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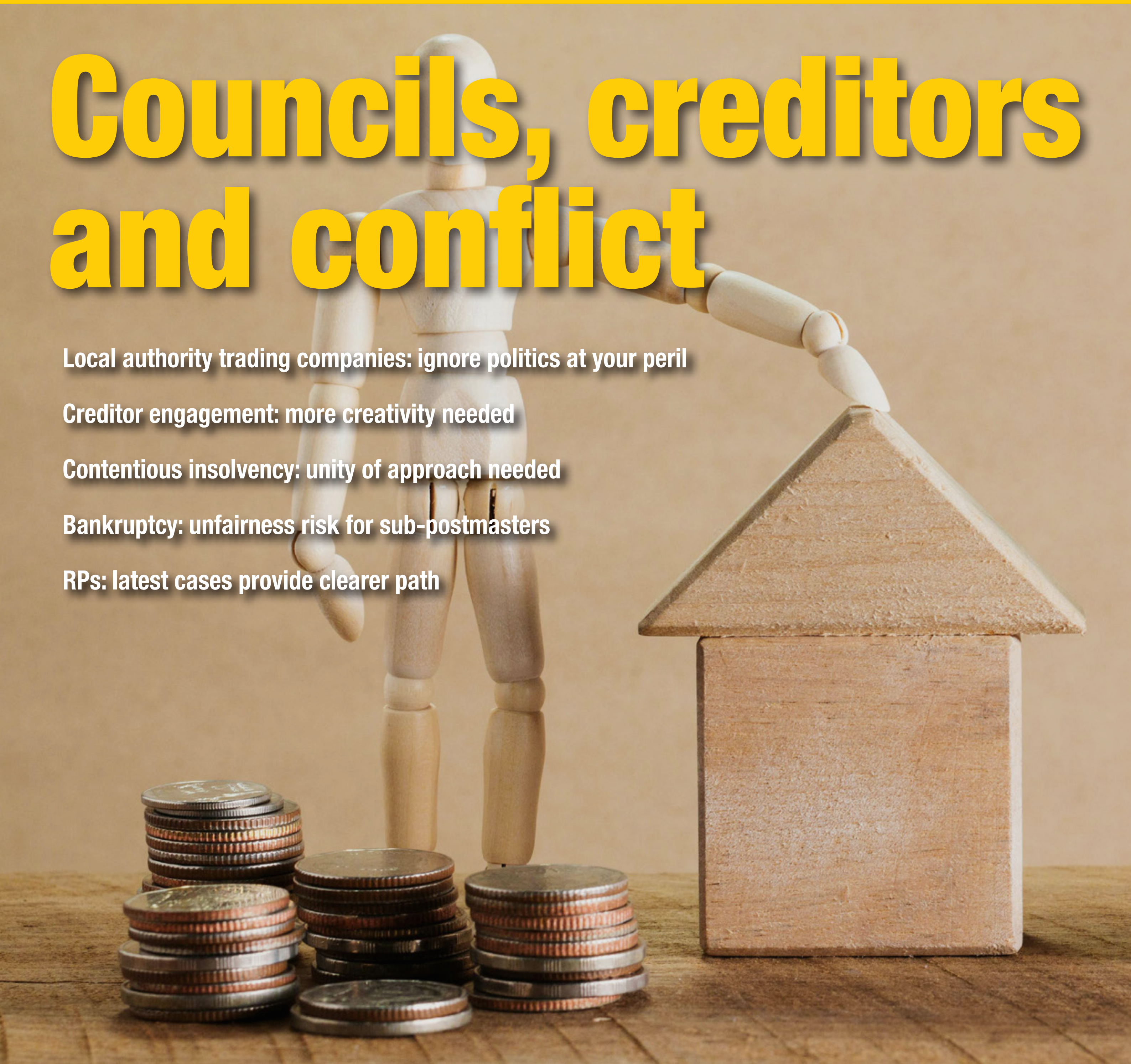

Councils, creditors and conflict

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From the editor

> We will all have heard about the terrible miscarriages of justice perpetrated against Post Office sub-postmasters and the steps that have been taken to quash convictions, but what about the various bankruptcy orders that have been made?

Let me start by congratulating R3's new incoming president, Tim Cooper, on his appointment and his first *Recovery* column, and thank you to our outgoing president and *Recovery* editorial board member, Nicky Fisher, for all her efforts over the past 12 months.

Not a month goes by now without a decision involving a restructuring plan and we now have our first Court of Appeal decision in *Adler*. Charlotte Møller and Rebecca Terrace at Squire Patton Boggs and Georgia M. Quenby at Fladgate LLP give their perspectives.

The press has extensively covered the financial position of local councils and their 'bankruptcy'. John Cullen at Menzies looks at the challenges of advising in this sector.

We will all have heard about the terrible miscarriages of justice perpetrated against Post Office sub-postmasters and the steps that have been taken to quash convictions, but what about the various bankruptcy orders that have been made? Jennifer Lockhart at Brabners looks at the current position.

Ben Luxford at R3 looks at the 'death of the creditor' and how provisions that were introduced to cut costs and increase creditor engagement are not working, but how the industry and AI can change this.

Georgia Morris at Gowling WLG and Stephen Rome at Penningtons Manches Cooper look at a recent decision demonstrating the tension between insolvency and family law.

Margaret Corbally at Grant Thornton tells us what we need to know about the construction industry scheme. Also on the subject of tax, Marcus Rea at Teneo looks at tax legislation challenges for IPs where director loans are outstanding on insolvency processes.

Guy Enright and Cecile Looseley at the Financial Services Compensation Scheme explain how IPs can help them ensure that financial compensation is made to those who are entitled to it, particularly in circumstances against which the compensation scheme was designed to protect.

Finally, Doug Robertson at Irwin Mitchell looks at issues that remain unresolved following the *Avanti* decision last year on fixed and floating charge security.

I hope you enjoy this edition and that it sets you up for an enjoyable summer.

Neil Smyth is a partner at Mills & Reeve and is the editor of *Recovery*

Regulars

R3 matters

Dates for your diary

Legal updates

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Councils, creditors and conflict

Features

Editor
Neil Smyth, Mills & Reeve LLP

Managing editor Matt Jukes
T: 020 7841 5963
E: matt.jukes@klarents.com

Advertising Ben Nelmes / Jay Pawagadhi / Markus Vogt
T: 020 7841 5962
E: ben.nelmes@klarents.com / jay.pawagadhi@klarents.com / markus.vogt@klarents.com

Production Millie Daltrey
T: 020 7841 5961
E: millie.daltrey@klarents.com

Recovery is the quarterly magazine of R3, the Association of Business Recovery Professionals, 3rd Floor (East), Clerkenwell House, 67 Clerkenwell Road, London EC1R 5BL
T: 020 7566 4200
E: association@r3.org.uk
www.r3.org.uk

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Bolstering public recognition

Incoming president **Tim Cooper** wants more publicity of the profession's valuable work for society and the economy, and to promote insolvency as a rewarding career option

In my first column as president, I wish to acknowledge the accomplishments of recent past office holders. As I step into this role, R3 is in a position of strength from which we can stride forward confidently to face the challenges that lie ahead.

Tribute to recent presidents

All our past presidents have had their milestones, but the most recent have had to contend with unprecedented challenges. Colin Haig saw us through the pandemic, taking on a second term of office to do so. Christina Fitzgerald's presidency saw three different prime ministers, and Nicky Fisher's term saw two major announcements around the future of regulation and personal insolvency, as well as an economic climate that hit both businesses and individuals hard in a number of ways.

As president, Nicky led R3 through the second phase of its post-pandemic recovery and helped the organisation achieve its most successful year in nearly a decade. Alongside that, she led the planning and delivery of our first international conference in five years and helped deepen and strengthen our links with members, the Government, national and international stakeholders.

> **I believe it is essential for anyone in insolvency and restructuring to be a member of R3**

Our recent presidents have steered the R3 ship through these choppy waters and emerged strong. All R3 members should be immensely grateful – I know I am!

It does not take a genius to predict that there are many challenges ahead for our profession. The view from the helm shows a general election on the horizon, rising insolvency numbers, an unsteady economy, global tensions, and storms brewing. There are also unanswered questions about the future of UK regulation and the shape of our personal insolvency regime. That is before we even talk about issues such as diversity, succession, health and wellbeing, technology and AI.

No one said this was going to be easy, and I look forward to the challenge. I hope I can end my term of office having forged some pathways to help our profession navigate the seas ahead of us.

An opportunity to serve

My ambitions for R3 and its members during my term continue the theme of Nicky's (and her predecessors') work, and I am grateful for her guidance as she assumes the role of immediate past president.

R3 has consistently been a source of support and knowledge throughout my career. The association has provided me and my colleagues with a voice on key issues, insights into the latest changes in legislation and best practice, and opportunities to build my network and make new connections, wherever my path has taken me. I believe it is essential for anyone in insolvency and restructuring to be a member of R3.

My goal is to ensure everyone in this field recognises R3 as the go-to association by the time I pass the chain to my successor, Tom Russell, next April.

A five-point plan

To achieve our ambitions, I have set five key aims:

1. Highlight the profession's socio-economic contributions through high-quality thought leadership, emphasising the value of saving jobs, rescuing businesses, and facilitating growth.
2. Advocate for the profession as an inclusive and rewarding career choice, providing clear pathways for qualification and progression.
3. Strive to improve the regulatory framework, reduce the burden on practitioners and firms, and foster positive relationships with regulators and government agencies.
4. Uphold the UK's position as a global centre of excellence for restructuring and insolvency, leveraging our links with INSOL International.
5. Lead discussions on the route to qualification for insolvency practitioners, ensuring it remains relevant and meets the profession's current and future needs.

> **After a year of work behind the scenes, we delivered an Annual Conference that explored a broad range of issues and provided a platform for some of the talent working at firms who are members of R3**

These aims are ambitious but achievable with the support of the team and the membership. I am confident we can reinforce R3's position and improve recognition of the profession and the valuable contribution it makes to society and the economy.

A flying start

My first month as president has been productive, chairing the Annual Conference in St Andrews and the first meeting of R3's Executive Committee of my presidency, representing R3 at INSOL's Annual Conference in San Diego, and attending meetings with stakeholders and staff.

I was incredibly proud to have chaired this year's Annual Conference. After a year of work behind the scenes, we delivered a programme, that explored a broad range of UK and international issues and provided a platform for some of the talent working at firms who are members of R3.

I'd like to thank the R3 team, sponsors, speakers and the conference committee members for their help in designing and delivering an excellent event that really helped set the tone for my presidency. I look forward to building on this, meeting as many members as possible and sharing our progress towards achieving our aims for this year as my term advances.

Tim Cooper is president of R3

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Legal Q&A

James Hyne and Carris Peacey answer your insolvency queries

Q I am a trustee in bankruptcy and I want to obtain copies of legal advice that the bankrupt received. What are my options, and in what circumstances can he claim privilege?

A Trustees in bankruptcy have a duty to investigate the affairs of the bankrupt and realise any assets, with wide powers of compulsion to achieve this. For example, s333 of the Insolvency Act 1986 (IA86) requires the bankrupt to give the trustee such information about his or her affairs as the trustee may reasonably require.

The bankrupt's obligations pursuant to s312 IA86 (and s333 IA86) should be read in conjunction with s311 IA86, which states that "the trustee shall take possession of all books, papers and other records which relate to the bankrupt's estate or affairs… (including any which would be privileged from disclosure in any proceedings)".

However, it is still common for the bankrupt to resist and assert privilege. It is important to note that trustees cannot use privileged documents in certain circumstances where the privilege belongs to the bankrupt; as per *Schlosberg v. Avonwick Holdings Ltd* [2017, CH 210]. Documents that attract privilege can be used for realising the bankrupt's estate, but only insofar as this does not waive privilege (which remains with the bankrupt). For example, the trustee cannot use the material in legal proceedings against third parties (i.e. in respect of antecedent transaction claims) if this would require privilege to be waived and the bankrupt has refused to do so.

In instances where a bankrupt has refused to consent to the disclosure (or delivery up) of privileged documentation, the trustee has no authority to compel a bankrupt to waive privilege. Furthermore, *Leeds & anor v. Lemos* [2017] EWHC 1825 (Ch) confirmed that the court does not have jurisdiction to direct a bankrupt to waive privilege, regardless of the potential benefit to the estate.

Our advice to a trustee would be to treat documents that come into their possession (that may be subject to privilege and without waiver) as privileged and to exercise caution before using this information in court proceedings; this could have significant consequences for the trustee and for any claim that seeks to refer to or rely on privileged material (and the likely adverse costs orders that may ensue). However, not all legal communications are protected by privilege. Even if they are, such information may still be of value to a trustee if, for example, the communications refer to the existence or location of previously undisclosed assets.

Q I have been appointed over a company and suspect breaches of duty by the non-executive directors (NEDs). Has Carillion changed the landscape for disqualification proceedings against NEDs?

A The collapse of Carillion in 2018 reignited the debate around the duties and potential personal liabilities of NEDs. The Insolvency Service initiated disqualification proceedings pursuant to s6 of the Company Directors Disqualification Act 1986 against five former NEDs of Carillion on the grounds that they were in breach of directors' duties as they did not know the true financial position of the company at all times (and specifically in relation to fraudulent misstatements as to the group's accounting position). Carillion's three executive directors had already agreed to lengthy disqualification undertakings.

