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Summer 2010

RECOVERY

Manufacturing

What's the future in these uncertain times?

The future shape of business
Future security requires a sustainable recovery

Tough trading conditions for manufacturers
What are the options?

PRC manufacturing: lessons for foreign investors
A new law could help creditors

Madoff and asset recovery issues
International issues are not plain sailing

A modern Greek tragedy
Will the economic cloud have a silver lining?

Interview Steven Law

Plus Legal update, Recent case summaries, Technical update and Legal Q&A.

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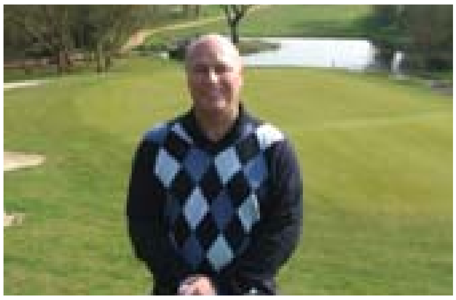
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Editorial

At the time of writing in early May, uncertainties abound. Politically, Gordon Brown presides over a caretaker government while Messrs Cameron and Clegg negotiate terms for co-operation. In consequence, the pound has suffered and there is nervous talk of the markets' response when they open on Monday. What's more, the Greek contagion threatening the other weak Eurozone economies has hit the euro (there's even talk of its collapse) as well as affecting the bond and stock markets more severely than many in the UK have yet recognised.

The unwelcome and unusual coincidence of these events threatens the economic recovery that we are just starting to enjoy, as discussed in the manufacturing features on pages 15–25. The restructuring and insolvency profession may have begun to get used to the relatively low rate of corporate insolvency prevailing as we exit the recession, but there are other uncertainties to challenge our business plans.

You will by now be familiar with the many detailed changes introduced by the Insolvency (Amendment) Rules 2010 and related legislation. Richard Heis identifies other possible statutory changes on pages 12–13, which one hopes will be introduced with rather more than four weeks' notice of the final version!

Case law is neither standing still nor producing ideal levels of certainty, as the rest of this issue's Legal update section reveals; and regulation of the insolvency profession is another area where change is likely although what that change may be and when it will come remains unclear. The OFT has insolvency regulation in its sights, with fewer than the present number of regulators a likely result. Practising IPs just want our whole profession to be regulated through a regime that ensures best regulatory practice is met in all cases, a key part of which is demonstrating to users of insolvency services that IPs' behaviour is beyond reproach. Oh for the certainty that we will reach that nirvana!

C. Laughton

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

Are Football League clubs currently unsustainable?

Brendan Guilfoyle believes a salary cap on players' wages and agents' fees is imperative in order to create sustainable Football League clubs.

An increasing number of Football League clubs are struggling to pay players wages, PAYE/NIC and VAT on time. This is ironic, given that attendances at Football League matches are increasing year on year, TV revenues have risen and the Football League has successfully rebranded since the collapse of ITV digital.

The opening of the transfer window in January 2010 saw a flurry of winding up petitions from HM Revenue and Customs (HMRC). In most cases payments were made to avoid the inevitable administration but I bet that in many cases someone was persuaded to part with more cash to save their club and that the fundamental problems with the club's finances were not addressed.

> "With every increase in TV income there is inevitably an increase in the already grossly inflated wages of players and agents' fees, the prune juice effect was how Sir Alan Sugar described it!"

With every increase in TV income there is, inevitably, an increase in the already grossly inflated wages of players and agents' fees, the prune juice effect was how Sir Alan Sugar described it! Yet as insolvency practitioners we know it is simply crazy to run a club that is losing millions of pounds a year. Clubs are spending money they do not have and will find it increasingly difficult to borrow.

Unsustainable model

Anecdotally, I have been told that this season, of the 24 Championship clubs, 20 are run on the benefactor model, ie they are dependent on a wealthy individual or corporation making good the excess of expenditure over income each season. Such a model is not sustainable and already, with the effects of the world recession on corporate and individual earnings and liquidity, I hear that some benefactors are unable or unwilling to continue financial support for their club; they are stacking their cards and leaving the table.

The huge gulf in income streams between the Premiership and the Football League facilitates short-term lunacy (or living the dream). God forbid that when football results go the wrong way and relegation happens clubs are stuck with long-term player contracts that are unsustainable in the lower leagues. Clubs like Norwich, Leeds, Charlton and Southampton being in Football League 1 bear witness to their inability to deal with the drop in income experienced by a club when it leaves the Premiership for a significant length of time.

Surely the new budget proposal to enable HMRC to require security deposits for PAYE and NIC will impact adversely on football clubs? Their ability to use HMRC monies as working capital will be further constrained. Working capital is harder for clubs to borrow as the banks have long since decided to restrict their exposure to football clubs.

> "If clubs do not put their houses in order and in the words of Lord Brian Mawhinney become 'Fit to trade' then I fear government will act to protect the national game."

How can clubs be more sustainable?

In any plan to create a sustainable Football League, players' wages will figure large; a salary cap based on a percentage of turnover is possibly now an imperative. I think it's an imperative because both wages and agents' fees are in danger of escalating further.

Benefactors who wish to invest or gift money to clubs should be encouraged to acquire equity rather than loans, which have to be repaid or are often settled by stadium transfers, undermining the future of a club.

Directors often provide finance to acquire players but do not supply finance to fund wages to the end of that player's contract – another recipe for disaster.

The ability to defer large elements of agreed transfer fees is another recipe for profligacy, if the football creditor rule was restricted and did not include deferred transfer fees or they were outlawed then perhaps the transfer market would become more stable and less complex; clubs would be unlikely to loan monies to each other in circumstances where they were taking a normal commercial risk.

A more equitable split of funds between the Premiership and the Leagues is long overdue but how this can be achieved in the face of the prospect of static TV revenues in the future is difficult to envisage. It will require the Premiership to take a very enlightened view, and early indications are that they will. There are rumours circulating of a closer working relationship between the Premiership and the Championship, which if true could have major implications for the lower leagues.

Hope for the future

If clubs did become more financially stable then this could open the door to greater fan involvement in clubs as the need for benefactors diminishes. Too often fans' groups have acquired clubs only to succumb to the pressure for success, run out of money and cede control to a benefactor.

If clubs do not put their houses in order and, in the words of Lord Brian Mawhinney, become 'Fit to trade' then I fear government will act to protect the national game. ☐

Brendan Guilfoyle is a partner at the P&A Partnership and a past president of R3.

President's column

In his first column as R3 president, Steven Law outlines the themes for his term of office and encourages all IPs to promote the valuable work they do to save jobs.

It is hardly surprising that the theme of this year's annual conference was 'IPs in the spotlight'. I have already been lightly grilled by *Channel 4 News* in December over the issue of consultation in the Nortel case. Looking at some of the headlines over the last few months, you would think that insolvency was perhaps a tad more exciting than the day-to-day workings of it or why else would a journalist come up with this unlikely headline in January this year, 'Abuse of pre-pack deals could turn Britain into an insolvency brothel'?

More than anytime I can remember in my working life as an IP, now is the time for a calm, measured response and repeating some basic key messages until they stick. I also want to emphasise really clearly in my presidential year the positive role we have in rescuing and turning around businesses.

I would group the themes for my presidency around the following statements:

1) Saving struggling businesses and protecting employees
2) The new Parliament and legislative challenges
3) Contributing to UK prosperity and underpinning entrepreneurship
4) Director disqualification and upholding IP integrity

> New statistics from ComRes show that last year a fraction under six thousand businesses were rescued and nearly two million jobs saved by the work of the insolvency industry. That's seven per cent of the working population, in both full- and part-time employment who have us to thank for keeping their jobs.

R3 members know how fortunate we are to work in this profession, and one of my objectives in office will be to promote to the outside world the valuable contribution we make to the UK economy.

Saving businesses and protecting employees

New statistics from ComRes show that last year a fraction under six thousand businesses were rescued and nearly two million jobs saved by the work of the insolvency industry. That's seven per cent of the working population, in both full- and part-time employment who have us to thank for keeping their jobs. We can be rightly proud of these achievements, and my view is that we don't get enough credit for this type of work, especially if it must be carried out under the radar to protect value.

Every day we face challenges, not of our own making. We have to exercise commercial judgement for the benefit of creditors and other stakeholders; whether it is trading a business in administration, helping to negotiate a pre-pack sale or helping a company restructure informally, we exercise significant experience and commerciality. It is a little known fact that the average age of successful candidates at the JIEB exam is 33, and I will do my best to explain the value and experience we bring to our profession.

> I see the new Parliament as an opportunity to present our strong messages to a significant number of new MPs.

A new Parliament and legislative challenges

I see the new Parliament as an opportunity to present our strong messages to a significant number of new MPs. Over the past two years or so, we have met with a number of MPs, and I will continue to support the work of the All-Party Parliamentary Group (APPG) to get our messages across.

However, it will remain an uphill struggle as demonstrated by one MP at the last APPG who was of the opinion that it was easy to get an insolvency licence! We must work hard to correct such misunderstandings by getting our points across in a simple and direct form. I will work hard with R3 council and the communications team to promote the positive work we do.

As you know we are currently dealing with the pre-pack consultation and reacting to the OFT market study into corporate insolvency. Latest indications are that their report will be produced in June and we have been liaising closely with them. My feeling is that the OFT have a fairly good grasp of what our industry does, but we must wait and see what recommendations they produce.

Contributing to UK prosperity and underpinning entrepreneurship

The statement from our original cebr research in 2008 on the vital role the insolvency industry plays in creating an environment in which 'creditors are willing to lend, entrepreneurship is encouraged and the economy can flourish' is as true today as then. The updated research from ComRes showed that the UK insolvency industry made a direct contribution of around £562 million to national GDP.

Director disqualification and upholding IP integrity

At the other end of the entrepreneurship argument are dodgy directors and I am keen to see The Insolvency Service pursue more reports from IPs. On the other hand we must all work hard to uphold standards within the profession, especially when regulation itself remains a topic under discussion. We cannot win any arguments unless we can show our willingness to maintain standards and this is the time to communicate what those standards are.

Before I close I would like to thank Peter Sargent for his outstanding energy and focus during his presidential year. Peter certainly brought his own personal style to the job and I look forward to building on what he achieved last year. I plan to meet as many of you as possible during the year, whether at national committee meetings, conferences or regional meetings. I also want to extend the scope of the JIEB award ceremony to include those who passed the exams more than seven years ago and missed out on receiving a certificate.

Let's be proud of our profession! □

Steven Law is a partner at Ensors.

News update

Is there a case for a unified fraud prosecution office?

The Fraud Advisory Panel (FAP) has called for a reopening of the discussion on changes, first suggested 25 years ago, into the way fraud is prosecuted in the UK.

The FAP has published a discussion document outlining proposals to unite the separate and conflicting agencies responsible for major fraud prosecutions. It proposes the creation of a unified fraud prosecution office comprising most of the existing agencies currently tasked with prosecuting fraud and financial crime.

The proposals are designed to stimulate discussion and debate and a series of events, co-hosted by the FAP, will take place over the coming months. See **www.fraudadvisorypanel.org/newsite/events**.

Fall in number of business insolvencies

Business insolvencies dropped significantly to 2,160 for March 2010, compared with 2,512 in March last year, according to research.

The figures, published by pH, which is part of the credit reference agency Experian, revealed that insolvency cases in March 2010 rose slightly by 0.114 per cent, up from 0.096 per cent in February, but were still significantly lower than in March 2009.

Last month's rise in insolvencies was driven by failures among businesses employing 26 to 50 people, of whom 0.34 per cent were reported to be insolvent.

However, among medium-sized companies – those employing between 101 and 500 people – the insolvency rate fell from 0.17 to 0.16 per cent in March. The lowest insolvency rate of 0.07 per cent is held by companies employing just one or two people.

All regions, apart from Scotland, saw a small rise in insolvency cases in March compared to February. Scotland was the only region to see its insolvency rate fall in this period, with cases down from 0.09 per cent in February to 0.08 per cent in March. The East Midlands, Greater London and the South East had the highest number of insolvency cases.

No package holiday

The downgrading of Greek government debt to BB-plus by S&P caused alarm in Euroland in late April. Subsequent urgent talks between Greece, the European authorities and the International Monetary Fund resulted in a decision on the first bail out of a single-currency member state. A three-year package, worth £95 billion (euro 110 billion) has been agreed but with a drastic overhaul of the economy being demanded, which is giving rise to growing social unrest.

Among the cuts demanded are:

- Public sector: a pay freeze until 2014; abolition of bonuses for most workers; further reductions in civil servants' allowances
- Tax measures: VAT to increase from 19 per cent to 23 per cent; taxes on fuel, cigarettes and alcohol increased by a further 10 per cent; one-off tax on highly profitable companies and further taxes on gambling and property
- Private sector: revision of laws on redundancy and severance payments
- Pensions: retirement age will be linked to life expectancy instead of 65 years for men and 60 for women; minimum contribution period for full state pension to increase gradually to 40 years by 2015; early retirement curtailed; pension to be cut to reflect lifetime earnings rather than final salary
- Banks: the Greek government is extending a bank assistance package to provide euro 17 billion in liquidity to the sector and will also set up, together with the IMF and EC, an independent fund to provide equity support to banks.

Portsmouth Football Club's debt mounts

Andrew Andronikou, administrator of Portsmouth Football Club, has revealed in a report that the club's debts have now reached £119 million. The report indicates that the club collapsed owing more than £9 million to agents, including £2.3 million for a single deal. The figures also show that the club's outstanding liabilities include £17.1 million in unpaid VAT, PAYE and NIC tax, as well as £17.3 million transfer costs. The list also includes £38 million owed to former owners.

The administrator has said that the £100,000 arrears of holiday pay to all employees up to the date of administration will be preferential during the insolvency.

Negotiations are currently underway to sell two players. The Premier League recently extended the transfer window to Portsmouth to allow it to sell some of its assets for much needed cash. In the creditors' report Andronikou said: 'On the basis that the club continues to play football it is accepted that it cannot dispose of its entire playing squad. However, as relegation to the FL Championship has been confirmed players will have to be sold to have a more realistic overhead structure.'

Andronikou proposed a company voluntary arrangement (CVA) to the creditors at a meeting on 6 May. The initial stage was completed and he will now pursue the next step of the CVA, which will mean the club pays 20p in the pound over five years. Another meeting will now be arranged within 14 to 28 days to approve the CVA. It is hoped to run an article on Portsmouth FC in the next issue of *RECOVERY*.

Legal update: golden years – but for whom?

The law of administration expenses takes another turn for the worse, making landlords smile but, warns Ken Baird, there is also bad news around the corner.

For a number of years, the problem of dealing with real estate and restructurings has been a major headache for practitioners. The existence of parent company guarantees and other structures designed to avoid tenants 'getting off the hook' has presented many challenges to achieving restructurings with a very heavy property element. Historically, this has never presented much of an issue for administrators. Indeed, standard practice has been to file a company the day *before* quarter day to retain cash in the company. Deals were then done, with landlords often requiring no more than a *per diem* payment for occupation and sometimes less. In a world that was discretionary, deals and apportionments were often done. The *Goldacre* case changes all of this and makes the world a much less certain place for administrators and a much better place for landlords. Conversely, landlords' attempts to keep tenants and their guarantors on the hook forever, despite assignments of leases, has been dealt a significant blow by the *Good Harvest* case. The following article analyses the good and the bad news for landlords.

Goldacre – key issues

In *Goldacre (Offices) Limited* v. *Nortel Networks UK Limited (in administration)* [2009] EWHC 3389 (Ch) the High Court considered the payment of rent as an administration expense. The key issues decided were:

- Where a company in administration uses leasehold property for the purposes of the administration, the rent payable under the lease ranks as an expense of the administration. It is payable as a matter of mandatory obligation, not as a matter of discretion.
- The administrators cannot reduce the amount of rent payable as an expense where they occupy only a small part of the property. If the administrator causes a company in administration to occupy leasehold property for the purpose of the administration, the occupation is subject to the full terms and conditions of the lease. The court does not have jurisdiction to apportion the rent according to how much of the premises the company occupies.
- Similarly, the administrators cannot apportion the rent payable where they vacate part way through a rent payment period. If rent is payable quarterly in advance, and the company is in occupation for the purpose of the administration at the beginning of the quarter, the rent for the whole quarter is payable as an administration expense.

Administrators have tended to address whether rent is payable as an administration expense on a case by case basis. Historically the court had a discretion and would determine this question by balancing the legitimate interests of the landlord against the legitimate interests of the other creditors of the insolvent company. However, the decision in *Goldacre* strengthens the position of landlords where the company in administration is using any part of a property for the purposes of the administration, even if only briefly.

> "The decision in *Goldacre* strengthens the position of landlords where the company in administration is using any part of a property for the purposes of the administration, even if only briefly."

Goldacre – the facts

Nortel was the tenant of a property under two long leases; Goldacre was its landlord. After Nortel entered into administration the administrators used the property for the more efficient conduct of the administration and continued to pay the rent. The issue before the court was that of future rent. The administrators were using only a small part of the property (part of each of the two demises). The landlord applied to the court for an order directing that the administrators pay the rent due under both leases as an expense of the administration. The administrators argued that they should only have to pay an apportioned sum to take account of the partial use.

Administration expenses are payable as a mandatory obligation

Certain liabilities incurred by a company in administration are classed as administration expenses (rule 2.67 Insolvency Rules 1986). >>

Administrators must pay these expenses from the assets of the insolvent company before paying preferential creditors, floating charge-holders and unsecured creditors. The House of Lords held (in *Re Toshoku Finance UK Plc* [2002] 1 WLR 671) that the expenses regime in liquidations is mandatory – in other words if an expense falls within one of the heads in the relevant rule, there is no discretion (for the liquidator or the court) regarding its payment as an expense. In a case on liability for rates (*Exeter City Council* v. *Bairstow* [2007] 2 BCLC 455; [2007] BCC 236) the court reached the same conclusion on administrations.

> The silver lining of *Goldacre* for administrators could be an argument against having to pay an apportioned amount in such circumstances.

There are two heads of administration expense into which rent may fall: 'expenses properly incurred by the administrator in performing his functions in the administration of the company' (rule 2.67(1)(a)) and 'any necessary disbursements by the administrator in the course of the administration' (rule 2.67(1)(f)). The judge in *Goldacre* was inclined to favour (a) making no distinction between expenses incurred by the administrator on his own account for which he was entitled to reimbursement and those incurred on behalf of the company. But the judge concluded that even were such a distinction appropriate, rent for a property used for the purpose of the administration would fall within head (f): payment of rent is necessary to allow the administrators to make use of or retain possession of the property for the benefit of the administration.

The court dismissed the administrators' argument that the court had a discretion. In *AIB Capital Markets Plc & Anor* v. *Atlantic Computer Systems Plc & Ors* [1990] EWCA Civ 20 the Court of Appeal held that the question of whether rent was payable as an expense of the administration was answered by balancing the legitimate interests of the landlord against the legitimate interests of the other creditors of the insolvent company. But *Atlantic Computers* involved a pre-Enterprise Act 2003 administration. The Enterprise Act introduced rule 2.67(1) into the Insolvency Rules and so established mandatory heads of expenses with priority. It is no longer appropriate to apply the *Atlantic Computers* balancing test to decide whether something constitutes an administration expense. If a liability falls within rule 2.67(1) it is payable in priority.

Administrators liable for rent for full payment period even if they cease use

The administrators in *Goldacre* argued that payment of rent should be tailored to their use of the property. They therefore sought to pay an amount apportioned as to the area of the property used and the period of occupation. The judge did not agree.

Under the salvage principle in liquidation if a liquidator adopts a contract for the purpose of the more beneficial conduct of the liquidation, all liabilities under that contract after the date of adoption have priority. This principle was applied to liabilities under leases in *Re Levi & Co Ltd* [1919] 1 Ch 416, approved in *Powdrill* v. *Watson* [1995] 2 AC 394. The judge in *Goldacre* applied the same principle to administration.

Rent under a lease is generally payable in advance, for example on four quarter days (or less commonly, but increasingly in the current market, monthly). The quarter's rent becomes payable in full on the first day of the quarter. The administrator must therefore settle the full quarter's rent: it will not be apportioned where he or she ceases to use the property for the purpose of the administration during the quarter.

