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RECOVERY

Trends in the construction industry Increasing complexity and demand for security

Metronet: the first PPP administration The special PPP administration process

Step-in rights How do they operate and what are the options?

Company Voluntary Arrangements A look at the case law

The British film industry – worth a look? There are opportunities to be had

Interview with Stephen Speed Plans for the IS in challenging economic times

Plus Legal update, R3 members' survey and three special features

Construction

As a barometer of the economy, construction is one of the KPIs…

RECOVERY

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Forthcoming themes & advertising
www.r3.org.uk/recovery

RECOVERY is the quarterly magazine of R3,
the Association of Business Recovery Professionals,
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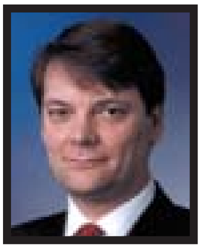
Published on behalf of R3 by
GTI Specialist Publishers, The Barns,
Preston Crowmarsh, Wallingford, Oxon OX10 6SL
www.groupgti.com, Tel: 01491 826262

 Contents

Editorial



Writing in late July, I anticipate the restructuring and insolvency profession continuing to enjoy the recent marked upturn in activity. Many of us had begun to foresee more work coming by September and so had to revise our expectations. Pundits are now predicting two to three years of economic stress for us to play our part in relieving. Is this the right time to revise the UK insolvency system? Some aspects of Chapter 11 are arguably appealing: debtor-in-possession financing where new money can dilute existing security is a fascinating proposition. But in the real world, on this side of the Atlantic, transactions and transitions simply would not be assisted by the type of court-driven procedure so beloved of US bankruptcy attorneys. We have a very different rescue culture in the UK, one that relies not on lawyers arguing about and judges deciding on what business managers are to do, but on experienced practitioners – as principals – executing the remedies, either outside formal insolvency as turnaround professionals or within it as IPs.

There may be perceived disincentives for incumbent managers in the UK to engage and the Enterprise Act could certainly be improved upon (can we please progress from the naïvety that insolvent companies have to be saved at the expense of their businesses), but if we are to change, let's do the right thing for the right reason. It is particularly important that the debate about change is neither manipulated nor ill-informed. *RECOVERY* does not exist merely to promote insolvency and neither are we beholden to a particular stakeholder group; rather, we welcome the constructive airing of the diverse and conflicting views that merit consideration.

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

Extending the availability of interim administration orders

To what extent are administrators able to take on an interim role in a company prior to it formally entering administration. David Fletcher looks at the law governing this thorny issue.

In the last edition of *RECOVERY*, Steven Law suggested some improvements to certain aspects of the law and practice relating to administrations. One of the issues raised was whether provision should be made for an interim role for an administrator between the serving of the Notice of Intention to appoint an administrator and the company entering administration.

The role of the prospective administrator is a topical subject at the moment, with the Insolvency Service having proposed some changes to provide a formal mechanism for the approval of pre-appointment costs. These proposals recognise the important role played by insolvency practitioners in the days leading up to their appointment, especially on a pre-pack, and therefore I thought it would be useful to look at Steven's suggestion in more detail to ascertain what could be achieved within the existing provisions and what changes might be necessary to reflect the appointment process post-Enterprise Act.

> **"Vinelott J was clear that the IP was not being appointed as an interim administrator (an order that had been drawn up following a previous hearing had erroneously referred to the IP using this title) as he believed that the court had no power to bestow the title."**

The old regime

Prior to the introduction of the Enterprise Act, the only route into administration was via a court application.

Section 9(4) of the Insolvency Act 1986 (the IA) allowed the court, on the hearing of a petition for an administration order, to 'make an interim order or any other order that it thinks fit'.

This scenario arose in *Re a company*[1]. The company had two directors; one was inactive and the other was in ill-health. The company was in difficulties so the second director applied for the appointment of an administrator. The company's bank was kept informed of developments and the ailing director believed the bank would have no objection to the appointment of an administrator. However, following the making of the application, the bank asked for an adjournment to consider whether to appoint an administrative receiver. The issue arose whether, in the circumstances, an interim administrator or some other form of manager could be appointed. Vinelott J said:

> *"I can see no reason why, if satisfied that the assets of a company are in jeopardy, and that there exists a* prima facie *case for the making of an administration order, the court should not… appoint the proposed administrator or some other suitable person to take control of the property of the company and manage its affairs pending the hearing."*

However, Vinelott J was clear that the IP was not being appointed as an interim administrator (an order that had been drawn up following a previous hearing had erroneously referred to the IP using this title) as he believed that the court had no power to bestow the title.

The same point arose in the later case of *Palmer*[2] in which Lord Penrose held that:

> *"While it is no doubt competent for the court to make an order which effectively provides* ad interim *for the administration of the company to be in the control of a nominee of the court, it does not follow that it is proper to describe the person so appointed as an administrator in the sense that term appears in the Act."*

Post Enterprise Act

Currently, if an application for administration is made via a court application the court may still make an interim order (paragraph 13(1)(d) of Schedule B1 of the IA).

The situation highlighted by Steven Law relates to the period of up to five business days between the filing of the Notice of Intention to appoint and the appointment, where notice has been given to the qualifying floating charge holder (the QFCH) and they have not yet responded. It should be said that in most situations the company will have obtained consent in principle from the QFCH in advance of the application.

Also, if the company is having difficulty obtaining the prior consent of the QFCH and believes that immediate assistance is required it still has the option of making the application via the court and seeking an interim order.

This does not, however, help a company that believes it has the consent in principle of the QFCH but finds, on initiating the out of court route, that consent is not forthcoming.

In this scenario it may still be possible for the company to revert back to the court process and make a new application together with an application for an interim order. This though is likely to create some confusion, given the continuing status of the out of court process; the company will also be faced with the need to prepare the various papers required to employ the court process at the very time when it needs immediate assistance.

For this reason, while IPs should be aware of the powers available to the court via the court application process, it would seem sensible for the IA also to provide the courts with the express power to make a similar form of interim order as currently prescribed in paragraph 13(1)(d) on the application of the company or its directors, once the out of court process has been initiated. ☐

[1] *Re a company* (No. 00175 of 1987) [1987] BCLC 467
[2] *Secretary of State for Trade and Industry* v. *Palmer* 1994 S.C. 707

David Fletcher is a partner at Farrer & Co.

President's column

Nick O'Reilly outlines the Conservative Party's proposals for reforming Britain's insolvency system.

In the current climate it is not surprising that insolvency and business recovery are hitting the headlines regularly and taxing the minds of policy makers both within the government and the opposition. We at R3 have had a busy time over the last month or so as David Cameron made a speech to the CBI Employers' Group on 15 July 2008 outlining proposals to import elements of the US Chapter 11-style insolvency system to the UK in order to, in his words, prevent companies going to the wall during an economic downturn.

The Conservatives' proposals

Primarily, the Conservative plan is to create a new fast track judicial process for distressed companies as an alternative to administration based on the best aspects of the American Chapter 11 system. They claim that there are three key elements to their proposed reform.

- Automatic stay of enforcement – this is intended to stop suppliers and customers from terminating contracts solely on the grounds that an insolvency process is in place.
- Priority funding for distressed companies – this is something that we in the UK have discussed on numerous occasions when legislation is being proposed, the last time being in the discussions leading up to the Enterprise Act 2002.
- Preventing unscrupulous creditors from vetoing desirable restructuring – this is to try and take stakeholders who have no financial interest in the restructuring out of the process of approval.

One of the other areas that would be

> "What has been particularly pleasing about the publicity created by David Cameron's speech is that it puts the insolvency regime on the public agenda. We look forward to consultation with all parties on this issue."

quite a radical change to the UK insolvency system is that the Conservatives are indicating that company directors should remain in control of the company during a restructuring (based on Chapter 11) whereas, under UK administration, an insolvency practitioner controls the process. We at R3 welcome the chance to have a debate both with the Conservatives

and with other creditor stakeholders' groups to see whether this radical shift would be acceptable.

R3's view

Our view at R3 is that the UK system works reasonably well. It is by no means perfect but we would much rather see reform of the existing system of administration rather than starting again from scratch. We have also made it clear in our press release following the Conservatives' proposals that we want to have a system that operates not only in periods of economic downturn, such as we are currently facing, but also is fit for purpose in more stable times. What has been particularly pleasing about the publicity created by David Cameron's speech is that it puts the insolvency regime on the public agenda. We look forward to consultation with all parties on this issue. This early dialogue, providing technical input as to the current system and thought leadership, shows that our organisation is committed to improving best practice both in terms of legislation and proposed thinking in the area. □

R3 News

The Lite Conference

This conference was held on 10 July at the University of Warwick. The quality of the presentations, which had first been aired at the annual conference in Cannes, was excellent and the general feedback on the technical and practical content of the presentations was very good. We are already looking at the venue for next year's conference and also trying to decide whether the Lite Conference is the best name for a conference – as it is so packed with technical content.