The Insolvency Service submitted that by simply not knowing about the alleged fraud, directors' duties had been breached. Therefore, the NEDs were unfit to manage and should be disqualified. The matter was described as a 'test case' by the Insolvency Service's counsel because no equivalent on non-executive directors' duties had been brought before. Had it succeeded, it would have raised the corporate governance standard that NEDs are expected to meet. Critics feared that this would subject NEDs to an unachievable and onerous standard (particularly for larger companies with complex businesses) and discourage individuals from acting as NEDs. Also, the impact on the directors' and officers' insurance market would have been significant.

> **"Carillion has shown that the Insolvency Service will not necessarily be satisfied by NEDs who do not exercise proper oversight"**

The Insolvency Service discontinued the proceedings just a few days before trial, and therefore there has been no judicial determination of the point. However, the case has shown that the Insolvency Service will not necessarily be satisfied by NEDs who do not exercise proper oversight, and the Financial Reporting Council is undertaking a review of possible revisions to the corporate governance code. As matters currently stand, there is no statutory distinction between the duties of NEDs and executive directors, much like the lack of distinction between first- and second-insolvency office-holders.

While NEDs can be reassured by the absence of an adverse judgment, given the apparent appetite of the Insolvency Service for proceedings of this nature, it would be pragmatic for potential (and existing) NEDs to consider whether a consultancy rather than statutory directorship would de-risk their potential personal liability and ensure directors' and officers' insurance cover is effective and in place.

James Hyne is a partner and **Carris Peacey** an associate at Charles Russell Speechlys

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Recent case summaries

The latest insolvency update from Angus Thomas and Alexander Bradford

Jeremy Charles Frost & Anor v. The Good Box Co Labs Ltd & Ors [2024] EWHC 422 (Ch)

In this case, His Honour Judge Klein provided clarity on the standing of former office-holders to apply to the court to increase their remuneration.

Good Box Co Labs Ltd entered administration in 2022. The joint administrators' remuneration was fixed by a resolution of the creditors' committee under the terms: "...by reference to the time properly spent... Fees on account of these costs to be approved at £235,000 plus VAT." The following year a restructuring plan was sanctioned, and the administrators vacated office. Having unsuccessfully claimed under the plan's adjudication process for payments above £235,000, plus VAT, the now former administrators applied to the court under r18.24 of the Insolvency (England & Wales) Rules 2016, which enables office-holders to apply for an increase in remuneration or to change the basis for fixing it if the rate or amount was insufficient.

"The administrators had not complained that the rate or amount of remuneration fixed was insufficient nor that the basis of the remuneration was inappropriate, but instead simply sought to be paid more"

The preliminary question was whether that application was appropriate. Ultimately HHJ Klein found that r18.24 did not apply because the administrators had not complained that the rate or amount of remuneration fixed was insufficient nor that the basis of the remuneration was inappropriate, but instead simply sought to be paid more.

The more noteworthy aspect of the judgment was that, although not strictly necessary to do so, HHJ Klein determined the question of the standing of former office-holders to bring the application. The judge accepted that the ordinary meaning of the language in rr18.24 and 18.28 ('an office-holder' and 'an administrator') was of those currently in office; however, following the recent Supreme Court decision in *Brake v. Chedington*, the judge adopted a purposive interpretation. When viewing rr18.24 and 18.28 in context, he noted that former office-holders had standing to make an application under rr18.23 and 18.34, even though neither rule so specified. The judge was assisted by the case of *Re Brilliant Independent Media Specialists Ltd* [2015] BCC 113, in which former administrators had successfully applied under an analogous rule to fix the basis of their remuneration.

Accordingly, the judge concluded that former office-holders do have standing to make an application under r18.28, a decision that will be welcomed by IPs.

Re Pure Zanzibar Ltd [2023] EWHC 2284 (Ch)

This interesting case gives useful guidance on when a compensation order may be made against a director who has caused loss to a creditor of an insolvent company, under s15A-15C of the Company Directors Disqualification Act 1986.

ICC Judge Barber observed that the power to make a compensation order is a new cause of action. It has two purposes: to enable creditors to receive compensation personally from a director where they have not been adequately compensated in the insolvency process, and to hold 'wrongdoers' accountable and increase confidence in the insolvency regime.

The judge also clarified that on the question of causation, foreseeability should play a role, i.e. that any losses remedied by a compensation order must be a reasonably foreseeable consequence of the director's conduct. This was distinguished from the earlier case of *Re Noble Vinters Ltd* [2019] EWHC 2806 (Ch), in which the court considered that even unforeseeable losses could be remedied by a compensation order.

The sole director had set up Pure Zanzibar Ltd as a travel operator providing safari holidays. However, he failed to renew his air travel organiser's licence (ATOL) after its expiry on 31 March 2017. The director was expressly warned by the regulator, the Civil Aviation Authority, of the consequences of not doing so. Despite this, he illegally continued trading and selling holidays to consumers that the company could not provide. The company entered into a creditors' voluntary liquidation in December 2017, with liabilities of £517,638. No refunds were provided to customers and no holidays were booked. The company also had various trade creditors.

"Practitioners should be careful not to ignore the question of causation when dealing with compensation order cases"

ICC Judge Barber held that the director's conduct was woefully 'reckless and incompetent', and that he had caused losses to five customers totalling £81,405, plus interest, which were a foreseeable consequence of the director's conduct. By contrast, the conduct did not cause any losses to the company's trade creditors.

In an important distinction, the judge noted the ATOL regime is intended to protect consumers; hence the director's conduct in selling holidays without an ATOL was irrelevant to any losses suffered by trade creditors. Practitioners should be careful not to ignore the question of causation when dealing with compensation order cases.

Angus Thomas is a barrister and **Alexander Bradford** a pupil at St Philips Chambers

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Latest cases provide clearer pathway to court approval

Judgments in *Adler*, *Aggregate* and *McDermott* suggest that excluding creditors from voting may be a powerful way to deal with disruption of RPs, say **Charlotte Møller** and **Rebecca Terrace**. On page 16, **Georgia M. Quenby** gives another perspective

Earlier this year the Court of Appeal handed down its judgment[1] on the appeal of the Adler restructuring plan (RP), which was originally sanctioned in April 2023.

The judgment provided a helpful framework for those looking to implement an RP, in particular highlighting where the principles applied to schemes of arrangement will differ where a cross-class cram down (CCCD) is, or is likely to be, engaged.

> **We saw in *McDermott* and *Aggregate* that, in appropriate circumstances not pertaining to urgency, the court will also allow a shortened RP timetable**

Since *Adler*, we have had the benefit of seeing how that framework has been applied and developed in the cases of *McDermott*[2], and *Aggregate*[3]. In this article, we consider some of the practical takeaways from the three cases for those considering an RP or considering challenging one.

Timetabling

It is clear from the recent cases that the question of urgency and timetabling must be dealt with appropriately. The court is not there to rubber stamp an RP, particularly where it is being asked to exercise its discretionary powers, and therefore the plan company must give careful consideration to timing. Generally, "sufficient time [particularly] for the proper conduct of a contested part 26A process must be factored into the timetable"[4], and failure to do so is likely to risk additional costs, a potential appeal and an unhappy judge.

Appropriate timetabling will be driven by specific circumstances and facts. *Adler* recognised that certain cases might need to be dealt with urgently (and therefore a shorter timetable required) and we saw in *McDermott* and *Aggregate* that, in appropriate circumstances not pertaining to urgency, the court will also allow a shortened RP timetable.

McDermott refused to adjourn proceedings at the behest of a challenger where the challenger's behaviour or motivation was in question, and *Aggregate* found it unnecessary to order a plan meeting on full notice where at least 97% of in-the-money creditors were known to be voting in favour and out-of-the-money creditors had been disenfranchised from voting.

There does however need to be a balance between forcing an RP through unnecessarily quickly based on perceived or purported 'urgency' and being pragmatic about the realities of an RP where a shorter timetable, based on genuine urgency or otherwise, may well be appropriate in the circumstances.

Forum shopping

Adler did not expressly deal with the question of whether 'issuer substitution' was appropriate to engage the court's jurisdiction to sanction an RP, as this was not challenged at the hearing. However, it was noted that such a technique was self-evidently for the sole purpose of introducing an English company into the group structure for the RP, without which the RP would not have been entertained by the English court.

In *Aggregate* the court was faced with arguments from the challenger creditor that Aggregate's COMI (centre of main interests) shift was either illusory and had failed, or an example of bad forum shopping. Although the court noted that it may scrutinise a COMI shift to ensure it is based on "substance and not an illusion and that the change has the necessary element of permanence", a plan company is "free to choose where it carries on the administration of its interests, and so is free to move its COMI to England for the

The McDermott Group provides services and construction in the energy sector

sole purpose of promulgating a restructuring plan under part 26A [of the Companies Act 2006]". Here, the plan company had taken extensive steps to move its COMI to England and accordingly had 'sufficient connection' to give the court jurisdiction to consider the RP.

Compromise or arrangement

There must be an element of 'compromise or arrangement', notwithstanding the very low jurisdictional hurdle for what a compromise may involve. There is a requirement of 'give and take' between the company and plan creditors, and there cannot simply be a "confiscation or expropriation of rights without compensating advantage"[5]. The question then arises as to what constitutes a compromise or arrangement and what level of compensation is required.

> **The court must be satisfied that the plan is fair (although not necessarily the fairest or best plan) and one that an 'intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve' of**

Relying on *Adler*, *Re Smile Telecoms Holdings Limited*[6] and *Re Virgin Active Holdings Limited*[7], *McDermott* and *Aggregate* found the following:

- a small payment of 0.04% or 0.025% of a creditor's claim would be considered sufficient; where 'out of the money' creditors have no genuine economic interest in the company, the rights being surrendered or compromised must be regarded as worthless;
- a *de minimis* payment would satisfy the requisite give and take to amount to a compromise or arrangement; and
- an RP must be a compromise or arrangement for *every class* of creditor or member to whom it is directed; the concept of a compromise or arrangement is wide, embracing almost everything with some element of give and take.

The lack of any compromise or arrangement (no consideration at all was offered) in Aggregate's initial RP resulted in the court finding it did not have jurisdiction to sanction the RP first time around. Although the initial RP was amended before the sanction hearing, this did not rectify this jurisdictional defect – instead, the court convened further plan meetings and the RP was then sanctioned at the second sanction hearing.

> **From a plan company's perspective, there does "not need to be, and indeed there cannot be, absolute precision as to how a [relevant alternative] would pan out"**

Exercising discretion

Adler confirmed that the principles used in a scheme of arrangement should be applied when the court is not being asked to cram down. The court must be satisfied that the plan is fair (although not necessarily the fairest or best plan) and one that an "intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve".

Adler also addressed the approach the court will take when asked to exercise its direction to cram down. Essentially the principles established for a scheme of arrangement need to be modified, with varying significance.

The 'no worse off' test

The burden is on the plan company to prove, on a balance of probabilities, that "none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative". A court should not just accept a plan company's evidence in this regard, but should scrutinise the evidence, which must show that there is real substance in the plan company's assertions that the relevant alternative put forward was most likely to occur.

From a plan company's perspective, "there does not need to be, and indeed there cannot be, absolute precision as to how a [relevant alternative] would pan out". From the challenger's perspective, any argument put forward to challenge the relevant alternative should not be 'fanciful', where any payment would be greater than that which a creditor might receive in the relevant alternative. It is difficult to argue against such a creditor being "no worse off than in the relevant alternative". It is therefore vital that dissenting creditors can forcefully, and genuinely, put forward a robust valuation argument, as failure to do so is likely to lead to a disappointing outcome for the creditor.

Fairness and rationality

The court will not take into account the level of voting, or the value of those votes, when deciding whether to apply CCCD but will look to engage with the underlying commercial issues. Further, the court will not use the 'intelligent and honest man' test to impose terms on dissenting creditors whose class interests are different to those of assenting creditor classes; the fact that one class approves the RP provides no information about the fairness of imposing the plan on dissenting classes with different interests.

Vertical comparison

The statutory requirements for the RP and CCCD conditions must be met, but this in and of itself does not give rise to a presumption in favour of CCCD and sanction; the court must still consider whether to exercise its discretion in light of all the relevant factors and circumstances.

Horizontal comparison

It is appropriate for the court to conduct horizontal comparisons in a CCCD scenario, and any differences in treatment of classes of creditors *inter se* must be justified – there should be a fair distribution of the benefits of the RP, over and above the relevant alternative, between those classes who have agreed to it, and those who have not. There needs to be a compelling reason to persuade the court to sanction an RP that allocates the benefits differently between classes of similar standing in any material respect. These are concepts familiar to practitioners from previous challenges to CVAs, and the Court of Appeal's adoption of these in the circumstances seems logical.

Fair distribution of surplus?

Shareholders stand to gain a benefit if an RP is successful, whereas out-of-the-money creditors do not. In a liquidation (often the relevant alternative to an RP) the position is reversed with shareholders ranking below unsecured creditors in the insolvency waterfall. While in *McDermott* the court recognised that there might be scope for comparing the treatment of shareholders with out-of-the-money creditors when testing whether the restructuring surplus has been fairly distributed, it did not go on to do this because the out-of-the-money challenger stood to benefit from a share of the group's equity and the court therefore decided that it had been treated "more than fairly".