> Some of the unanswered questions from *Goldacre* include the extent to which ancillary liabilities associated with a lease may also become expenses.

Some commentators have extrapolated from this that if administrators start using premises for the purposes of the administration the day after a rent day, the whole of that quarter's rent will not be an expense of the administration. The *Re Levi* and *Powdrill* cases refer to liabilities incurred while the lease is being enjoyed or retained for the benefit of the liquidation being payable as expenses. Arguably rent falling due *prior to* such enjoyment or retention, even if payable for a period that includes such enjoyment or retention, is therefore not payable as an expense. Administrators have tended to apportion rent in such circumstances, agreeing to pay for the period of their use. The silver lining of *Goldacre* for administrators could be an argument against having to pay an apportioned amount in such circumstances.

Payment of lower rent in *Innovate Logistics* distinguished

At first glance the decision in *Goldacre* may seem at odds with that in *Innovate Logistics Ltd* v. *Sunberry Properties Ltd* [2008] EWCA Civ 1321. In *Innovate Logistics* the Court of Appeal applied the balancing test from *Atlantic Computers* in order to decide whether a landlord could terminate a licence granted by the company in administration in breach of the lease. The Court of Appeal limited the amount of rent the tenant in administration had to pay to the licence fee that it received from the licensee. The court also held that the administrators should pay interest on the passing rent only to the extent received by them, not at the contractual rate.

The judge in *Goldacre* accepted that the Court of Appeal in *Innovate Logistics* had clearly indicated that the issue of what administrators should pay should be approached flexibly. In *Innovate Logistics*, however, the landlord had accepted that it had no automatic right to be paid the contractual rent. The Court of Appeal did not therefore rule on this point and consequently the judge in *Goldacre* was not bound by it. The judge, in common with many commentators, remarked on the lack of consideration of the salvage principle and *Re Toshoku* (and other cases) in *Innovate Logistics*.

Interestingly the judge in *Goldacre* set out how he would have ruled had he been required to apply the *Atlantic Computers* balancing test. He perhaps had an eye to the possibility of an appeal and wanted to make clear that his conclusions would have been no different on that basis. He would, he said, have required the administrators to have paid the full quarter's rent. While the administrators argued that they should pay for the part of the property that they were using and the landlord could take the rest back, the expert evidence provided demonstrated that there was no realistic possibility of the landlord maximising the return for the property while the administrators used part. There were issues of data security that impacted adversely on the prospect of redevelopment.

Not a carte blanche for landlords: some discretion and risk of non-payment remains

Goldacre has by no means completely displaced the court's discretion: the judge held that the court did not have discretion over the payment of rent as an administration expense. However, the court still has discretion regarding the remedies available to landlords. In *Innovate Logistics* the Court of Appeal applied the principles in *Atlantic Computers* to the question of whether to lift the moratorium to grant the landlord's request for an order terminating a licence to occupy granted in breach of lease. This is still good law.

The judge in *Goldacre* observed that treatment of rent as an administration expense did not necessarily determine

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when the rent should be paid. If the sufficiency of the assets is in doubt, the landlord might have to wait and see to what extent its claim can be satisfied. Even where rent ranks as an administration expense, there may be other items that have priority over his claim or that rank alongside it such that available funds may have to be allocated elsewhere or split. There is, therefore, no automatic right to immediate payment.

Good Harvest – bad news for landlords and uncertainty all round

While landlords have welcomed the decision in *Goldacre*, they have greeted another recent High Court decision with alarm: *Good Harvest Partnership LLP* v. *Centaur Services Limited* [2010] EWHC 330 (Ch). *Good Harvest* did not specifically relate to insolvency but it is highly significant for landlords, tenants and lease guarantors with potentially important implications for insolvency practitioners.

Authorised guarantee agreements and ongoing liability following assignment

Tenants under 'new' leases (defined by the Landlord and Tenant (Covenants) Act 1995 (the Act) as leases dated on or after 1 January 1996, subject to some exceptions) are by law automatically released from their lease obligations on assignment. An anti-avoidance provision declares any agreement relating to a tenancy void to the extent that it frustrates the operation of the Act. However, the Act expressly allows leases to impose conditions to assignment, including requiring the outgoing tenant to enter into an authorised guarantee agreement (AGA) by which it guarantees its assignee's performance for the period that the assignee is the tenant. In the event of the assignee's default, therefore, the landlord has recourse to the previous tenant (but not tenants further back in a chain of assignment).

The position of guarantors is not clear cut. The Act provides that the guarantor of an outgoing tenant is released from its covenants on assignment by the tenant but it does not expressly state whether the guarantor can be party to an AGA. It is common practice, nonetheless, for leases to require tenants' guarantors to enter into AGAs on assignment and for landlords to demand (and guarantors to enter into) such AGAs. Generally the AGA is worded as a sub-guarantee: the guarantor guarantees the former tenant's obligations rather than the assignee's. However, in the *Good Harvest* AGA both the outgoing tenant and the guarantor guaranteed the assignee's performance.

Good Harvest – the facts

Centaur was the guarantor under an underlease. The underlease allowed the undertenant to assign with consent, subject to a condition that the undertenant and any guarantor of the undertenant enter into an AGA with the tenant (as landlord of the underlease). When the original undertenant assigned, Centaur guaranteed the assignee's performance under the underlease. The tenant later surrendered its lease and shortly after Good Harvest acquired the freehold, becoming the immediate landlord of the assignee. The assignee subsequently failed to pay rent and Good Harvest sought summary judgment against Centaur for the arrears.

Guarantor cannot guarantee assignee's covenants – or perhaps the former tenant's

The judge in *Good Harvest* held that if a guarantor could be required to enter into a guarantee of the tenant obligations on assignment, this frustrated the aim of the Act. He relied on the House of Lords decision in *Avonridge Property Co Limited* v. *Mashru* [2005] UKHL 70 that the anti-avoidance provision should be interpreted 'generously, so as to ensure the operation of the Act is not frustrated, either directly or indirectly'. If Parliament had intended the former tenant's guarantor to be able to give a guarantee for the assignee it could have been expected to say so explicitly. The particular guarantee given in this case, where Centaur guaranteed the assignee's performance, was therefore void.

The judge briefly considered the more usual sub-guarantee AGA structure. He did not think it 'by any means clear' that this was permitted. The arguments turn on the exact wording of the Act and the judge concluded that it would not help to answer this question given the terms of the Centaur guarantee. Nonetheless these comments, although not binding, have caused much concern to landlords and their advisors.

> "The judge in *Good Harvest* held that if a guarantor could be required to enter into a guarantee of the tenant obligations on assignment, this frustrated the aim of the Act."

Commentary

The problem of what to do with landlords has been at the heart of restructuring over the last three to four years. As always, the evolving law seems to throw up surprises and more questions than answers. Before the 2003 Enterprise Act regime, the law of administration expenses was reasonably clear and at least clear enough. The element of discretion and balancing act of the interests of the parties resulted in very few real disputes about ability to pay rent. Typically, the administrators would have to pay for their actual occupation and, while they might 'push the envelope' a little bit, it was not in their interests to push it too hard. It was a regime that didn't seem to be broken so why fix it? Incorporation of liquidation-style expense rules post the Enterprise Act has changed that. We now have very clear authority that discretion is not part of the analysis. If something is an expense, it gets paid and it has its statutory priority.

This change in regime has huge implications for those practitioners planning restructurings with a Plan B that might involve administration. The costs of those Plan Bs has now risen dramatically. In addition, the risk has also increased. Some of the unanswered questions from *Goldacre* include the extent to which ancillary liabilities associated with a lease may also become expenses. If somebody is in occupation of a lease and during their occupation there is damage to the property or subsidence or general dilapidation, why should that not be an expense? If the consideration for the lease is primarily to put the property in the same condition as it started in, could all dilapidations not become an expense? These as yet unanswered questions pose real risks for insolvency practitioners.

On the other hand, a number of restructurings have proved very difficult because of the problem of dealing with parent company guarantees of multiple leasehold estates. The *Powerhouse* CVA case, while it failed on its facts, showed what could be done. Recent CVAs of businesses such as JJB, Blacks and others have shown that the balance has tipped. The commercial imperative to have deals done has outweighed the 'never say compromise' attitude of some in the landlord community. Arguably, the balance has been tipped too far. The value being given up by landlords in some of the retail CVAs is significant when compared with the value accreting to other stakeholders. In this context, the *Good Harvest* case comes at a bad time for landlords. Many structures have sought to work around the effect of the Act and to allow recourse, as long as possible, to original guarantors. If *Good Harvest* is good law, that recourse will be substantially limited in future.

It is a fascinating period of the downturn for those with an interest in real estate. For everybody, the law has just taken a couple of turns for the worse… or the better… It all depends on your point of view. ☐

Ken Baird is a partner and head of the Restructuring & Insolvency Group at Freshfields Bruckhaus Deringer LLP.

Recent case summaries

Corporate insolvency update from Ben Griffiths.

Corporate insolvency

***Re Stanford International Bank Ltd* [2010] EWCA Civ 137 (CA)**

Facts: The case concerned an application to the English court for recognition of foreign proceedings in respect of Stanford International Bank Ltd (SIB), a company incorporated in Antigua and Barbuda, under the Cross Border Insolvency Regulations 2006[1].

SIB was alleged to have been involved in a fraudulent Ponzi scheme, perpetrated by Sir Allen Stanford and his associates, which collapsed in 2009. In proceedings commenced in Texas by the US Securities and Exchange Commission, a receiver (the receiver) was appointed over the assets of SIB. Two months later, SIB was ordered to be wound up by the High Court of Antigua and Barbuda and liquidators were duly appointed. The Antiguan liquidators (the liquidators) applied to the English court for recognition of the Antiguan liquidation as the foreign main proceeding under the UNCITRAL Model Law (the Model Law), as incorporated into English law by the Cross Border Insolvency Regulations 2006. The application was opposed by the receiver, who instead sought recognition of the US receivership by the court.

At first instance, Lewison J granted recognition of the Antiguan liquidation as the foreign main proceeding and dismissed the application of the receiver for recognition of the US receivership. The receiver appealed.

Held: A proceeding will be a foreign proceeding under Article 2(i) of the Model Law where it is a collective judicial or administrative proceeding in a foreign state pursuant to a law relating to insolvency in which proceeding the assets and affairs of the company are subject to control or supervision by a foreign court, for the purpose of reorganisation or liquidation. The Court of Appeal held that the Antiguan liquidation was to be recognised as a foreign proceeding within Article 2(i), but that the US receivership did not fall within Article 2(i) as it was not a collective proceeding nor had the US court's jurisdiction to appoint the receiver arisen from a law 'relating to insolvency'.

The Court of Appeal went on to hold that the Antiguan liquidation was a foreign main proceeding under Article 2(g) as SIB's centre of main interests (or COMI) was located in Antigua. The presumption that a company's COMI is the place of its registered office (as contained in Article 16.3) could be rebutted only by factors that are 'both objective and ascertainable by third parties'. The presumption was not rebutted in this case.

Comment: The *Stanford* case provides important guidance as to the interpretation of the terms 'foreign proceeding' and 'foreign main proceeding' under the Model Law. It involved consideration by the English Court of Appeal for the first time as to the test to be applied in determining a company's COMI for the purposes of the Model Law. Two points in particular are to be highlighted. First, it is now settled that the phrase centre of main interests is to be construed in the same way for the purposes of Article 2(g) of the Model Law as under the EC Regulation on Insolvency Proceedings 2000 (see *Re Eurofood IFSC Ltd* [2006] Ch 508). This approach is consistent with earlier US jurisprudence (see, eg, *Re SPhinX Ltd* (2006) 351 BR 103). Secondly, the Court of Appeal disapproved the 'head office' test of COMI which had previously been applied by Lewison J in *Re Lennox Holdings Ltd* [2009] BCC 155; a company's COMI is to be determined instead by reference to factors that are objective and ascertainable by third parties.

***Re Johnson Machine and Tool Co Ltd* [2010] EWHC 582 (Ch) (HHJ Purle QC)**

Facts: A company applied to the court for an administration order. It was proposed that the administration would be pre-packaged, so that upon appointment the administrator would immediately sell all the company's existing business and assets to another company connected with the existing directors and shareholders. The judge made the administration order. The company sought an order that the pre-appointment costs of the administrator be treated as an administration expense.

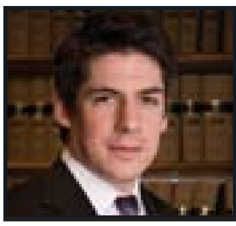
Held: The judge accepted that he had a statutory discretion to allow pre-appointment costs as an administration expense (IA 1986, Sch. B1, para. 13(1)(f)) but he declined to exercise that discretion in this case for two reasons.

First, the judge accepted, following *Re SE Services Ltd* (9 August 2006), that an administrator's pre-appointment costs should be allowed as an administration expense only where the administration is plainly for the benefit of the creditors rather than where the balance of advantage lies with the company's management. He was not persuaded that the company had demonstrated sufficient benefit for its creditors in this case to justify treating pre-appointment costs as an expense of the administration.

Second, the judge noted that on an out-of-court appointment a company's creditors have no power under the insolvency legislation to approve any payment to the proposed administrators in respect of pre-appointment costs. It would therefore be inappropriate to allow pre-appointment costs to be treated as an administration expense in this case merely because the company had made an application to court for an administration order rather than seeking to appoint administrators out of court.

Comment: The decision in the *Johnson Machine* case serves as a salutary reminder that insolvency practitioners cannot be assured that in the case of a proposed administration they will recover their pre-appointment costs as an expense of the administration. If their costs do not rank as an administration expense, they will be left to prove as unsecured creditors of the company. Insolvency practitioners should seek to protect themselves by insisting upon payment in advance by the company or by contracting personally with, or taking a guarantee from, the company's directors, shareholders or others. Failure by a proposed administrator to take either of those steps will expose him or her to the risk that pre-appointment fees will not rank as an expense of the administration. The consequences of such failure will typically be more acute in cases of pre-packaged administrations, where the bulk of the insolvency practitioner's work is likely to be undertaken before appointment. ☐

1 An issue also arose on the appeal as to whether a restraint order that had been obtained by the UK Serious Fraud Office under the Proceeds of Crime Act 2002 should be discharged or varied. That issue involved questions of criminal law and is not addressed in this case summary.



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Legal voice

Are you an R3 member? Could you write the Legal Q&A column? If you have advice you could usefully share with your fellow professionals please contact **Sarah Houghton** at GTI (**sarah.houghton@groupgti.com**).

Legal Q&A

Alexandra Wood answers your insolvency queries.

I have just been appointed as the administrator of a manufacturing company and the company's assets are due to be sold on an urgent basis. Given the nature of the company's business, I am aware that some suppliers may have the benefit of retention of title (ROT) provisions, although no such claims have been asserted. Do I risk personal liability if the company sells assets which are the subject of an ROT provision?

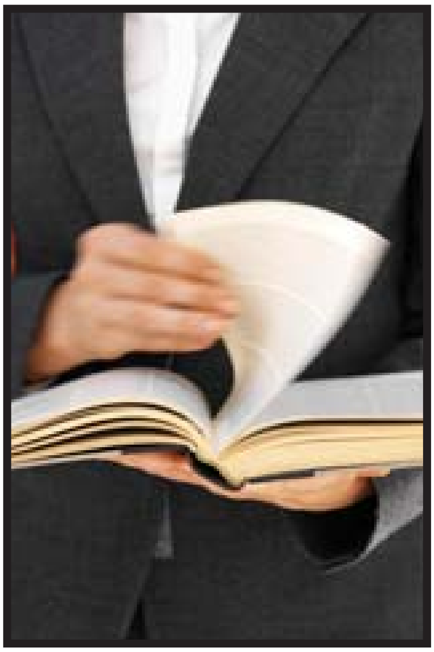
If there are valid and enforceable ROT provisions that cover the assets in question then the answer is 'yes', there is a risk of a claim against you personally for *'wrongful interference with goods'* (which, pursuant to the Torts (Interference with Goods) Act 1977, includes conversion of goods).

Conversion is an act of deliberate dealing with goods in a manner that is inconsistent with another's rights (the supplier's, in this case) such that it is deprived of the use and possession of the goods. In relation to a proposed sale, you may be liable for conversion if the goods are either sold (such that title is transferred) or the company parts possession with them. Assuming that the goods are in the company's possession, in order to bring a claim the supplier will need to demonstrate an immediate right to possession of the goods (usually by way of ownership), which is based on a proprietary (and not merely a contractual) right.

As there is no requirement that you intended to affect the supplier's rights, you may still be liable even though you are unaware of the ROT provision. Further, although as an administrator you act as agent of the company, this is not a defence to a claim in tort.

It is usual for a company in administration to sell only *'whatever right, title and interest'* it may have in the goods in its possession. However, this would not be a defence against a claim for conversion that is based upon parting with possession (rather than being confined to a sale). Even if subsequently the purchaser were to return the goods or a supplier regains possession through court proceedings, a court may find that conversion had taken place at the time at which the company initially parted with possession and may still award damages.

s234(3) and (4) Insolvency Act 1986 provides a defence if an administrator can show that, at the time they either seized or disposed of the goods, they had reasonable



> "A liquidator has the power to disclaim the company's continuing contractual liabilities under the lease as an unprofitable contract."

grounds for believing that they were entitled to do so (and the supplier's loss was not caused by the administrator's negligence). What steps a court will expect an administrator to have taken (in order to be able to rely upon this defence) will depend upon the circumstances but could include reviewing the company's records, checking with directors and relevant staff members and speaking to suppliers. If any clauses are identified, their scope will need to be considered and legal advice should be obtained.

As liquidator, can I use my power of disclaimer in relation to the company's liability to pay rent as the original tenant under a lease that was executed in 1993 and that it subsequently assigned? The assignee is insolvent.

The date of the lease is crucial to your question. Had the lease been executed after 1 January 1996, pursuant to the Landlord and Tenant (Covenants) Act 1995, the company would automatically have been released from contractual liability upon its assignment of the lease. In such a case it is likely that the landlord would have required, in accordance with a condition in the lease for granting its consent to the assignment, the company to enter into an authorised guarantee agreement (or AGA). Under the AGA the company would have agreed to be liable to the landlord for breaches of the lease until such time as there was a subsequent assignment of the lease. In those circumstances you would be looking to disclaim the company's obligations under the AGA.

A liquidator has the power to disclaim the company's continuing contractual liabilities under the lease as an unprofitable contract. This would terminate the landlord's claim for rent, which otherwise would continue to accrue for the remainder of the lease under the doctrine of privity of contract (provided the landlord notifies the company of any liability within six months of it becoming due under s17 Landlord and Tenant (Covenants) Act 1995). The landlord will be left with a statutory claim for loss or damage arising as a result of the operation of the disclaimer, which is provable in the winding up.

However, there are a number of factors that may reduce the quantum of this statutory claim. There is a discount for early payment to reflect the fact that the landlord is being paid upfront. Further, the landlord also has a duty to mitigate its loss, including remarketing the premises. When assessing the quantum of the claim a court would take into account how quickly the premises could be re-let. However, if the assignee is in administration, arguably such mitigation is unreasonable because the statutory moratorium prevents the forfeiture of the lease (unless the administrator is willing to consent or the court gives leave). As a practical point, the landlord's statutory claim will also be reduced by any recoveries that it is able to make from the insolvent assignee. □

Alexandra Wood is a senior associate at Mayer Brown International LLP.

Technical update

Law reform past and future: the implications for the insolvency community.

In April we saw the biggest shake-up of the Insolvency Rules for 25 years, together with a number of amendments to the Insolvency Act, which were needed in order to make the rule changes. But it doesn't end there. A re-ordered and consolidated version of the rules will now be produced, which is expected to be available for consultation by March 2011 and to come into force in October 2012. The Insolvency Service has a little list of possible amendments to the Insolvency Act 1986 and the Company Directors Disqualification Act 1986, which it is minded to introduce if a suitable legislative opportunity arises.

The effects of changes on the ground

While this is great news for the publishers of insolvency law handbooks, how does it affect insolvency practitioners and others involved in the insolvency process?

