean that administrations will be consigned to history.”

pursue a compulsory liquidation absent liquid assets to fund a process. This risk (and issue) will remain until the insolvency legislation is amended to accommodate US-style DIP funding, although that is also dependent on the relevant company's assets available to repay the DIP.

Limited trading

Another reason why the special manager regime is being considered an effective

insolvency tool in extreme scenarios is the willingness of the Official Receiver, in instances of public interest, to be prepared to trade a business to facilitate a more orderly closure compared with an immediate shut down. This has meant the consequences for creditors is potentially less severe than in a scenario where there was a hard close on day 1. It is a matter of public record that it is likely there will be some dividends paid across a small number

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We believe the Official Receiver will only consider special manager appointments in the most extreme of circumstances.”

of entities within the Carillion Group and it is unlikely this would have been possible had the Official Receiver not allowed a limited period of trading.

However, the fact that there have been a number of high-profile uses of the special manager regime does not mean that administrations will be consigned to history. We have seen in the most recent statistics that they remain one of the most popular routes for dealing with corporate failure with nearly 500 administrations in the third quarter of 2019, an increase of 20% over the second quarter and 27% over the third quarter of 2018.

In case of emergency

It would be wrong of insolvency practitioners to think a soft option is to approach the Official Receiver for a special manager appointment as an insurance policy against the normal risks insolvency practitioners must assess and be comfortable with on any appointment. For this reason, we believe the Official Receiver will only consider special manager appointments in the most extreme of circumstances. We would also expect there to be challenges given to directors and advisers in the future as to why other contingency planning options were not considered or worked up as part of the responsible discharge of director duties. □



**DAVID KELLY
(LEFT)**

is a restructuring partner at PwC and special manager of Carillion Plc.

**MIKE JERVIS
(RIGHT)**

is a restructuring partner at PwC and special manager of Carillion Plc.

Wonderful Copenhagen

Frances Coulson reports back from
INSOL Europe's Annual Congress in the Danish capital.

The INSOL Europe Annual Congress took place in the beautiful city of Copenhagen on 26–28 September with a fantastic turnout of just under 500 delegates. Council members met on 26 September with an efficient meeting chaired by president Alistair Beveridge of Alix Partners (amazingly able to attend despite the calls on his time from Thomas Cook).

At the same time a majority of the 23 members of the judicial wing met and exchanged views and papers between the different jurisdictions and continued their furthering of judicial international collaboration.

HHJ Edward Bailey is our UK representative, but I am pleased that our own Chief ICC Judge Briggs has recently joined INSOL Europe and, while he could not attend this time, I am sure he will be an excellent addition to a very respected and

“I was impressed to see the energy, innovation and drive in INSOL Europe, such as the new Legal Tech & Digital Assets Group, which was set up in April this year.”

productive group. Other specialist meetings included the anti-fraud forum and the financiers group, enabling like-minded insolvency lawyers and practitioners from across Europe to work more closely together on their particular areas of interest.

Multinational multi-jurisdictional musings

The conference programme covered a broad range of topics, such as healthcare and airline insolvencies, in breakout sessions. The main conference forum saw a session on preventive restructuring work, following the 6 June 2019 adoption by the EC of the *Directive on preventive restructuring frameworks*. The presence of so many nationalities at the conference gave us a good flavour of the issues facing each member state in implementation of the Directive.

Other sessions included non-performing loans and – topically – recognition issues, such as ‘When Brussels regulation, European Insolvency Regulation and UNCITRAL Model Law



cross paths’. INSOL Europe is well placed to take a lead in this debate having been invited to send a delegation to the 55th session of UNCITRAL’s Working Group V (Insolvency Law), which was held in May 2019 in New York. Our delegate was Florian Bruder of DLA Piper.