The court did not compare the position of shareholders and out-of-the-money creditors in *Aggregate* either because the out-of-the-money challenger creditors were so out of the money that the court felt that it

The Adler Group is a Luxembourg-based real estate group that mainly operates in Germany

> **The court will need to be persuaded that there is a good and proper justification for departing from the *pari-passu* principle**

was "none of their concern" how the benefits of the RP should be shared. Although those seeking to challenge cram down on the basis that the restructuring surplus has been unfairly distributed will be given a voice by the court (including out-of-the-money creditors) we are yet to see a case where the court has been required to give proper consideration to the views of out-of-the-money creditors.

Deviation from *pari-passu*?

The court will need to be persuaded that there is a good and proper justification for departing from the *pari-passu* principle in an RP. This does not mean that all parties should be treated equally, but rather that they should be treated in line with what their rights would be in the relevant alternative such as an administration or liquidation, respecting the waterfall of priorities, while also taking account of what would happen in practice. For example, duress creditors being paid in full where a pre-pack administration sale is being conducted, or employees being paid to allow the business to continue to trade.

Without providing an exhaustive list, *Adler* found that deviation might be justified where:

- creditors provide an additional benefit or accommodation to assist the achievement of the RP in the interests of the creditors as a whole (for example, new money being repaid in priority to existing creditors); or
- trade creditors or employees that are vital to the continuation of the business and success of the RP being paid in full rather than compromised.

> **Shareholders who attempt to use an RP unduly aggressively are likely to face disappointment**

Any deviation should be proportionate, which is, of course, likely to be a subjective test.

A better or fairer plan?

The court should consider whether a different allocation of assets would be possible and whether an alternative arrangement would have been fairer. In practice, this means that shareholders who attempt to use an RP unduly aggressively are likely to face disappointment.

Disenfranchisement

Although section 901C of the Companies Act 2006 has been used relatively rarely, it was engaged in *Aggregate* such that out-of-the-money creditors were excluded from voting at the plan meeting on the basis that they had 'no genuine economic interest'. This could prove a useful and powerful way of dealing with dissenting creditors who might otherwise disrupt a plan and avoid the difficulties we have seen in satisfying the court it should exercise its discretion to cram down.

Although we can expect further developments in this area as we see more RPs before the court, the decisions in *Adler*, *Aggregate* and *McDermott* provide a clearer pathway for those considering a plan and will no doubt guide the shape of RPs moving forward.

1 [2024] EWCA Civ 24
2 [2024] EWHC 398 (Ch)
3 [2024] EWHC 468 (Ch)
4 Per Lord Justice Snowden in the *Adler* judgment at paragraph 65
5 Snowden LJ in *Re NFU Development Trust Limited*, [1972] 1 WLR 1548
6 [2023] 1 BCLC 352
7 [2021] EWHC 1246 (Ch)

Charlotte Møller is a partner and **Rebecca Terrace** a senior associate at Squire Patton Boggs

10 pointers for IPs post-*Adler*

Lord Justice Snowden's detailed judgment in *Adler* has provided a route map to avoiding pitfalls that could lead to a plan refusal, says **Georgia M. Quenby**

Follow Goode principles

Snowden LJ quoted Goode's *Principles of Corporate Insolvency Law*: The most fundamental principle of insolvency law is that of *pari passu* distribution. If, in your proposed plan, the relevant alternative is an insolvency process, then the *pari passu* principle must be maintained unless there is a very good reason to diverge.

Be wary of substitution

It looks like the Court of Appeal has invited a challenge to the use of issuer substitution (a legal vehicle to establish a change in jurisdiction). Snowden LJ wrote: "The appellants did not oppose the plan before the judge on the basis that the issuer substitution was an artificial device that could not justify the exercise of discretion to sanction the plan … I would wish to make it clear that the fact that this judgment does not deal with this issue should not be taken as an endorsement of the technique for future cases."

Class distinctions matter

It is critical to take extra time to consider class constitution (who a creditor group is composed of) and cross-over interests where debt holders are in more than one class – should the cross-over holders have their own class? Although the solvent scheme jurisprudence still applies, you might need to give additional consideration to whether cross-holdings mean that the ability to consult with other class members is real or only theoretical. The *Telewest* dicta "the creditors will have been placed into separate classes because there is more about the plan that divides than unites them" is still good law though.

Don't get vertigo

Vertical comparisons are of each class with that class's outcome in the relevant alternative. You must do a vertical comparison, but it is not determinative as to whether a plan is fair to the dissenting class of creditors.

Look at the horizon

Horizontal comparisons look at the position of each class of creditors and compare it to the position of other classes of creditors or members if the plan goes ahead. Not only must you do a horizontal comparison, it is more important than the vertical comparison if a class may be crammed down. And from Snowden LJ: "I consider that reliance upon the overall level of voting across all classes of creditors is not something that should be taken into account in conducting the horizontal comparison and deciding whether it is fair or appropriate to cram down a dissenting class."

Ask if fairness is as good as it gets

Post-*Adler* the judge must ask if the plan could have been made better or could have been improved. As Johnson J said in *Great Annual Savings*, "The basic challenge is likely to be: this is not fair – things could and should have been done differently." So you need to demonstrate that other options have been considered and rejected: the plan as presented needs to be as good as possible. Overall fairness is not enough, or even important. Each class's share of the benefit derived from the restructuring must be individually assessed for fairness.

Don't rush the judge

The judge needs sufficient time to consider the class construction, key valuation issues and the terms of the plan. According to Snowden LJ: "The sanction exercise had been done to a timetable that was, for all concerned and especially the judge, inadequate."

Minimise valuation disputes

The valuers need to get together and negotiate competing valuations so that the scope of difference between them is as narrow as possible when the scheme comes to court for sanction. 'Plausibility checks' as to the robustness of valuation data are not sufficient.

Security requires a quid pro quo

If a class of creditors will be granted new security under an RP, which therefore advances their position in the insolvency waterfall, then that is fine and doesn't infringe the *pari passu* principle so long as those creditors are giving something in exchange, like an extended maturity date or some additional finance. There must be a *quid pro quo*.

Delayed payment equates to elevated risk

If the plan requires asset liquidation to pay creditors and one class of creditors will recover later than another under the plan, then this increases the risk that they will not be paid the proposed plan distribution whereas earlier-in-time creditors have less risk of this. This offends the *pari passu* principle and so, if the relevant alternative is insolvency, it is likely that pre-plan variable maturity dates need to be aligned by the plan.

Georgia M. Quenby is a partner at Fladgate LLP

Manolete
— PARTNERS PLC —

Manolete Head Office, 21 Gloucester Place, London, W1U 8HR

Steven Cooklin Chief Executive
steven@manolete-partners.com 07900 985 559

Mena Halton Managing Director
mena@manolete-partners.com 07912 466 695

Andrew Cawkwell Head of Business Development
andrew@manolete-partners.com 07702 319 421

The Manolete model successfully aligns the interests of the IPs and their lawyers and we form a powerful partnership.

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Ignore political pressure and social values at your peril

Threats to professional independence and shareholders wanting dividends are just some of the issues that arise when dealing with local authority trading companies, says **John Cullen**

Our job in the insolvency profession is hard but if you add to the multiple precedents set by insolvency law and rules a large helping of the Local Government Finance Act 1992, the cultural and social responsibilities of a council, the political flavour that comes with it and the historical 'way things are done', life can get even trickier.

If you dig deep into the staff of local authorities and local authority trading companies (LATCs), you can find really talented people – from the council CFO (section 151 officer, a financial controller role established under the Local Government Act 1972), and the talented LATC board member with years of experience in their field to the elected representative, who may have significant political ambition, you should see a more advanced diversity agenda than in our own profession (as of the time I write this article) and a greater transparency in doing business. But, like any organisation, there will be silos where neither of these points is true.

Services of the profession required

The next few years could be tricky for a number of local authorities. The cost of running an authority has increased. There are a number of reasons for this, including the increased cost of living, the effect of the 2020 Covid-19 pandemic, higher energy costs, and the dichotomy between having to provide statutory services and maintain long-term infrastructure within which those services are provided. The services of the insolvency profession will be required and more of us will see instructions coming from local authorities and LATCs, or their alternative service providers.

> **At their worst, LATCs can accumulate and store losses in service provision. They can add layers of governance to a public sector organisation that could mean they lack the agility to surf the waves of the current economic climate**

Often, the statutory services can be delivered by an LATC that carries out activities on behalf of the authority. There are plenty of benefits to an authority in setting up an LATC as they can access alternative sources of funding, take advantage of tax and procurement benefits and foster specific projects in collaboration with others. They have a laser-like focus on their service provision while still having the social values of the authority built into their governance. Often owned by the authority, their profit can provide an income that the authority can allocate as it sees fit.

At their worst, LATCs can accumulate and store losses in service provision. They can add layers of governance to a public sector organisation that could mean they lack the agility to surf the waves of the current economic climate.

Willingness to underwrite losses

When advising an LATC, the issues that may affect them will often depend on which side of the fence they sit in relation to profitability. At a basic level, it may be an organisation with a single major client and a time-limited contract. That contract may be inherently profitable, or it may have been set up without flexibility prior to the rise in energy prices and cost of living. The contract may be nearing its end, and the unspoken understanding that it would be renewed turns out to be incorrect. Worse still, the unprofitable contract may be extended pending what appears to be an interminable tendering process.

The section 151 officer has a role with responsibility. Under section 114 of the Local Government Finance Act 1988 (or as modified by section 54 of the Local Government and Elections (Wales) Act 2021), the officer has a duty to make a report if the incurred expenditure of the authority (including expenditure it proposes to incur) in a financial year is likely to exceed the resources available to it to meet that expenditure.

One of the biggest risks to our profession may be the shareholders' willingness to underwrite the losses sustained by an LATC. The comfort that the above should provide is tempered by the recent s114 notices issued by several authorities which may, in practice, render the indemnity meaningless.

When a notice is issued, it triggers a series of actions aimed at stabilising the council's

Local authorities must provide statutory services such as waste collection, but have no requirement to prop up a failing LATC

Birmingham city council issued two s114 notices in September 2023 attributed to equal pay liabilities for the local authority

financial position. These actions may include a freeze on non-essential spending, a review of all contracts and commitments, and the implementation of much stricter financial controls. The authority must also produce a plan to balance its budget and demonstrate how it is going to deliver its statutory services with the available resources. These services include education, waste, housing and social care in addition to environmental health, planning, and transportation.

One of the things it does not have to do is prop up a failing LATC. In fact, in a worst-case scenario, the Government can intervene and take over decision making in relation to spending. This is not only politically damaging but it can significantly affect the people living within the authority's area.

> An LATC should have a 'what if' plan – a contingency cash flow into what it needs to wind down its position in a worst-case scenario

But there is some good news. The authority has to distinguish between its capital budget and its resource budget and must keep spending separate and budget-specific, the Government can, in exceptional circumstances, authorise resource expenditure to be met from the capital budget. This might be useful for an LATC that requires funds from resource expenditure but unhelpful for those that rely on the capital budget.

So what should we, as a profession, watch out for when approached by authorities, LATCs or essential service providers for advice?

A strategy of cost cutting

If you are dealing with a profitable LATC owned by a local authority, there will be significant pressure for dividend payments to

> The LATC board is usually appointed due to their ongoing and historical experience in working in local authorities and, always at the back of everyone's mind, will be the threat of future employment opportunities drying up

the authority. That pressure will be keenly felt by the LATC board and it should not simply be an issue of whether there are sufficient reserves to make the dividend payment. I will not go into the Sequana decision here but the findings are helpful to a board in this position. In addition, an LATC should have a 'what if' plan – a contingency cash flow into what it needs to wind down its position in a worst-case scenario. This should have some bearing on amounts available to distribute to shareholders.

At this time, both the authority and any LATCs it has may have a strategy of cost cutting. The temptation is to cut costs until there is no need to issue a s114 notice but, of course, this strategy stores up the potential problem of not being able to provide statutory services. The LATC may have a request to cut its budget by 20%, for example. The question the board responsible has is whether the services remain deliverable after those cuts, regardless of the pressure that the LATC finds itself under. The LATC board is usually appointed due to their ongoing and historical experience in working in local authorities and, always at the back of everyone's mind, will be the threat of future employment opportunities drying up.

Looking in from the outside, private companies are often suppliers to authorities and LATCs. Too often as a profession we have seen businesses wholly reliant on the public sector, which is fine in good times but an inherent risk when economic difficulty arises. When advising those companies, our starting point should be to consider whether the supply serves a statutory service. Following closely on is whether the supplier can diversify.

Conflict with shareholders

The forefront consideration with any engagement with an authority or an LATC should be the threat to our independence. Authorities will, for the most part, engage advisers they know and trust. That can sometimes mean they introduce us to a subsidiary LATC that needs specific advice on some or all of the matters mentioned above. That advice can put the LATC into direct conflict with its shareholders. That may mean we are in conflict with a historical client. Our profession has solid groundings in identifying and dealing with such threats but if your advice could jeopardise a significant income stream, the introduction could turn into a valuable referral opportunity rather than threat mitigation.

I have not dealt with the political pressures that the authority or its service providers often find themselves under. They are always specific to the instructions provided by the authority or service provider and can vary from region to region. They should not be disregarded as they can be a motivator regardless of the professionalism of those providing the instructions. In addition, of key importance to both the authorities and the LATCs will be the social values at the heart of their service provision. We ignore those at our peril.