According to The Insolvency Service, the latest rule changes are intended to reflect modern business practices and reduce unnecessary administrative burdens, thereby delivering more efficient insolvency processes. The Service estimates that this will result in cost savings of nearly £50 million a year, which it hopes will be passed on to creditors in the form of better returns.

There is no space here to go into the details of the new rules, but guidance is available from various sources, including Dear IP 44 and R3 Technical Bulletin 90. The Insolvency Service has also posted a helpful consolidated version of the 1986 Rules incorporating the latest amendments on its website.

Many of the changes simply update the rules to accord with modern practices, such as the substitution of statements of truth and witness statements for affidavits. Many make the process more streamlined and reduce administrative burdens. These include the more flexible remuneration provisions, simpler disclaimer procedure, the ability to have pre-administration costs paid as an expense, the abolition of the requirement for annual meetings in voluntary liquidations, and the ability to have remote attendance at meetings. On the other hand, many of the reporting requirements are more detailed and onerous than before and seem unlikely to result in cost savings.

Challenge to expenses

One matter of particular concern has been the new provision allowing creditors to challenge an office-holder's expenses,

including expenses incurred in trading cases, and for the court to order that such expenses be disallowed or repaid. When The Insolvency Service consulted on an earlier version of the draft Amendment Rules in 2007, they contained a provision allowing the challenge to expenses that appeared to be confined to the office-holder's own expenses but not payments that he had made to a third party. The provisions that have appeared in the Amendment Rules are seen by many as raising the prospect of challenge by aggressive creditors, with the benefit of hindsight, to commercial decisions made by office-holders in the fast-moving circumstances of a trading insolvency.

"The Service estimates that the latest rule changes will result in cost savings of nearly £50 million a year, which it hopes will be passed on to creditors in the form of better returns."

The response of The Insolvency Service has been to point out that the rules prescribe a very high test. It is for the creditor to persuade the court that the expenses are excessive *in all the circumstances*, and not for the practitioner to prove that the expenses are reasonable. The Insolvency Service has suggested that this test is linked to one of good faith, but further clarity would be helpful.

Technical Bulletin

Technical Bulletin 90, which dealt with the Insolvency (Amendment) Rules 2010 was issued in March.

Technical Bulletin 91 was issued in April. Its contents included:

- Changes to insolvency deposits and fees
- Insolvency (Amendment) Rules 2010 – Update to Technical Bulletin 90
- Student loans and individual voluntary arrangements
- Child maintenance payments and individual voluntary arrangements
- Rent in administrations
- Pre-packs – further judicial comment
- Pay when paid clauses in construction contracts.

Other proposed changes

In March, The Insolvency Service issued a further consultation document setting out a number of provisions, which they had identified in the primary legislation and that they thought would benefit from amendment if a legislative opportunity were to arise. Many of the proposed amendments are technical and non-contentious, but some do raise serious questions. One sensible suggestion is to extend the provisions of section 216 of the Insolvency Act relating to restrictions on the re-use of names of failed companies to those cases where a company enters administration and does not continue as a going concern.

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Less convincing is a proposal to allow insolvency practitioners to be authorised to act solely in personal or in corporate cases. R3 has always taken the view that the skills required to deal with personal and corporate insolvency cannot be separated. There will frequently be aspects of a case that require knowledge of both: for example, directors of an insolvent company will often have consequential bankruptcy issues arising from guarantees and knowledge of both regimes is necessary in order to give appropriate and comprehensive advice. Splitting apart the IP qualification in this way will erode public confidence and the value of the qualification. There is no concept of a half-lawyer or half-accountant so it is hard to see why we need a half-IP.

> “R3 has always taken the view that the skills required to deal with personal and corporate insolvency cannot be separated. Splitting apart the IP qualification in this way will erode public confidence and the value of the qualification.”

Finally, the document includes the surprising proposal to extend the scope of section 281(5) of the Insolvency Act so that an award for damages, libel or slander would not be released on a debtor's discharge from bankruptcy. It is hard to see any good reason for this, which is part of a more general creeping extension of the categories of debt that are excluded from the bankruptcy regime.

In view of the size of damages that can be awarded in libel cases the implementation of this proposal would in many instances be to condemn debtors to a lifetime of debt. From this there would be no possibility of escape and no incentive to acquire further assets, which would simply be vulnerable to continued action by the successful litigant.

In the light of the concern that has been expressed about libel tourism and the use of British libel law to stifle freedom of speech, this seems like a step in the wrong direction, and entirely in conflict with the objective of bankruptcy as being a mechanism for debtors to achieve a fresh start. One wonders what the reason is for this proposal.

Clearly the question about whether any of these proposals are actually put into effect depends entirely on the legislative programme of the next government. Will insolvency law reform be a priority?

Online filing of corporation tax returns

In the last edition of *RECOVERY* I mentioned the exemption that had been obtained from the requirement to file corporation tax returns online where companies are subject to formal insolvency proceedings. Because of the dissolution of Parliament, the amendment regulations will not now be made before Parliament reconvenes, which is likely to be on 18 May. They will not, therefore, take effect until early June. □

Richard Heis is a partner in KPMG Restructuring.

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The future shape of business

Tim Bradshaw indicates that manufacturing is slowly beginning to recover but that future business security needs to be based on more sustainable growth.

Industrial trends survey

The CBI's latest industrial trends survey (March 2010) shows that manufacturing business is slowly beginning to pick up as the UK emerges from the depths of the recession. Export orders are still depressed but are steadily improving as global demand starts to recover. The recovery isn't uniform though, and home-grown demand remains very weak. As a result, we expect manufacturing output to grow only modestly for some time.

We also expect efforts to restructure and refocus businesses to continue as they take stock of their position and prospects for future growth. However, we are seeing significantly fewer redundancies and insolvencies than at the same stage in previous recessions. Across the economy, output may have fallen 6.2 per cent from the peak but employment is down only 1.9 per cent. In the last recession, by contrast, GDP was only down 2.5 per cent and yet employment fell 3.4 per cent.

Ultimately, we believe this is because UK businesses entered this recession in a much fitter state – having learned many lessons from the early 1990s. Companies are now looking at the current recession and, as it is clear we will not be returning to 'business as usual' soon, we are seeing a renewed emphasis on how their operations will need to evolve and adapt to the new conditions. And not just for short-term tactical positioning but strategically, for the long term.

The shape of business – the next ten years

The CBI captured some detailed insights into this change process in a major piece of work on *The shape of business – the next ten years* (see **www.cbi.org.uk/shape-of-business**), which we published at the end of 2009. The report was developed through conversations with over 500 of our members and covered businesses of all sizes, from all sectors and from across the whole of the UK. We looked at both the drivers for change around the recession and the business response to these drivers and found that businesses expect to become more flexible, collaborative and leaner as a result.

Credit constraints

Most immediately, the price and availability of credit will remain constrained for some time, prompting questions about how businesses will finance their growth. And, even after the recovery takes hold, businesses expect the macroeconomic environment to remain volatile and uncertain. Conditions are very different to the previous economic cycle where we saw GDP growth exceed 2.5 per cent in nine of the eleven years between 1995 and 2005 while inflation was contained between 0.5 to 3 per cent over the entire period. In addition, existing challenges such as the decline of trust in business, social and demographic shifts, the pressure to keep up with radical technological change and the move to a low-carbon economy have been exacerbated. The need to tackle climate change and prepare for an ageing population, for example, have been known for some time, but the ongoing fiscal crisis now means that businesses can expect much less support from government in adapting to these challenges.

> "Business is seeking a more balanced, less risky pathway to growth."

Important messages to corporate leaders

Several messages of importance to corporate leaders come out of our research.

1) **Creating value through collaboration and partnership**. There will be less emphasis on transactions and more on relationships. The new world will be more about working closely with a wide group of stakeholders to produce value. The consensus is that businesses will be stronger if they work together. We already see many companies starting to embrace more open systems of innovation, working with universities and with each other on pre-competitive research, but the future may see a much more diverse mix of collaborations. Where competition law allows, we can even expect competitors to work together to tackle mutual problems such as carbon reduction in their supply chains and operations.
2) **Business strategies are likely to be more conservative than previously**. Companies want to take lower risks with their balance sheets and are seeking to de-leverage, reducing their reliance on debt while looking at equity and other forms of finance for growth. In particular, there are indications that finance for investment will start to flow *through* supply chains as larger companies with more secure balance sheets are more prepared to help finance their trusted suppliers. In this way, smaller firms will increasingly look upstream, rather than to banks, for funds.

   We can also expect capital to be used much more cautiously as companies place a greater emphasis on risk management, assuring return on investment and understanding payback periods.

   However, the new conservation is not just financial. The recession has forced firms to recognise the vulnerabilities of a long, geographically stretched supply chain in which they are dependent on a small number of key suppliers. These chains will be managed differently in future. We are already seeing signs of supply chain elements moving back to the UK where efficiencies and new technology, combined with a lower risk profile, can make the UK competitive again.
3) **Business executives have a lot of new thinking to do**. In this more collaborative world, they are going to need closer and more lasting relationships with other interest groups: their customers, suppliers, employees, shareholders and communities within which they work. Ultimately, that may require them to take a rather longer term view of shareholder value – with greater priority given to innovation and wider wealth creation than immediate profit maximisation.
4) **Flexibility will be a watchword throughout the business**. In particular, there will be new relationships with employees, perhaps even a new style of work contract, to provide at least a level of resilience against uncertainties ahead.

Together, these messages suggest business is seeking a more balanced, less risky pathway to growth: one in which the short-term returns may be lower but the long-term rewards for management success will be a lot more sustainable and secure. □

Tim Bradshaw is head of enterprise and innovation at the CBI.

Restructuring and turnaround in a manufacturing context

Recovery plans for many of the developed economies will be based on increased exports of manufactured goods. Julian Cooper investigates the specific restructuring challenges faced by the UK manufacturing sector.

Free money

When compared with the scale of the problems in the financial sector, there is a surprisingly low level of apparent distress in the manufacturing sector. The combination of virtually zero base rates, substantial state support for banks and massive quantitative easing have provided enough momentum to the economy to avert a continuing recession. Most importantly:

- banks have sufficient liquidity to avoid the need for a widespread fire-sale of assets
- highly leveraged borrowers can continue to service the very low interest on their loans
- consumer demand has remained quite robust (the housing market resilient and unemployment low)
- equity markets have remained open to support refinancings.

The notable corporate failures of the past two years have been confined largely to the banking sector, fraudulent situations (Madoff – see page 28) and certain other specifically vulnerable companies (eg Woolworths).

Primus inter pares

Governments remain stuck in a 1970s time warp when it comes to supporting struggling businesses and, banks aside, none seem more worthy of special treatment than the car industry. Over the past 18 months, the government's own turnaround team at the Shareholder Executive has been heavily involved in the rescues at Jaguar and Land Rover, and rumoured to have been involved in several other large manufacturers. Furthermore, the motor industry has benefited from the cash-for-bangers scheme.

Extend and pretend

So if leveraged industrial companies have not been collapsing en masse, what has been happening? Firstly, not all companies entered the downturn with high levels of debt. Even in a serious downturn, companies with minimal borrowing can reduce their fixed costs and continue trading, albeit at a lower level of activity/profitability.

Generally, for more highly leveraged companies, banks have been keen to help them restructure their balance sheets. This can mean rolling over debt maturities, waiving covenants, providing principal loan repayment holidays and even converting part of cash paid interest to non cash paid.

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Not all borrowers are suitable candidates for restructuring. The key requirements are an underlying viable business, a competent management team, positive operating cash flow and supportive stakeholders.

Loan to own

Whereas the dominant restructuring tool of the last UK recession was a fire-sale of assets via an administrative receivership appointment, the current trend is toward creditors converting part or all of their debt into an equity interest.

> "Not all borrowers are suitable candidates for restructuring."

Banks and bondholders, who are not compelled by their own funding needs to liquidate impaired loans, are increasingly comfortable to swap part of their debt into equity, akin to a private equity investor, in order to support the borrower through a medium-term turnaround, with a view to an exit within three to five years' time. The underlying purpose is to avoid a fire-sale of a distressed business in a depressed market, and to maximise value recovery through a combination of improved business performance, a more buoyant market and a managed sale process.

Margin squeeze – blame the Chinese?

Highly volatile input prices (materials and fuels manufacturers buy) and output prices (what manufacturers sell) have been a major issue for many manufacturers over the past 18 months.

Input annual price inflation was 6.9 per cent in February 2010, compared with output annual price inflation of 4.1 per cent. Manufacturers' margins have been severely squeezed over the past year as they have been unable to pass on rising input prices in full to their customers. There are various reasons, but substantial commodity price increases are particularly significant. For example, over the past year, crude oil, aluminium, lead and tin prices have risen in US$-terms by 65 per cent, 62 per cent, 74 per cent and 75 per cent respectively. Not all commodities have seen such dramatic price increase. Coal, iron ore and steel prices have remained rather flat throughout 2009 and natural gas prices more than halved in the year. Furthermore, world prices do not always reflect what is actually happening at the factory gate; recently BHP agreed a 99.7 per cent price rise with its Asian customers for iron ore deliveries for Q2 2010. Much depends on the specific market dynamics that prevail for each particular manufacturer. However, it is clear that booming demand in Asia, and particularly China, where the heavy industrial sector has benefited from massive government stimulus, has been the main driver for higher commodity prices. Worryingly, for UK manufacturers, the major exporters (China, Germany and Japan) are all continuing to export their manufactured goods' deflation globally, with no immediate end in sight.

MPC has recently been working with a European tarmac business. Bitumen, a

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heavy fraction from crude oil distillation, is a key input for tarmac production. It is in relatively short supply in Europe, with few producers and substantial demand from the public sector for road building, particularly in eastern Europe. Consequently producers have been able to drive through several price rises over the past year, on the basis that if we in the UK cannot afford their products, they have plenty of other customers, with a stronger currency in Europe, who can. Increasingly, it is possible that UK manufacturers will struggle to compete for scarce global resources with larger, richer competitors with stronger currencies.

Gold-plated employment benefits

Many companies are now discovering that generous employment agreements that were affordable in a more benign economy, are now increasing unaffordable.

Qinetic, the defence research group, is currently seeking to end all collective agreements this year, including very generous redundancy provisions. Attempting to row back from the provision of generous but uncompetitive, compensation/manning arrangements is a tricky matter, particularly in a unionised environment.

We are currently addressing a similar challenge at an automotive company where the workforce benefits from generous arrangements that date back to when the business was acquired in the 1990s. The business is in the process of moving into bank ownership under a debt equity swap, and, unsurprisingly, the new owners would like to move the employment terms to a more commercially competitive basis. Clearly, any such negotiation involves give and take from both employer and employee; in this case employees are being asked to forego generous short-term and contingency benefits that impact on annual profitability, in exchange for participation in a long-term incentive scheme related to an eventual exit.

Pension black holes

Systemic long-term, massive problems do not go away of their own accord; they linger and continue to debilitate entire industries until there is a comprehensive industry-wide solution. Asbestos contamination is one such issue, unaffordable gold-plated defined benefit (DB) pension schemes is another. The manufacturing sector is particularly exposed as DB schemes are prevalent in long-established labour intensive industrial companies.

The rate at which pension scheme deficits have increased over the past 18 months is quite extraordinary. A fall in equity prices, increased longevity assumptions and, most importantly, a collapse in bond yields have caused an explosion in deficits. We have been working recently with an industrial ceramics business that traces its origins back to making furnace lining bricks for the steel industry in the nineteenth century. Between 2006 and 2009, this group's pension scheme shortfall has nearly tripled to approximately £50 million, caused almost entirely by a change in the actuarial assumptions.

In such a situation one has to consider whether the business can afford to fund such a deficit, bearing in mind that any such funds diverted to clearing a pension deficit are not otherwise available to invest in the long-term future of the business, service bank debts or pay dividends. It is tempting to hope that the deficit will shrink with rising bond yields and equity markets. Such a course of action can have a cost; while the BA board has continued to preside over what appears to be an unaffordable pension deficit of £6 billion, some four times its market capitalisation, the Iberian merger has been on hold and current employees are being squeezed for the benefit of their predecessors, with the resultant strike action.

> "One option for companies facing a massive unaffordable pension deficit is to reach a negotiated agreement with the Pension Protection Fund in which the PPF assumes responsibility for the scheme as part of a fundamental financial restructuring."

One option for companies facing a massive unaffordable pension deficit is to reach a negotiated agreement with the Pension Protection Fund in which the PPF assumes responsibility for the scheme as part of a fundamental financial restructuring. Such schemes are complex to execute and the PPF's terms for agreeing are stringent and potentially painful for the existing shareholders.

Do not remove a fly from your friend's forehead with a hatchet

The Chinese have many useful proverbs, including the aforementioned, but unsurprisingly nothing to warn foreign companies about the potential dangers of handing over whole chunks of their intellectual property and manufacturing capacity to wily Chinese partners. While the majority of manufacturers have benefited from outsourcing production to low cost countries (LCCs), increasing numbers are learning that it is often better in the long run to go it alone in emerging markets rather than work with local partners who may have very different cultural values, operating procedures and business ethics.

The potential problems are legion, but the most common appears to be that strategic partners can quickly become their competitors. It has long been rumoured that the majority of fake luxury products are produced by sister factories operated by the very same local organisations who the European goods companies have partnered with as part of an outsourcing strategy.

We have been working with a UK head-quartered automotive hose manufacturer that had established an LCC capability in China with a local partner. The company transferred their entire UK manufacturing capacity almost overnight. The transfer was initially satisfactory but soon major problems appeared. Quality standards fell and local Chinese labour and utility prices and shipping rates escalated dramatically. The Chinese partner became increasingly awkward and started to compete directly with the UK company. At this point the UK company had burned its bridges and found itself stuck in a failing JV, which brought the entire group to the point of collapse. A key element of the MPC-led turnaround strategy was based on the recognition that the Chinese venture was irretrievably broken and that an entirely new LCC approach was needed. We ended the Chinese JV completely and transferred all production to a new, wholly owned, green-field facility in Romania.

At our industrial ceramics client, we have faced a similar problem. Ten years ago the group established a facility in Indonesia under a JV with a local 'highly regarded and influential' businessman from a prominent wealthy family. Ten years later, it seems our influential family is not so suitable after all. One of the principals has been convicted of a major bank fraud and has fled the country and our key contact has just been declared bankrupt. We now find ourselves bogged down in the quagmire that is Indonesian insolvency law.

Night of the living dead

The UK economy urgently needs its manufacturing sector to restructure quickly, but the current outlook is mixed. Some companies are agreeing fundamental restructuring with their financial stakeholders as a necessary step towards rehabilitation. Others, however, seem to be entering a Japan-style decade of never ending half-baked restructuring solutions, which risks creating an entire swathe of zombie companies that will continue to labour under the burden of unsustainable debts. ☐

Julian Cooper is managing director of MPC Partners LLP

Tough trading conditions for manufacturers

Trading on in the current economic conditions is becoming more difficult. Russell Cash explores the options.

Manufacturers have been grappling with extremely difficult trading conditions for 18 months, some may say significantly longer. Many statistics can be used to illustrate just how difficult life has been – one that resonates with me is the fact that the number of cars on UK roads has fallen for the first time since the end of World War II; in fact the last 12 months have seen the first peacetime decline since records began in 1904. Equally, the fact that the Index of Production has fallen by approximately 13 per cent in the last 18 months demonstrates the degree of difficulties being faced.

Few positive trends

Balanced against such doom and gloom, recent months have seen an improvement in the Purchasing Managers Index where close to two thirds of buying teams are recording more favourable conditions than prior months as well as a small increase in the level of production. However, there is little, so far, under the heading of what you could legitimately call positive trends.

While there has been modest economic growth in Q1 2010, the climate for most businesses, in most sectors and most locations is typically somewhere between tough and very tough! In a recent survey of finance directors undertaken by Baker Tilly, 54 per cent of respondents expected no improvement in trading conditions during 2010 and a further 28 per cent predicted things will get worse.

The debate rages as to when businesses will really feel as if they are out of recessionary conditions – the answer will obviously vary between sectors and locations. One thing is for sure, while the economy and the subsections within it will, at some point, come out of recession, it will take a lot longer for it truly to feel like we are out of the downturn. As we all know, history has shown that more companies fail as we are coming out of a recession than while the economy is still in one. So whether it is turnaround or insolvency, our profession has been busy in recent times and is likely to get busier still.