SPG Forum – 16 and 17 October

The programme for this event has now been dispatched to our members and I especially like the fact that it is all themed around food, including our guest dinner speaker, Clarissa Dixon-Wright. I was particularly pleased to be described as the Head Chef for my presentation, though I will try and ensure that delegates are not treated to an impression of me doing it in the Gordon Ramsay-style!

Insolvency Service and R3

I would like to correct any unintended, negative impression occasioned by a recent *Accountancy Age* article that quoted me. I greatly regret that it caused deeply felt concern and upset to the Service. The article gave entirely the wrong impression of the high regard I have for Stephen Speed and the Service's staff, past and present. I am proud to be the first R3 president who started their career in the Service.

I wish also to thank Stephen for his time in contributing to this issue by his open and thoughtful answers in his challenging interview (pages 59–60). As fellow professionals we, our respective staff and members share a common desire to produce a complementary, high-quality, public/private sector service to our various stakeholders. Long may that continue.

Nick O'Reilly is client partner at Vantis.

Burning platform

Have your shout. If you have comments about articles in *RECOVERY* or concerns about the industry we'd like to hear from you.

Dear Sir,

In response to your article 'Debtors deserve a choice' (*RECOVERY* summer 2008, p22), this should read 'Debtors deserve a chance'.

Your article concerning Northern Rock (NR) and their attitude about supporting retail consumers in their IVAs was enlightening and showed that, although IVAs are meant to be 'fair and feasible' to all concerned, this was being disregarded by NR.

We are all well aware that NR have taken a tough stance as they are now under pressure with the level of unsecure debts on their books. They were one of the first lenders happy to lend with high LTVs, sometimes as much as 125 per cent, taking the risk that a buoyant economy would fuel house prices and afford them better protection. This policy seems to be biting them back.

We have seen clients, specifically with 'Together' mortgages, still being debited their unsecured loan payment even when the IVA has been approved for several months. This has resulted in a lack of faith by the clients in their arrangements from the outset of approval, and financial hardship.

We have also experienced NR sending mortgage redemption figures to solicitors that have included the unsecured element. Needless to say, NR have rectified this when discovered but it's more than possible that some consumers may not appreciate that the unsecured element shouldn't have been added, and solicitors giving undertakings are unaware of the issue.

One way of removing the manipulation of the 'requisite majority' would be to change the 75 per cent rule, and that all creditors should vote to accept, reject or abstain.

Small creditors don't tend to vote as they either don't have the legal resources or expertise, or because they feel that their vote just doesn't count against the big boys. As all creditors receive the same dividend the issue of the size of the debt is relative only to the creditor concerned and as such irrelevant as to whether the IVA is fair and feasible to all.

If the debtor is insolvent then the chances of receiving the full debt is non existent but, even then, NR has been witnessed rushing through interim charging orders to secure their unsecured debts, although there is no equity to secure them against. Couple that with the ending of fixed-rated mortgages and NR's re-mortgaging criteria (one of the toughest in the market) and we have the consumer in a repossession situation being unable to reschedule his mortgage, or even sell his property.

The government is ploughing millions into charitable advice services but this isn't really going to help these people when the writing is already on the wall. The government needs to divert these funds to a social fund to help those who need real mortgage support, and they can repay the fund when their salary or sale of the property allows. ☐

Suzanna Walker is a compliance officer at Kingsgate Insolvency Ltd.

News update

Industry news update

SPG members' survey

The results of the recent SPG members' survey have now been published. Thank you to all of you who took part. The information you have provided will enable members to identify their strengths and weakness, make adjustments where necessary and continue to provide a thoroughly professional service to clients.

Those of you who took part in the survey will receive your copy shortly. If you didn't take part but would like to purchase a copy, please contact Victoria Jonson director of communication and public affairs at R3 on 020 7566 4223 or **vjonson@r3.org.uk**.

Nick O'Reilly at the JIEB Awards

JIEB Awards

The JIEB Awards ceremony was held on 27 June at Gray's Inn. Congratulations to all successful candidates, many of whom were able to attend the occasion. The event was organised by R3 and Nick O'Reilly, president of R3, addressed the audience and introduced Stephen Speed, inspector general and agency chief executive of the Insolvency Service, who presented the certificates. (See pages 59–60 for an interview with Stephen Speed.)

Another successful JIEB candidate

Congratulations to Fox T (8167), Manchester, who also passed the JIEB examinations in December 2007. We apologise for not publishing his name in the list of successful candidates in the March 2008 issue of *RECOVERY*.

Surveys confirm business pain

The pain of the business community continues unabated and this issue of *RECOVERY* contains several surveys conducted during Q2 that confirm it. On this page are the highlights from the Equifax Business Failures Report but see page 42 for the R3 members' quarterly survey, page 34 for the Baker Tilly survey and page 37 for *RECOVERY's* own survey of recruiters in the insolvency sector.

David Kerr

Carl Faulds

New appointments at IPA

David Kerr has been appointed chief executive officer of the Insolvency Practitioners Association (the only specialist insolvency regulatory body in the UK). He is a licensed insolvency practitioner, with a background in insolvency regulation and practice, and is the first IP to hold the post.

Carl Faulds, MD of Whiteley-based Portland Business Recovery, has been appointed deputy vice-president of the IPA, and will become president in 2010. Part of his role is to ensure that the insolvency profession is seen to be applying the highest standards and to reassure businesses that, when a business failure occurs, the consequences are dealt with fairly and professionally.

Big companies are delaying payment

The Federation of Small Businesses (FSB) says that big companies are delaying payment to smaller suppliers by more than 100 days.

The FSB reports the situation has worsened dramatically in the past few weeks and it is concerned that big companies are starting to formalise longer payment periods, rather than merely settling their bills later in an ad hoc way.

According to the Institute of Credit Management, the average payment period across all FTSE 100 and FTSE 250 companies is 34 days. For all plc businesses it is 44 days.

Late payment will undermined business confidence further. According to Lloyds TSB's Business Confidence Index, firms' optimism for the next six months is lower than at any time since the index began in 1992, with eight per cent more firms expecting profits, sales and orders to fall rather than rise.

UK business failures rise as slowdown takes hold

The Equifax Business Failures Report for Q2 2008 reveals that total failures rose by 10 per cent when compared to the same period last year. This follows the trend set in Q1 when there was a 9.10 per cent increase year on year. Although some sectors appear to be managing business and cashflow to keep failures under control, the construction and retail sectors are faring worst. The construction sector saw a rise in failures of 20.30 per cent in Q2, compared to same period last year and the retail sector followed close behind with a year on year increase in businesses going bust of 15.70 per cent. Looking at the wider picture, other sectors haven't been as badly hit, and the manufacturing and services sectors saw increases of only 4.80 per cent and 3.10 per cent respectively.

Regionally, year on year figures showed that businesses in the North East were worst hit while Scotland saw a decrease in the number of failures over the same period.

Regional increase or decrease in failures

	Q2 2008 v. Q2 2007 %	January–June 2008 v. January–June 2007 %
East Midlands	+22.60%	+21.70%
East England	+7.10%	+2.40%
London	+1.80%	+7.60%
North East	+30.80%	+24.80%
North West	+23.00%	+22.20%
Scotland	-3.00%	-14.30%
South East	+16.50%	+7.60%
South West	+3.20%	+4.10%
Wales	+12.30%	+12.60%
West Midlands	+11.40%	+12.30%
Yorkshire & Humberside	+6.20%	+13.10%
Total year on year	**+10.00%**	**+9.60%**

Legal update

Nicholas Pike examines a recent case that demonstrates that IPs in out of court appointments need to take care in the achievement of statutory purpose as courts will make a personal costs order against them if an inappropriate approach is used.

Hamish Anderson commented in the last issue of *RECOVERY* that House of Lords' judgments in insolvency cases are few and far between. Court of Appeal decisions are more numerous, but on costs issues, less so.

So, when determining which case to analyse for this issue, my attention was drawn to *Coyne and Hardy* v. *DRC Distribution Limited and Foster* [2008] EWCA Civ 488, a case ostensibly dealing with an argument over costs but in reality carrying out a deft analysis of the actions of a director and the administrators who were appointed over his company.