John Cullen is a partner at Menzies

Lack of blanket provisions risks unfairness for sub-postmasters

Despite legislation to quash the wrongful convictions of Horizon sub-postmasters, problems remain with the many bankruptcy orders still in place, says **Jennifer Lockhart**

"This is money these people are actually owed, and they've been owed it for years…"

This year's ITV dramatisation will undoubtedly be remembered as the moment the Post Office Horizon IT scandal came into widespread public consciousness, but it is a scandal that has been years in the making.

The comments above, given to the media in February by the now well-known former sub-postmaster Alan Bates, were accompanied by a call to "just get on and pay people". However, almost six months after the TV series lit the touchpaper on redress, time and delay continue to be the enduring theme.

We as restructuring professionals are perhaps more aware than most of the legal hurdles and conflicting interests that can lead to delays in what are often time-sensitive, emotion-driven scenarios. However, even by the standards we are used to, it remains that in this case – where there is overwhelming support for the wrongly-convicted sub-postmasters – delivering redress both quickly and fairly has become a complex issue.

> **"Unfortunately, the compensation that is being awarded for personal loss in relation to Horizon is simply not sufficient for those that have been made bankrupt to put them back in the financial position they would have been but for the Horizon scandal"**

This is particularly true when you consider cases where sub-postmasters have been declared bankrupt.

Compensation vested in the OR

While the blanket legislation introduced in March to quash wrongful convictions has been broadly welcomed, no proposal has been brought forward to automatically rescind or annul bankruptcy orders involving sub-postmasters who may have borrowed money or used their savings to rectify shortfalls created by the Horizon computer system.

For those looking to access the government's redress schemes that have previously been or remain bankrupt, it is currently unclear what steps they can take and what impact those steps may have on the compensation they are entitled to. Indeed, in the absence of a scheme specifically for bankrupts, a number of sub-postmasters are finding that they are significantly worse off than those who were able to remain solvent despite the Horizon shortfalls.

In the majority of Post Office redress cases to date, and in keeping with insolvency law, compensation for financial losses has vested in the Official Receiver (working on behalf of the Insolvency Service) and only the compensation awarded for personal loss has been due to the individual. Unfortunately, the compensation that is being awarded for personal loss in relation to Horizon is simply not sufficient for those that have been made bankrupt to put them back in the financial position they would have been but for

> Many sub-postmasters are suffering as a result of the statutory interest of 8% per annum being charged on each of their debts, meaning a large proportion of any eventual compensation payment is being eaten up in interest

the Horizon scandal – and to adequately compensate them for the damage to their creditworthiness and the suffering they have experienced.

Asking creditors to waive debts

The unfortunate reality is that, in these cases, the majority of the compensation is being used to discharge the debts, costs and expenses of the bankruptcy – leaving a very small amount remaining for the sub-postmasters. These include the costs and expenses of the Official Receiver, who is taking 15% of the compensation paid as a realisation fee (in accordance with the insolvency framework). As a government agency, the ethics of it recovering the 15% from compensation paid by another government agency is questionable.

To further complicate matters, many sub-postmasters are suffering as a result of the statutory interest of 8% per annum being charged on each of their debts, meaning a large proportion of any eventual compensation payment is being eaten up in interest.

One proposed solution adopted by the Official Receiver is to invite creditors and lenders to compassionately waive their entitlement to the statutory interest or the debt in its entirety. Having become creditors on fair terms, and without knowledge of the plight of the sub-postmasters, such a request undoubtedly leaves most creditors in a moral dilemma, not of their own making. There is also some debate as to whether HMRC is in a position to waive its debts under the current statutory framework. It would seem somewhat unfair if one government agency is asking creditors to waive their debts and entitlement to statutory interest but HMRC, another government agency, is not.

These complexities beg the question as to whether – as with the blanket pardon on convictions – similar provisions should be put in place for bankruptcies. Again, this brings with it its own intricacies. Chief among them being whether each bankruptcy should be annulled or rescinded.

Reputationally unfavourable

Rescinding – where the bankruptcy is terminated retrospectively rather than being legally considered to have never been made – is one option. The court can rescind a bankruptcy order if there are exceptional circumstances justifying the exercise of the court's discretion and a material difference to the position as it was known to the court when the order was originally made. When considering an application to rescind a bankruptcy order, the court is free to consider any new information that was not considered at the time the order was made. This option is not favourable for reputational reasons as legally it does not put the sub-postmaster back in the same position they would have been in if the bankruptcy order had never been made. In addition, for commercial reasons it may not be as beneficial as it is not uncommon for contracts to include clauses that trigger certain events where a bankruptcy order has been made. An annulment would not trigger these types of clauses whereas a rescission would likely do so. For example, in the case of *Hoare v Inland Revenue Commissioners* [2022] EWHC 775 (Ch), Mr Hoare had commercial arrangements with third parties that had clauses that might expose him to pay substantial sums of money in the event of a bankruptcy order being made. On his appeal, the rescission of the bankruptcy order by the registrar was set aside and the bankruptcy order annulled instead.

The effect of an annulment – as the alternative option – is that the bankruptcy order would be considered to have never been made, which is understandably the more favourable outcome for sub-postmasters. Annulment can be granted on the basis that the debts and cost of the bankruptcy have been paid in full (which is only likely to be an option where compensation has been paid out, but for the reasons set out above is not without its issues).

Politicking and delays

An annulment can also be granted on the basis that the order ought not to have been made at the time. However, based on the law as it stands, annulment is only likely to succeed on this basis where it is possible to show that the debts claimed were not due and owing at the time of the making of the bankruptcy order. The existence of a judgment or order may prevent this being an option.

Critically, if an annulment were to succeed on this basis, in most cases it would result in the Post Office being ordered to bear the costs of the bankruptcy and the substantial fees incurred by the office-holder. While this is likely to be viewed as fair in many circles, apportioning these costs would likely create a further source of debate, politicking and, ultimately, delay.

The position is even more complicated in the event that a sub-postmaster has filed for their own bankruptcy. Firstly, they would additionally need to prove that they had made themselves bankrupt as a result of the debts that had accrued because of the Horizon shortfalls – a difficult feat in itself. Secondly, as the Post Office would not have been a party to the bankruptcy proceedings, it would not automatically follow that they would be ordered to pay the cost. Instead, the sub-postmasters may in the first instance have to discharge or provide security for those costs to gain an annulment, and then seek to recover those costs from the Post Office.

At present, whether or not rescission or annulment is the appropriate route will depend on the particular facts of each case. Non-cooperation and the existence of other creditors who might lose any remedy given the expiration of limitation periods due to the passage of time are all factors that the court will take into account.

Hopes of swift redress ill-founded

While many sub-postmasters will be receiving pro bono legal support to navigate this complex area of law, without blanket provisions being introduced the risk of inconsistencies and unfairness in how these sub-postmasters' bankruptcies are dealt with and are compensated is high.

On the other hand, these legal challenges perhaps explain why there appears to be little appetite to provide a blanket provision. Indeed, in taking the responsibility for administering redress away from the Post Office after it was deemed unfit to do so, the Department for Business and Trade outlined that final decisions would be made by independent panels or individuals. These considerations in relation to bankruptcy will need to be well understood if the sub-postmasters are to get the justice they seek and deserve. Sadly, however, the hope of seeking swift redress in these cases is likely to be ill-founded.

Jennifer Lockhart is a partner at Brabners

More creativity needed to avoid 'the death of the creditor'

Dull reports and scant publicity have forced the formal jacket of creditor participation to fall out of fashion. Firms must embrace brevity to bring it back, says **Ben Luxford**

Guy Ritchie, the British film director and writer, spoke in 2017 on a podcast about the death of the suit. Ritchie said: "The death of the suit was the prosaic attitude towards going to work." In a monotone voice he continued: "I'm going to work and I got to put on a suit and I got to put a tie on and I don't want to stick out [sic]." According to Ritchie, men have been brainwashed to not dress like gentlemen. I agree with him in this respect.

The same year that Ritchie made those comments, the insolvency profession started to witness the death of the creditor. Ironically, this was also the year that changes to legislation came into force encouraging creditor participation in insolvencies — the decision-making processes currently in place. Like men in the eyes of Ritchie, creditors may have been brainwashed to not engage with the profession. By whom, you ask? I will leave you to ponder that question.

You are probably thinking: "Where is he going with this? What do the deaths of the suit and the creditor share in common." Bear with me and let me take you on a journey.

> **"The disengaged creditor cannot be told to engage. The creditor has to want to engage with the process they are involved in"**

On 6 April 2017, the Small Business, Enterprise and Employment Act 2015 (SBEEA) made changes to the Insolvency Act 1986 that would remove the use of physical meetings as the default mechanism for decision-making by creditors in insolvency proceedings. Instead, office-holders would be able to use a variety of other procedures that did not involve creditors meeting together in the same space. On the same day, the Insolvency (England and Wales) Rules 2016 came into force to complement the SBEEA changes.

According to the Insolvency Service, these changes were part of a wider effort to streamline the insolvency regime and reduce unnecessary regulation, the ultimate goal of which was to provide better outcomes from insolvency and increased returns to creditors. However, the general consensus among the profession is that the changes made have damaged rather than improved creditor engagement. Information overload, decision-making complexity and inconsistencies have all made it hard for all but the 'most experienced' creditors to get involved in insolvency processes[1], which I assume does not include 'John the plumber from Bolton'. Therefore, like the suit, many perceive the creditor as dead. I think the size of reports now and the lack of engagement from creditors is not a coincidence.

Present day

It is now 2024 and both of the deaths haunt me. To bring the suit back to life, the narrative around the suit needs to change. The person with the suit will not put it on because he is told to put it on. He has to want to put it on. And the same can be said for the creditor. The disengaged creditor cannot be told to engage. The creditor has to want to engage with the process they are involved in.

 Editor editor@r3.org.uk

> **Could reports be turned into two-minute videos using artificial intelligence? I believe this is the future**

How can the profession change the narrative? We need to be creative. We need to get small creditors back on side and wanting to engage with the process. At the end of the day, we are acting for them. We do not need to be concerned with the 'experienced creditors' as they are apparently very much still engaged, but who are these experienced creditors? HMRC? The experience of many in the profession is that HMRC are not engaged to the extent that they would like them to be.

As a profession we need to promote our successes more often, and we need to summarise the long, over-detailed and often dull reports into an executive summary at the start of each report. The summary should bring the most important matters to creditors' attention from the outset. It is now 2024, and society wants information immediately. If the information provided is engaging, creditors will continue to scroll down to read instead of swiping up to exit. We need to grab their attention. Could reports be turned into two-minute videos using artificial intelligence? I believe this is the future.

Firms need to promote the work of their IPs. Over the past few years, I have seen a few firms advertise on social media that they are paying dividends to creditors, but this is a rare sight on my feed. I doubt many in the modern world read the *London Gazette* for pleasure or for insolvency announcements.

Where there is only one creditor, IPs may wish to consider calling the creditor in advance of a request (for example, for fee approval) and sending a formal report. This delicate touch may go some way in helping the creditor understand the work that has been done on their behalf. Another sensitive suggestion is that IPs may also want to consider setting aside funds to pay a dividend to creditors to entice them to engage in the process.

> **Changing the narrative will take time and patience, but there are members out there that need help now**

At the most recent meeting of R3's Council, the nominee for R3 deputy vice president gave a speech about why they would be a good fit for the role. It was an excellent speech, and they were wearing a lovely suit — the member will make an excellent R3 president in 2026. Anyway, in the speech the member spoke about 'inclusion' and how the next generation will demand inclusion in every aspect of life. This applies to creditors now and in the future. When creditors do not feel included in an insolvency process, they are more likely to be distant and disengaged.

Impact on remuneration

Changing the narrative will take time and patience, but there are members out there that need help now. One of the areas of focus for R3's General Technical Committee is the impact on IPs — in particular smaller practice IPs — of creditors not actively voting in respect of remuneration. This often results in IPs having to seek the approval of the court or, in some circumstances, writing off fees. A survey was recently circulated to members about the costs of CVLs, including those where creditors do not vote and their current experiences in seeking fee-approval from creditors. The survey is now closed but the results will assist the GTC working group in drafting changes to legislation and shaping R3's proposal for changes to the Insolvency Service.

A hypothetical future

Look ahead to 2030 and what that might bring. The restructuring profession is now run by an AI operating system called 'The Duke'. Achieving objective one of paragraph 3 of schedule B1, administration, (rescue of a company as a going concern) is now considered the norm. The moratorium has just been used for the 20th time since its creation in 2020. Restructuring plans are now being used by SMEs, and creditor voluntary liquidations are still being dealt with by the private sector.

In addition to the above, the following has occurred:

- AI is used to convert reports into two-minute videos for creditors to watch, increasing engagement.
- Creditors help IPs realise more assets for the benefit of the creditors as a whole, resulting in an increase in dividends.
- Section 98 meetings have returned with worldwide adoption of Apple's Vision Pro goggles.
- Media outlets have stopped referring to every corporate insolvency process as 'bankruptcy'.
- The profession and wider society embrace the suit and the bowler hat makes a comeback.
- I have written a screenplay based on the profession with a *Lock, Stock and Two Smoking Barrels* feel to it.