It will be interesting to see the types of solutions that our profession will be able to offer and implement to support businesses. In this article I have sought to draw on a number of my own experiences in recent times as well as taking a trip down memory lane to reconcile the current tools of our trade to those that we employed in the last recessionary environment – sadly I have enough grey hair (my children would say I don't have much hair at all!) to make such comparisons.

> “The Index of Production has fallen by approximately 13 per cent in the last 18 months demonstrating the degree of difficulties being faced.”

The ability to trade on

In this environment it is becoming increasingly rare to see situations where IPs are able to continue to trade a business within the framework of an insolvency appointment.

By 'environment' I am not only referring to economic conditions but, importantly, to other factors such as the increased savvy of stakeholders. Let me take these factors and illustrate what I mean with reference to a number of key areas.

In the early 1990s, the strategy in an administrative receivership (yes do you remember that form of appointment!) typically centred around trading a business for six to eight weeks while entering into discussions with interested parties with a view to completing a sale of the business and assets. Turn the clock forwards 20 years and implementing corporate finance processes in condensed timeframes to ensure best value is obtained for creditors has become the norm. In this context, I have deliberately used this form of wording because the process must be professional and structured to ensure we are getting the best result for stakeholders as well, of course, as being compliant with SIP 16 requirements.

Trading on has just become plain difficult, for a variety of reasons:

- balance sheets seem more stretched with very little, if anything, under the heading of unencumbered assets
- creditors have become far more savvy
- stakeholders are all too keen to criticise an IP if a trading strategy ultimately proves anything other than wholly successful.

Let me examine a number of these challenges.

Duress and ROT creditors

Understandably, creditors will seek to protect their positions when a customer fails. Over the years, creditors have increasingly begun to take their own professional advice and as a result attitudes have typically hardened.

For years these suppliers may well have been extremely supportive towards the business, agreeing all sorts of concessions in a going concern environment. However, backed into a corner and potentially fighting for their own lives, the corporate Jekylls are increasingly changing into corporate Hydes. In some cases the stance adopted is influenced by the terms of credit insurance cover that the suppliers may have in place; more commonly the attitude is heavily influenced by a desire to survive themselves.

Full consideration of the likely attitude of key suppliers and the balance of power in the relationship must be made if a trading strategy is to be adopted. It is particularly important to determine which suppliers, if any, the business is wholly reliant on and which are capable of being substituted if the stance taken by the creditor dictates that this is necessary.

Some of the examples of creditors who had particularly strong negotiating positions in recent cases I have been involved with:

- a provider of scaffolding equipment that was crucial to work being performed for a demanding customer in extremely tight timeframes with huge penalty clauses associated with late completion
- a sole supplier of case-specific labels to a manufacturing business – there was no ability to resource, at least not within an acceptable timeframe.

In the heat of battle it is easy for an IP to become frustrated with the stance taken by such parties. But would you adopt a different approach? I very much doubt it. The impact of a big bad debt and the loss of a chunk of turnover can be devastating – I guess we have all experienced situations where the failure of one business has had a ripple effect and led to the demise of many other businesses that were very, or overly, reliant on it.

Managing the customer base

The onerous demands of key customers are often the reason for the demise of the business. The irony is that the same stakeholders can become the IP's best friend providing the confidence and, crucially, cash flow, which may be required to support a trading strategy. Again it is hugely important to understand the nature of the customer/supplier relationship and rehearse the likely reaction of key customers to their supplier's failure.

Customers who have squeezed margins and extended payment terms over a number of years can suddenly have no choice but to pay their outstanding debts in full and commit to take further products at 'proper' prices. A good example of this is the supply of food products into supermarkets – all of a sudden where the customer is unable to secure alternative products without going through lengthy quality control procedures, the balance of power in the relationship completely turns. By way of example, I found on one case it was quite remarkable what concessions a supermarket customer was prepared to make in return for delivery of sausage rolls!

We regularly hear about the degree of reliance a business places on its customers but how often do businesses fail to appreciate just how reliant they are on key suppliers. It is frequently the experience of a key supplier failing that awakens a management team to the inherent risk. I have been banging this drum for many years – insolvency helps focus the mind!

Motivating the workforce

'It's business as usual, as best it can be.' We've all said this or words to this effect when standing in front of the shop floor of employees on Day One of an appointment. But how can it possibly be business as usual?

It is difficult to quantify the impact that an announcement like this will have on productivity within a trading on scenario. From experience, one thing that will help is regular, open communication.

One particularly challenging assignment I led involved the need to motivate (and ultimately incentivise) shop floor workers to complete projects on a timely basis. Initially every hour early meant an hour's less remuneration – human nature dictated that an early completion incentive plan was always going to be core to a successful trading scenario. Such issues need to be acknowledged and planned for at the outset of any assignment.

At best, there will be a short period of disruption to the business; at worst, continuing to trade will be just impossible. I never rule out trading on as a strategy, of course not, but now, more than ever before, such a decision needs to be taken with very careful consideration of all such factors and of the support of key stakeholders who have a commercial interest in the ultimate outcome.

The move to a speedy conclusion

Against this background it is hardly surprising that over a number of years there has been a move to agreeing the sale of a business and its assets prior to an appointment. This ensures a seamless transition from the problem of insolvency to a solution of the sale of the business. Identification of interested parties and the progression of detailed discussions can be handled within a controlled environment without all the firefighting and problems encountered when trading on.

Of course, without being able to openly expose a business to the market during a trading scenario presents challenges to the IP who needs to ensure best value is obtained for the business and assets. SIP 16 compliance does raise some difficulties but provided there is time available there is no reason why a properly structured process should not deliver tremendously effective results.

“Against this background it is hardly surprising that over a number of years there has been a move to agreeing the sale of a business and its assets prior to an appointment.”

Summary

In summary, I believe as a profession we are likely to be as busy as most of us can remember by the end of this calendar year. I see no reason why we will not be able to support stakeholders in what will be turbulent times. Where it does not prove possible to save the balance sheet, careful consideration will need to be made as to whether trading a business in insolvency is (i) possible and (ii) likely to produce a better return than a properly structured, and therefore SIP 16 compliant, accelerated sale process. More than ever before it becomes crucial that we are engaged on a timely basis where a number of options are still available. ☐

Russell Cash is a partner at Baker Tilly Restructuring and Recovery LLP.

China: the world's factory

Dealing with insolvencies in the manufacturing sector in mainland China and Hong Kong in the light of the introduction of the law on Enterprise Bankruptcy in June 2007.

First some clarification; although Hong Kong is part of the PRC, it is a Special Administrative Region whose laws derive from English common law and statute. Moreover, over the last two decades, Hong Kong-based manufacturers have moved their production facilities into the mainland leaving only head office or administrative functions within the territory. Accordingly, the laws of Hong Kong *and* the PRC apply to most manufacturing sector insolvencies.

Applicable laws in Hong Kong are old; there is no rescue procedure apart from a scheme of arrangement which, unlike in Singapore and Malaysia, does not initiate a moratorium prior to creditor approval and court sanction. The only rescue process is the judicial band-aid of provisional liquidators available in limited circumstances. There are no laws dealing with cross-border issues and frequently local creditors obtain advantages – often under the auspices of freezing orders obtained from the People's Court.

To exacerbate matters, banks and other lending institutions are reluctant to provide rescue financing necessitating distressed businesses to continue to operate with inadequate working capital. This creates the work-down rather than the more common work-out.

Manufacturing in China

Against this backdrop, manufacturing in China has:

- significantly improved its prowess following the shift from a command economy towards a socialist market economy
- cost advantages such as low land prices, natural resources, local part suppliers and competitive labour expenses
- the scale and ability to produce quality goods
- captured worldwide markets: the city of Wenzhou in eastern China, produces 70 per cent of the world's metal cigarette lighters
- concentrated upon the production of goods for export rather than for domestic consumption: Walmart buys in excess of US$18 billion of goods from China annually.

Economic and restructuring challenges

A massive shift in economic power is underway, which was confirmed by the resilience of the Chinese economy to the recent financial crisis. Nevertheless, problems have occurred and continue to do so. The mainland is subject to effective competition from newly developing countries like India, Indonesia, Cambodia and Vietnam. These factors in conjunction with poor management, over expansion, poor corporate governance and fraud cause distress, as elsewhere.

Legal challenges

The PRC Law on Enterprise Bankruptcy (Bankruptcy Law) attempts to unify insolvency legislation under a single framework consistent with the socialist market economy. However, despite its introduction, challenges remain in navigating the restructuring of an insolvent enterprise. Generally, these challenges favour commercial negotiation and persuasion over the implementation of formal insolvency and restructuring procedures.

The majority of Asian jurisdictions present similar challenges. From a technical perspective, the lack of laws addressing recognition of foreign insolvency proceedings is the main rationale for a consensual approach. While the Bankruptcy Law includes suitable provisions, there has been no successful attempt to use them. Recent restructurings suggest that foreign creditors (especially those who are structurally subordinated to local creditors) face considerable hurdles in obtaining recoveries from the mainland.

An example is the restructuring of Guangdong-based Asia Aluminum Group (AA) involving a sale of all PRC operating companies to existing owners following the appointment of provisional liquidators in Hong Kong. While the claims of local creditors were preserved in full, structurally subordinated foreign holders of senior and payment in kind notes received returns of only 19.03 per cent and 0.72 per cent respectively. These notes did not have the benefit of security, leaving holders ranking behind local creditors. Similarly, in the case of FerroChina, a steelmaker in Jiangsu, foreign creditors were excluded from the mainland restructuring process despite having appointed receivers overseas.

Preferential treatment of creditors

Preferential treatment of local creditors is a discernable feature of insolvencies in the PRC, irrespective of industrial sector. One of the problems faced by the provisional liquidators of AA was the ability of local creditors (and suppliers) to (i) obtain freezing orders over assets in China (including the power station supporting its factory) and (ii) exert influence over governmental authorities, which in turn sought to influence the direction of the restructuring to preserve social stability. Freezing orders were also obtained recently by local creditors of Ya Hsin Electronics (YHE), a Suzhou-based electronics manufacturer, to secure assets of the company and to create leverage.

Government or regulatory pressures

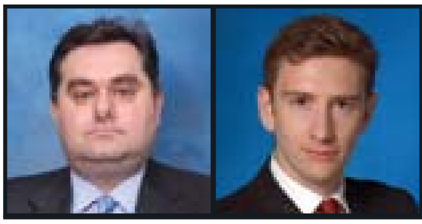
Another common theme in Asia is the distortion of commercial and legal processes through governmental or regulatory pressures. In China, the Bankruptcy Law is ultimately interpreted by the Supreme Court, overtly reflecting the policies of the State Council in Beijing. The influence of government is particularly prevalent in the manufacturing sector because manufacturers often play a pivotal role in providing employment. The importance of maintaining social stability cannot be underestimated.

The YHE restructuring is relevant; following demonstrations by employees, the local government stepped in and negotiated the terms of a restructuring plan with creditors, which preserved their claims but disenfranchised the owners in Taiwan. Similarly, the restructurings of Shanghai-listed San-an and Huayan creditor committees were dominated by governmental agencies.

Will the Bankruptcy Law be the route for restructuring in the future?

In practice, the Bankruptcy Law is not the starting point for any restructuring given systemic weaknesses, which include the People's Court not being obliged to accept any case. This uncertainty caused Smart Union Group (a toy manufacturer from Dongguan) to abandon operations leaving the government to deal with the aftermath.

As global competition has intensified, China has not been insulated from its impact; for example, many shoe manufacturers have closed because of alternatives made in Laos. More widespread difficulties have been cushioned by the economic stimulus provided by the central government. However, as that liquidity is removed, further problems in manufacturing are likely to emerge. It remains an open question whether the Bankruptcy Law will become the core of the insolvency process. □



Mark Fairbairn is a partner and Damien Coles is an associate at O'Melveny & Myers LLP.

PRC manufacturing: lessons for foreign investors

Cosimo Borrelli suggests that a new law could help creditors in cases of insolvency.

The world financial turmoil of late 2008 and 2009 has brought a renewed focus on the People's Republic of China (PRC). PRC is a major destination for foreign direct investment (FDI). Most of the FDI finds its way to PRC through companies incorporated in offshore jurisdictions such as the Netherlands Antilles, Cayman Islands (Cayman) and British Virgin Islands (BVI). More than 60 per cent of FDI inflow to PRC is focused on the manufacturing sector and a large portion of that inflow comes from the European manufacturing community. As a result, many recent PRC insolvency and restructuring projects have involved the manufacturing sector with the heavy involvement of European investors, joint venture partners, suppliers and customers.

There are many reasons why offshore holding structures are popular with foreign investors in PRC, particularly European investors. These include preferences for offshore regimes and processes; unfamiliarity with or wish to avoid PRC's legal; and regulatory systems; and tax planning and benefits.

> "The concept of a legal representative is important in PRC and never more so than when there are signs of trouble or distress."

It is no secret that the pros and cons of all investment structures should be thoroughly reviewed before entering into any foreign investment. The importance of this is often highlighted when a PRC investment does not go to plan and an insolvency or restructuring professional (usually from Hong Kong or Singapore) is called in to help.

Investment vehicles in PRC

There are five common foreign investment structures for manufacturing related investments into PRC:

1) Investing directly (direct investment) – foreign investors directly hold (limited classes) assets in PRC through an offshore company.
2) Representative office (RO) – an extension of a foreign company. It cannot engage in any direct profit-making activities.
3) Wholly owned foreign enterprise (WOFE) – separate legal entity formed in PRC with foreign capital. The foreign investor has full management control through the appointment of a legal representative.
4) Equity joint venture (JV) – entity where foreign and PRC investors jointly provide capital contributions and the investors share risks, losses and profits proportional to their contributions. Also controlled by a legal representative.
5) Co-operative joint venture – based on a contractual agreement between PRC and foreign investors, and sharing risks, losses and profits in accordance with arrangements, as agreed. This entity is also controlled by a legal representative.

Legal representative

The concept of a legal representative is important in PRC and never more so than when there are signs of trouble or distress. A legal representative is an individual with board powers and unlimited liability. A legal representative of a WOFE/JV is appointed by the members in accordance with the Articles of Association and such appointment must be registered with Administration for Industry and Commerce (AIC) in order for the appointment to take effect. The legal representative exercises rights of and assumes obligations on behalf of the WOFE/JVs and the behaviour of the legal representative is often deemed as the corporation's behaviour. In other words, the PRC entity can only exist through the legal representative and only the legal representative can speak for or bind the PRC entity.

In a distressed or troubled situation, such as when administrators or liquidators come to control one of the foreign shareholders, the appointment of the administrator as the legal representative of the WOFE/JV is a crucial step in taking control of the assets and/or business in PRC. This is often an early battleground for any foreign administrator trying to obtain control of or realise an investment or assets in PRC as the legal representative is often the local partner and, very often, reluctant to cede control.

Controlling distressed assets in PRC

The options available for foreign investors in controlling distressed investments in PRC largely depend on the original holding structure of the PRC entities or assets.

Direct investment and representative office

Taking control of PRC assets through changes in directors under these two structures is relatively straightforward when all directors are co-operative. However, in a distressed situation, such co-operation is rare and the appointment of an administrator to the offshore holding company is a necessary first step. A notarisation of the appointment documents, including the appointment order granted by the offshore court by a China-appointed attesting officer will then be required in order to obtain the recognition of the appointee's role in PRC. There are currently no reciprocal treaties between the PRC and most of the favoured offshore jurisdictions in respect of such appointments. A PRC legal opinion in respect of the appointment may also be required and thereafter, the liquidators will be able to control the PRC assets.

WOFE and JV

WOFEs and JVs are the most popular structures used in the manufacturing sector in PRC. Where the legal representative is not prepared to assist the administrator, it is necessary to replace the legal representative of any WOFE/JV in order to take control of the company. The first task is to pass a members' resolution of the WOFE/JV pursuant to the company's articles and association. An application in respect of the registration of the appointment will then be filed with AIC. The liquidators will need to submit the notarised appointment order together with the company chop or seal and the business licence of the WOFE/JV to AIC in order for this to happen.

In the case of a JV, the change of legal representative will require the co-operation of the PRC investor. Where the PRC investor does not co-operate or the liquidators cannot take control of the company chop or seal and business licence, an application to the PRC court will be necessary. Such an application can take weeks or months to be resolved and until

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there is a decision or a resolution, the assets will remain under the control of the PRC partner. If the assets are considered at risk, an application can be made to a PRC court for seizure or attachment orders. Such orders are often a valuable tool for any foreign administrator.

> In a PRC bankruptcy the preservation orders over assets (by creditors) will be released thereby improving the return to the other creditors.

Onshore bankruptcy

In some circumstances, the bankruptcy of a local WOFE/JV in PRC may be beneficial to the foreign investor or administrator. In distressed situations, individual creditors of a PRC entity can apply to seize or attach assets in their favour – it is a first come first served entitlement. In a PRC bankruptcy the preservation orders over assets (by creditors) will be released thereby improving the return to the other creditors. All legal proceedings against the WOFE/JV in PRC will also be stayed.

Pursuant to the PRC New Enterprise Bankruptcy Law (new law), a bankruptcy petition can be made to the PRC court by the company and creditors. The PRC court shall decide whether to accept the petition within 15 days but the acceptance of the petition by the PRC court does not mean that the company is bankrupt. Prior to any such decision, an independent administrator will be appointed to assess the possible bankruptcy, manage the affairs of the company and prepare a reorganisation plan (if possible).

The new law requires the administrator to prepare an asset realisation and distribution plan and submit it at a creditors' meeting for discussion and adoption. Unless otherwise agreed by creditors, the administrator is obliged to dispose of all assets by auction. The new law provides that secured creditors have priority over assets pledged to them by the company and allows them to claim any shortfall suffered after realising the secured assets as ordinary creditors. The distribution plan adopted at the creditors' meeting should be submitted to the PRC court for approval and then carried out by the administrator once approved.

The company may be made bankrupt by the PRC court where:

- the company cannot meet its debt obligations and the liabilities of the debtor exceed its assets
- the administrator is unable to prepare a reorganisation plan in respect of the company
- such a plan is not approved by the creditors
- the company fails to implement the plan.

To date, the new law has been used infrequently, usually to aid government and/or industry consolidation and reforms rather than as a result of any creditor initiatives. ☐

Cosimo Borrelli is managing director of Borrelli Walsh.

Is the Trade Credit Insurance scheme good for small business?

John Walker asks whether the government's Trade Credit Insurance scheme is too little, too late?

As the voice of small firms, the Federation of Small Businesses (FSB) had reservations about the impact the Trade Credit Insurance (TCI) scheme would have on our members. The recession hit us hard and although only eight per cent of members used TCI, we felt they would suffer as the restrictions placed meant they wouldn't be able to access the scheme.

To put into context, the recession of 2008 to 2009 hit all businesses hard but small businesses, without the back up of the profits larger firms enjoy, felt it the most. Business and consumer confidence was – and in some respects still is – at an all time low. People and firms tightened their belts and reigned in spending, meaning cash-flow suffered further. At the height of the crisis, up to 120 businesses were closing their doors per day as banks were unwilling to lend and creditors were paying late.

When the banking system collapsed in 2008, the FSB was on hand and advocated a £1 billion loan guarantee, which was subsequently adopted as the Enterprise Finance Guarantee by the government. This and other emergency measures, including the TCI top-up scheme, have helped stem the flow of insolvencies but we should not be lulled into a false state of security as much larger and longer term structural problems remain.

SMEs and trade credit insurance

As businesses faced bankruptcy, many insurance companies began to reduce the amount of trade credit insurance cover they would provide. This meant that many businesses, especially in manufacturing and related industries, faced increased exposure in the event of a customer default.

These businesses also faced huge problems accessing finance through the banks, which made headlines, but more importantly caused real difficulties to all firms. This lack of funds caused job losses, reduced output and put growth and expansion plans on hold. While this situation has changed somewhat and small businesses can access finance now, the FSB is worried that the cost of this money has shot up.

Has TCI helped small businesses?