The proceedings concerned Ulva Limited (Ulva) of which DRC Distribution Limited (DRC) was a sizable creditor. The second respondent, Mr Foster, was Ulva's managing director. The appellants were appointed as administrators of Ulva on 14 August 2007. Less than a month later, DRC applied to court to have them removed from office. Prior to the hearing of DRC's application, the administrators applied to court for an order that their appointment cease to have effect and a compulsory winding up order be made. DRC's application was therefore unnecessary. Yet, despite this, the judge ordered the administrators and Mr Foster to pay DRC's costs jointly and severally. The administrators appealed that decision to the Court of Appeal, claiming that the judge should not have adopted a 'summary' procedure when ordering the administrators to pay costs. In other words, he should have allowed them to give evidence from the witness box as to why they should not be ordered to pay costs before ordering them to do so.

Simply a technical point on procedure?

No, not at all. Consideration of the case involved the Court of Appeal engaging in a comprehensive analysis of the administrators' actions and setting out some useful guidelines as to what is expected of office-holders when undertaking their work.

The background

Ulva agreed to buy products from DRC on a long-term supply agreement. Subsequently, in breach of their contract, Ulva started to source suppliers from elsewhere. DRC began proceedings against Ulva seeking damages for breach of the supply contract. Ultimately, Ulva admitted it was in breach, although it argued that it could terminate the contract in any event. The litigation was tried and DRC was successful. A damages award was made in its favour.

In the meantime, Mr Foster set about what the Court of Appeal termed 'an asset stripping exercise enabling him to carry on business through another company with a similar name'. He transferred Ulva's plant and machinery to Ulva International (UI), another company controlled by him, for the sum of £121,000. Although he obtained a valuation supporting that sum, it was almost £100,000 less than the book value stated in the accounts Mr Foster had signed the day before the date of valuation. In any event, UI did not pay.

Not content with that, Ulva transferred its business premises to Mr Foster for the sum of £810,000. He did not pay that either, but instead took over Ulva's HSBC mortgage (and made a £150,000 adjustment in Ulva's favour in his loan account). Mr Foster then leased the premises back to Ulva for 10 years at a rent of £60,000 a year subject to review.

Six weeks later, on 29 June, Ulva ceased trading and UI began operating the same business from the same premises. All the employees transferred from Ulva to UI. Ulva's trademark was transferred to UI for £10. Another (unregistered) trade name Ulva had previously used was registered to UI. Finally, Ulva provided £300,000 in cash to UI. This was said to be due to Ulva's overseas agents. But UI did not assume the liability to those agents; that remained with Ulva. It was a clear misappropriation of Ulva's assets.

The proposed administration

On 23 July, Mr Foster met the second appellant, Mr Hardy, who is an insolvency practitioner. Mr Foster told Mr Hardy that Ulva was insolvent, owing HMRC £835,000 and DRC at least £750,000 following its successful litigation against it. Mr Hardy said that formal insolvency process was necessary. Mr Foster claimed he wanted to purchase Ulva's assets by way of pre-pack sale but Mr Hardy wisely counselled against this. Mr Foster told Mr Hardy about some of the pre-insolvency transactions and the setting up of UI and, said the Court of Appeal '[Mr Hardy] knew that the Ulva employees had gone to UI [and] he must have know that Ulva was no longer trading'.

In the main judgment, Lord Justice Rimer raised issues about the lack of pertinent questioning by Mr Hardy of Mr Foster, despite an 'incomplete – and thoroughly suspicious – picture, which ought to have rung alarm bells as to what had been going on'. In particular, the judge questioned why, given the extent of what had gone on, administration was the appropriate insolvency process.

Moreover, the judgment highlights the fact that Mr Foster was apparently not asked to unravel the transactions he had caused Ulva to carry out as a pre-condition of administration. There was a subsequent meeting on 25 July which, according to the judgment, should have raised more concerns since it transpired that Mr Foster had been on the edge of prosecution for tax irregularities. Lord Justice Rimer pointed out, rather graphically, that had Mr Foster made an application to court for an administration, given what had happened 'the court would probably have checked the diary to see that it was not 1 April'.

> “Consideration of the case involved the Court of Appeal engaging in a comprehensive analysis of the administrators' actions and setting out some useful guidelines as to what is expected of office-holders when undertaking their work.”

The appointment of administrators

Notwithstanding this, on 14 August Messrs Coyne and Hardy were appointed as administrators. Two days later, Mr Coyne met DRC and its advisers. DRC was told that the administrators would take immediate steps to recover Ulva's assets and property including, if necessary, the taking of proceedings against Mr Foster. However, a meeting took place with Mr Foster and his advisers on 23 August at which Mr Foster indicated to the administrators that he was prepared to make an offer for the business. Given that, and the fact that the administrators were then given access to Ulva's premises, the court proceedings against Mr Foster were not commenced. Indeed, the administrators appear to have abandoned any attempt to recover Ulva's assets from Mr Foster and instead sought to sell what was left of Ulva's business.

On 28 August, UI offered £500,000 for Ulva's assets, payable in instalments. DRC was also interested in purchasing

Ulva's business and offered a lesser sum, but with royalty payments spread over five years to provide a total consideration of up to £1.1 million. However, given that most, if not all, of the assets were no longer in Ulva's ownership but instead that of UI, the administrator said that to perfect any purchase further steps would need to be taken to vest 'complete' ownership with the purchaser. It followed that any prospective purchaser (other than Mr Foster) was wholly unclear as to precisely what he would be buying.

Between 4 and 11 September, Mr Foster improved his offer and, having learned that the administrators were inclined to deal with him, DRC issued an application for their removal. There was a flurry of evidence exchange, but on the eve of the adjourned hearing for their removal on 24 September, the administrators insisted that terms of any sale to UI must be agreed by midnight on that day. UI withdrew its offer.

> **"Had Mr Foster made an application to court for an administration, given what had happened 'the court would probably have checked the diary to see that it was not 1 April'."**

Against that background, the administrators concluded that the purposes of administration could not be achieved and issued an application to be heard the following day for an order that their appointment cease to have effect and for Ulva to be placed into compulsory winding up.

At the hearing, the judge made a compulsory winding up order. DRC's application for the removal of the administrators had therefore been overtaken by events. Notwithstanding this, the judge made an order that the administrators and Mr Foster pay DRC's costs of their aborted application.

The judgment

The judge was critical of a number of the administrators' actions. First, their consent to act did not disclose the fact that Ulva had been advised by their firm in July 2007. Even though the advice given in July was given at a stage when the decision had been taken to place the company into insolvency process, the judge was of the view that it should have been disclosed. The judge said he placed 'limited, if any' reliance on the administrators' statement that the purposes of administration were likely to be achieved because the care and attention paid to the filling in of this form seemed to be 'slight to put it at its highest'. He further criticised the attempted sale process, which appeared to him to be an attempt by Mr Foster to 'cure the past' while the other bidder, DRC, was wholly unclear as to what assets it was in fact able to buy. The judge's view was that the purposes of administration could never have been achieved, given what Mr Foster had done prior to the administrators' appointment and the proper course was liquidation. The administrators had 'behaved very sloppily… and had not adhered to the standards of competency one is entitled to expect'. Accordingly, they were obliged to pay DRC's costs, even though DRC's application ultimately proved unnecessary.

The appeal

The administrators appealed, claiming (among other things) that if a costs' award against them was to have been considered they should have had been afforded an opportunity to give oral evidence on that point. There was some conflict of facts in the evidence that had been given to the judge. There was also criticism of the way in which the judge had analysed the evidence against the administrators.

The Court of Appeal did not agree, stating that it was quite appropriate for the judge to determine the liability for payment of DRC's costs without hearing evidence from the administrators on this point. Here, leaving aside the issue as to whether the administrators were right to accept their appointment in the first place, they should never have considered offering the business for sale. Instead, their job was to recover the entirety of Ulva's business and assets, having been improperly misappropriated by Mr Foster. Only then could they have marketed the business and assets. The decision on 22 August not to recover the assets from UI represented 'a fatal wrong turn in the administration they never attempted to correct'. Thereafter their conduct of the administration had 'the potential for disaster written all over it, and disaster is what happened'.

> **"The number of cases in which cost orders are made against insolvency practitioners personally seems to be on the increase. It is clear that, generally, the courts are taking a rather sterner view now than perhaps they have done hitherto."**

While the Court of Appeal was sympathetic with the administrators' criticism of some of the points made by the judge, in particular his comments as to the consents to act, overall it did not alter the view that it was right for the administrators to pay DRC's costs.