Creditor engagement remains vital and until the narrative changes I would encourage IPs to "present necessary information to creditors in the most attractive way possible – an executive summary may be the best medium to convey information in a complex case". Not my words, but those of the Insolvency Service in April 2022.

Men's suits may have fallen out of favour, but still serve as a good analogy for creditor engagement

This article was written by Ben Luxford while wearing a suit and tie with a pair of Oxfords. The views are the author's own and do not necessarily represent the views of R3.

1 "The anecdotal evidence suggests little change in engagement from the most experienced creditors" First Review of the Insolvency (England and Wales) Rules 2016, 5 April 2022.

Ben Luxford is head of technical at R3

Unity of approach needed when dual court judgments involved

A caravan park dispute highlights a tricky situation where family law proceedings can change ownership of the insolvent company, say **Georgia Morris** and **Stephen Rome**

Over the last four years, a long-running dispute has been bitterly fought in the High Court between caravan park owners Mrs Loveridge and her husband the late Mr Loveridge, with claims brought against them by their son Michael Loveridge. The dispute has resulted in two Court of Appeal decisions[1] (both in Mrs Loveridge's favour) and well over 15 contested applications, including unsuccessful committal proceedings brought by Michael against Mrs Loveridge in the Birmingham High Court. While that litigation has largely come to an end, a single site, Breton Park, was the subject of further action under the insolvency regime.

Objection to administrators' request

Breton Park is a residential caravan park near the village of Muxton on the northeastern fringe of Telford. It is owned by Breton Park Residential Homes Limited, with shares in that company legally owned equally by Mrs Loveridge and Michael Loveridge. On 27 July 2022 Breton went into administration following its failure to pay statutory demands issued by associated companies Bewdley Caravan Sales Limited and Kingsford Caravan Park Limited. Craig Povey and Charles Turner of Begbies Traynor Group were appointed joint administrators, with them seeking the statutory objective of selling the company's land and property for the benefit of creditors. Avison Young was instructed to market the site for offers in excess of £3.95 million, and received offers ranging from £3.3 million to £5.75 million – the latter being a bid made by Michael Loveridge to purchase the site.

Mrs Loveridge, in her capacity as a director of Kingsford and Bewdley, objected to the administrators' request to seek an extension of time on the basis that the company could be rescued as a going concern. The parties reached an agreement whereby Mrs Loveridge, via her company MIAD Group Limited, offered to refinance Breton's liabilities with a £4 million loan such that the secured creditor, Royal Bank of Scotland, and all unsecured creditors would be repaid in full (save for one disputed debt allegedly owed to Michael Loveridge, for which provision was made should a claim for the debt be successfully pursued).

Multiple court applications

His Honour Judge Williams was prepared to approve an order allowing the administrators to revise their proposal pursuant to paragraph 68 (3)(c) of schedule B1 of the Insolvency Act 1986 so that Breton could be rescued as a going concern. However,

Michael Loveridge brought multiple claims against his parents, the owners of a caravan park

HHJ Williams held that Michael lacked standing in circumstances where he ... was pursuing the application 'without any legitimate interests as a member for doing so, but rather in an attempt to pursue his interest as a prospective purchaser'

the judge ordered that Michael Loveridge be given notice of the proposed loan.

Michael subsequently applied to court on a number of issues:

1. An application under paragraph 74 of schedule B1, to direct the joint administrators to proceed with the proposed sale of the site and abandon the company rescue offer;
2. He also issued an unfair prejudice petition against Mrs Loveridge claiming she was in breach of her duties as a director of Kingsford, which was lending funds to MIAD for the refinancing; and
3. He additionally applied for an interim injunction to stop MIAD paying the £4 million to Breton.

A further application for the court to grapple with was previously made by Melinda Loveridge, the estranged wife of Mrs Loveridge's younger son, Audey Loveridge, who brought financial remedy proceedings in the family court seeking to reverse a transaction transferring Audey's shares in Breton Park to Mrs Loveridge and Michael Loveridge in 2019. HHJ Williams sought to deal with the insolvency and company applications at a hearing on 29 November 2023.

Michael sought to persuade the judge that any rescue scheme was not reasonably practicable, and, in circumstances where a company is balance sheet solvent, the administrator had a duty to have regard to members. The joint administrators had, Michael alleged, not adequately taken this into account in their decision. The joint administrators said they were bound by the statutory scheme and the priority of the rescue objective under paragraph 3, schedule B1 of the Insolvency Act 1986. They were given a wide latitude, and the court should only intervene where their decision was made in bad faith or was so perverse no reasonable administrator could have thought it was practicable. Mrs Loveridge supported the administrators' position.

Michael's paragraph 74 application failed for a number of reasons. Firstly, a finding was made that it was contrary to the fair administration of justice for Michael to argue his interests as a member of the company were harmed in the insolvency proceedings. Michael had failed to engage at all in the family proceedings brought by Melinda Loveridge (seeking to reverse the ownership of his shares in Breton) to the extent that he was debarred from asserting a beneficial interest in Breton.

Administrators afforded wide latitude

HHJ Williams held that Michael lacked standing in circumstances where he had absented himself from the financial remedy proceedings and was pursuing the application "without any legitimate interests as a member for doing so, but rather in an attempt to pursue his interest as a prospective purchaser". Further, HHJ Williams held that if he was wrong on that point, he would still find that Michael was unable to establish that such a decision lacked commercial justification or was so perverse that no reasonable administrator could have reached the same decision.

The decision is a reminder to disgruntled members that… only if the administrators' thought process was either in bad faith or perverse would the court interfere

Michael's injunction application also failed because, while the judge was satisfied there was a reasonable issue to be tried in respect of Michael's unfair prejudice claims, he found that damages would be an adequate remedy to compensate him should he establish those claims, given that an adjustment in share price could be made to account for the alleged prejudice.

Notably, the judge considered the views of not only the current members but also those who would be directly affected by any rescue or sale of the company

As reported in a previous edition of *Recovery*[2], the decision is a reminder to disgruntled members that administrators are afforded a wide latitude in their decision making, especially where they are bound by a mandatory legislative scheme. To bring an application in the guise of a member but pursuing interests in a different capacity risks issues of standing. Further, only if the administrators' thought process was either in bad faith or perverse would the court interfere – a reminder that a judge will not subvert an administrator's decision for their own unless a complete lack of commercial justification can be shown.

The case is also of interest given the intertwined nature of the insolvency proceedings acting independently of the family court proceedings, which could reverse ownership of Breton's shares. Notably, the judge considered the views of not only the current members but also those who would be directly affected by any rescue or sale of the company in the event that the family application is successful. This stresses the importance of engaging in multiple proceedings even if they exist within different forums to ensure there is unity in the approach being adopted. Failure to do so can later create difficulties in the future limiting the options available.

Stephen Rome and Georgia Morris previously acted for Mrs Loveridge on a number of company, partnership and insolvency proceedings prior to their current roles.

1 *Loveridge and others v Loveridge* (No 1) [2020] EWCA Civ 1104 and *Loveridge and another v Loveridge* (No 2) [2021] EWCA Civ 1697

2 Office-holder discretion restored in 'legal return to common sense', *Recovery* magazine, Winter 2023, page 10.

Georgia Morris is an associate at Gowling WLG and **Stephen Rome** is a partner at Penningtons Manches Cooper

IPs must obtain online access for industry tax scheme

With large fines quickly accumulating, navigating the construction industry scheme presents special challenges in insolvency, says **Margaret Corbally**

Construction companies are subject to an additional tax withholding regime called the construction industry scheme (CIS) which carries stringent compliance obligations and the risk of substantial penalties for errors. Therefore, IPs should take particular care when considering an appointment in this sector. But what is the CIS, and how can an IP navigate it?

Broadly, the CIS applies to businesses operating in the construction industry in the UK, but the scope is wide-ranging and can apply to non-construction companies too. Its purpose is to reduce tax evasion and make sure that tax on payments to subcontractors is properly accounted for and paid to HMRC. This article focuses on the implications of CIS for companies, but it can apply to unincorporated businesses too, for example, partnerships and sole traders.

> **HMRC periodically reviews companies' GPS status, so if the insolvent company is reviewed, it is likely to fail these conditions and the insolvency is unlikely to be a valid excuse under tax law**

Entities subject to the CIS are either contractors, subcontractors, or both, and each has different obligations. It is important to note that even where a company has ceased to trade, the CIS still applies to payments made in respect of construction operations (which are broadly defined in the tax legislation). CIS therefore needs to be considered in all construction insolvencies.

The operation of CIS

Contractors must pay their subcontractors in accordance with the subcontractor's CIS status, as instructed by HMRC. An unregistered subcontractor must be paid under a tax deduction rate of 30%. A registered subcontractor can have either 20% deducted, or nil if they have gross payment status (GPS). GPS is granted by HMRC where a subcontractor meets various conditions; generally, when the business has received sufficient turnover and is up to date with its tax filings and payments for all taxes.

Contractors must file monthly online returns detailing all CIS payments made to subcontractors that month and pay the tax withheld to HMRC

Any tax withheld from payments is set against the subcontractor's PAYE liability, and at the end of the tax year any surplus tax withheld can be repaid by HMRC. Contractors must file monthly online returns to HMRC detailing all CIS payments made to subcontractors that month and pay the tax withheld to HMRC. This is usually administered via the PAYE scheme and can be set against any CIS suffered if they are also a subcontractor.

> **If the only payments subject to CIS are likely to be those made to creditors towards the end of the insolvency, the account can be marked inactive for six months at a time. This is a good alternative to closing the scheme or having to file nil returns every month**

HMRC can charge penalties for incorrect/late returns and withholding failures. In addition, failing to withhold can result in the contractor being liable for the withholding tax, so large fines can quickly accumulate.

Accessing accounts

If trading, CIS should operate as normal. If trading has ceased, then for a subcontractor CIS is likely to apply to book debt recoveries, and for a contractor it could apply to payments to creditors. There are a number of practical issues an IP needs to consider.

CIS and PAYE are operated online, so the IP will need access to these accounts in order to make monthly returns for a contractor and/or seek repayments for a subcontractor. Getting online access can be tricky and will take time. Technically the IP should create their own online registration as the company, but as a company can only have one online registration at a time, that first requires HMRC to close down the existing account. An alternative is to take over the existing account, but this involves being granted access by the relevant person at the company. The IP could register as the company's agent, which while often the easiest route to take is not correct as under tax law – the IP is the company's proper officer, not its agent. As HMRC looks to do more digitally, I am working with HMRC to improve the process for IPs getting online access to a company's records across all heads of tax.

Gross payment status

If the subcontractor has GPS, an IP will need to appeal against any attempt by HMRC to remove it. An insolvent company will almost certainly have outstanding tax returns and liabilities, thereby failing the conditions for GPS. HMRC periodically reviews companies' GPS status, so if the insolvent company is reviewed, it is likely to fail these conditions and the insolvency is unlikely to be a valid excuse under tax law. However, HMRC can exercise discretion when removing a company's GPS. As an insolvent company that is not trading, the risk to HMRC of non-payment of post-insolvency tax is low, and there are administrative benefits to both HMRC and the IP of the company continuing to receive payments gross. It is therefore worth appealing to HMRC's on those grounds.

If tax has been withheld, it is possible for it to be recovered. IPs appointed over subcontractors should be eligible to make an in-year repayment request rather than wait for the end of the tax year. The tax is recovered through a real-time information submission and therefore requires online access and an open PAYE scheme. Does the IP have both of those?

Filings and distributions

If trading and paying subcontractors, then monthly returns should be filed by the contractor, even if some months are nil returns. However, if the only payments subject to CIS are likely to be those made to creditors towards the end of the insolvency, the account can be marked inactive for six months at a time. This is a good alternative to closing the scheme or having to file nil returns every month.

Before making any payment or distributions to creditors, the recipient's CIS status needs to be verified, which is usually done via HMRC online. Once online access has been obtained, time (and budget) needs to be factored into the distribution process to run these checks, including obtaining the relevant additional information from the subcontractors, calculating the required withholding rate for each payment, filing the return and paying the tax to HMRC. Does the IP's receipts-and-payments software allow them to withhold the tax, or does it all have to be done manually? With incorrect payments and returns attracting penalties, getting the process wrong could be very expensive. As mentioned above, if the correct amount of tax is not withheld, the contractor becomes liable for it, plus penalties and interest. With all funds distributed, how is this to be settled?

> **HMRC has been asked to automatically close the company's online CIS account upon insolvency so that the IP can take control of the process, and to take a practical approach to the issuance of penalties to insolvent companies in the first few months**

For pre-appointment liabilities, unpaid pre-appointment CIS deductions form part of HMRC's secondary preferential claim.

Review of scheme

HMRC has recently consulted on simplifying the operation of CIS and has stated that it is considering the points raised around simplifying its operation in an insolvency. On the basis of the low risk of non-payment of tax, the proposal to HMRC is that it automatically gives GPS to all subcontractors in administration or liquidation. In addition, due to the practical issues around getting online access and the impact that has on the ability to make the relevant filings, HMRC has been asked to automatically close the company's online CIS account upon insolvency so that the IP can take control of the process, and to take a practical approach to the issuance of penalties to insolvent companies in the first few months of its insolvency. While it is good that HMRC is considering these proposals, any changes are unlikely to happen quickly.