The government quickly stepped in and introduced several business support schemes under the umbrella 'Real Help Now', to support businesses through the recession and access much-needed finance. The TCI top-up scheme was announced in the summer of 2009 to top up the policies for up to six months for businesses that had their cover reduced. The government allocated £5 billion to the scheme but we felt it was put in place too late after the initial shockwaves of the recession took hold; we were also very concerned that it would not help if credit had already been withdrawn from the business.

> "For many SMEs, the original £20,000 threshold and two per cent premium were too high for them to be able to afford to take up the cover and we felt it cut off those firms that needed short-term TCI cover, or TCI at a low level."

For small businesses, the problem of trade credit is not so acute. Only eight per cent of FSB members used trade credit insurance and for most, it was on an ad hoc basis. However, it made it ever more difficult to get cover when they wanted it. The high thresholds and punitive charges of the scheme meant that, even if a small firm wanted cover, it was unlikely that it could afford it.

Our initial concerns seem to have been proved right. A recent National Audit Office report into the government's business support schemes said that only 109 businesses had been successful in accessing the scheme and that take up was significantly lower than expected with only £18.6 million of the £5 billion available being delivered to businesses.

For many SMEs, the original £20,000 threshold and two per cent premium were too high for them to be able to afford to take up the cover and we felt it cut off those firms that needed short-term TCI cover, or TCI at a low level. Many small firms didn't have rolling contracts and would take policies out as a one-off to cover certain jobs, meaning they too weren't eligible for the scheme.

Another cause for concern cited by SMEs is that they felt that the extra premium charged by the government was never explained and that, at a time of severe lack of orders and cash flow for businesses, this was an increased cost they could ill afford. Although the scheme was reformed mid-way through, removing the threshold and reducing the premium to one per cent, businesses had already adapted to the situation.

Promoting TCI

Another issue we feel could have contributed to the low take up of the scheme is that while some of the initiatives introduced to help businesses were properly advertised, such as the Enterprise Finance Guarantee and the scrappage scheme for cars, the TCI scheme was never properly highlighted.

The FSB-ICM Voice of Small Business Annual Survey showed that 72 per cent of respondents were unaware the scheme existed, perhaps because it was introduced when it was too late for it to be of use to businesses but also because of a lack of understanding about the sector by the government. The National Audit Office report says that the 'Department had virtually no knowledge of the trade credit insurance sector' and it is likely that this meant there was no enthusiasm to communicate the scheme, even with the help of business groups.

Although the situation could have been worse for small businesses – the lifeblood of the economy – there are still long-term challenges that need to be addressed to ensure the UK keeps going on the road to recovery. □

John Walker is national chairman of the Federation of Small Businesses.

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Trading in administration: a manufacturer's tale

Brian Rawlings advises that advance planning is key to trading any administration successfully.

Trading insolvencies are relatively rare these days. More commonly, assets are disposed of by way of a pre-pack or the business is traded for a very limited period before a sale.

This article concerns some of the legal issues administrators may encounter if they trade a manufacturing business. These issues are considered below.

Issues with customers

There are two broad strategies for dealing with customers:

(i) seek to retain customers to maximise value on the sale of the business; or

(ii) seek to extract the maximum possible value from the supply of parts to the customer.

Both depend to an extent upon the customer not being able to switch suppliers.

> "The administrators' ability to increase the price paid by the customer may depend upon whether the company's agreement with the customer imposes a continuing obligation on the company to supply parts or whether the company has the right to accept or refuse future orders."

In strategy (i) the administrators will wish to ensure at least that the company will not incur a loss. They will seek either to increase the price of parts or to agree a formula that ensures that no loss is made. They will also wish to avoid any liability for quality or fitness for purpose or failing to supply on time, or at all.

In strategy (ii) the administrators will seek to maximise the price at which they sell parts to the customer. Strategy (ii) is only likely to succeed where the customer will suffer significant loss if they do not receive the parts.

The administrators will wish to avoid the same liabilities as in strategy (i). Their ability to increase the price paid by the customer may depend upon whether the company's agreement with the customer imposes a continuing obligation on the company to supply parts or whether the company has the right to accept or refuse future orders. If there is a continuing obligation to supply the administrators may be restricted to a small operating profit.

Issues with suppliers

While administrators may be in a position to extract 'ransom payments' from customers, equally, the company's suppliers may be able to extract similar sums from the company.

Two issues that administrators will frequently encounter are:

(i) retention of title claims, made by suppliers; and

(ii) the question of ownership and the right to possession and control of tooling.

Claims for retention of title are common. If parts, subject to claims, are required for the purpose of trading the starting point is that the moratorium created on appointment of administrators prevents the claimant from repossessing their goods without the consent of the administrators or permission of the court. This does not entitle the administrators to use goods that are subject to valid retention of title claims. It is common for the administrators to give an undertaking to pay the invoice value for goods provided the claimant is able to establish, to the satisfaction of the administrators or a court, that the title claim is valid. This will normally avoid a court granting an injunction requiring the company in administration to refrain from using the goods.

Where a supplier manufactures bespoke parts for the company in administration, specialist tooling is often created to enable the supplier to manufacture those parts. The existence of this specialist tooling may restrict the ability of the company to switch from one supplier to another and may prejudice a subsequent disposal of the business and assets because the purchaser may fear that a supplier in possession of the specialist tooling, may require ransom payments from the new business.

Questions commonly arise as to whether the company or the supplier owns the tooling or if the supplier is entitled to retain the tooling rather than the company.

The determining factor is likely to be what was agreed between the company and the supplier when the tooling was initially fabricated or delivered to the supplier (if anything was, in fact, agreed) and who paid for the tooling. If the tooling is owned by the company then, absent specific agreement, it is unlikely the supplier will have a right to retain the tooling (other than for costs that the supplier incurred directly in relation to the tooling).

Leases

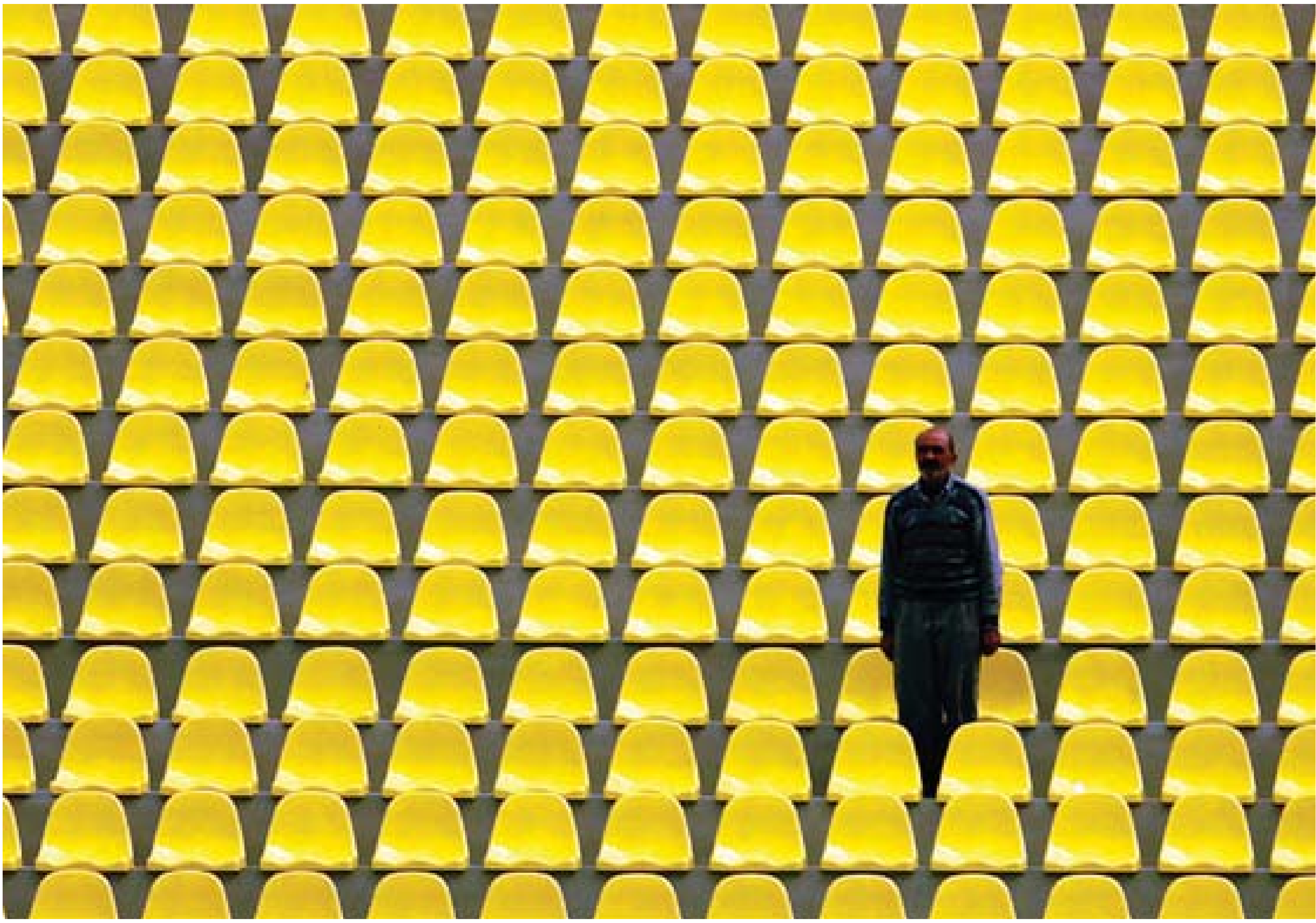
The starting point on leases (whether of land or chattels) is that the moratorium provides that such a lease cannot be forfeit without the consent of the administrators or the permission of the court. This protects the company's occupation of the trading premises and its use of essential plant and machinery.

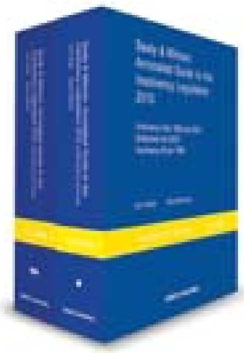
So far as payment for occupation and use of chattels is concerned, administrators frequently seek to restrict rental payments to the area and period of occupation thereby potentially substantially reducing the rentals that would otherwise be payable under the lease.

The recent High Court decision in *Goldacre* (see page 7) appears to require that the administrators (if they choose to use the premises or chattels subject to the lease) pay the full rental due under the lease or contract on the contractual dates (in the case of a land lease, normally quarterly in advance). This may, in certain cases, make it very much more expensive for the administrators to trade a manufacturing business particularly if the premises or plant and machinery are substantial and the administrator intends to use only part for the administration trading period.

Advance planning is key to trading any administration successfully. □

Brian Rawlings is a senior associate at Eversheds LLP.





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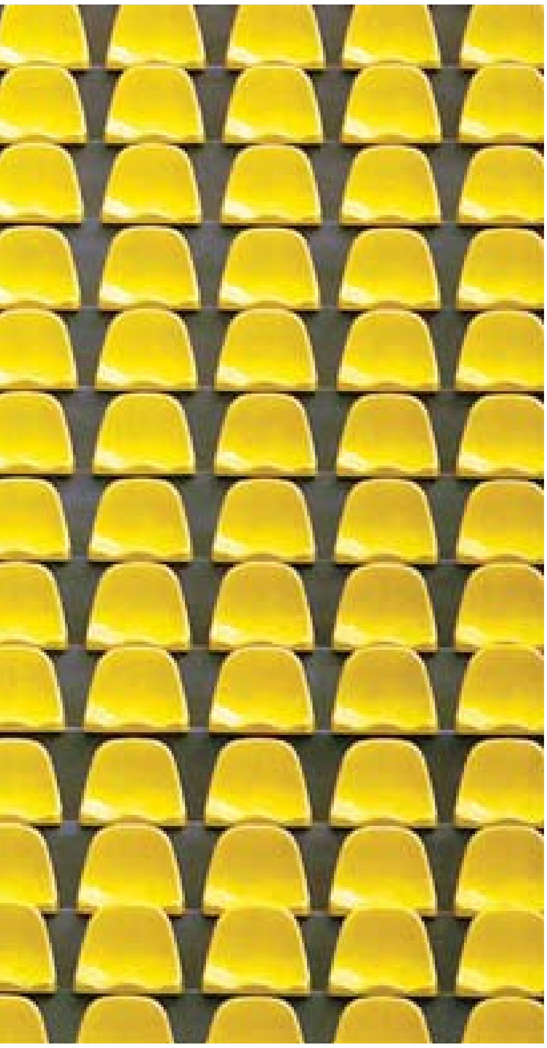

Madoff and asset recovery issues

John Verrill outlines why resolution of the Madoff fraud is not plain sailing.

When on 11 December 2008 Bernie Madoff revealed his Ponzi scheme to a startled world most people asked themselves, 'Where's the money?' Of the $64 billion reportedly lost about £1.4 billion has been recovered in total, globally. Since a Ponzi scheme involves new investors paying the coupon of the old investors, cash is eaten up paying for historical performance, so there was never likely to be much of a recovery in percentage terms.

In the US Bernie's revelation resulted in a two-pronged regulatory response: first under the Securities Investor Protection Act 1970 (SIPA) a trustee was appointed to Bernard L Madoff Investment Securities LLC (BMIS) and in parallel the Securities and Exchange Commission (SEC) appointed a receiver and obtained temporary restraining orders (TRO) over the assets of Madoff, the man, globally; this apparently included assets within Madoff Securities International Limited (MSIL) his personally owned London operation.

Recovering the assets in the UK

On becoming aware of the scale of the fraud and the comprehensive nature of the TRO, all Madoff bank accounts in the US and the UK were frozen. UK banks with US branches were not in a position to take a view on the scope of the TRO and its effect in London. In the week commencing 15 December 2008 the SEC receiver arrived in London and set out to secure his assets. Unfortunately for him, as the recent *Stanford* case in the Court of Appeal shows, as SEC receivership is not a collective insolvency proceeding, it has little or no traction in this jurisdiction, notwithstanding the terms of the TRO.

To protect the assets of MSIL properly, the intervention of the courts in England was needed. Having briefly considered administration (discarded on the grounds of no purpose) the MSIL directors petitioned for the appointment of provisional liquidators: the Joint Provisional Liquidators' order was made on 18 December 2008 (JPL order).

Making use of the CBIR

As well as UK asset and data preservation, a key component of the JPL order was the ability to co-operate, to the extent possible, with the SEC receiver and with the SIPA trustee. It became clear that the SEC receiver had very limited effect outside the US but that the SIPA trustee was capable of recognition under the Cross-Border Insolvency Regulation 2006 (CBIR).

The SIPA regime applies only to securities' companies that have failed (such as Lehman). The asset recovery process is entrusted to the SIPA trustee and funded by the Securities Investor Protection Commission (SIPC). The SIPA trustee also administers a compensation scheme on behalf of SIPC where victims receive up to US$500,000. The SIPA trustee also marshals any securities held by the failed institution with a view to returning them to investors *in specie*. BMIS hardly ever traded so there were no holdings to return to victims; all the statements of account issued to victims were fictitious. SIPA also works like a Chapter 11 case and the relevant parts of the Chapter 11 Code apply to the proceeding, in particular, the investigatory powers and the transactional avoidance provisions are in play.

On 27 February 2009, the SIPA trustee obtained recognition of his US SIPA proceedings in the High Court under the CBIR as foreign main proceedings. Recognition brings with it the active assistance of the English court and enables the US proceeding to be treated as home grown in a number of important respects. Also on that day, the SEC receiver resigned ceding his functions to the SIPA trustee.

Potential to fall foul of the Data Protection Act

During investigations which, for the JPLs, started in earnest in January and February, it became clear that the freedom to pass information to the SIPA trustee in the US from the JPLs in the UK was fraught with difficulty because a huge amount of information was held electronically and could be personal data. In view of the criminal investigations on both sides of the Atlantic, the data would need to be reviewed to establish whether individuals were complicit in Bernie's fraud. It appeared that the data would include personal data, the disclosure of which outside the EU could have exposed the JPLs to personal risk from those claiming to be distressed – the expression used in the Data Protection Act.

Accordingly, application was made to the court to pre-clear disclosure of information to the SIPA trustee under the public policy exception of the Data Protection Act. This was against the backdrop of asset recovery activity but also involved a huge amount of fruitless (in asset-recovery terms) but necessarily important investigatory work.

Rather than risk having this work unrewarded, when the JPLs fees came to be fixed, a work programme and expense schedule was approved by the English court in advance. As part of this approved process, all the staff of MSIL were interviewed over the summer of 2009, for the most part with representatives of the SIPA trustee taking an active role.

Recognition under the CBIR in principle enabled the SIPA trustee to use section 236 of the Insolvency Act to get at information such as staff interviews. Formal orders of the court have generally proved to be unnecessary so that the JPLs and

> "A cross-border protocol was executed to serve as an aide memoire to the level of co-operation that both the JPLs and the SIPA trustee were committed to."

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SIPA trustee have been able to interview in tandem, saving cost and time.

One issue that arose was the management of privilege. It was important that only those central to the SIPC/JPL process had access to documents and transcripts. Privilege in England arises from the nature of a document or communication; in the US a claim to privilege has to be asserted. To address this concern a Common Interest Privilege agreement was executed in tandem with a confidentiality agreement to address residual concerns about disclosure.

Co-operation between the US and UK

It is also clear that US/UK co-operation was key, particularly following the recognition of the BMIS proceeding and the DPA judgment. A cross-border protocol was executed to serve as an aide memoire to the level of co-operation that both the JPLs and the SIPA trustee were committed to. This was approved by the US and English courts.

Asset recovery was a key function. In the US the proceeds of crime regime provides that from the date of commission of a crime its proceeds are held on trust for the state. This process is enforced by the Department of Justice (DoJ) who, from the outset in December 2008, had argued that even the assets of MSIL in the UK were the proceeds of a US crime and belonged to the DoJ.

There is no international recognition of the DoJ's position. However, unlike the Proceeds of Crime Act in the UK, once forfeited, the assets recovered by the DoJ are generally applied to compensate victims of the crime.

MSIL's assets comprised open trading positions that were closed out, cash and Bernie's big boys toys: his €5 million yacht in Antibes in the South of France and his brother's vintage Aston Martin in Florida, both paid for by MSIL (and also claimed by the DoJ).

To secure the car, proceedings recognising the JPLs' appointment under Chapter 15 of the US Code, which implements the UNCITRAL Model Law on Cross-Border Insolvency in the USA, were opened in Florida. Recognition was granted and a consensual solution is in sight.

Dealing with a French claim

As regards the yacht, the JPLs arrested the vessel under the International Convention for the arrest of sea-going ships (Brussels 1952) but on the same day a French company, purporting to be a victim, made its own arrest. Brussels 1952 applies only to maritime claims, which was clearly the case in respect of MSIL's ownership assertions but wholly unclear in the case of the French victims who had invested in a Luxembourg SICAV (Sociétés d'Investissement à Capital Variable). The yacht, *Bull*, was registered in Cayman to the Yacht Bull Corporation, a Cayman company, despite having been paid for by MSIL. Urgent steps were taken to lift the French victims' arrest, which succeeded at the end of 2009 in the Appeal Court of Aix en Provence.

The JPLs had also commenced proceedings under section 234 of the Insolvency Act seeking a declaration as to ownership and also seeking to stay the French victims' proceedings as far as they affected the yacht as an asset of MSIL relying on section 130 of the Insolvency Act. However, the French victims argued that the arrest was a submission to the jurisdiction of the French court for all purposes and that, despite the provisional liquidation being a main proceeding under the EC Insolvency Regulation, it did not apply because the petition forming the basis for appointment was based on just and equitable grounds and also that MSIL was an investment undertaking. Investment undertakings are outwith the EC Regulation.

> "This saga shows how a determined claimant can frustrate, even in the modern cross-border co-operation environment, efforts to realise assets for all creditors not just some."

The victims argued that since the section 234 proceedings did not have the necessary close connection with insolvency proceedings (they are a means of bringing claims that could be brought by a solvent company) the EC Judgments Regulation applied, which required them to be sued in France where they were domiciled. Matters were complicated by the fact that in order to harden the MSIL arrest of *Bull*, as required by Brussels 1952, proceedings had been commenced in Cayman to rectify the register of ships to show MSIL as true owner. These had been stayed pending resolution of the jurisdiction issue in England.