IPs should review businesses carefully

The number of cases in which cost orders are made against insolvency practitioners personally seems to be on the increase. It is clear that, generally, the courts are taking a rather sterner view than perhaps they have done hitherto. Now that the Enterprise Act has swept away the requirement for a report under old Insolvency Rule 2.2 – and most appointments are made outside of court in any event – it may be the case that some potential appointees are not reviewing businesses as closely as they might have done under the old regime. In certain circumstances, administration is becoming the 'default' option for corporate insolvency.

The lesson from this case must be that such an approach is inappropriate. The reality is that each out of court appointment should be approached with the same care as might previously have been expended on an old-style administration application, particularly when approaching the issue of the likelihood of achievement of the statutory purposes. Moreover, practitioners who litigate will be well aware of the risks of doing so and what may appear to have been a sensible, pragmatic step to take in their eyes can be viewed entirely differently by the High Court or, as in this case, the Court of Appeal. The administrators here may well have thought that it was in the best interests of creditors to market the business in the way they did, particularly bearing in mind the alternative: costly litigation against an individual who the Court of Appeal found to be 'bereft of the basic instincts of commercial morality'. If so, the Court of Appeal did not share that commercial pragmatism and believed that the recovery of assets from UI and Mr Foster should have been the priority. It is not known whether funding was available for litigation against Mr Foster.

The Court of Appeal also noted that the guidance given in *AMP Music Box Enterprises Ltd* v. *Hoffman* [2003] BPIR 11 on the approach to take when considering the removal of liquidators should also be applied to administrators. There, Neuberger J said that a court should have no hesitation in removing a liquidator who fails to live up to a standard whereby he is 'efficient, vigorous and unbiased'.

Finally, practitioners are reminded that the achievement of the statutory purpose of an administrator is an issue to consider both prior to appointment and continually thereafter. Indeed, they are under a duty to do so. It is clear now that courts will not hesitate to make a personal costs order against an administrator if a disgruntled creditor successfully demonstrates a breach of that duty. □

Nicholas Pike is a partner at Lawrence Graham LLP.

Recent case summaries

Corporate and personal insolvency update from Martin Ouwehand.

Corporate Insolvency

***First Independent Factors & Finance Ltd* v. *Mountford* [2008] EWHC 835 (Ch) (Lewison J)**

Facts: This was a claim against a director under sections 216 and 217 of the Insolvency Act 1986 which, in certain circumstances, imposes personal liability for the debts of a company where that company uses a name previously used by a liquidated company, or a name suggesting an association with that liquidated company.

In 1998, Mr Mountford began his personal business under the name Classic Conservatories & Windows or Classic Conservatories. Then in July 2002, another company, Classic Roofs Ltd, began trading as a manufacturer of roofs for the trade. Mr Mountford was a director of Classic Roofs Ltd but also continued his personal business. Classic Roofs Ltd went into liquidation in February 2004. In May 2004 Classic Conservatories & Windows Ltd, which had previously been dormant, acquired Mr Mountford's personal business. It also acquired some of the assets of Classic Roofs Ltd but did not carry on that company's business. It traded using the same logo as Mr Mountford's personal business. However, in January 2005 Classic Conservatories & Windows Ltd also went into liquidation leaving the claimant's debts unpaid.

Held: Mr Mountford was personally liable under section 217 for the relevant debts of Classic Conservatories & Windows Ltd. The court had no power to read down those sections as applying only to the phoenix phenomenon in the true sense. Nor could it excuse Mr Mountford from liability under section 727 of the Companies Act 1985 on the grounds that he was acting honestly and reasonably in the circumstances.

Comment: Mr Mountford relied on case law confirming that sections 216 and 217 were intended to protect creditors from the confusion arising from the phoenix phenomenon; ie, the mischief caused by the continuance of the activities of a failed company by those responsible for the failure, using the vehicle of a new company. Mr Mountford argued that Classic Conservatories & Windows Ltd only took over his personal business and was not a phoenix company rising from the ashes of Classic Roofs Ltd; it had not acquired that company's assets or profits or continued that company's business. He argued that where there is no phoenix company the provisions should not be applied because the mischief to which the provisions are directed is not present. The judge acknowledged that sections 216 and 217 were directed to the phoenix syndrome but said that the words of those sections encompassed wider circumstances and cannot be interpreted restrictively to apply only to 'true cases of phoenix syndrome'.

Mr Mountford also argued that the court has power to relieve a director from liability under section 727 of the Companies Act 1985. This allows the court to excuse an officer of a company from liability for negligence, default, breach of duty or trust where that person acted honestly and reasonably in the circumstances. However, the judge held that section 727 applied to claims brought by or on behalf of the company, rather than a third party, and which involved contravention of an officer's duties under the Companies Act. In this case, a third party had brought a claim and the claim did not involve a breach of Mr Mountford's duties as a director. This case is a reminder of how little discretion the court has in imposing personal liability under section 217 once it is established that a prohibited name has been used in breach of section 216.

Personal Insolvency

***Re Peter Francis Barcham* [2008] EWHC 1505 (Ch) (Blackburne J)**

Facts: Mr Barcham's trustees in bankruptcy applied for an order for sale, together with other relief, in respect of the property that Mr Barcham and his wife jointly owned and occupied. It was common ground that the trustees, on the one hand, and the wife on the other, each had an equal share in the property and that the wife was entitled to be compensated for payments she made towards the liabilities relating to the property. It was also common ground that, despite not being in occupation of such a property, a trustee in bankruptcy was not a beneficiary entitled to compensation under sections 12 and 13 of the Trusts of Land and Appointment of Trustees Act 1996 (the Act). The central issue was whether the wife's share nonetheless should be reduced to account for an occupation rent in favour of Mr Barcham's estate in light of the House of Lords decision in *Stack* v. *Dowden* [2007] 2 All ER 929 regarding the effect of sections 12 and 13 of the Act.

Held: Sections 12 and 13 of the Act were not an exhaustive regime for compensating a beneficiary for being excluded from occupation of property subject to a trust of land. Therefore the trustees in bankruptcy could have recourse to the court's equitable jurisdiction. The court ordered that the wife's share be reduced by half of the property's letting value since the date of bankruptcy.

Comment: The relevant parts of section 13 of the Act provide that '*where the entitlement of any beneficiary to occupy land under section 12 has been excluded or restricted, the conditions which may be imposed on any other beneficiary under subsection (3) include, in particular, conditions requiring him to… make payments by way of compensation to the beneficiary whose entitlement has been excluded or restricted*'. The trustees' case was that, even if these sections did not apply, the wife was liable for occupation rent for occupying the property during the time that the trustees had been vested with Mr Barcham's interest. The wife argued that this could not be the case in light of Baroness Hale's observations in *Stack* v. *Dowden* that '*these statutory powers replace the old doctrine of equitable accounting under which a beneficiary who remained in occupation might be required to pay an occupation rent to a beneficiary who was excluded from the property*'. The judge concluded that Baroness Hale was referring to a case where both parties had a right of occupation and was not suggesting that a party who has no right of occupation can no longer claim occupation rent in any circumstances whatsoever.

Having reviewed the authorities, the judge said that '*the essential point, in my view, is that when on inquiry it would be unreasonable, looking at the matter practically, to expect the co-owner who is not in occupation to exercise his right as a co-owner to take occupation of the property, for example because of the nature of the property or the identity and relationship to each other of the co-owners, it would normally be fair or equitable to charge the occupying co-owner an occupation rent*'. Ordinarily, if not invariably, this means an occupying co-owner must account to a trustee in bankruptcy for occupation rent. However, the court may take a different view if the occupying co-owner was given to understand by the trustee in bankruptcy that occupation rent would not be charged or had no means of discovering the other co-owner's bankruptcy. □

Martin Ouwehand is a barrister at 11 Stone Buildings.

Legal Q&A

Grant Rechnic answers your insolvency queries.

I have recently been appointed as an administrator of a chain of shops. The stock is stored by an independent warehouse, which is owed a substantial amount of money. They have now decided to exercise a warehouseman's lien over the stock and the shops will soon run out of goods. What can I do?

Under paragraph 43(2) of schedule B1 to the Insolvency Act 1986 no step may be taken to enforce security over the company's property except with the consent of the administrator or with the permission of the court. Section 248 of the Insolvency Act 1986 defines security to include any lien. The warehouse should therefore apply to court for permission to exercise its lien. In such an event, the court would have to exercise its discretion and carry out a balancing exercise between the proprietary rights of the warehouse to exercise their lien as against the release of the stock for the benefit of the administration. The court would consider the factors set out in *Re Atlantic Computer Systems Plc* [1992] Ch. 505. Each case would be decided on its own facts.

In practice, most administrators would seek to reach a commercial deal with the warehouse. A normal deal would be to pay the warehouse a percentage of the net sale proceeds of the stock realised through trading and the sale of the business.