In the meantime, as a tax which is administered online, the biggest practical issue for IPs is getting online access. Once in, the next challenge is knowing what needs to be reported, or not. When taking an appointment over a company in the construction sector, I would recommend, ideally as part of the insolvency planning process, seeking tax advice on how to safely navigate the CIS rules.

Margaret Corbally is a tax director at Grant Thornton

Protection may be triggered beyond just regulated firms

If there are phoenixing concerns or multiple complaints about a firm, the FSCS may be able to support the insolvency process, say **Guy Enright** and **Cecile Looseley**

In April, the Insolvency Service released figures[1] that showed that insolvencies in England and Wales remained well above pre-pandemic levels, after reaching a 30-year high in 2023, with all large industry sectors impacted. For eligible customers of UK-regulated financial services firms it will be reassuring to know that if their financial provider goes out of business, the Financial Services Compensation Scheme (FSCS) is here to help and may be able to protect their money, typically up to a compensation limit of £85,000.

Perhaps best known for protecting deposits and savings in banks, building societies and credit unions, FSCS protection covers a much broader range of financial products including investments, pensions, insurance, funeral plans, financial advice and more[2]. Our service is completely free to customers who claim directly with us, and is funded through a levy paid by authorised financial firms.

> Gathering evidence and data from third parties is vital to our investigations but can take some time, particularly for complex claims such as those involving pension transfers, fraud, Sipp operators, or non-standard investments

In support of our regulatory partners, the FSCS helps minimise the impact of disorderly firm failures by protecting consumers from serious financial harm and promoting financial stability. To do this, we work closely with IPs appointed over regulated firms to investigate redress claims as quickly as possible and to recover the costs of any compensation that may arise.

IPs need to maintain compliance

To uphold a claim, we need to be satisfied that requirements are met for a protected claim defined by the FCA handbook's Comp rules[3]. Gathering evidence and data from third parties is vital to our investigations but can take some time, particularly for complex claims such as those involving pension transfers, fraud, Sipp operators, non-standard investments, or when it's unclear if requirements for a protected claim have been met.

Regulated firms that enter insolvency still have regulatory obligations and it is important for their appointed IPs to maintain compliance with these. The FCA has published helpful guidance for IPs[4] on how to approach regulated firms.

Where regulatory obligations relate to redress liabilities that may lead to claims with the FSCS, engaging with us early can help support an efficient insolvency and improve outcomes for customers. For example, coordinating communications with the FSCS to customers who may be eligible for compensation can help ensure all necessary information about FSCS protection is provided in a consistent way that supports customers to claim. In addition, sharing relevant datasets early can help the FSCS investigate its claims and can minimise the need for us to request information from third parties multiple times, which can prolong the time it takes for customers to receive compensation.

Data may identify phoenixing

Working with all partners in an insolvency can help ensure that the minority of bad actors in the system can be identified, helping to reduce consumer harm in the longer term, as well as reducing the cost of compensation and the FSCS levy on the wider industry. Concerns around phoenixing, where directors, shareholders or senior staff of a failed firm reappear in another guise to avoid liabilities or debts, or concerns about individuals who repeatedly set up non-standard investments that are at higher risk of failure, are also areas where early engagement with the FSCS can support IPs' considerations.

> High volumes of upheld claims against a failed firm can lead to the FSCS becoming one of the largest creditors in an insolvency

FCA guidance highlights that IPs should not facilitate phoenixing, for example when transferring client assets, and should inform the FCA promptly of any phoenixing concerns. The FSCS also collects data and insights from our claims that may help identify phoenixing concerns.

High volumes of upheld claims can often lead to the FSCS becoming one of the largest creditors in an insolvency

The FSCS is best known for protecting deposits and savings in banks, but it also covers a wide range of products including funeral plans, pensions and financial advice

£54 million recovered

If a failure triggers FSCS compensation, customers' legal rights in relation to their claims are transferred to us upon the payment of compensation. High volumes of upheld claims against a failed firm can lead to the FSCS becoming one of the largest creditors in an insolvency. Where creditor committees are established, the FSCS may be able to stand as a member, contributing to efficiencies that can help reduce costs to the insolvency.

> **"Increasingly, we are taking more complex recovery actions, sometimes spanning international jurisdictions where engagement with the relevant authorities and IPs in those regions may be required"**

Where reasonably possible and cost-effective to do so, the FSCS works to recover the costs of compensation, usually by making a claim in the firm's insolvency, and/or by pursuing recoveries against relevant third parties who may carry a legal responsibility for customers' losses e.g. professional indemnity insurers. Our recoveries work helps to reduce the cost of the levy on the financial services industry and hold those responsible for causing financial harm to account.

The recoveries team at the FSCS is committed to pursuing the best outcomes for our customers and levy payers. In the last financial year alone, we recovered more than £54 million relating to failed financial firms, helping to reduce the FSCS levy. We were able to pass on around £2 million of those funds as an additional recovery to customers who had lost more than the FSCS compensation limit when their providers failed.

Increasingly, we are taking more complex recovery actions, sometimes spanning international jurisdictions where engagement with the relevant authorities and IPs in those regions may be required. Actions over the last year have included recoveries secured through the insolvency of failed insurers based in Gibraltar, litigation in Denmark to ensure our claim in the insolvency of another failed insurer is suitably recognised, as well as pursuing recoveries relating to our interest in numerous high-risk, illiquid investments worldwide that customers have often been badly, or fraudulently, advised to enter into (usually as part of pension arrangements). We have also pursued recoveries through the sale of various asset types, including the recent successful sale of farmland in Western Australia.

Common signs for IPs to look for

While FSCS protection typically applies to UK-regulated financial services firms, we would encourage IPs to engage with us even when dealing with unregulated firms operating in this sphere. We regularly see the activities of unregulated firms impacting the claims we receive, in particular with firms who have raised capital through consumer investment vehicles, such as bonds or property investment schemes where customers were given unsuitable advice to invest in the products offered.

There are a few common signs that IPs can look out for which may suggest early engagement with the FSCS could be beneficial. High volumes of complaints submitted due to a firm's conduct or ongoing complaints made to the financial ombudsman may indicate that FSCS protection could be triggered once the firm fails. Director conduct that raises phoenixing concerns, as well as the existence of high-risk illiquid funds are also potential signals that FSCS engagement could support an insolvency.

At the FSCS, we are committed to working collaboratively with all partners involved in the insolvencies of both regulated financial firms and unregulated firms whose failures may trigger FSCS protection, so together we can ensure the best outcomes for customers and the financial services industry. If you would like to contact us about an insolvency you have been appointed to, reach out to FSCS by email at communications@fscs.org.uk.

1 The Insolvency Service, Company Insolvency Statistics, March 2024, published April 2024, www.gov.uk/government/statistics/company-insolvency-statistics-march-2024/commentary-company-insolvency-statistics-march-2024
2 For more information about FSCS protection visit www.fscs.org.uk/what-we-cover
3 www.handbook.fca.org.uk/handbook/comp
4 www.fca.org.uk/publication/finalised-guidance/fg21-4.pdf

Guy Enright is recoveries finance manager, and **Cecile Looseley** head of recoveries, at the Financial Services Compensation Scheme

HMRC tax stance complicates recoveries for close companies

Lengthy director negotiations become even more cumbersome when personal tax charges are triggered by section 455 repayments, says **Marcus Rea**

Under company law, unless approved by shareholders (with minor exceptions), loans to directors are unlawful. But assuming one is approved, which is clearly not particularly tricky in owner-managed businesses, a personal tax charge may arise on interest-free or low-interest loans and on any loan waivers. Meanwhile, from the company's tax perspective, where the loan is made to a 'participator' (broadly, a shareholder) in a close company, a tax charge arises on the company itself, which is recoverable in the event that the loan is repaid.

All of this may give IPs some practical issues if any directors' loans exist on the date of an appointment.

Beneficial loans

An income tax benefit-in-kind charge arises where a director or employee obtains a loan or any form of credit from their employer or a company under common control. It also applies to arranging, guaranteeing or in any way facilitating the continuation of an existing loan, just as it does to the making of a loan.

> **"Negotiating the repayment of the loan from a director will be complicated by their knowledge of the personal tax implications for themselves… a director will be taxed at a rate of up to 39.35% on any amount written-off"**

Broadly, if the loan outstanding is greater than £10,000 at any time during a year of assessment, the employee is liable for income tax, and will normally be collected via PAYE. The charge is based on the difference between the interest (if any) the individual pays and interest calculated by reference to an official rate prescribed by the Treasury (for the fiscal year 2023/24 this remains a modest 2.25%).

Loans to participators

However, importantly, where a close company makes a loan to a participator, the company itself is liable for tax (under s455 of the Corporation Tax Act 2010) currently at a rate of up to 33.75% of the loan for the period of accounts in which it is made. Effectively the loan is treated as if it were a dividend distribution to the participator, with the company obliged to withhold tax until the dividend unwinds by the loan being repaid.

Broadly, a participator is a shareholder (or certain other person with an interest) in a close company, generally with a minimum 5% stake, and broadly, a close company is one under the control of five or fewer participators or one which is controlled by its directors.

The tax is due from the company nine months after the end of the relevant accounting period. If the loan itself is repaid after the period end but before the tax is due, then no charge arises.

If the loan is repaid, released or written-off at a later date, the s455 tax is repaid to the company. If only part of the loan is repaid etc, then a pro-rata share of the tax is repaid. According to statute, repayment of the s455 tax is not to be made until nine months after the end of the period in which the loan is repaid.

The company is unlikely to get a tax deduction for any write-off of a director's loan, but this position is worth further consideration based on specific circumstances.

Meanwhile, the individual borrowing director is treated and taxed as receiving a dividend of the amount written off. The dividend treatment takes precedence over treating the write-off as remuneration for a director. However, to avoid a national insurance charge, the write-off would instead need to be a formal deed of release that has been documented by shareholders and agreed to be by reason of the director's status as one of those shareholders.

The issues for an IP

If a loan has been made to a director and is still outstanding at the time of an IP's appointment a handful of issues arise.

If the loan was recently made and no s455 tax has been paid to HMRC, then the tax will rank as an unsecured creditor in the insolvent estate. The scenario where a director is lent money might seem less likely if the appointment of an IP were imminent, but it might arise where, for instance, owner-managers are lent funds from a company throughout a year to be repaid via a dividend distribution post-year-end.

Almost by definition the loan will either be repaid or written-off as part of the insolvency process (or perhaps wither on the vine as a company is finally dissolved) and therefore the s455 tax should be recoverable at some point during the process. We are currently therefore in conversation with HMRC about not including the s455 tax that is theoretically due at the date of appointment in their proof of debt, given that the liability should reverse.

> "An IP will need to weigh up the value of the s455 tax to be refunded against the costs of keeping an insolvency open for a further nine or more months"

As an aside, if the loan was very recently made and any payroll tax on a beneficial loan had not been paid to HMRC, then this would rank as a secondary preferred creditor in the insolvent estate.

If the loan was made some time ago and s455 tax has been paid to HMRC, then that tax is a potential asset of the insolvent estate (again, given that the loan will either be repaid or written-off). However, negotiating the repayment of the loan from a director will be complicated by their knowledge of the personal tax implications for themselves. While still arguably better from their perspective than repaying the debt in full, a director will be taxed at a rate of up to 39.35%[1] on any amount written off and, assuming he or she is properly aware of the implications, is likely to factor this into any negotiation on repayment.

HMRC's position

The R3 Business Tax Working Group thought we had persuaded HMRC that a decision by an IP not to pursue a debt from a director (i.e. as opposed to a write-off or a release) ought to be sufficient to enable any s455 tax to be repaid without triggering a tax charge on the individual.

> "Like in so many other areas, the interaction of insolvency and tax laws doesn't work particularly smoothly"

HMRC's recollection differs. It seems to have accepted this view in terms of the s455 repayment. However, it is also of the view that this can only be as it is equivalent to a write-off and triggers a personal tax charge.

To the working group there is clearly a difference because in the, admittedly unlikely, hypothetical scenario where a director were to win the lottery, the IP might reverse their decision that the debt was irrecoverable and the debt would still be capable of being collected. And the IP, having neither written-off nor released the debt, may enable a director to argue that no income tax is crystallised on a deemed distribution. Whether that argument would remain sustainable for a director if the debt had not been repaid after the ultimate dissolution of the company is clearly debatable.

A claim by the company (via its IP) to recovery of the s455 tax by reason of a write-off or release of the director's debt (or, according to the HMRC view, the decision by the IP not to pursue the debt) apparently automatically triggers a 'nudge' notice being sent to the director from HMRC reminding them that income tax will now be due with the expectation that it be included in their self-assessment return. Therefore, even if a director was not aware of the personal

tax implications during the negotiation on repayment of a debt, they soon will be.

However, as noted, the s455 tax is not repayable by HMRC until nine months after the end of the relevant period of account. It may be possible to foreshorten an accounting period to accelerate repayment, but an IP will need to weigh up the value of the s455 tax to be refunded against the costs of keeping an insolvency open for a further nine or more months. This is especially true given that it is rare for any negotiation about recovery of a loan from directors to be a quick exercise and therefore the insolvency may already have been running for some time and have already been extended.

It is unfortunately not possible to assign the benefit of the s455 tax refund to another party. HMRC's view is that its hands are tied as the refund timeframe is statutorily prescribed. Hence it is sadly not uncommon for the tax refund to be foregone rather than incur the additional costs.