On Saturday 28 October bright and (too) early, 20 or more of the braver (but not necessarily only the younger) members took part in a 5k run around the city, looking fine in INSOL Europe blue t-shirts (sponsored by Horten), but still managed to attend the day’s sessions, which included panels on pre-packs and employees, and director’s duties. Having kicked off the sessions with a keynote speech from professor Henning Jorgensen, a former director of the European Trade Union Research Institute, Alistair handed over to new president Piya Mukherjee, whose home town we were enjoying.

I was impressed to see the energy, innovation and drive in INSOL Europe, such as the new Legal Tech & Digital Assets Group, which was set up in April this year and led by José Carles from Spain.

While the sessions were of the usual high quality, to me a large part of the value comes from the networking and building of continuing friendships and working relationships. Over one of the coffee breaks, I was able to source immediate assistance on a job in Romania, finding that I had more tools at my disposal than I thought, and to discuss other ongoing cases with colleagues in and around Europe. David Rubin and I are tasked with the UK membership drive and, to my mind, INSOL Europe is something we will need more and more whether we are a facing a ‘no deal’ Brexit, ‘some sort of deal’ Brexit or remain, to help us through the rocky road that no doubt looms ahead in our European relationships. Each country coordinator is submitting a country plan to the INSOL Europe Council to tailor the support needed to build membership and

collaboration within their jurisdictions and I cannot commend membership highly enough to my colleagues in the UK.

Social scene

There was a good social scene at conference, with two sponsored full member dinners, including the spectacular gala dinner at the Wallman’s Circus Building on Saturday night. I particularly enjoyed the hospitality of Gorrisen Federspiel, at whose offices I arrived on Friday night expecting a quiet set of professionals exchanging business cards

“I arrived on Friday night expecting a quiet set of professionals exchanging business cards only to find a great bunch of INSOL Europeans joining in with a pair of fantastic singers crooning everything from Dolly Parton’s ‘Jolene’ to the Beatles.”

only to find a great bunch of INSOL Europeans joining in with a pair of fantastic singers crooning everything from Dolly Parton’s ‘Jolene’ to the Beatles.

I am looking forward to working with David Rubin and my fellow country coordinators to build on great work in growing INSOL Europe. I am also looking forward to working as chair of the R3 Fraud Group and as deputy chair of the anti-fraud charity, The Fraud Advisory Panel, which will work with the anti-fraud forum of INSOL Europe (led by Carmel King and Bart Heynickx) for a joint fraud conference in London next year. □

For more information about INSOL Europe, visit: www.insol-europe.org



FRANCES COULSON is a senior partner at Moon Biever, a council member of INSOL Europe and chair of the R3 Fraud Group.

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*Note that £85 +VAT only applies when both Part 1 and Part 2 of the Channel Islands webinar are purchased in one booking and only applies to these two webinars. Otherwise if not purchased in one booking each part will be £50 +VAT.

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From reporting rogue advisers to combatting compliance issues, R3's SPG Committee stands up for the smaller practice.



The R3 members within smaller practices make up a significant and vital part of R3's membership. R3's Smaller Practices Group Committee (SPG) is a specialised group within R3 dedicated to supporting the needs of smaller practice members in all areas of their work. The SPG Committee consists of smaller practice IPs, lawyers and compliance experts, and is supported internally by Freddie Webster – the dedicated R3 resource to address the requirements of smaller practices – and the long-serving committee chair, Simeon Gilchrist.

From the SPG Committee...

As your dedicated committee, we know how important it is to address key areas where the needs of smaller practitioners often differ from those of medium- or large-sized practices, providing resources and support in areas such as compliance, education and training.

Over 2019 we have continued our work in these main areas:

- Reporting rogue advisers and those pretending to be IPs to the Insolvency Service. It was really pleasing to see action being taken as a result of your concerns being raised with the closure of the Rigil Kent group of companies.
- Clarifying issues with pension providers, particularly those set up to deal with auto-enrolment pensions. As a direct result of your concerns we have produced our *Pensions Booklet*, providing practical guidance on all aspects of

dealing with pensions in an insolvency situation, including checklists to be used by you and your staff to ensure compliance with the regulations.