I have replaced the original administrator as the new administrator. He had traded the business at a loss and so there are insufficient assets available to pay both his administration expense creditors and my remuneration. I still have a lot of work to carry out. Is there anything I can do?

At first glance the answer would appear to be no as, under paragraphs 99(3) and 99(4) of schedule B1 to the Insolvency Act 1986, there is a statutory charge over the assets that gives priority to the original administrator's expense creditors.

This was the situation that arose in *Re Sports Betting Media Ltd* [2008] BCC 177. However, the new administrator was able to argue successfully to the court that as he was acting as a quasi trustee on behalf of the expense creditors under their statutory charge – in that he had to realise the assets, then investigate their claims and pay them a dividend – he should be entitled to the costs of this work. The court was able to apply the equitable doctrine set out in *Re Berkeley Applegate (Investment Consultants) Ltd (No. 2)* (1988) 4 BCC 279. This doctrine applies where the office-holder needs to undertake work for the benefit of beneficiaries and it would be unfair for the office-holder to incur time and costs without getting paid.

The *Berkeley Applegate* doctrine is therefore a useful tool for applying to court to rearrange the order of priority of payment to allow office-holders to get paid for work that they would otherwise not be entitled to get paid for.

“Under paragraph 43(2) of schedule B1 to the Insolvency Act 1986 no step may be taken to enforce security over the company's property except with the consent of the administrator or with the permission of the court.”

The bank has appointed me administrator. Unfortunately, the realisations have been insufficient to pay off their debenture and so the bank now wishes to participate as an unsecured creditor in the prescribed part. Can the bank do this?

I am afraid that you are going to have to disappoint the bank. While the position is set out at section 176A(2) of the Insolvency Act 1986, two cases had to go to court before the position was fully clarified. In *Permacell Finesse Ltd (in Liquidation)* (30 November 2007, *Birmingham District Registry* (4792 of 2007) and in *Airbase (UK) Ltd; Thorniley & Anor* v. *HM Revenue and Customs & Anor* [2008] EWHC 124 (Ch), the courts held that as a matter of construction, the charge-holder's shortfall, whether fixed or floating, should not constitute an unsecured debt for participation in the prescribed part. Accordingly, the prescribed part is only for the benefit of unsecured creditors and not under secured fixed and floating charge-holders.

The directors of a company want to appoint me as administrator. However, the majority creditor has presented a winding-up petition and is objecting to any administration. Would any application for administration be doomed to fail?

This was the issue that arose in *Re DKLL Solicitors* [2007] All ER (D) 68 (Mar). The court had to consider whether HM Revenue and Customs, as the majority creditor, could veto an administration order on the basis that they were opposed to it and whether such opposition could prevent the purpose of administration from being achieved. The good news for practitioners is that the court held that the majority creditor did not hold such a veto power. While it was a factor that the court had to take into account, the court would place greater reliance on the expertise, experience and impartiality of the insolvency practitioner. If the prospective administrator reasonably believed that the purpose of the administration could be achieved, it would require very clear evidence from the majority creditor to overturn that view. □

Grant Rechnic is head of corporate recovery and insolvency at Rochman Landau Solicitors.

Technical update

Set-off in administrations. Richard Heis explains why the Financial Markets Law Committee is worried

In the preface to his 1,393 page treatise on *English and International Set-Off*, Philip Wood says: 'Set-off is not a little subject.' He adds: 'The question of whether set-off is available is immensely refined and it is easy to go wrong.' It is undoubtedly an area that constantly gives rise to problems and uncertainty.

One example of such uncertainty is the effect of set-off in administrations, which has recently been the subject of an interesting discussion paper issued by the Financial Markets Law Committee (FMLC). The FMLC was set up by the Bank of England in 2002 following the closure of the Financial Law Panel. The role of the committee is to identify issues of legal uncertainty or misunderstanding in the framework of the wholesale financial markets that might give rise to material risks, and to consider how such issues should be addressed.

The operation of set-off rules in administration

The FMLC is concerned that the operation of the set-off rules in administration, and their interplay with the administration expenses regime, could give rise to legal uncertainties that could discourage counterparties from dealing with a company in administration, thus harming attempts to rescue the company. The FMLC notes that although these uncertainties are of general application, they could affect the financial markets if the insolvent company entered into swap or other derivative transaction or was itself in the financial sector. The committee's concerns are set out in a paper entitled *Administration set-off and expenses – Legal assessment of rule 2.85 of the Insolvency Rules 1986 and its interplay with other insolvency provisions in respect of post-administration liabilities owed to counterparties*, which was issued in January of this year (although it is dated November 2007).

The problem, as the FMLC sees it, stems from the changes introduced by the Enterprise Act 2002 that give an administrator the power, with leave of the court, to make a distribution to unsecured creditors. These changes meant that various rules had to be introduced to deal with the mechanics of submitting claims, quantifying debts and paying dividends. The rules included set-off provisions that broadly mirror the set-off rules applicable in liquidations. It is the operation of these rules that causes the FMLC its concerns.

The administration set-off rules provide that where there have been mutual dealings between the company and a creditor, the amounts due from each to the other shall be set off and only the balance will be due. They also provide that the mutual dealings taken into account when calculating set-off do not include debts arising out of obligations incurred after the company went into administration or after the creditor had notice of an administration application or notice of intention to appoint an administrator. Debts acquired by a creditor pursuant to an agreement entered into after these events are also excluded for set-off purposes. In other words, the cut-off date for set-off purposes is the date of administration or earlier date of notice of the administration. The policy behind the cut-off date is to prevent the creation of claims, or the trafficking in claims, after the creditor knew, or should have known, that an administration was imminent. However, these provisions only apply if the administrator gives notice that he proposes to make a distribution to creditors. If the administrator does not propose to make a distribution, then the administration set-off rules will not come into play.

> "The policy behind the cut-off date is to prevent the creation of claims, or the trafficking in claims, after the creditor knew, or should have known, that an administration was imminent."

Which set-off rules apply?

The FMLC points out that this makes it difficult for a counterparty to determine which set-off rules will apply to it, and whether any liabilities incurred by the company after the beginning of the administration will be available for set-off. A counterparty that has dealings with the company may have independent or contractual rights of set-off on which it can rely in its normal course of dealings. However, such a counterparty may not know at the outset of the administration whether the set-off rules will come into play. If they do not, then the counterparty will continue to be able to rely on its existing set-off rights. On the other hand, if the administrator decides to make a distribution, thus bringing the set-off rules into play, then the cut-off will be back-dated to the commencement of the administration (or earlier notice) and any claims incurred or acquired after that date will not be available for set-off. The FMLC calls this the 'uncertainty of outcome' issue.

If a right of set-off is not available, the counterparty may wish the post-administration liabilities owed to it to be treated as expenses of the administration so that they are paid in priority to unsecured, pre-administration claims. However, if there are insufficient assets available to meet the administration expenses in full, such liabilities may not be paid in full. This has become an increasing risk in the light of court decisions to the effect that post-administration claims can rank as expenses of the administration even where there is no benefit to the insolvent estate. This gives rise to the potential injustice that a counterparty may be required to pay into the estate for pre-administration liabilities, but only be paid a proportion of its administration expenses claim. The FMLC calls this the 'shortfall' issue.

Dealing with the issues

The FMLC puts forward two proposals for dealing with this. The first is to allow administration expenses incurred before the administrator gives notice of his or her intention to make a distribution to be treated as mutual dealings for the purposes of set-off. This would still mean that debts *acquired* after the beginning of the administration would not be eligible for set-off, because such debts would not be administration expenses. The policy objective of preventing counterparties from improving their position by trafficking in claims during the administration would therefore be preserved.

The second proposal is to provide for different cut-off dates for debts arising out of obligations incurred during the administration, and debts acquired by a counterparty after the relevant cut-off date. If the cut-off date for debts arising out of obligations *incurred* by either the counterparty or the insolvent company were to be the same as the date when the administrator gives notice of his intention to make a distribution, then any post-administration liabilities entered into by the company would still be available for set-off up to the point at which the counterparty had notice that the administration set-off rule had come into play. However, the FMLC considers that the cut-off date for debts *acquired* by a creditor should continue to be back-dated to the date of the administration (or earlier notice). As with the first proposal, this would prevent the trafficking of claims during the administration by parties wishing to improve their set-off position.

Further areas of uncertainly

The FMLC identifies two further, subsidiary, areas of uncertainty, which it calls the 'meaning of distribution' issue, and the 'contingent claims' issue.