In short, like in so many other areas, the interaction of insolvency and tax laws does not work particularly smoothly. Recovery of directors' loans can be an emotive topic and the tax implications are unlikely to make those conversations easier.

1 For an additional rate taxpayer. 8.75% for a basic rate taxpayer and 33.75% for a higher rate taxpayer.

Marcus Rea is a senior managing director at Teneo and chair of the R3 Business Tax Working Group

Income-generating assets issue left unresolved by *Avanti* judgment

IPs should be cautious when using established tests to determine whether an asset can be subject to a fixed charge under the limited value exception, says **Doug Robertson**

Re Avanti Communications Limited[1] is the most recent decision on the long-running issue as to whether a charge is fixed or floating, but has potentially created a conceptual problem where again you can have a fixed charge over an asset with no control over its proceeds.

The case is interesting as it is, but it is also the first case which has sought to add nuance to the judgement in *Re Spectrum Plus Ltd*[2].

Avanti involved a group of companies which dealt with the wholesale sale and supply of satellites and satellite capacity. At first glance, the case is a move away from the principle that full control over an asset is essential for a charge to be fixed. But is it really?

> **The limited value exception allows income-generating assets with a fair value of less than £2 million to be disposed of**

This article will look in a little more depth at the 'limited value exception' in the example of a Ferris wheel and whether there is a confusion between the classification of the tickets and the ride itself. The findings may mean that there is a flaw in the reasoning in this part of the Avanti judgement and that IPs should be cautious about moving away from the control tests as set out in *Spectrum* whereby, for an asset to be subject to a fixed charge, the chargee has to have absolute control over its disposal and sale proceeds.

Case summary

There have been several articles and cases summarising the *Avanti* decision but, in the round, where the group of companies sought to sell income-generating assets (as distinct from stock), the judge found that in very limited circumstances the assets could still be subject to a fixed charge.

The reason for this was that there is a general prohibition on dealing with the assets subject to four limited exceptions. The exceptions are:

1. The limited value exception;
2. The capacity exception;
3. The obsolete and usefulness exception; and
4. The licence exception.

The focus of this piece is on the limited value exception. The limited value exception allows income-generating assets with a fair value of less than £2 million to be disposed of in two different ways. If the value is between £1-2 million, then there are strict stipulations as to what is to happen with the proceeds of sale. However, where the value is less than £1 million, the asset can be sold with no restrictions on the proceeds of sale.

> **Any attempt in the present context to separate the ownership of debt from the ownership of their proceeds (even if conceptually possible) makes no commercial sense**

The judgment

The judge still held that those assets could be subject to a fixed charge regardless of the level of control over the proceeds. In the judgment, he referred to the case of *Arthur D Little Ltd (In Administration) v Ableco Finance LLC* [2002] EWHC 701 (Ch) [2002] 3 W.L.R. 1387 and commentary by Goode and Gullifer, in particular quoting the following: "The position is less clear where the charge is over an income-generating asset. Where the asset is clearly separate from the income generated, for example, a chattel which could be hired out, control of the income is not required for a fixed charge over the asset itself. It is a matter of construction of the fixed charge as to whether it is over the asset itself or over the lease by which the asset is hired out. If it is over the former alone, there is no need for a charge to control any rental income."

The judge then went on to quote the Privy Council's position in *Agnew v Commissioners of Inland Revenue*[3]: "While a debt and its proceeds are two separate assets, however, the latter are merely the traceable proceeds of the former and represent its entire value. A debt is a receivable, it is merely a right to receive payment from the debtor. Such a right cannot be enjoyed in specie, its value can be exploited only by exercising the right or by assigning it for value to a third party. An assignment or charge of a receivable which does not carry with it a right to the receipt has no value. It is worthless as a security. Any attempt in the present context to separate the ownership of debt from the ownership of their proceeds (even if conceptually possible) makes no commercial sense."

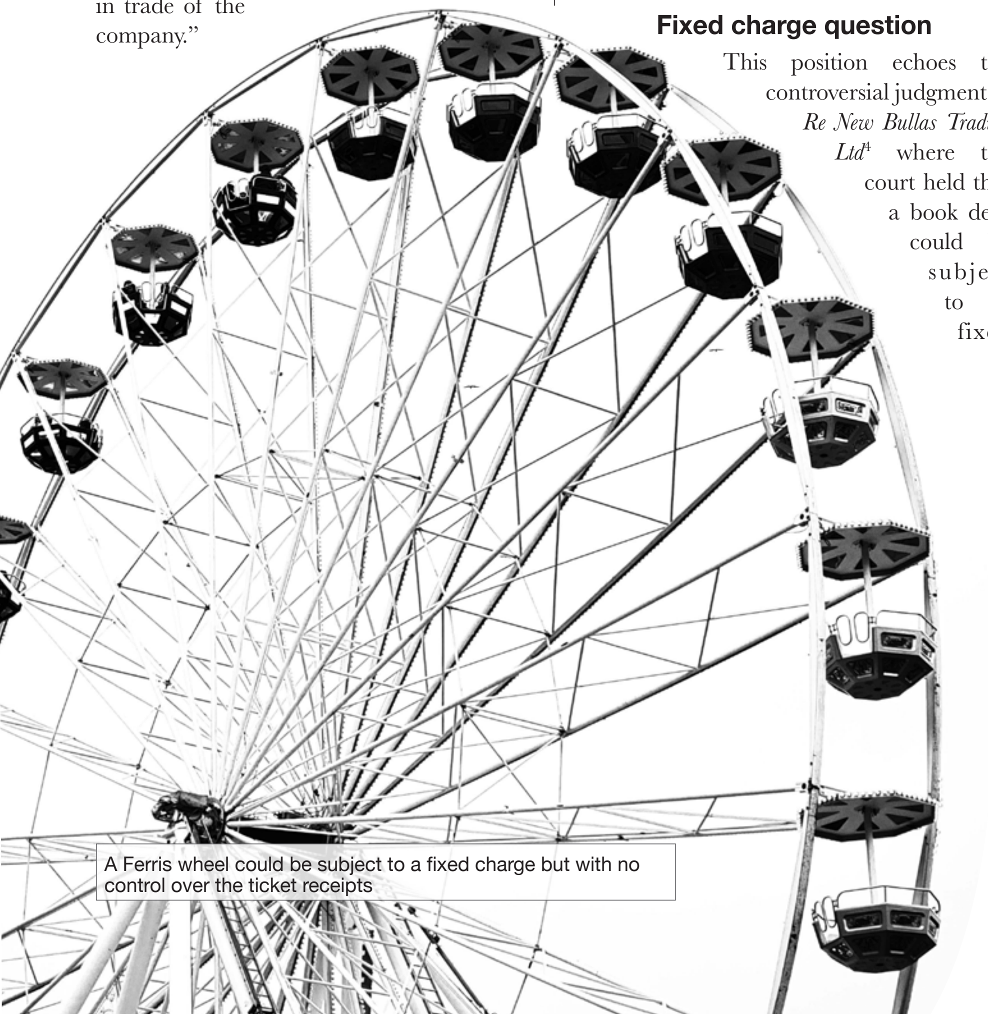
The judge concludes that the problem did not seem to arise with *Avanti*, due to relevant assets being income generating. He acknowledged that the assets could have been the subject of a fixed charge, saying: "They were income-generating assets of the company, which were not themselves part of the circulating capital or fluctuating assets or circulating stock in trade of the company."

"I anticipate *Avanti* will need to be treated with caution in respect of the findings with regards to the 'limited value exception'"

The judge has concluded that when dealing with income-generating assets as distinct from stock or other fluctuating assets, you do not have the same issues that arise when a book debt is collected. Namely, that you need to have control of the proceeds as well as the asset itself.

We can follow the judge's analysis using the fairground example. A Ferris wheel could be subject to a fixed charge but with no control over the ticket receipts. This is uncontroversial and is entirely consistent with *Spectrum*.

However, following *Avanti*, in this case, the Ferris wheel itself appears to be able to be subject to a fixed charge but, provided it is sold for less than £1m, there would be no control over its proceeds. This would mean that the fixed charge was defeasible (cancelled or changed) solely at the instance of the chargor and, referring back to Goode and Gullifer, is inconsistent as a fixed charge.



A Ferris wheel could be subject to a fixed charge but with no control over the ticket receipts

Fixed charge question

This position echoes the controversial judgment in *Re New Bullas Trading Ltd*[4] where the court held that a book debt could be subject to a fixed charge but its proceeds subject to a floating charge. The case was subject to much academic discussion and, ultimately, the conclusion was reached that you could not have a book debt subject to a fixed charge and receipts subject to a floating charge. The charge, as created, must have been floating because there was insufficient control — it could be defeated at the instance of the chargor by collecting the debt.

By way of a further illustration, if a liquidator is appointed over a company that leases out generators, each worth £750,000, the post-*Spectrum* position was that there had to be sufficient control retained by the chargee for there to be a fixed charge, such as chattel mortgage, prohibition on dealing or asset stamp. Where dealings have taken place, previous proceeds have been paid to the chargee or into a blocked account with the chargee having appropriate control.

However, if *Avanti* is followed and a similar charge granted, regardless of there being no chattel mortgage, asset stamp or absolute prohibition on dealing etc, the company would not only be able to retain its lease income if it sold the generators, it would also be able to retain the proceeds of sale from the generators themselves – even if the sale was not in the ordinary course of business – and this would be a fixed charge, which appears inconsistent with the *Spectrum* control tests.

It appears that the judge on the one hand has distinguished between book debts and income-generating assets. On the other hand, in saying "the proceeds of the sale from an income-generating asset do not need to be subject to sufficient control" the judge has created a conceptual problem that was discussed in *Re New Bullas Trading Ltd* – that you can have a fixed charge over an asset with no control over its proceeds, regardless of whether or not it is a revolving asset used in the ordinary course of business or an income-generating asset.

For this reason, I anticipate *Avanti* will need to be treated with caution in respect of the findings with regards to the 'limited value exception'.

1 [2023] EWHC 940 (Ch)
2 [2005] UKHL 41
3 (also known as Re Brumark Investments Ltd) [2001] UKPC 28
4 [1994] 1 BCLC 485

Doug Robertson is a partner at Irwin Mitchell

Building bridges after the Budget

R3's president's lunch discussed the changing role of the chancellor's report, while R3's view on rogue directors resonated with Spotlight on Corruption, says **Amelia Franklin**

In the last issue of *Recovery* we mentioned plans for R3's annual President's Lunch and I'm pleased to say that the event was a resounding success!

Held on 11 March at the Cinnamon Club in Westminster, nine MPs and Peers, accompanied by R3 president Nicky Fisher and 11 other senior members of R3, came together to break bread, swap insights on the economic landscape, and see R3 demonstrate the value of the work done by the profession.

With corporate insolvencies at a 30-year high in 2023, discussions around the table focused on the questions of why so many businesses faced difficulties last year, how we can ensure that directors and business owners are well-informed of the first signs of financial distress and how to encourage them to seek early advice when those signs present themselves.

> **Interesting points from the future of the profession survey were that respondees felt that technology, talent and regulation were likely to be the biggest drivers of change over the next five years**

The upcoming general election was fresh on everybody's minds and attendees discussed how the potential change in Government could affect the economy and the insolvency profession.

We were also joined by Ben Chu, economics editor of BBC *Newsnight* who served up some food for thought on the current economic outlook in his keynote speech. With the ink still fresh on the spring Budget, the session focused on the changing role of the Budget, and highlighted how the format of its release has evolved over time, with much of it now leaked well in advance.

Thank you to everyone who attended the lunch, and to Ben Chu for his thought-provoking insights.

Changes to DROs

On the topic of the March Budget, the chancellor announced some changes to the monetary thresholds for DROs.

> **The Spotlight on Corruption report mentions R3 directly, highlighting our view that director disqualification alone is not a strong enough deterrent to prevent rogue directors from committing repeat frauds**

The £90 DRO administration fee was removed on 6 April. We will be keeping a close eye on the personal insolvency statistics from the Insolvency Service to see how this change is reflected in the data.

The Government also announced that, from 28 June 2024, the total amount of debt that can be covered by a DRO will increase from £30,000 to £50,000 and that the maximum value of a motor vehicle that an individual can retain will rise from £2000 to £4000. We are waiting to see whether the vehicle value threshold change will be adopted by the Official Receiver for bankruptcies in future.

Digging into data

Though last Christmas feels like a distant memory, you may remember completing a member survey over the festive period. The survey sought to understand how members consider that the insolvency and restructuring profession has evolved since the introduction of the Insolvency Act 1986, what opportunities and challenges currently face the profession, and how changing legislation could impact IPs.

Interesting points from the survey were that respondees felt that technology, talent and regulation were likely to be the biggest drivers of change over the next five years.

We showcased some of the results of the survey at the Annual Conference in St Andrews in May – and a full future of the profession report will be published shortly.

Director disqualification discussion

Back in February we were pleased to see R3 mentioned in a report from the anti-corruption charity, Spotlight on Corruption. The report was titled 'Power without responsibility: The state of senior executive accountability for economic crime in the UK today'.

The report mentions R3 directly, highlighting our view that director disqualification alone is not a strong enough deterrent to prevent rogue directors from committing repeat frauds.

It also includes our recommendation that disqualifications should be just the first step in tackling rogue directors, and that the deterrent should be accompanied by prosecutions and the recovery of misappropriated assets.