- We continue our work with HMRC, clarifying the tax treatment of directors' loans and confirming that directors' loan accounts may be distributed *in specie* in an MVL without a tax charge arising; making your views heard through consultation responses on the reintroduction of Crown preferential status, tax abuse and phoenixing.
- Working with the RPBs to tackle the practical issues that continue to arise out of the General Data Protection Regulation.
- Making representations to the RPO when they decided to stop voting on IP fees – as a direct result of comments made by the SPG Committee they reversed their decision, which was welcomed.

SPG needs YOU

Your views and thoughts inform R3 and direct our Policy, Education and Technical teams on areas on which to focus. Our programme of educational events, and especially the SPG Technical Reviews and Forums, are designed to deliver answers to the questions raised by you, our members.

Come to these courses and you will hear direct from policy makers, HMRC, the RPO and the Insolvency Service – keeping you up to date with changing legislation and policies. The regulators will tell you what they are seeing on regulatory visits, meaning that you don't make the same

2020 SPG course dates

SPG Technical Review

Leeds – 3 March 2020

SPG Technical Review

London – 12 March 2020

SPG Technical Review

Warwick – 2 April 2020

SPG Forum

(Location TBC) – November 2020

View more information and book over on our website www.r3.org.uk/events

Testimonials

'As always, this was a really useful technical day. It should be mandatory for all office-holders!'

'The most practical, relevant training I have attended since last year's SPG Technical Review.'

'The most relevant and comprehensive update on insolvency matters.'

'An interesting and varied range of topics.'

'All topics and presenters were interesting and engaging – everything was relevant.'

'The contents were relevant as well as enlightening.'

2018 SPG Technical Review delegates

mistakes as your peers. Expert speakers tackle difficult practical topics, giving you insight into many areas and providing expert tips that you can take back to improve your practices.

We will continue to support your needs and to ensure that the voices and interests of smaller practitioners are taken into account, both within R3 and with external stakeholders.

SPG is here to represent the interests of smaller firm members so please get in touch with the SPG Committee (via the representatives listed) or directly with Freddie Webster at Freddie.Webster@r3.org.uk in order to provide your suggestions, concerns or requests for areas that you would like the Committee and R3 to address.

You can also find out more information about the Committee and its members on our website, under, www.r3.org.uk/what-we-do ■

Front of mind, front of lobby

The PPP team responds to government's plans for airline insolvencies and keeps the pressure on Crown preference, no matter what government is in power.

The last three months have seen R3's Press, Policy and Public Affairs (PPP) team working to keep on top of a number of key insolvency issues. As the Johnson government found its feet and the Brexit deadline grew closer (before its last-minute extension), a number of areas of policy that will affect the profession came into the spotlight.

Airline insolvency, Crown preference, and corporate insolvency reform have all been front of mind for the PPP team. In addition, we have been feeding members' thoughts on the question of regulating the profession into government.

It has been a busy quarter, and we have a lot to update you on.

R3 was quick off the blocks to respond to both the plans laid down in the Queen's speech and a parliamentary statement from the Secretary of State for Transport in October.

Airline insolvencies: the big picture

Two high-profile insolvencies in recent years – and the mass repatriations that resulted from them – have prompted the government to review the framework for dealing with airline insolvencies.

Its current preference is to introduce the 'keep the fleet flying' approach proposed by the *Airline Insolvency Review*. R3 was quick off the blocks to respond to both the plans laid down in the Queen's speech and a parliamentary statement from the Secretary of State for Transport in October – both in the press and on the public affairs side. (See Duncan Swift's column on page 4, for our concerns on the policy proposals.)

As a result of this work, we were quoted in stories in BBC News Online and Sky News Online about the government's proposals; R3 President Duncan Swift was interviewed on BBC Radio 5Live's 'Wake Up to Money' and BBC News about the Thomas Cook liquidation. We have received interest from a number of parliamentarians in meetings after sending letters and briefing documents to their offices about this issue.