The administration set-off rules only come into play if the administrator, having been authorised by the court, gives notice that he proposes to make a distribution to creditors. The FMLC points out that the expression 'distribution' is used in various ways in the Insolvency Act and Rules, sometimes referring to a distribution to secured and preferential creditors, sometimes to a distribution to any class of creditor. The question therefore arises as to whether a 'distribution' for the purposes of the set-off rules is limited to a distribution to unsecured (including preferential) creditors or whether it could include any payments made to secured creditors. On balance the FMLC inclines to the view that the set-off rules will only come into play if the administrator proposes to make a distribution to unsecured (including preferential) creditors or secured creditors in respect of any unsecured element of their claims, and that the non-insolvency set-off rules will continue to apply if the administrator makes any payments to secured (including floating charge) creditors. However, the FMLC believes that this is an area of uncertainty that needs to be clarified, either through amendment to the rules or by case law.

Contingent claims and claims of uncertain amounts

Finally, there is the question of how contingent claims and claims of an uncertain amount should be dealt with where the administration set-off rules come into play.

The rules provide that, where the administration set-off provisions apply, contingent debts owing both to and by the insolvent company are to be set off, provided they arise out of obligations incurred prior to the cut-off date. The rules also provide that the value of contingent debts, whether owed to or by the company, is to be estimated by the administrator. If the balance of the claim, after set-off, is a sum owing to the insolvent company and all or part of that balance results from a contingent or prospective debt owed by the solvent counterparty, then the balance only becomes payable by the counterparty when the debt actually becomes due and payable. In other words, the set-off provisions do not accelerate the payment of contingent or future debts payable by a solvent counterparty otherwise than for the purposes of set-off.

On the other hand, where the balance is an amount due to the counterparty by the company, then only the balance owed to the creditor is provable in the administration. The FMLC raises the question of whether the rules as currently drafted allow for an appeal by a creditor against the valuation placed on a contingent claim by the administrator. It also wonders what would happen if, having valued the incoming contingent claim for set-off purposes, the circumstances changed (so that, for example, the contingent claim crystallised at more than its valuation or it became apparent that the contingent claim could never, in fact, arise). If the change of circumstance resulted in a greater amount being due to the creditor, and the administrator still had assets available for distribution, an adjustment could be made in subsequent distributions to take into account the change of circumstances in accordance with the provisions of the rules relating to the alteration of proofs after the payment of dividend. If the change of circumstance results in a lesser amount being due to the creditor, and a dividend has already been paid in this regard, the rules do not currently state whether the creditor would be obliged to repay the difference to the company in administration.

"The FMLC raises the question of whether the rules as currently drafted allow for an appeal by a creditor against the valuation placed on a contingent claim by the administrator."

Giving guidance is a legal issue

The FMLC suggests that it would be helpful if guidance could be given, either by the Insolvency Service or by R3, on how administrators should deal with contingent claims that turn out to have a different value from the estimate placed on them for set-off purposes. However, as this seems to be more of a legal than a technical issue, and R3 cannot give legal advice, guidance from R3 is unlikely to be the answer (and it is possible that this is a question that will have to be decided by the courts).

Those interested in following this up should read the FMLC paper in full. It is available on the FMLC website at **www.fmlc.org/papers/Issue108(nov07).pdf**. □

Technical Bulletin

Technical Bulletin 83 was issued in June. Its contents included:

- New address for sending all VAT returns and payments
- Representation of HM Revenue and Customs at creditors' meetings
- Money laundering – updated guidance
- Distribution of capital outside formal winding up – clarification from treasury solicitor
- Meaning of 'unable to pay debts as they fall due'
- Contingent claims – application of the hindsight principle
- Protective award made after date of liquidation is a provable debt
- TUPE and the 'controlling mind'
- Award of costs against administrators personally
- Receivers not liable for costs
- English provisional liquidators ordered to remit assets to main liquidation proceedings in Australia
- The Pensions Regulator – revised clearance guidance

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Courtesy: kyz

Trends in construction insolvency

Richard Davis finds that construction insolvency is becoming increasingly complex and that there is a growing demand for security.

The construction process tends to follow the same pattern wherever it occurs. Contractors are everywhere dazzled by positive cash flow, mistaking receipts on account to pay others for freely disposable money. Drawing on case law worldwide, this article focuses on two questions: Are there any identifiable trends in construction insolvency law? If there are, what might be their implications for insolvency professionals?

This area of work is concerned with unlocking the value of construction contracts, most often by novating them to an incoming contractor. This is not straightforward because these types of contract have inbuilt limitations, which make them difficult to value and market. Of these, the extended termination clause operating on insolvency or default is the most intractable. In the past, the insolvency events triggering the right to terminate varied among the standard forms. Anomalies have now largely been removed so that they all take the same approach. They are also fairer in giving reciprocal rights to terminate to both parties.

Increasing demand for security

The balance of power has, however, always lain with the employer as the paying party. This situation has intensified in recent years following the introduction of PFI and PPP. There has been an increase in the security demanded of contractors due to the way these projects are structured. Typical devices include bonds and guarantees, warranties, step-in agreements, assignments and charges. This trend fails to respect traditional contractual relationships, eg where a contractor has to assign to a project funder an on-demand bond provided to it by a subcontractor.

Construction contracts appear to resist being treated as property, whether for purposes of sale or security, because they consist of mutual benefits and burdens on both sides, which depend on the acts of a third party (architect, engineer or project manager) for enforcement. In ordering variations, for example, they may act as the employer's agent; whereas in certifying payment they act independently of both parties. The capacity of the engineer can affect the employer's rights on the contractor's insolvency: *Smith* v. *Bridgend CBC* [2002] BLR 160. These contracts also have bars on assignment. The case law on this topic, as well as novation, has expanded dramatically in recent years and is a useful resource for practitioners.

Paradoxically, the increase in security for performance has been accompanied by an increase in security for payment (albeit on a smaller scale). The evidence for this is anecdotal, based on an analysis of case law across Commonwealth jurisdictions. I am using 'security' in its widest sense to include any arrangement whereby payment is made more likely, not limited to devices with an equity of redemption.

In this connection, the introduction of adjudication pursuant to the Housing Grants, Construction and Regeneration Act 1996 has provided a useful security for cash flow, and been replicated in Australasia and South-East Asia. It allows either party to refer a dispute at any time to a named person who gives a binding decision within a short timescale. The underlying philosophy is that the creditor is entitled to recover on an interim basis without the debtor losing its rights to

> "There has been an increase in the security demanded of contractors due to the way these projects are structured… This trend fails to respect traditional contractual relationships, eg where a contractor has to assign to a project funder an on-demand bond provided to it by a subcontractor."

challenge the claim later in court or by arbitration. So far, the informal insolvency of the applicant has not been a bar to recovery, although a formal procedure such as administration is regarded as sufficient ground for a stay of enforcement of an adjudicator's decision. Most disputes over set-off and abatement are now decided by an adjudicator rather than the court. Adjudication is thus a procedural security benefiting the supply chain.

“In construction procurement any perceived gap in risk is often ‘plugged’ by a bond… In form this is a banking instrument payable against presentation of documents but in function it is a security for performance. The existence of such bonds can be a major stumbling block to a restructuring of a contractor.”

Case law suggests there is an increase in the use of one-off protective measures such as direct payment agreements either at the inception or during the course of a project. Going against the trend for more security, however, is the reduction in the use of retention (the practice of holding back a small percentage of the contract sum, say three per cent of the value of work done, until after the completion of making good defects).

The introduction of trusts

A further surprising trend is the emergence of the trust as the means of payment of the contract sum (rather than being limited to retention as with JCT forms). In the past, this has been restricted to North America, but the practice has become more frequent in Commonwealth jurisdictions.

A body of case law has grown up that has explored the main problem areas, which focus on the relation between the instrument creating the trust and relevant provisions of main and subcontracts, eg set-off, termination and disputes. In the UK, the Office of Government Commerce now advocates project bank accounts for government contracts based on the trust concept. Several banks have launched new products to meet this demand: Barclays is marketing its new account to private sector clients such as supermarkets and high street retailers. As these accounts come into use it will be interesting to see whether lessons have been learned from the cases.

The misuse of bonds

In construction procurement any perceived gap in risk is often ‘plugged’ by a bond. If this can be done by a group guarantee or a surety bond so much the better for the contractor. But commonly only an on-demand bond will do. In form this is a banking instrument payable against presentation of documents but in function it is a security for performance. The existence of such bonds can be a major stumbling block to a restructuring of a contractor.

The precise link between the bond and the contract is often not fully articulated, leading to accusations of unfair calling. The UK courts apply a very high standard of proof to any contractor who wants to prevent a call: the only possible inference from the facts must be that the demand is fraudulent to the knowledge of the issuing bank.