In February 2010, the chancellor decided that the EC Judgments Regulation did apply to the 234 proceedings indicating that matters in France must take their course and there would be no stay as requested by the liquidators; [2010] EWHC 133 (Ch).

The status of MSIL

By the time of the hearing MSIL was in compulsory liquidation. On 15 December, the court had been satisfied that MSIL was insolvent as a result of claims for the return of cash from the BMIS trustee and the petition, which had been amended so that it was based upon MSIL's inability to pay its debts. This left the issue of MSIL's status as an investment undertaking. The victims argued that since MSIL was FSA registered it was an investment undertaking. The liquidators, in response, pointed out that the expression 'investment undertaking' in the EC Insolvency Regulation is qualified by wording to the effect that MSIL must have held money for third parties and provided services to them on a regular basis. Evidence was produced to show this did not happen so that the chancellor was able to conclude that the EC Insolvency Regulation did apply. During the course of the hearing he also gave permission to amend the 234 claim to one including relief under sections 238 and 423 of the Insolvency Act, remarking that since such claims were closely connected to the liquidation the EC Regulation the Judgments Regulation would apply. These claims were not available while MSIL was in provisional liquidation.

The scope of the EC Insolvency Regulation

The case shows that the courts here and in the EC are narrowing the scope of the EC Insolvency Regulation. Part of the decision was based on the case of *German Graphics* in the European Court of Justice in September 2009, this emphasised that only proceedings closely connected with the insolvency case would enjoy the territorial reach of the EC Insolvency Regulation, which applies UK insolvency law throughout the EU. In other proceedings the Judgments Regulation applies even though the UK debtor is in an insolvency proceeding.

At the time of writing, there are no proceedings concerning title on foot in France; so there is an impasse, and it is likely that the issue will fall to be determined in Cayman, until the MSIL claim is amended to include relief under sections 238 and 423. Also, after the Court of Appeal in Aix en Provence had lifted the victims' arrest, they re-arrested the vessel asserting that since a portion of the stolen money, albeit very tiny, must have found its way into paying for maintenance of the boat, their claim was indeed maritime. This is being challenged in the Aix court.

This saga shows how a determined claimant can frustrate, even in the modern cross-border co-operation environment, efforts to realise assets for all creditors not just some. The delay to the efforts to realise the yacht are unhelpful but the courts have been unable to assist to the extent one might have hoped in dealing with what is, at best, an opportunist claim. ☐

John Verrill is a partner at Dundas & Wilson.

International recoveries: strategic considerations

Obtaining early, high-quality, local advice is key to developing and implementing a successful international recovery strategy.

The pursuit of claims by insolvency office-holders on behalf of insolvent estates where the prospective defendant and/or its assets are located abroad presents complex challenges. In which jurisdiction and by what means should the claim be pursued? Will the office-holders be recognised by local courts? What needs to be done to safeguard the defendant's assets pending enforcement? This article highlights some of the main preliminary considerations when formulating a strategy to take the claim forward.

Choosing the right jurisdiction for the claim

In some cases the claim will have to be brought in a particular jurisdiction but in others there may be a legitimate choice as to where to bring the claim. Where that is the case, the following factors should be considered in relation to each potential jurisdiction:

1) Will a judgment from the courts in that jurisdiction be recognised and enforceable in the country or countries where the defendant's assets are located? If so, how complex is the recognition and enforcement process? The simplest option is to bring the claim in the jurisdiction in which it will need to be enforced but that may not always be possible or preferable.
2) Does the jurisdiction provide a robust and fair court system? Questions might arise as to the timetable for court proceedings and the ability of the defendant to cause delays; the impartiality and experience of the judges that will hear the case at each stage; and the levels of appeal available to the parties.
3) Can the office-holder get effective legal representation in that jurisdiction? The available pool of high-quality legal advisers experienced in the relevant field may be limited in some jurisdictions. If so, it will pay to retain the preferred adviser early, and doing so first may be crucial to a successful outcome. If a number of jurisdictions are involved, it is not uncommon for office-holders to use their domestic advisers to co-ordinate advice from across the relevant locations.
4) Will the courts in that jurisdiction respect different governing laws that may apply to all or certain aspects of the case (for example, the law of a particular contract)? The system of law by which the dispute is to be determined is not always the law of the jurisdiction where the claim is best pursued.
5) What are the rules on privilege, disclosure and evidence? Do these rules work for or against the office-holder?
6) What is the costs regime in that jurisdiction? Do the courts award adverse costs and, if so, if the case is lost, is there any risk to the office-holder personally?
7) Is that jurisdiction the one that can most efficiently hear the case? This brings in considerations such as where the parties, witnesses and documents are located and the main language(s) used in the evidence.
8) What are the court fees applicable to a claim in that jurisdiction? In some jurisdictions the court fees may be a percentage of the value of the claim and can become a material factor.
9) What remedies can be granted by the courts in that jurisdiction? Consider not only final awards but also the potential to obtain interim relief pending trial, such as a search order or a freezing injunction.
10) Will the office-holder be recognised as having capacity to bring a claim in the name and on behalf of the insolvent estate? This should present less difficulty in countries to which the EC Regulation on Insolvency Proceedings applies and countries that have implemented the UNCITRAL Model Law (assuming, of course, that the requirements for recognition under the Model Law are satisfied).

Is it appropriate to use the English courts?

Given that English office-holders will be familiar with the timescales and workings of the English courts and the legal advisers available to represent them, they may well prefer, if possible, to pursue the claim in England with a view to enforcing the judgment in other jurisdictions if necessary.

In very broad terms, the English courts may have jurisdiction (despite the fact that the prospective defendant is located abroad and assuming it has no intention of submitting to the jurisdiction) if:

- the case involves certain types of assets, such as land or intellectual property rights, located or registered in England;
- the parties have agreed that the English courts should have jurisdiction; or
- the claim has some other sufficient connection with England, such as that the underlying contract was agreed or performed in England or subject to English law, or the act causing loss occurred in England.

Even if the English courts accept jurisdiction, the defendant might be able to mount a challenge to that jurisdiction, delaying progress. For example, if the jurisdiction of the English courts is based on a connection with England, the defendant may argue that the courts of some other jurisdiction are more conveniently placed to decide the dispute for reasons such as the location and convenience of witnesses, the governing law of any relevant agreements, the whereabouts of documentation, and/or the place where the parties reside or carry on business.

> "Even if the English courts accept jurisdiction, the defendant might be able to mount a challenge to that jurisdiction, delaying progress."

In addition to questions of jurisdiction, it is also necessary to confirm at the planning stage the extent to which, and the means by which, an English judgment could be recognised and enforced in the jurisdiction(s) where the prospective defendant's assets are located. This will be much simpler if enforcement is to take place within another EU member state (or certain other European states including Switzerland, Norway, Gibraltar and Iceland), which are subject to European regulations limiting the ability of the courts in those states to re-examine the merits of the case or the jurisdiction of the English court. If enforcement needs to take place

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outside Europe, the position is likely to be more difficult and depends on the local law and practice of the jurisdiction concerned. In some countries an English judgment may have little or no value; in others there may be reciprocal arrangements in place to allow for registration and enforcement, as in the case of quite a number of Commonwealth states, including India, Pakistan, Australia and Canada (albeit that these arrangements are not as tightly drawn as the European regulations referred to above).

It should also be borne in mind that the level of participation by the defendant in the English proceedings can have an effect on enforceability overseas. Thus, an English judgment obtained after a full trial of the merits is likely to be easier to enforce in other jurisdictions than a default judgment where the defendant has taken no part in the proceedings or a summary judgment. If the office-holder does not expect the prospective defendant to seek to defend English proceedings that should be factored into the choice of jurisdiction.

> "Once the preferred jurisdiction for the claim has been established it is advisable to move quickly to commence proceedings there… as there is always a risk that the prospective defendant may commence alternative proceedings first in a different jurisdiction."

Once the preferred jurisdiction for the claim has been established it is advisable to move quickly to commence proceedings there. Until then there is always a risk that the prospective defendant may commence alternative proceedings first in a different jurisdiction. This can be a very effective delaying tactic by the prospective defendant, since the office-holder's ability to proceed with the claim in his or her chosen jurisdiction may be held up while the jurisdiction of the courts where the defendant has initiated its 'alternative' proceedings is challenged.

International arbitration

In certain industry sectors, such as construction, energy and shipping, contracts will usually provide that disputes are to be resolved by arbitration rather than through the courts, although in some cases a 'split clause' may have been used, potentially giving the office-holder a choice as between arbitration and litigation.

In theory, an award granted in arbitration proceedings may be easier to enforce internationally than a court judgment. The New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards 1958 (the New York Convention) provides a framework through which an arbitral award may be enforced in the 144 ratifying states with, in theory, minimal grounds for objection. (There is, as yet, no global equivalent to the New York Convention applicable to court judgments, although attempts have been made to put in place a similar regime.)

The 'in theory' caveat here is important. The New York Convention provides various grounds for refusal to enforce an arbitral award, including invalidity of the arbitration agreement, serious procedural defects and contravention of public policy. While these grounds are not intended to be overly obstructive, the reality is that they will be interpreted more generously in some jurisdictions than others (in particular the public policy ground) and can, therefore, be exploited by defendants to delay or frustrate the enforcement process.

Preserving the assets

Where there is a demonstrable risk that the prospective defendant's assets will be dissipated before enforcement takes place, the office-holder should consider seeking interim relief to safeguard them. Most developed, commercial jurisdictions will have mechanisms available to achieve this.

If the English court has jurisdiction over the substantive claim, the office-holder may apply for a freezing injunction in England. The English courts may, where appropriate, make the injunction applicable to assets outside the jurisdiction (a worldwide freezing injunction). Even if the English court does not have jurisdiction over the substantive claim, in certain circumstances, they can grant a freezing injunction in support of foreign proceedings and, indeed, international arbitration.

Breach of a freezing injunction is a contempt of court. If the defendant has no presence within the jurisdiction then the effect of the injunction depends on the extent to which it is recognised and enforced by the relevant local courts. However, if the defendant does have some form of presence in England then the contempt jurisdiction of the English courts will bite. In addition, third parties, such as banks, may be bound by a freezing injunction if they are holding the defendant's assets. Thus, even if the defendant itself stays out of reach of the English courts, the injunction may have some utility.

Applications for freezing injunctions (or similar forms of relief) are usually made before proceedings are started, and without notice to the prospective defendant, especially in fraud cases where there may be a heightened risk that the assets will be dissipated if the prospective defendant becomes aware of the prospective claimant's intentions. They are often combined with ancillary orders, for example, requiring the defendant to disclose information about its assets.

As well as safeguarding assets for the benefit of the claimant, a freezing injunction may have collateral benefits: it may encourage the defendant to provide, as an alternative, security over some of its assets, or even to consider settlement. But the benefits will need to be measured against the (sometimes very substantial) costs of obtaining this type of relief and the exposure undertaken by the estate in potential adverse costs and as a result of the so-called cross-undertaking in damages. This is an undertaking given by the claimant to the court (sometimes required to be backed by security or a payment into the court) that the claimant will compensate the defendant for any loss it suffers as a result of the injunction in the event that it turns out that the injunction should not have been granted. (The potential exposure of the estate pursuant to this undertaking may be limited in practice by keeping the scope of the injunction as tight as possible, for example, by limiting it to a single major asset of sufficient value.) In addition, if the injunction is sought without notice to the prospective defendant, the office-holder must disclose all material information to the court, whether supportive or not. The injunction may be discharged if that duty of full and frank disclosure is later found not to have been satisfied.

In conclusion

Over and above the normal considerations applicable to the pursuit of a claim in the domestic courts, before launching proceedings that have an international dimension office-holders should consider, with their advisers:

- where those proceedings should be launched
- where and how any judgment is going to be enforced
- what needs to be done to protect the target assets while the proceedings are ongoing.

In our view, early, high-quality, local advice in the relevant jurisdictions is key to developing and implementing a successful strategy. □

Radford Goodman is a partner and George Walton an associate in the Dispute Resolution Department at Norton Rose LLP.

Insolvency and pensions: using a regulated apportionment arrangement

Five points for an insolvency practitioner to remember when using a regulated apportionment arrangement.

Regulated apportionment arrangements (RAAs) provide insolvency practitioners with a very useful tool for managing defined benefit pension scheme liabilities in the context of a distressed sale. As with many aspects of pensions law, RAAs appear relatively straightforward but can give rise to difficult issues for the uninitiated. This article sets out five key issues that insolvency practitioners should remember and highlights pitfalls to avoid. But firstly it answers two preliminary questions: when exactly would you use an RAA and how does an RAA work?

When would you use an RAA?

Distressed groups have historically looked to isolate their defined benefit pension liabilities with the less attractive businesses, with the aim of keeping the stronger businesses away from any insolvency process and enabling them to continue to trade free of their defined benefit pension liabilities. Ordinarily, extracting companies from a defined benefit pension scheme will trigger a statutory debt calculated on the basis that pension benefits are bought out with an insurer (a section 75 debt). These can be very significant amounts and would usually result in a formal insolvency for the distressed group, including the viable companies within it. An RAA provides a valuable mechanism whereby viable companies within a group may be permanently separated from their defined benefit liabilities with no risk of any liability arising in the future.

How do RAAs work?

An RAA is an apportionment agreement entered into by the trustees of the scheme, the withdrawing employer and one or more of the other participating employers. It provides for the amount that would have been the extracted company's share of the section 75 debt liability to be apportioned to one or more of the remaining companies participating in the scheme. There is no set amount that must be apportioned and a withdrawing company is allowed to apportion its entire share of the liability to a remaining company or companies

although it is common for the withdrawing company to pay a nominal amount, say a pound. By means of an RAA, a more expendable company, or even a special purpose vehicle, can assume the whole section 75 debt and then enter into an insolvency procedure to move the scheme into the Pension Protection Fund (PPF), allowing the rest of the group to restructure free of the pension scheme.

> "An RAA is an apportionment agreement entered into by the trustees of the scheme, the withdrawing employer and one or more of the other participating employers. It provides for the amount that would have been the extracted company's share of the section 75 debt liability to be apportioned to one or more of the remaining companies participating in the scheme."

Five points that insolvency practitioners should remember

It is important that insolvency practitioners understand the hurdles that will need to be overcome if an RAA is to be successfully put in place and are aware of and prepared to deal with the issues that may arise.

1) **There must be a reasonable likelihood of the scheme entering into a PPF assessment period within a year**

It is not possible to enter into an RAA unless the trustees of the scheme are able to take the view that there is a reasonable likelihood that, as a result of the insolvency of the companies participating in the scheme, the scheme will enter a PPF assessment period (during which the scheme's eligibility for the PPF is assessed) within the following twelve months.

Unhelpfully, the legislation does not define, nor does the Pensions Regulator (the Regulator) provide any guidance on, what is meant by 'reasonable likelihood'. It will be easy for the trustees to reach this opinion where the insolvency of a participating company or companies is imminent (and it is in these circumstances that an RAA will be most commonly used).

Difficulties will arise in more border-line cases. The trustees would almost certainly want supporting evidence that an insolvency event is reasonably likely to occur in relation to the company, if they were being asked to reach this opinion. The directors, in providing such evidence, would need to be mindful of their duty to minimise loss to creditors under wrongful trading law particularly if their company is continuing to trade.

Further difficulties can arise because the legislation refers to the likelihood of a PPF assessment period commencing, or having already commenced, 'in relation to the scheme'. This requirement will generally be easy to meet where a group is in a distressed situation. However, problems can arise in relation to 'last man standing' schemes where insolvency events are required in relation to a number of scheme employers in order for the scheme to enter an assessment period. In particular, this requirement could include employers who had left the group but are still considered to be scheme employers for the purpose of the legislation because they did not settle their section 75 debt liability to the scheme when they left. If this situation arises, there are ways in which former employers may be discharged and so cease to be scheme employers but this will require careful planning. The options for achieving this will be case-specific.

2) **Following agreement, Regulator approval takes 28 days**

The RAA must be approved by the Regulator who is required to issue an approval notice in accordance with a statutory procedure.

The Regulator must follow a statutory procedure because its power to issue the notice of approval is a regulated function. This requires that the Regulator first issues a notice of determination in which it informs the directly affected parties that it is considering exercising its power to issue an approval notice. The notice is issued 28 days later, assuming that the determination is not referred to the Pensions Regulator Tribunal (the Tribunal) by the directly affected parties. These are likely to be the pension scheme employers and the trustees but may include scheme members in some circumstances. While, in practice, it is unlikely that a referral will be made at such a late stage, the Regulator cannot issue its approval notice until the reference and any appeal against the Tribunal's determination have been disposed of.

Meanwhile, the section 75 debt will have been triggered (unless the parties are able to wait for the 28-day period to expire, which is usually not possible in a distressed scenario) and if the RAA is not approved for any reason, the withdrawing employer will continue to be liable for its share of the section 75 debt. This can give rise to significant concerns on the part of a buyer of the exiting group company. However, in practice, the risk of a successful challenge to the approval notice can be minimised and the consequences of such a challenge can be mitigated by means of 'claw-back' provisions in the sale and purchase agreement.

3) **The PPF has a veto**

The PPF plays a key role in the RAA process because it may object to the regulated apportionment arrangement and thus veto it.

This requirement reflects the fact that as a result of entry into an RAA the scheme will inevitably be taken on by the PPF. The PPF's participation in such a situation is contrary to pension policy, which is targeted at preventing employers from walking away from their pension obligations. However, the PPF has confirmed that it is prepared to participate in the restructuring or rescue of an insolvent business if certain requirements are met[1]. These include a requirement for appropriate mitigation in return for the PPF assuming responsibility for the scheme's liabilities. However, the PPF will need to be convinced that insolvency is inevitable and, if the proposed restructuring did not go ahead, the scheme would, in any event, end up in the PPF.

4) **The PPF only assumes the trustees' rights and powers in relation to the scheme once it enters a PPF assessment period**

Pension legislation provides that once a PPF assessment period commences, the rights and powers of the trustees of the scheme in relation to any debt (including any contingent debt) due to them by the employer, whether by virtue of section 75 of the Pensions Act 1995 or otherwise, are exercisable by the board of the PPF to the exclusion of the trustees. This distinction is easily overlooked, as, the respective roles of the trustees (pre-commencement) and the PPF (post-commencement) can become blurred during negotiations leading up to completion of the transaction. This is because, in practice, it will normally be the PPF who will determine the scope of both the pre- and post-commencement obligations and actions to be undertaken by the scheme.

The PPF will, therefore, only be prepared to agree to assume any obligations or procure that any action is taken to the extent that creditor rights have transferred to it from the trustees. This will need to be reflected in the transaction documentation by way of a qualification to the obligations imposed on or undertaken by the PPF in the assessment period to deal with a scenario in which the Regulator fails to approve the RAA, or another issue intervenes, and the anticipated assessment period does not commence as originally envisaged.

5) **The PPF's usual requirements apply and are largely non-negotiable**

The RAA is generally part of a restructuring. As such, where the restructuring will result in the pension scheme being assessed for assumption into the PPF, the PPF will expect its usual requirements in relation to restructured businesses to be met. These are:

- an immediate cash sum
- a 33 per cent equity stake in the continuing business if the pre-transaction investors remain involved; and
- a 10 per cent equity stake in the continuing business in respect of new money provided by a new investor.

The cash sum must be 'significantly better than the dividend that would be received if the company went into ordinary insolvency and must be fair given what other creditors and shareholders are to gain'[2].

The PPF puts no value on the equity stakes but they are non-negotiable and are termed 'anti-embarrassment provisions' by the PPF who wish to avoid a situation in which the distressed company dumps its defined benefit pension obligations on the PPF and then, free of its obligations, goes on to make a profit at the expense of the PPF and the PPF risk-based levy payers. Ultimately, the Board of the PPF must be able to demonstrate that the PPF received a greater return than it would have done if there had been an ordinary insolvency.