Crown preference: campaigns continue

Campaigning against the proposals to reintroduce Crown preference in insolvencies continues to be a priority for the PPP team. The government's plans to make HMRC a priority creditor in insolvencies will harm business rescue, access to business finance, and, ultimately, the economy.

Since the last issue of *RECOVERY*, we have met a number of parliamentarians to brief them on the impact this will have on business and enterprise, as well as officials from BEIS and HMRC to voice our concerns about the proposals.

We also submitted suggested technical revisions to proposed legislation contained in the draft Finance Bill, and, at the end of September, organised a letter to the Chancellor of the Exchequer, which was signed by ten other business and insolvency stakeholders, including the ACCA, the British Property Federation, and ICAEW.

This letter – and our concerns and proposed modifications to the draft policy – was covered in a story published in *The Times*, and R3's views on Crown preference have been featured in a number of pieces in the national media, including *The Times*, *The Telegraph*, and the *Financial Times*. At the start of October, we launched a campaign to get members writing to their local MP about this issue.

Thank you to those of you who sent letters before the election was called. It has delayed, rather than derailed, our campaign; we are well prepared if Crown preference reappears on the next parliamentary timetable.

Evidence gathering, then engaging

In the summer, the government launched a call for evidence on the regulatory framework for insolvency practitioners, which closed in October. The consultation did not make any further proposals for reform; officials have repeatedly stated that this exercise is simply to gather evidence upon which future reforms may be based. R3 sought members' views through a series of workshops that we held in London and Manchester, and a member survey. Thanks

to everyone who attended or responded. Your feedback was invaluable in helping us shape our response to the call for evidence, and to help highlight the options that are open to government on this issue.

R3 in the news

In addition to the media coverage mentioned above, there have been a number of areas of government policy, high-profile insolvencies, and national and R3 research that have provided opportunities for us to help promote the profession, its work and its expertise.

R3 has been quoted in a number of national, regional and trade outlets over the last three months – including *The Guardian*, *The Telegraph*, *MailOnline*, *The Times*, Reuters and the *Financial Times* – on a wide range of issues including airline insolvencies, Crown preference, and the potential impact of Brexit on supply chains.

We will keep campaigning to ensure the profession's voice is heard by the new government – whatever form it takes.

R3's comments on October's insolvency statistics generated more than 200 media cuttings and were covered by a range of national media outlets including Press Association, *The Times*, *The Sun*, *The Guardian*, BBC News's business liveblog, Reuters, and the *The Telegraph*, while our research into companies' Brexit business supply chain readiness was covered by *The Times*.

A changing landscape

While this column was being drafted, the general election was called. MPs, ministers and shadow ministers will inevitably change once the results are in, but we will keep campaigning to ensure the profession's voice is heard by the new government – whatever form it takes. □



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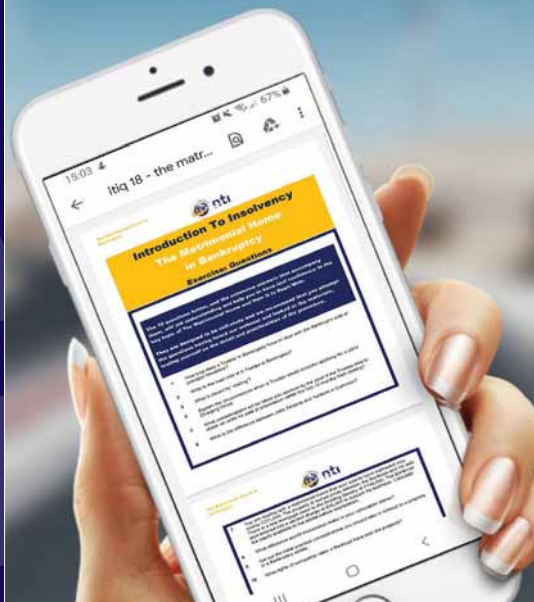


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