A very rare case in which fraud was found shows how high this standard is. In *HLC Engenharia* v. *ABN Amro* [2005] EWHC 2074, a special purpose vehicle set up under a PFI contract with a local authority entered into a turnkey contract as employer and obtained an on-demand bond from the contractor's bank, which it assigned by way of security to a bank providing finance to the project. The SPV employer went into administration and the bank as assignee served a demand under the bond. On the evidence served by the contractor, it appeared that on the employer's admission the contractor was entitled to a full extension of time, and that an expert appointed by the assignee bank had advised there were no defects. The court held that the only inference to be drawn was fraud by the bank in seeking to enforce the bond solely to reduce its financial exposure on the project. Unusually, this was a written judgment on an *ex parte* application at which the assignee was not present and the end result is not reported. If we simply take the alleged facts as an example, however, they indicate the court's willingness to intervene in an extreme case and the questionable value of the bond as a security asset for a loan where all the evidence points to full performance of the construction contract in support of which the bond was provided.

Conduct that is unconscionable

Internationally, there is a trend towards lowering the standard of proof. In the Australian case of *Boral Formwork* v. *Action Makers* [2003] NSWSC 713, for example, a standby letter of credit (virtually identical to an on-demand bond) was procured by a contractor in favour of an English supplier of scaffolding components. Under the credit the supplier had to state that the sum claimed was due. Administrative receivers appointed to the supplier were informed that some of the goods were defective, that they had had to be repaired and that the cost would be passed on to the supplier. The receivers chose to ignore this and called the whole amount of the credit making no allowance for the defective items. They informed the contractor it would be an unsecured creditor in the supplier's liquidation and that no dividend was expected. Under Australian legislation, companies must ‘not engage in conduct that is unconscionable’. Although their actions might not have amounted to outright fraud, they were declared unconscionable and the demand was unenforceable.

It is worth asking: Will the heavens fall if banks lose the protection of the fraud exception? The starry sky still shines over Australia and other jurisdictions such as Singapore where the test has been lowered. I suspect there will be more cases in the UK where the court agrees to take pre-emptive action, especially where the contract sets out the grounds for calling the bond.

Emerging trends

In the construction industry, security is derived from a number of sources: from the common law, the rules of the court, statutes, the construction contract, collateral agreements, as well as mortgages and charges. I have mentioned a few legal developments that may represent trends. Except for the treatment of retention, they all point toward increasing demands for security in one form or another.

“Administrative receivers appointed to the supplier were informed that some of the goods were defective, that they had had to be repaired and that the cost would be passed on to the supplier. The receivers chose to ignore this and called the whole amount of the credit making no allowance for the defective items.”

It may be that the most fundamental trend of all is that of increasing complexity as the interests of project financiers come into conflict with protections afforded to contractors and those lower down the contractual chain, especially those conferred by statute. What are the implications for insolvency professionals? Perhaps these trends show that it is getting even harder to extract value from an insolvent contractor. I hope, however, that an awareness of the different modes of security at work in the industry will enable practitioners to negotiate a path between them, using those which benefit the company, and exploiting the flaws in those which do not. □

Richard Davis is the author of *Construction Insolvency: Security, Risk and Renewal in Construction Contracts* (3rd edition, 2008).

Richard Davis is a consultant with **Pinsent Masons.**

A build-out needs careful consideration

Many IPs will be dusting off their hard hats in anticipation of a rise in activity in the construction sector but there are practical matters that should be considered in the early stages of assignments.

It would be difficult to have missed the recent press coverage concerning various national building companies shedding jobs and reorganising their activities. It would appear this is the result of a decline in unit sales and write down in land values, which have driven holes through many balance sheets. As companies of this size start to struggle it impacts on the rest of the industry as many smaller builders and trade contractors who are retained as subcontractors to the larger firms will be affected by the contraction in the market. The extent of this ripple effect is not yet clear but it is inevitable that there will be casualties.

The construction industry, even in the good times, works on incredibly tight margins so let's be under no illusion that the opportunities for profits to be generated from a trade-on or build-out under distressed circumstances are at best remote. Therefore, caution needs to be applied when preparing a strategy for construction assignments.

Silence is golden

The legal implications of commencing an insolvency process are covered elsewhere in this edition. You will note they are likely to have a significant impact on the ability of the insolvency practitioner to achieve the upper hand in negotiations with the contract employer. 'Knocking' contractors and subcontractors is almost a pastime in the construction industry. Although the Housing Grants Construction and Regeneration Act 1996 (The Construction Act), which is currently under review, was intended to prevent these practices, the harsh practicalities of this industry are such that if there is an excuse, valid or otherwise, not to make further payment it will be used. An experienced commercial manager in a contracting organisation will find it very easy to create disputes to delay or avoid payment, particularly when a company is subject to some form of insolvency proceedings so it is imperative that the fragility of a company is not leaked to the marketplace.

Care and caution should be adopted when considering who within the company to confide in because if news of a potential failure spreads, confidence in the company will fall off a cliff face: subcontractors will chase for arrears, the main contractor or contract employer will slow down on making payments and supplies will become harder to source. With these problems the demise of the company may become inevitable.

Review existing contracts

A great deal of added value can be achieved prior to the necessity to commence an insolvency process and this can potentially save the company as a going concern. However, if failure of the company is unavoidable then, given the complexities and risks associated with the construction industry, only in extenuating circumstances, with available funding and subject to the usual constraints regarding ongoing trading activity, would it make commercial sense to progress the contracts until a business sale or novation and the assignment of the contracts has been achieved.

It is strongly recommended that a full review of all existing contracts in progress is undertaken as soon as possible following any introduction to a company. The review should assess the stage of completion of each contract together with a calculation of the profit remaining in the individual contracts and the timing of future stage payments. A full review of all of the company's contracts and contract debts would then follow. This review is likely to consist of three categories.

1) **Successfully tendered contracts where works are yet to commence**. It is very unlikely that a situation will exist where works should be commenced due to the inherent risk of recovering payment for costs undertaken. However, there is always the possibility that such contracts could be sold to third parties.
2) **Contracts in progress**. These contracts will then require the most attention. The intial broad considerations will be to assess the various book value figures, their current progress and the saleability of these contracts. Only where the contract is close to completion and a significant amount is owed might you give consideration to the completion of the contract.
3) **Completed contracts where retentions are held**. Other than the possibility of crucial remedial works no further action is required, nor should any be undertaken without prior payment or specific written payment guarantees from the contract employer.

With the schedule to hand, it will be possible to assess the risks and benefits applicable to each contract and thus determine which, if any, should be progressed and where the scarce financial resources should be applied.

Secure payments

If there are significant stage payments due it would make sense to ensure these amounts have been paid and cleared into the company's bank account at the earliest opportunity. This action coupled with ensuring that the company's credit controllers are vigorously pursuing such payments will enhance cash collections. Consideration could also be given to early payment discounts as an inducement to secure key payments.

> "A great deal of added value can be achieved prior to the necessity to commence an insolvency process and this can potentially save the company as a going concern."

Completion of key stages may be considered where it will maximise leverage in the subsequent negotiations with the contract employer. Appropriate works may also substantially reduce the opportunity for contra charges thus enhancing ultimate realisations. However, if continuance of the contracts is considered attractive, either prior payment or written specific guarantees of payment should be obtained. Completion to key stages will also be beneficial if it is envisaged that a transfer of contracts to a replacement contractor will improve the outcome, as it provides an easily measurable handover point.

Certain contracts may appear to be unprofitable or too costly to progress. In this situation the obvious solution would be to abandon the contract. However, the costs of completion may be significantly less than the ensuing counter claim. Opening a dialogue with performance or guarantor bond obligors may reveal an appetite to advance funding. Consideration may then be given to completing contracts to an appropriate stage or to maintaining an on-site presence while alternative contractors are secured, thus reducing the potential for calls under the bonds.

Talk to staff as well as management

The first and principal point of contact is likely to be the board of directors. Their relationship with other stakeholders should be borne in mind, particularly if they have given personal guarantees. Their view on the viability of the contracts may be unduly optimistic and pressure will be exerted to continue trading to reach key contract points or pursue unreasonably high settlements that are virtually impossible to obtain in an insolvent scenario. Even if key stages are achieved it won't necessarily result in direct recoveries due to contra charges.

With this in mind it is important to take early counsel from other staff members. Other staff members who are key to understanding the business are the in-house quantity surveyor(s), commercial manager(s) and the contract or site managers. They will be able to give a warts and all assessment of the contracts. These will either support the views of higher management or possibly temper their optimistic assessment of the estimated values. This additional information will greatly assist with the formulation of the strategy to be adopted.