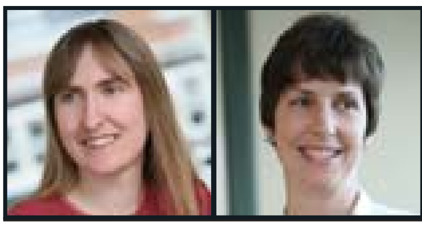
> "Ultimately, the Board of the PPF must be able to demonstrate that the PPF received a greater return than it would have done if there had been an ordinary insolvency."

In summary

Insolvency practitioners should be aware of the benefits of RAAs and how they work. Where the intention is to transfer pension liabilities to a special purpose vehicle or, for wider commercial or tax reasons, the parties wish to structure a pre-packaged administration (in part or in whole) as a share sale, but the target companies participate in a defined benefit pension scheme, RAAs are a valuable tool enabling the defined benefit pension liability to be successfully managed. ☐

[1] Pensions Protection Fund: Guidance for insolvency practitioners and official receivers – April 2009 – part 5.

[2] Ibid.



Rosalind Connor (far left) is a partner and Nicola Rondel (left) is an associate at Jones Day.

Courtesy of Capita Symonds

The first UK liquidation of an Open Ended Investment Company

Prav Reddy outlines the events in this unique case.

The liquidation of Arc European Property Fund (Arc European), an Open Ended Investment Company (OEIC), is the first of its kind. Authorised investment vehicles, including OEICs, are strictly regulated by the FSA.

In mid December 2009, Arc European sought professional advice in relation to its financial position following creditor demands and its failure to complete a solvent winding up of its assets within a reasonable period. Following professional advice, consultation with the FSA and in light of the OEIC Regulations 2001 and the FSA's Collective Investment Schemes sourcebook (COLL), an administration procedure was not available to Arc European and a compulsory winding up petition was necessary.

In view of the risk of dissipation of assets and need to preserve and realise Arc European's assets, an application for the appointment of a provisional liquidator was made. The High Court granted the appointment of the provisional liquidator in January 2010 pending the hearing of the company's petition for its compulsory winding up. Following the compulsory winding up order in March 2010, a liquidator was appointed on an emergency appointment by the Secretary of State. The liquidator is currently seeking to realise the assets of Arc European for the benefit of the investors and creditors.

> "Arc European raised £4 million in capital from some 300 UK investors to invest in the European property market, of which £3 million was raised in the first month."

What is an OEIC?

An OEIC is a form of investment vehicle that operates as a type of collective investment scheme. It has a corporate structure and is subject to regulation by the FSA as the investment activity it undertakes can be promoted to the UK general public.

The OEIC, as a corporate entity, has a board of directors. One member of the board will be authorised by the FSA and their function will be to run the operations of the OEIC on a daily basis. This person will usually be an authorised corporate director who is engaged under an authorised corporate agreement (their role is similar to that of a fund manager).

The OEIC is structured in such a way that the property of the entity will be held on trust for it by a depositary, who must also be authorised by the FSA. The depositary ensures compliance with the regulatory requirements pursuant to the OEIC Regulations 2001. The depository also has legal title to the OEIC's investments and is responsible for the safe custody of certificates of title and/or property deeds (in relation to property). In certain circumstances, the depository can delegate the function of being the registered owner of the investments to the authorised corporate director.

Unlike investment trusts, which have a set number of units or shares, OEICs have no set number of units or shares and can create and cancel them depending on the number of investors. Investors will buy units or shares in the anticipation that they will rise in value. Their value will depend upon the performance of the underlying investments. Recently, OEICs have been authorised to invest in a variety of asset classes, including property, as was the case with Arc European.

The history of OEICs

OEICS were first introduced in 1997 under the Open Ended Investment Companies (Investment Companies with Variable Capital) Regulation 1996. These regulations only allowed investment in transferrable securities such as listed securities, other collective investment schemes or certificates of deposit.

After the emergence of a single regulator via the FSA, the regulations were replaced by the Open Ended Investment Companies Regulations 2001, which allowed a substantially wider scope of investments such as money market funds and property funds.

Arc European

Arc European's focus was providing investors with direct exposure to European property and, in particular, to residential property. The initial focus of Arc European was a property in Poland and then residential property in Spain. In October 2004, Arc European obtained authorisation from the FSA as an investment company with variable capital. It raised £4 million in capital from some 300 UK investors to invest in the European property market, of which £3 million was raised in the first month. Investors were asked to invest a minimum of £5,000, for which Arc European would invest in the residential property markets of Spain and Germany, as well as the emerging markets of Croatia, Greece and Turkey. Its aim was to deliver a pre-tax investment return of eight per cent a year over the medium term. For this the investors paid a six-and-a-half per cent initial charge and a two-and-a-half per cent annual management fee. The investment objective was to achieve a relatively secure investment through a mixture of capital growth and income distributions over the medium term. It targeted retail investors with a medium-risk profile who sought to invest in a diversified portfolio including property and government securities. It was said to be the first such fund investing in European property.

In the last 18 months, the value of Arc European's investments plummeted, due mainly to the poor performance of the European property market. As a result, in December 2008, given that the international markets were shaken by the banking crisis (and by the collapse of Lehman Brothers) a number of investors wished to redeem their investments. As a precautionary measure Arc European (with the approval of their depository) suspended dealings in their own shares.

Arc European (with the approval of the FSA) attempted a solvent winding up process in order to redeem the investors' shares. However, given that Arc European's assets were tied up in substantial property portfolios (either because the properties comprised partially completed developments or because they were the subject of litigation proceedings) it was unable to realise the investments on a timely basis and redeem investors' shares. As a result, Arc European had no funds with which to pay its debts as they fell due and was therefore cash-flow insolvent.

Thereafter, Arc European presented a petition for its own compulsory winding up. The OEIC Regulations 2001 specify that a winding up petition must be under part V Insolvency Act 1986 as an unregistered company. Prior to the hearing of the winding up petition and on the basis that certain property and assets in the UK, Spain and Italy were at significant risk of dissipation, the assets needed to be dealt with immediately. Therefore, Arc European made an urgent application for the appointment of a provisional liquidator to protect the value of its assets. Given that Arc European was an OEIC and pursuant to the OEIC Regulations 2001, it was necessary to secure the consent of the FSA prior to making an application for the compulsory winding up order and the appointment of a provisional liquidator.

> "Arc European's plight has been compounded by investments in multiple jurisdictions subject to different laws and procedures that have made the task of realising its assets additionally complex."

On 9 January 2010, the High Court granted Arc European's application for the appointment of a provisional liquidator, pending the hearing of the winding up petition, so that the liquidator could immediately administer the affairs of Arc European. On 10 March 2010, a liquidator was appointed and he continues to administer and realise the assets of Arc European for the benefit of its investors and creditors.

Comment

Traditionally, investors and fund managers perceived investment in bricks and mortar as a solid, tangible asset that inspired confidence and security in relation to investment opportunities. Investment in property has historically provided high return with low risk over the medium to long term. European property was particularly thought to be a growth investment opportunity and a number of real estate press recommended investments in European property in late 2003/2004. The liquidation of Arc European has highlighted the fallibility of property investment in the current economic climate. Arc European's plight has been compounded by investments in multiple jurisdictions subject to different laws and procedures that have made the task of realising its assets additionally complex. Given that its investment was focused solely on property, the OEIC was made more susceptible to the recent volatility in that sector. Arc European's insolvency arose as a result of its investment portfolio being entirely in property, an illiquid asset. As a result Arc European was unable to return the investment to its investors. Other OEICs that have operated in the property sphere have limited the time periods in which investors can redeem their investments to avoid such illiquidity problems in the short term.

The liquidation of an OEIC is unique in that investors are usually able to redeem their investments at short notice. As such, OEICs should not ordinarily be the subject of insolvency proceedings as they are also subject to strict borrowing limits imposed by the FSA. The risk is therefore small but not negligible. If, for example, an OEIC operates a large number of sub funds, some of which may have cautious risk profiles and some comprising far riskier investments, if the riskier fund collapsed with its liabilities exceeding its assets, creditors would have a claim on all assets of the OEIC. As a result, the investors in the cautious fund may be susceptible to risk in relation to their investments as the OEIC is dealt with under one umbrella company. Consequently, it is proposed to amend the OEIC Regulations 2001 to effectively ring-fence sub funds. This will be compulsory for new OEICs and with a one-year transitional period for existing OEICs.

> "Consequently, it is proposed to amend the OEIC Regulations 2001 to effectively ring-fence sub funds. This will be compulsory for new OEICs and with a one-year transitional period for existing OEICs."

Furthermore, given that the regulation of OEICs is closely monitored by the FSA, it is imperative that the OEIC, via its authorised corporate director and depository, works closely alongside the FSA on matters concerning its administration. □

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A modern Greek tragedy: the cross-border insolvency perspective

Will the economic cloud over Greece have a silver lining?

The present fiscal and financial position of the Greek state requires no introduction. The crisis of the Greek economy is well documented both in the press and most importantly on the balance sheet of corporate entities. The current financial health of Greek companies signals a broader concern, one that surmounts the prospect of default for a comprehensive number of domestic corporations and expands, amid nervousness, to a possible contagion of the member states with which Greece maintains strong financial ties. In a parallel convergence of factors, Greece could fit the profile of a regional magnet forum and could become the epicentre of cross-border insolvency proceedings, with the potential of a larger volume of transnational cases than otherwise expected.

One of the parameters endorsing such an eventuality is Greece's foreign direct investment in Southeast Europe, the result of a grandiose effort to infiltrate developing economies with high yields of return. It is estimated that the stock of Greek capital in the Balkans is over €7 billion, making Greece one of the largest investing countries in the Balkan states. The relatively recent European enlargement further propagates this prospect on the premise that Greek courts, under set conditions, could *de jure* assume jurisdiction over insolvency proceedings instigated in the new EU entrants in the region[1].

New Greek insolvency code

Profoundly reformed, the new Greek insolvency code (the IC) was never more adequately equipped with theoretical context to facilitate the efficient operation of complex cross-border insolvencies[2]. The current legislative framework has parted from the adverse practices and hereditary remnants that have limited its scope in the past. By the paradigm of modern nomothetical provisions, insolvency proceedings are no more statutorily reserved for merchant debtors and can now be instituted against unions pursuing an economic activity, to avoid the possibility of certain legal entities being immune from insolvency and to prevent the concealment of assets. To further broaden the scope of proceedings, the IC provides means of early recourse, affording debtors the prerogative to instigate proceedings, on the basis of a foreseeable inability to satisfy obligations, in addition to the cessation of payment grounds existing under the previous legislation. Evidencing its rescue ethos, the IC has adopted new institutions for the reorganisation of corporate entities including workouts under the insolvency mediation of article 99 and restructuring of chapter 7 (articles 107 ff).

The optional statutory appointment of expert professionals further assists the operation of such institutions, particularly when dictated by the perplexity of corporate group structures and the intricacies of cross-border proceedings. Finally, to mobilise external financing, creditors providing funds for the continuation of the business activities may share in the benefit of preferred creditor status, which has been tested and found effective in other jurisdictions as comfort to commercial lenders' risk. These are all measures that were absent in the previous legislation, at least in their current sagaciousness, and created hurdles when the effect of Greek insolvency legislation had to be transposed across frontiers.

The challenges of becoming a regional magnet forum

The challenges associated with the prospect of Greece becoming a regional magnet forum are detached from possible concerns of illegality on account that Greek courts have refrained from asserting jurisdiction in the absence of sufficient evidence to justify the cross-border ambit of proceeding, perhaps applying stricter criteria in doing so than those in the juridical reasoning of EIR jurisprudence on the establishment of transnational jurisdiction by other venues[3]. Greek legislation on jurisdiction allocation actually coincides with European provisions, adopting *mot a mot* the wording, and rebuttable presumption, of the notion of the centre of main interest, as the legal basis for the inception of proceedings.

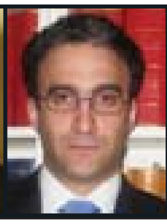
Nevertheless, an increased number of petitions, especially in cases of complex cross-border proceedings, will have a significant impact on the workload of the judiciary, particularly when added to the high number of pending insolvency and debt recovery proceedings. Drawing from the experience of the past, the IC adopted measures to relieve court dockets from the plethora of small insolvencies, for which an accelerated procedure is now provided. With the same underlying reasoning, courts can now examine whether the assets of the estate suffice to cover the expenses of the procedure before deciding to retain the case. Together with the stipulated time framework for the determination of hearings and issuing of decisions, these measures purport to reduce the overall time required from filing to the conclusion of proceedings and, most importantly, to ensure that the judiciary's resources are put to better use, especially in matters requiring immediate attention, like the crucial first day orders and the determination of the core matter of jurisdiction.

Future opportunities?

As Greece enters more turbulent times, the reformed insolvency code is an opportunity to attract attention in a favourable manner. The current legislative framework is not free of criticism, but amalgamates modern provisions that corporate entities should explore to their fullest extent in achieving corporate recovery. There is no doubt that reorganisation is not a panacea, but the socio-economic impact of the generalised financial default requires that efforts should be made to this direction, and could hopefully in turn operate as a way to assuage the crisis and restore some faith in the markets. At the same time, in cases where the 'domino effect' crosses national frontiers, there is an opportunity for Greek courts to issue influential judgments in the field of cross-border insolvencies, always in conformity with the principles and spirit of the EIR, demonstrating the deeply rooted European mentality of the Greek state. ☐

[1] Council Regulation 1346/2000 (EIR)
[2] Law 3588/2007, SG A 153/10.7.2007
[3] Piraeus Court of Appeal 670/2009 64 DEE1/2010





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The failed leader: why do CEOs crash and burn?

David Griffiths offers an explanation for this phenomenon.

The fault, dear Brutus, is not in our stars,
But in ourselves…
Julius Caesar Act I scene 2, William Shakespeare

Most of us admire success. It is uplifting to read the biographies of men and women who have excelled in the many fields of human endeavour.

Failure is, at the same time, concerning and fascinating for us. We search for explanations. Some person or persons must be responsible and we seek to allocate blame.

Not many of us are quick to find fault in ourselves. Among the many business men and women I have met in the course of my job as an insolency lawyer, only a minority had a degree of insight into or awareness of the causes of the commercial failures with which they were connected. According to them, it was largely the fault of others: the economy, the weak pound, the market that just disappeared and, latterly, the profligate banks and the breakdown of regulatory control.

The purpose of my article is not to explore this 'otherness' but to focus instead on the individuals responsible for the management of businesses that failed or who conspicuously strayed from the straight and narrow.

Common threads

My methodology is to take the case of CEOs who failed and see if there are any common threads by going through some biographical details and behavioural characteristics. Here I think it is important to be realistic and not too ambitious. For example, two of the CEOs had no formal training or qualifications for their respective businesses and two were professional standard squash players but I doubt whether these common factors on their own lead to any great insights.

I shall identify the CEOs as A, B, C, D, E, F, G and H. I then propose to share my views of what went wrong and what might have been done better. To make it more interesting, I shall make the cases anonymous and leave it to the reader to identify the CEOs concerned. (Tip: a few of the individuals A to H aren't really CEOs as we would understand it but certainly had comparable positions of authority. Letter F contains the identities of two CEOs: one male and one female.)

Tragedie is to seyn a certeyn storie,
As olde bookes maken us memorie,
Of hym that stood in greet prosperitee,
And is yfallen out of heigh degree
Into myserie, and endeth wrecchedly.
The Canterbury Tales Prologue to the Monk's Tale, Geoffrey Chaucer

A

Born into the lower echelons of the aristocracy, A advanced himself through the system to become minister of finance. The finances of the state were in a ruinous condition as a result of mismanagement of fiscal revenue and meeting the cost of continuous warfare with neighbouring countries. He succeeded in turning round the fortunes of the state by honouring existing governmental contracts, including pledging his personal credit and effecting a revaluation of the currency.

He also succeeded in creating a tidy amount of cash on the side, which he applied in ambitious building projects. The finest architects of the time were engaged in their construction and design. A assumed (wrongly) that the autocratic head of state (AHOS) would appreciate the construction and a big party was thrown for the AHOS. This caused the AHOS to become jealous and led to the inevitable downfall of A, who received a term of life imprisonment after a show trial, the initial sentence being increased by the personal intervention of the AHOS.

> Intriguingly, D had great premonition and prescience concerning the fate that would overtake not just his own industry but the capital markets.

His successor had better luck and his particular style of economic management gave rise to a neologism that is current today. The successor also was able to put together a tidy sum on the side but did not make the mistake of flaunting it and so lived to enjoy it.

B

Sent away to boarding school as a child, B learned that: 'It teaches you to be independent. It also teaches you not to show emotions.'

When he first started work, he was often late and had little idea of how the business worked. A first-class sportsman, he was able to combine being CEO and captaining his county cricket club as well as being a keen five-a-side football player. Sport also informed his business life when he stated: 'There is a finite life in being a chief executive. It is rather like being a football manager. Very few people get to choose the timing of their leaving.'

B left the business not at his own timing when it rapidly imploded. His parting words were: 'I hugely love this company. I'd love to be a part of rebuilding it, if asked to.'

C

C enjoyed a rapid rise to success as an accountant, becoming a partner in a Big 4 practice before his 30th birthday. His first major achievement was in the administration of a huge cross-border bank failure where he was responsible for a team of 1,000 people. Partly as a result of his efforts, creditors received a dividend of more than 50 pence in the pound.

Five years later, C switched jobs and was soon promoted to CEO. He embarked on a ruthless and successful acquisition trail. Assets of the business quadrupled in value and profits soared.

In his personal life, he was known to be able to recite all six verses of 'American Pie' by Don McLean.

It would be fair comment to say that C's interpersonal skills were not strong. A former chief executive of one of the subsidiaries described his manner as 'facetious and withering – a classical psychological bully'. He would hold a management meeting each morning for his top executives which would last for anything up to an hour and that became known as 'morning beatings'. Another senior executive recounted that such meetings 'were never about enlightening anyone about anything'.

It is a reasonable inference that at such meetings non-enlightenment was two-way traffic, ie, why speak and draw attention to yourself and risk humiliation?

In the ensuing collapse, C received a generous severance package and subsequently agreed to commute some of the benefits. Shareholders are still counting the cost.

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D

D was a phenomenally successful manager. He had increased annual profits over 40-fold in a period of 13 years and the share price of the company had multiplied 20-fold. He made a lot of people rich beyond their wildest dreams: shareholders, employees and of course himself.

Success, however, came at a price. Nicknamed the Gorilla, he was the classic exponent of the command and control style of management. He would inspire in his senior management both great loyalty and fear. One commentator described how: 'Those closest to him slaved like courtiers to a medieval monarch, second guessing his moods and predilections, fretting over minute details of his schedule down to the flower arrangements and insulating him from trouble – *from almost anything he might not want to hear*' (my emphasis).

Intriguingly, D had great premonition and prescience concerning the fate that would overtake not just his own industry but the capital markets. At the annual meeting of the World Economic Forum in January 2007, he observed that: 'This could be the year when the markets crack.' He was wrong only on the timing. The markets cracked the year after.

In his management, D became increasingly isolated from the coal face, being fed carefully vetted information from his own inner circle. He would happily deliver perorations to customers but seldom spent time listening to investors.

The collapse of the business of which he was CEO has not come easy for D. He has publicly stated that the world is not yet ready to hear his side of the story. They (not quite clear who) are 'looking for someone to dump on right now, and that's me'. No doubt the time will come for him to tell his story.

E

Biographical details of E are somewhat sparse, which is understandable given his necessarily short tenure of office. One of his first actions after being appointed CEO was to insist, in a fit of pique, that his PA not only change his name to Miss but undergo surgery to effect a sex change.

His sycophantic board members would agree with him on almost everything and saluted his identification of Mitsubishi as the capital of Japan as a stroke of genius.

It was only when the non-execs learned that he had been dipping employees in varnish and using them as office furniture that patience finally ran out. His severance package included a lump sum payment of $100 million, the corporate jet, perpetual benefits and a salary of $1 million per year.

F

Described as a classic example of the leader who hung on for too long, he was surrounded by weak people who tended to agree with him. He was eventually pushed out by those whom he (wrongly) believed were his most loyal supporters. As a result he failed to produce a worthy successor.

A great leader, he failed to recognise the effect of his personality on those surrounding him. This manifested itself in a tendency to shoot the messenger bearing bad news so bad news stopped reaching him with the inevitable consequence.