Following the release of the report, our team headed to Westminster for a panel session hosted by the APPG on Anti-Corruption and Responsible Tax. The session invited the panel to share their views on whistleblowing and how senior executives can be held to account for corporate wrongdoing, and included lessons learned from the Post Office scandal.

Engaging with the media

Media interest in the profession remained high in Q1. Our comments on corporate and personal insolvency statistics from the Insolvency Service have been quoted in 26 articles in national titles, including *The Times*, *The Guardian*, *The Sun*, the *Financial Times* and more.

R3's analysis of business trends data has also been popular, with stories highlighting a rise in start-ups in Scotland, Yorkshire and Northern Ireland gaining coverage in *The Sun*, *The Yorkshire Post* and *The Irish News*.

News of Tim Sloggett's appointment as R3 chair in the South West and Wales picked up coverage in titles including *The Business Desk*, *Business News Wales* and *Bristol Business News*, while Kelly Jordan's appointment as chair of R3 in the North East featured in publications including *Insider*, *Business Live* and *The Journal*.

Amelia Franklin is campaigns and communications executive at R3

R3 Events

Gaining insights, making connections

R3 & INSOL Europe Restructuring Conference

27 June
London

R3 Business Lunch

4 October
London

R3 SPG Forum

6-8 November
West Midlands

...and some future dates for your diary

South West & Wales Dinner
12 September
Bristol

Northern Forum
19 September
Durham

Eastern Forum
26 September
Norwich

Scotland Annual Dinner
10 October
Glasgow

To view the full range of R3 networking events and conferences please visit **www.r3.org.uk/events-training** or for more information including sponsorship opportunities contact **events@r3.org.uk**.

R3 contacts

Executive

Caroline Sumner Chief executive officer
T 020 7566 4207
E caroline.sumner@r3.org.uk

Technical

Ben Luxford Head of technical
T 020 7566 4218
E ben.luxford@r3.org.uk

Moira Fitzpatrick Technical manager
T 020 7566 4210
E moira.fitzpatrick@r3.org.uk

Training Academy

Robert Beer Head of training
T 020 7566 4215
E robert.beer@r3.org.uk

Alexander Carver Training coordinator
T 020 3869 1035
E alexander.carver@r3.org.uk

Miya Hukins Training executive
T 020 7566 4229
E miya.hukins@r3.org.uk

External Affairs

Stuart McBride Senior communications manager
T 020 7566 4214
E stuart.mcbride@r3.org.uk

Amelia Franklin Campaigns and communications executive
T 020 7566 4203
E amelia.franklin@r3.org.uk

Lyle Horne Public affairs and policy officer
T 020 7566 4202
E lyle.horne@r3.org.uk

Membership

Andrew Heffernan Head of member services
T 020 3869 1034
E andrew.heffernan@r3.org.uk

Freddie Webster Senior member engagement executive
T 020 7566 4230
E freddie.webster@r3.org.uk

Shemin Varma Senior membership officer
T 020 7566 4211
E shemin.varma@r3.org.uk

Events

Nicola Pogson Senior events manager
T 020 3987 9918
E nicola.pogson@r3.org.uk

Mercedes Lopez Senior events organiser
T 020 7566 4236
E mercedes.lopez@r3.org.uk

Lottie Condron Events organiser
T 020 7566 4233
E lottie.condron@r3.org.uk

Richard Broekman Events organiser
T 020 3989 8774
E richard.broekman@r3.org.uk

Marketing

Neill Howard Marketing manager
T 020 7566 4219
E neill.howard@r3.org.uk

Ella Curle Marketing executive
T 020 7566 4209
E ella.curle@r3.org.uk

Office

Harvinder Kular Head of finance & operations
T 020 7566 4213
E harvinder.kular@r3.org.uk

Zuzana Kyselova Accountant
T 020 7566 4226
E zuzana.kyselova@r3.org.uk

Fiona Connor Office and finance assistant
T 020 7566 4231
E fiona.connor@r3.org.uk

R3 Association of Business Recovery Professionals

3rd Floor (East), Clerkenwell House,
67 Clerkenwell Road, London EC1R 5BL
T 020 7566 4200
E association@r3.org.uk
www.r3.org.uk

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Introducing R3's new president: an interview with Tim Cooper

Nearly three decades of service to the profession have prepared president **Tim Cooper** to take office. He tells *Recovery* about his big plans for his year-long term of office

"When I hand the chain of office over to my successor [R3 vice president Tom Russell], I want to know I've done everything I possibly can to champion R3 and the profession, and ensure that both are as widely understood, recognised and valued as possible, " says Tim.

Tim's passion for the world of insolvency and restructuring is born out of a near 30-year career in the profession – one which has seen him support a range of high-profile clients including Leeds United Football Club, The Scottish Coal Company, paper manufacturer Arjowiggins, and pulp producer OSO Fiber UK.

"I've only ever worked in insolvency and restructuring, and I've seen the great work the profession does for nearly three decades, so it's a real honour to lead its representative body and stand up for the profession that has given me a living, given me a career and that I've hugely enjoyed working with, in and for, " Tim adds.

> **Insolvency practitioners are the NHS of the economy – they're the rescue service**

His legal career began at sole practitioner John AB Ridley following his LLM in public international law at Edinburgh and a brief spell working in wholesale import and export. After qualifying, he worked in Leeds for Dibb Lupton Allsop (as then was) and then Hammonds (as then was), before moving to his first role as a partner in their Manchester office. Tim moved to HBJ Gately in Scotland in early 2012, which then merged with Addleshaw Goddard in 2017.

In his current role, Tim acts on UK-wide corporate restructuring and insolvency, and leads Addleshaw Goddard's insolvency dispute resolution workstream nationally as a dual-qualified lawyer across England and Wales and Scotland.

And, of course, he has been heavily involved with R3 for a number of years, having been a member for most of his career before chairing R3 in Scotland and, more recently, the Regional Communications Committee. He has also served as a member of R3's Scottish Technical Committee (STC) and the R3 Council.

Tim says: "I've supported most areas of R3's work over the years – from helping plan and deliver events in Scotland through to looking at the detailed aspects of legislation on the STC, and the strategic side of R3 through my involvement with the Council.

"This meant that when I put my name forward for the presidency, I had a very clear idea of what I wanted to do and where I felt I could make the biggest contribution."

Five points, clear priorities

Tim's clear idea for his presidency has been codified into a five-point presidential agenda setting out priorities for his term of office. Top of the list is highlighting the value of the work of the profession to the UK through demonstrating the social and economic impact of its work. Tim says: "This is about doing high-quality thought leadership work to really showcase and help people outside the profession realise just how much the work we do benefits people, society and the economy.

"Insolvency practitioners are the NHS of the economy – they're the rescue service. I'm keen that, as well as continuing to highlight the importance of early engagement with the profession and the benefits of doing so, we help people understand the value we deliver to clients, supply chains and the wider economy."

Another key priority, he says, is advocating for the profession as a career choice, and looking to build on R3's work with the Insolvency Service in the area of equity, diversity and inclusion.

"Insolvency and restructuring will always face competition for talent, and if we can promote the profession as a career option to people who are thinking about their next steps after GCSEs, A levels and university, we'll stand a much better chance of attracting as high a calibre of new entrants as possible, " he explains.

International opportunities

Tim's desire to champion the profession does not stop at the UK's borders – he is keen to be a part of global insolvency and restructuring debates as well. He is aware the UK has been sliding down the World Bank's 'doing business' rankings in recent years and is facing challenges when it comes to cross-border work as a result of Brexit.

"The UK's insolvency and restructuring framework is still well-regarded globally – and there's good reason for that. We do some great work, both in the UK and other jurisdictions across the world. Many UK practitioners find themselves working in foreign jurisdictions because of their skill sets, their expertise and ability, which is well respected, " he says.

"We've been through years of seismic changes here in the UK, especially in the last four or five years, but the profession has continued to adapt and evolve to be able to support the businesses and people who need our skills"

"There are massive career opportunities for practitioners who qualify and build themselves within the UK to spread their wings and go out and take on those opportunities, and I want to make sure that the great work done by the profession in the UK is recognised as far and wide as possible."

Promoting the next generation

As well as future entrants to the profession, one thing Tim is keen to do is promote the up-and-coming talent in insolvency and restructuring. This was the driving force behind the 'Class of 2024' initiative that was part of the 2024 R3 Annual Conference, which saw 10 emerging talents from the profession speak about a range of personal and technical issues.

This initiative was sparked by a conversation with one of Tim's former mentors, Richard Obank, who had been part of a similar initiative in 2000, and Louise Durkan, who was then the chair of R3's New Professionals Committee.

He explains: "When I spoke to Richard it struck me how some of the real luminaries of the profession came from that class of 2000, and when I thought about that and how keen Louise – and everyone at R3 – was to get more of the emerging talent from the profession not just attending, but contributing to, the Conference, I thought this was the perfect way to do it."

What struck him most, he says, was just how forward-looking some of the speakers were: "One of the Class of 2024 spoke about the key skills of restructuring professionals which make us, as people and a profession, ideally suited to adapt to change. We've been through years of seismic changes here in the UK, especially in the last four or five years, but the profession has continued to adapt and evolve to be able to support the businesses and people who need our skills."

A year of change

Change and challenge have been a theme for a number of R3 presidents over the years. Recent incumbents have faced Brexit, the Covid-19 pandemic, multiple prime ministers and a cost-of-living crisis, but Tim's term is particularly interesting as it will span a period of serious geopolitical change, with more than 50 countries going to the polls this year.

"That's going to have a serious impact both here and abroad, and consequently on the profession, " he says. "I can't speculate

about what it means for other jurisdictions, but here in the UK we're going into a general election with the future of a number of key policy areas very uncertain, whichever government we get."

Maintaining the work R3 has already done on the Government's proposed changes to the insolvency framework is another key priority for Tim's presidency. The most contentious point of the current Government's plans was the proposal to introduce a 'redress and compensation scheme' targeted at IP misconduct – something R3 has been campaigning against since it was first proposed, Tim says: "We understand what the Government is trying to do with this, but there's a real and serious risk it could lead to something akin to the PPI industry, and that will have serious consequences for firms, for clients and creditors and potentially for the UK's national and international reputation for having an effective insolvency framework and profession.

> **The restructuring plan process is currently inaccessible to the kind of businesses that make up a huge percentage of the UK's economy, but it could be a game-changer for them and for business rescue**

"These are points we need to stress now so that when the new Government is formed they understand the potential consequences of it – maybe then they'll reconsider whether it achieves their intended aims."

Another key area R3 is keeping a close eye on is the adoption of restructuring plans as feedback from the profession is that the process is not working for smaller businesses.

Tim says it's a challenge that can be overcome: "Another of our Class of 2024 spoke passionately about this at the Conference, and I really agree, we need something that works for SMEs. It's an intricate issue – the process is currently inaccessible to the kind of businesses that make up a huge percentage of the UK's economy, but it could be a game-changer for them and for business rescue if this issue could be overcome.

"We need to find a way of making the costs of developing the proposals work for the IP and for the client, while ensuring the documents themselves go into enough detail to satisfy creditors. There's an appetite from the courts for this solution – we just need the right opportunity to present itself."

> **If the current structure and process of qualification is not seen as conducive to that, then we need to look at what we can do to change that while preserving the very high standards the profession rightly demands**

Continual evolution

The final priority for Tim's presidency is looking at the route to qualification for insolvency practitioners, and he and R3 are keen to ensure that the current process remains in step with the changing needs of, and demands on, the profession. Tim says: "Pass rates for the JIEB exams have been low over many years, but it is the number of candidates that concerns me. While we absolutely don't want to water anything down, some member feedback suggests that the current process does not incentivise business owners and managers to invest in qualification in their talent pool at an early enough stage. This might be having an impact on staff retention, with some members telling us that this is often a factor in someone leaving the profession to go into another field.

"R3 has very strong links with the JIEB and we have the experiences and views of our members to inform our understanding as to what is behind both the pass numbers and the numbers of candidates coming forward.

"We want to see the profession promote their talent and rising stars, to invest in the future of the profession and keep them within the profession once they get through the exam and licensing process. If the current structure and process of qualification is not seen as conducive to that, then we need to look at what we can do to change that while preserving the very high standards the profession rightly demands."

The place to be

A final, but critical, point Tim is keen to stress is his desire – like previous holders of the presidency – to boost R3's membership numbers. He adds: "R3 has done a huge amount for me over my career – I can't think of a good reason why anyone shouldn't become a member of the Association and that's something I want to stress throughout my year in office.

"R3 is a very broad church in terms of membership, and the advantage of that is the fact we have a long history of bringing all parts of the profession together, and that we have something in our membership offering for everyone in the profession. It really is the place to be for anyone working in insolvency and restructuring – and I'll be saying that a lot over the next 12 months."

Tim Cooper biography

Age: 53

Lives: Edinburgh

Education:

School: Thomas Rotherham College, 1987-1989

University: University of Staffordshire, LLB (Hons), Law 1989-1992

University of Edinburgh, LLM, Public International Law, 1992-1993

Career:

1995-1997: John AB Ridley

1997-2004: Senior Associate, DLA Piper

2004-2008: Senior Associate, Hammonds

2008-2011: Partner, Squire, Sanders and Dempsey

2012-2017: Partner, HBJ Gateley

2017-present: Partner, Addleshaw Goddard

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