This leader had a background in retail. (Tip: I use the convention of the masculine including the feminine and the singular, the plural etc.)

G

G succeeded in his early twenties to running the family business which in present-day values was producing a sum in excess of £50 million a year. The fifth holder of an aristocratic title, the first holder had distinguished himself by great military and political successes.

By the end of his 20s, the family fortune had been largely dissipated. G had, however, enjoyed modest success as a dancer even if not quite of the 'Strictly Come Dancing' variety.

He died a bankrupt aged 30 in Monte Carlo. The family fortunes never recovered.

H

Faced with criticism from a non-executive director as to a proposed merger, this CEO refused to give any proper answers to the objections raised, went red in the face, and shortly afterwards left the room stating that he could not be expected to deal with 'amateurs'.

A few years later, joined by a corporate finance expert, H embarked on a policy of spending the company's cash, selling the cash cows, borrowing heavily and buying manufacturing companies at the top of the market.

The crash came shortly afterwards when the company had to be bailed out by its banks and new management. The shares in the company became effectively valueless, causing loss to thousands of small shareholders.

> *The purposes in the human mind are like deep water,*
> *But the intelligent will draw them out…*
> *The Bible* Proverbs 20:5

What went wrong?

So what went wrong in the curious cases of A, B, C, D, E, F, G and H? Is there a sort of psychological smoking gun we can point to, perhaps a dominating and domineering father figure or a childhood loss that commits the subject to a fruitless and futile search for compensation? Given infinite resources, skilled psychologists and therapists and the willingness of the subjects to submit themselves to the process (difficult where some of them are sadly no more with us) no doubt some answers would emerge. Not having that luxury, what follows, therefore, are some reflections on what went wrong in the absence of fully documented case histories.

Absence of feedback

Here, it is not just a question of the unwillingness of the CEO to receive feedback but, crucially, the unwillingness of those closest to him to give it. In many of the cases above, the reaction of the CEO was to shoot the messenger bringing bad news. As the bearer of bad news, therefore, why run the risk of humiliation, facing the bad temper of the CEO and even dismissal? It is much easier even if no less culpable to filter out the bad news and feed through only what the recipient wants to hear.

Research carried out in the US by Jackman and Strober[1] reveals that only half of the managers sampled had ever asked for feedback[2] A number of reasons for this pattern of avoidance were given, such as:

- re-awakening of feelings of childhood dependence;
- denial and procrastination, ie, an unwillingness to explore what is wrong;
- comparison with others will show them in a negative light; and
- self-sabotage where the subject looks for ways to make the expected negatives real.

For example, we don't wish to hurt other people's feelings; we don't wish to become separated from the group; we need to keep our job; look what happens to whistleblowers. The unwillingness both to receive and give feedback is part of the bigger picture of our unwillingness to tell the truth. In this area, cognitive justifications abound.

We conveniently overlook the fact that, taken to its conclusion, the absence of truth or rather the unwillingness to say it leads to the death march and the extermination camp.

Over-optimism

In a commercial context, over-optimism means being overly, or naively, optimistic about current undertakings and prospects. It is also known as the overconfidence effect[3]. Over-optimism is based on our own selective perception of reality. We tend to seek out those facts and matters that support our own views and discount heavily those that do not. As a litigation lawyer and mediator, it is a bias I know only too well.

I should of course point out that over-optimism is not in itself a bad thing. In many areas of business and life, you are likely to get along much better with a tendency to over-optimism rather than pessimism and you are more likely to end up happier. Treat yourself to a copy of Professor Seligman's book *Authentic Happiness*[4] and a modest dose of positive psychology and you will see what I mean.

However, in many situations over-optimism is misplaced. To take an obvious example: would you prefer the pilot to carry out a second check that the wings of the plane had fully de-iced before take-off or would you rather not have the 20-minute delay and run the risk?[5]

>>

Loss aversion

The commonly observed condition of loss aversion refers to the human tendency to take only a few risks to make a small gain as opposed to taking bigger risks to avoid losses. It is this condition that stops us from selling our loss-making stocks and shares because rather than focusing on the current price and the present prospects of the stock in question, we remain fixated on the original and higher price paid. In the words of the authors of a recent publication: 'Unrealistic optimism is a pervasive feature of human life; it characterises most people in most social categories. When they overestimate their personal immunity from harm, people may fail to take sensible preventive steps.'[6] Why? 'People hate losses. Roughly speaking, the misery you experience from losing something is twice as much as the happiness derived from gaining the same thing'[7].

There were many chances for subjects A to H to bail out before the inevitable. What a delicious irony for the sacked whistleblower of HBOS to tell the Treasury Select Committee that he had already warned management years earlier that the business was embarked on activities that were speculative and likely to lead to losses[8]. Less recently, even professional analysts and investors chose to ignore the warning signs from Enron and deleted or filtered worrying information[9].

It is not necessary, however, to go back to Enron. The last two years have produced numerous cases of eye-watering ineptitude and incompetence.

Because of their high profiles, the respective falls from grace of A to H were spectacular. And yet their failings were only too human and not a special privilege of their exalted position. In other words, there are lessons to be learned by all of us. ☐

Thanks are due to the following people for their help in the preparation of this article: Anton Smith, Mary Howell and Jenny Rogers.

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This article first appeared in Geldards newsletter, December 2009.

To find out who the CEOs are turn to page 43.

David Griffiths is of counsel to Geldards LLP and an IP.

Economic snapshot: South West and South Wales Region

The South West has not seen as sharp a decline as some other regions but, says Andrew Sheridan, it could lag behind in recovery.

In spite of a gradual upturn, UK Plc still has some way go in recovery terms, and the South West and South Wales each have their own issues to contend with.

As one of the most diverse R3 regions, the South West and South Wales can be seen as three areas in one: finance and industry, principally around Bristol; tourism in the far South West; and a devolved government and different economic spectrum in South Wales.

The past 18 months can best be described as patchy as regards formal insolvency work, which has been less than many had forecast. Given the dynamics of the region and the sectors that prevail combined with low interest rates, Time To Pay arrangements and the flexible ways of retaining key skill sets in local workforces, this is not surprising.

The South West has suffered less unemployment than other regions at just 5.5 per cent (English average 7.1 per cent), but may lag behind the recovery curve and the summer months will be all important for the tourism and leisure industry that is concentrated here.

South Wales has been hit hard by the recession with major redundancies at Bosch, Corus and local councils, but the Welsh Assembly Government (WAG) has established the successful ‘ProAct’ initiative to help businesses.

The importance of tourists

Last year, the South West accounted for 20 per cent of England’s domestic and 6.6 per cent of its overseas visitors. However, the extreme weather at the beginning of 2010, coupled with rising fuel costs had a detrimental effect on visitor numbers, which resulted in many leisure facilities, hotels and tourist attractions having a particularly torrid time. With another summer season about to begin, so vital to much of the regional economy, many insolvency practitioners and bankers expect there could be an upturn in work levels as autumn approaches, particularly if trading hasn’t improved for those businesses that tried to make efficiency savings through the tourist season.

Although not heavily reliant on manufacturing, there is a significant amount of unoccupied commercial property and, in some areas, the levels of empty space are as high as they have been in more than a decade. Much of this has arisen as a result of property developers failing and the West Country’s abundant waterfront appeal is rapidly turning into an eyesore with unfinished apartment developments being mothballed as constructors wait for the somewhat elusive upturn.

The future will look different

In the last six months, the WAG has begun holding Economic Summits every other month at different locations around the country. The Summits include 40-plus representatives from businesses and banks as well as senior politicians who discuss the local economy as well as solutions to problems being experienced across the country.

The resultant initiative, ‘ProAct’, provides Assembly support to businesses that might otherwise be making redundancies or reducing working hours, in placing those workers in training one day a week. This enables employees to stay employed for longer, companies to retain skilled staff and increase skill levels.

Looking at the wider economy, there have been some major blows, particularly the decision to close the Bosch factory in Cardiff with the loss of 900 jobs and the ongoing trouble at Corus’s Port Talbot plant. However, these events have been marginally offset by some good news – Virgin Atlantic’s plans to open a customer service centre in Swansea, which will create some 200 jobs.

Future manufacturing in Wales will look different, with small companies making niche products for niche solutions. Cardiff is very much at the heart of Wales’ competitiveness, but there needs to be better business networks between the capital and the valleys to maximise its effectiveness.

Cadburys and Corus – the ripple effect

The threatened closure of large production plants such as Corus in Port Talbot and the much publicised demise of Cadbury’s Somerdale Plant on the outskirts of Bristol have been met with fierce opposition. In the case of Somerdale, the South West Regional Development Agency (SWERDA) is looking to minimise the impact of closure and is in discussions with the Department of Business, Innovation and Skills and DEFRA to understand the full impact of the closure for both the region and the UK.

Funding for the future

There has been much debate recently about the provision of funding and, in the March Budget, the chancellor announced that Lloyds and RBS would lend a further £94 billion to SMEs this year.

The SWERDA-managed Rural Development Programme for England, funded by the EU and DEFRA, has earmarked £152.5 million of funds for the South West. One recent investment was to Trewithen Dairy, which was awarded a £5.7 million grant to enable it to increase annual milk production by 80 per cent from 25 million to 40 million litres. The expansion will take place over four years and see 40 jobs created.

> “The SWERDA-managed Rural Development Programme for England, funded by the EU and DEFRA, has earmarked £152.5 million of funds for the South West.”

The Grant for Business Investment, also administered by SWERDA, has invested £350,000 in Devon-based microelectronics business The Eurotech Group to assist it build new high-tech manufacturing facilities at its Exmouth site. The investment will secure the existing 100 jobs and create additional posts once complete.

The WAG has awarded £250,000 to Nantgarw-based FD Systems. Coupled with £300,000 of new funds from RBS, FD Systems will be able to expand its Sage and Microsoft businesses as well as continuing the expansion of its e-commerce software offering. Founded in 1997, the company is owned and managed by its directors. □

Andrew Sheridan is Restructuring and Recovery partner at Baker Tilly.

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R3 events, courses and conferences

Date	Event title	Venue
June		
4	Yorkshire Women's Group Ladies Lunch	
7	Eastern Regional Meeting	
7	North West Regional Meeting	Dukes 92, Manchester
8	Debt Restructuring	Queens Hotel, Leeds
8	CVAs Under the New Regime	Queens Hotel, Leeds
8	Introductory Programme Rescue 2	etc Venues, London
8	Introductory Programme Rescue 2	Deloitte, Birmingham
10	Introductory Programme Rescue 2	Irwin Mitchell, Leeds
10	South West & Wales Women's Group Dinner	The Bristol Marriott Royal
10	Yorkshire Golf Day	Scarcroft Golf Club, Leeds
11	Cross-Border Insolvency & Restructuring	Radisson Blu Portman, London
17	Yorkshire Regional Meeting	Crowne Plaza, Leeds
17	Insolvency Litigation – Maximizing Recoveries	Chase Hotel, Cheltenham
18	North West Ladies Lunch	Lowry Hotel, Manchester
22	Debt Restructuring	Holiday Inn Bloomsbury, London
22	CVAs Under the New Regime	Holiday Inn Bloomsbury, London
22	Scottish Regional Meeting	Burness, Edinburgh
25	JIEB Graduation Ceremony	BMA House, London
29	Insolvency: a Guide for Professionals New to the Sector	The Met Hotel, Leeds
July		
1	Insolvency Litigation – Maximizing Recoveries	Cedar Court Hotel, Bradford
6	Introductory Programme Rescue 3	etc Venues, London
6	Introductory Programme Rescue 3	Deloitte, Birmingham
8	Introductory Programme Rescue 3	Irwin Mitchell, Leeds
13	Insolvency Litigation – Maximizing Recoveries	Grange City Hotel, London
August		
19	Scottish Women's Insolvency Group Fringe Festival	

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

regional events **R3 events**

Failed leaders – who are they? (see article on page 38)
A. Nicolas Fouquet, Marquis de Belle-Île, Vicomte de Melum et Vaux **B**. Adam Applegarth, Northern Rock **C**. Sir Fred 'The Shred' Goodwin, RBS
D. Dick Fuld, Lehman Brothers **E**. Ratbert (the cartoon character), Dilbert, Scott Adams **F**. Lady Thatcher AND Sir Richard Greenbury, Marks & Spencer
G. Henry Paget, 5th Marquess of Anglesey **H**. Lord Simpson of Dunkeld, Marconi

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Southern ....Julie Palmer 01202 786 560
South West & Wales ....Richard Hill 0117 905 4069
Yorkshire ....Robert Brown 0113 244 3121

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

- A copy of *RECOVERY* every quarter
- Attendance at regional meetings
- Priority bookings for R3 courses and most of its conferences
- Technical bulletins and releases
- Access to the members' section of the R3 website
- An invitation to the R3 annual conference
- Continuing professional education at discounted rates

Please see below for details of the different categories of membership:

Full members are invited to contribute to the development of insolvency, business recovery and turnaround professions at both local and national levels. Benefits include: use of the designatory letters MABRP and a certificate of membership, inclusion in the *R3 Directory* and a copy of it, membership of INSOL International.

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

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

New Professional (Networking) members are individuals who have recently joined their firm, and/or are new to the business recovery sector and wish to network with R3 members. This category receives electronic copies only via access to the R3 website.

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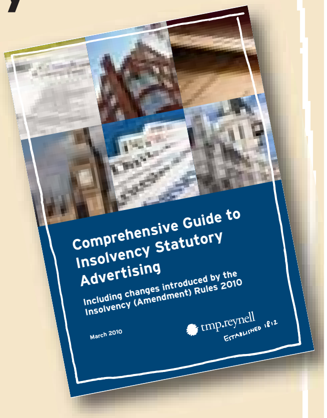
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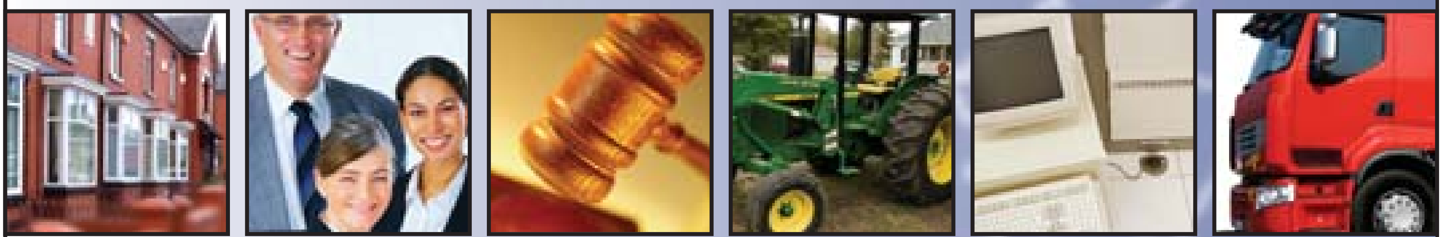

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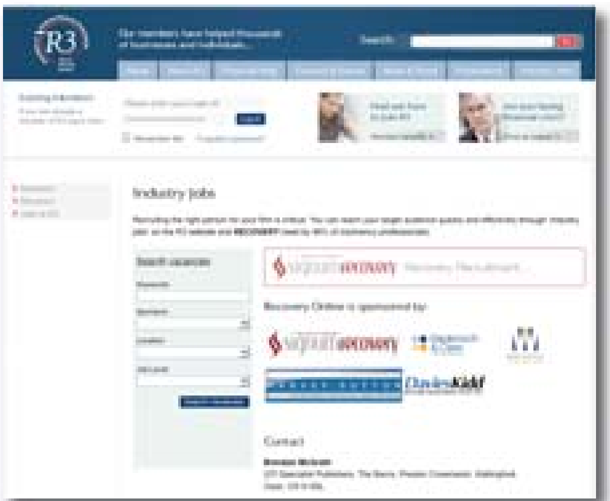

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Interview with Steven Law

Steven Law is the new president of R3. He has a long-standing relationship with the organisation and believes it is well positioned to react to the challenges of the economic climate.

Did you set out to become an IP?

It's rare that anyone sets out to become an IP. Like most people, I had a taste of the work, enjoyed it and wanted to carry on. I qualified as a chartered accountant at Grant Thornton, Ipswich, and became an audit manager. The office was headed by Andrew Conquest. I became involved in business reviews during 1989 and transferred to the insolvency department where I took my JIEB examination in 1991 (the same year as Nick O'Reilly), and started to handle receiverships.

My father ran his own business and I'd always taken an interest in it. Being commercially minded comes naturally to me. I enjoy dealing with and helping people.

How did you get involved with R3?

When I was studying for my insolvency exams, I was encouraged to become an R3 student representative for the region. Later, I joined the committee and then became vice-chair and subsequently chair of the Eastern Region. I also became chair of the Regional Activity Committee (now called the Regional Communications Committee). In 2000, I represented the enlarged Midlands and Eastern committee on the Council and became chair of the Smaller Practices Group. So I've had a number of roles and understand well how R3 ticks. Effectively, I've been on Council for nine years now and on the National Council for six years.

I've found that being involved with R3 can help with the day job. It keeps you up-to-date with the technical action, the issues and gives you good networking opportunities. I'd encourage everyone to get involved. It can be most fulfilling and rewarding.

What are you most looking forward to in your year as president?

I'm sure this is what most presidents say, but I'm looking forward to meeting and helping other members. It will be nice to visit the different areas nationally.

It will also be interesting to meet key influencers, for example, politicians and bankers.

Spreading the message about what IPs do and the value we add to the economy is also important. R3's independent research, commissioned two years ago with the Centre for Economics and Business Research, shows that IPs saved 900,000 jobs during 2008. This has now been updated and that figure has doubled to nearly two million jobs saved in 2009. IPs are not just undertakers; we try to help businesses stay in business. Interestingly, my personal experience is that the banks support where they can and they are not rushing companies into administration: they are less trigger happy than in the last recession. And property owners and suppliers are being supportive too.

> "My father ran his own business and I'd always taken an interest in it."

Will the result of the general election make any difference to your approach to the R3 presidency?

R3 is not a political organisation and will work with whatever government is in place. Insolvency practitioners are in the spotlight and the election will give us a good opportunity to influence the new intake of parliamentarians. It is also important to maintain a good relationship with The Insolvency Service, which we do; we need to continue working together for the good of the profession.

What are the key challenges you will have to deal with over the coming year?

Part of R3's role is to react to challenges as they occur. For example, we've given a good account of the work we do to the OFT. We are hoping for a 'thumbs up' but will have to react to whatever comes out of the OFT market study in June.

If we could influence procedure, it would be good to see more CVAs. It is an excellent tool. Some companies may have issues with creditors and need time to stabilise the organisation and then get things moving again.

A consultation on pre-packs has been announced by The Insolvency Service. In the right circumstances, pre-packs are a good tool to have at your disposal. Independent research shows that 92 per cent of jobs are saved in a pre-pack. I will follow the good work of my predecessors by trying to demonstrate the benefits of pre-packs and helping others understand them.

A challenge will be to stress to the APPG all the good work that IPs do. This is a very important forum for us. New statistics from R3 members' surveys during my presidential year will help to reinforce this message.

Have you seen a change in the number and type of cases in East Anglia as a result of the recession?

The Eastern Region has fared fairly well in the recession and business confidence is pretty high. We have little manufacturing and quite a lot of agriculture – and everyone needs to eat. In the financial services sector, insurers such as Aviva (formerly Norwich Union) and Willis have done OK.

However, there have been a number of long established, family owned construction companies, with a workforce of about 40 to 50, which have suffered recently. Larger construction companies hire in contract labour and this enables them to undercut the prices of the more traditional companies. Restructuring through redundancy can also be expensive as many employees have been there a long time.

A number of intellectual property companies and those in the bio-chemical field in the Cambridge area have also experienced difficulties. They used to be able to get funding for research relatively easily but this is harder to come by now and they've needed help with restructuring.

What are your interests outside of work?

It's important to have a work/life balance. Most of my interests are family and sport-related. I used to play tennis as a county player but I'm now a league player. I've got a 12 handicap at golf and try to play once a week. ☐

Sarah Houghton is the publishing manager of *RECOVERY*.

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IN A CHANGING WORLD IT PAYS TO SEE BOTH SIDES OF THE EQUATION