Staff in these positions of responsibility will be only too aware of the difficulties associated with trading on and may well be sceptical of the promises of 'it'll be OK if we all pull together'. Therefore, it will prove beneficial to provide a sensible and direct approach when seeking to engender their support. Given the earlier comments in relation to knowledge in the market it can only make sense not to alienate these key members of staff who will have the ear of key people such as tradesmen and the contract employer's agent. In addition, the contract manager may well hold knowledge of the contract that will be essential to satisfy the enquiries of a replacement contractor. Prior to initiating discussions with these employees it is worth assessing the status of any pay arrears and whether funds could be made available to bring arrears up to date or to provide incentives for loyalty and a successful outcome.

"There may be circumstances where it is considered beneficial to trade on certain contracts. If so… secure the ongoing costs incurred on the contract."

Plan for the worst

On the assumption that the distress the company is facing will lead to its failure it would be appropriate to commence continuity planning (make discrete enquiries with alternative contractors to carry forward the profitable contracts). This can be achieved either by assignment (broadly: same contract, same terms, different parties) or novation (broadly: new contract, varied terms, different parties).

Your retained agent may have contacts that are experienced in purchasing contracts under distressed circumstances and who are in a position to proceed quickly with the appropriate and reasonable level of due diligence. Also look to the other contractors who were unsuccessful at the tender stage who, by virtue of the tender process, have knowledge of the contract and will also be considered as acceptable to the contract employer or main contractor. It should also be remembered that certain contract employers will have lists of approved contractors and it is often a very frustrating task trying to impose new contractors that are not on this list. There is a temptation to be drawn into protracted negotiations with interested parties to maximise the sale consideration. However, the costs and risks of continuing on site while progressing these negotiations can increase rapidly. It is also probable that the profit calculated as available to the company will be significantly greater than that available to a replacement contractor. This is as a result of their unfamiliarity with the works to date and the risk of taking on remedial works already attaching to the contract. It is not unusual that the offers received are at zero or minimal value despite the calculations indicating potential profits from the contract. This apparent poor value could hold an advantage in that the contra charges from the contract employer or main contractor could be significantly reduced or even eliminated thus resulting in higher recoveries from stage payments and retentions.

Health and safety

Building sites are dangerous places and a health and safety nightmare. On appointment, it would be a sensible action to secure the site to reduce these risks. It is usually the contract employer and their agent's responsibility to secure the site, as soon as an insolvency practitioner has been appointed. Up to that point, unless the company's employment has been determined due to non-performance, the company will remain in control of the site. This assumes that the company is a main contractor. If it is a subcontractor, then it will be the main contractor's responsibility to protect the subcontractor's work, following an insolvency appointment.

Protection of the site also guards against potential vandalism or theft by disgruntled subcontractors or supplier creditors. If the site is damaged it may reverse or adversely affect the works that have been carried out to reach a stage payment. Ensuring adequate security and protection by the contract employer and their agents should help protect any debt equity. However, while the cost and responsibility of securing the site may remain with other parties higher up the supply chain this notice has to be weighed against the possibility of recovering any significant payments before the contract employer or their agents become aware of the company's failure.

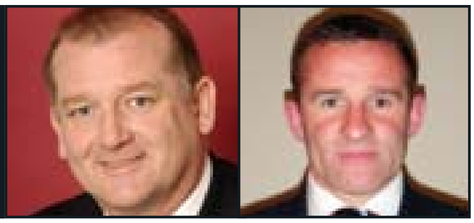
There may be circumstances where it is considered beneficial to trade on certain contracts. If so, it is recommended that either payments in advance or specific guarantees to meet arrears and future works should be sought from the main contractor or contract employer to secure the ongoing costs incurred on the contract.

The matters considered above relate to general construction. However, it is worth noting that any party in the pay of a contractor or subcontractor could also be deemed to be in the construction industry and therefore could be subject to certain of the risks mentioned above. □

Key actions

- devise strategy quickly
- select your in-house team with care
- maintain silence to the market until the strategy is in place and capable of being delivered
- progress negotiation for sale, assignment or novation of the contracts at the earliest point and don't be drawn into protracted negotiations
- if trading on or building out seek specific guarantees from the employer or main contractor that the payment terms will be made without set-off.

Richard Toone (left) is a partner at Chantrey Vellacott DFK and **Vince Rolandi (right)** is the regional director at Naismiths.



Dispute resolution in the construction industry: a guide for IPs

Lewis Cohen explains the different forms of resolution and compares and contrasts how these can be used by insolvency practitioners.

The construction industry accounts for approximately 10 per cent of the capital's GDP of the United Kingdom. The industry has developed a sophisticated and complicated system of dispute resolution, which increasingly overlaps with the insolvency industry.

The main forms of dispute resolution

Traditionally, disputes in the construction industry were addressed via litigation in the courts or arbitration.

> "Two 'new' forms of resolution appeared during the 1990s. The first was mediation, which is now virtually mandatory for all disputes in High Court litigation, and the second was a statutory regime for fast-track adjudication."

High Court litigation has evolved from a situation where complicated matters of fact and contractual issues were addressed in the Official Referee's corridor of the High Court to the stage where they are now dealt with by a specialist court: the Technology and Construction Court (the TCC). This has its own premises. The court is largely made up of judges who have practised for most, if not all of their careers, at the construction bar.

The alternative, which was in vogue for much of the 1980s and 1990s, was arbitration. Arbitration was utilised for this period on the basis that the Court of Appeal had removed the ability to open up, review and revise architects' certificates from the judiciary. This changed in the late 1990s and this power was restored to the courts.

Two 'new' forms of resolution appeared during the 1990s. The first was mediation, which is now virtually mandatory for all disputes in High Court litigation, and the second was a statutory regime for fast-track adjudication. Adjudication had been known previously through particular forms of subcontract but, as a result of legislation in the late 1990s, this became an option for almost all parties to construction contracts.

High Court v. Arbitration: the pros and cons

Litigation can be used at any time during the currency of a contract or up to 6 years or 12 years subsequent to a fixed point, normally from the date of practical completion. (The actual limitation period depends upon how the contract was executed.) There does not have to be a formal dispute to commence litigation proceedings and, in some cases, the issue of the proceedings themselves will constitute the dispute. In arbitration, there must be a dispute prior to commencement of the proceedings.

The only time when litigation will not be appropriate is where there is an arbitration clause in the contract and the defendant to the action elects to apply to the court to stay the litigation to arbitration. (NB parties can also agree to arbitrate, even if there is no contractual provision, although, for reasons set out below, it is more likely that they would choose to litigate.)

The advantages of issuing High Court proceedings are that both in London and in the provinces, there are specialist TCC judges familiar with the issues that occur throughout the construction industry. Following the reforms brought in almost ten years ago by Lord Woolf, the judiciary now has very tightly controlled procedures and the courts are very efficient. Furthermore, there are limited costs for issuing proceedings and the cost of the judge and the court room are covered by the public purse.

> "Clearly mediation offers a fast and cheap procedure. If the parties can agree to mediate, it is often possible to arrange this in a short period of time and for relatively little cost."

The disadvantage of litigation is that the proceedings are not private although this is not normally a concern for insolvency practitioners.

Arbitration, on the other hand, does provide confidentiality although if the arbitrator's award is appealed to the courts then that confidentiality will be lifted. It also allows the parties to choose an arbitrator who does not necessarily have to be legally trained. Arbitrators are often more flexible and the procedure is less strict than that adopted by the courts.

On the downside, arbitration can be more expensive than High Court proceedings and the parties will be obliged to pay the arbitrator's fees and other disbursements such as room hire. Also, the process does not allow for full disclosure unless ordered by the arbitrator; arbitrators who have been chosen for technical expertise may not necessarily have the requisite expertise to determine law and, when hearing witness evidence, be able to determine the veracity of the evidence given.

A further advantage to utilising the courts is that in addition to the TCC, the Companies Court and the Bankruptcy Court of the Chancery Division are also available. Both these courts are very familiar with insolvency procedure and the ability to use statutory demands (where circumstances are appropriate), which is not available within arbitration.

Mediation

Mediation evolved quickly during the 1990s after its introduction from America. The construction industry has been a leading exponent in the field of mediation and, for much of the last decade and considerably in advance of the rest of the High Court, TCC judges were using significant pressure to push parties to mediation at an early stage.

The various mediation bodies such as the Centre for Effective Dispute Resolution (CEDR) report very high levels of success. It is true that many construction disputes are not ready to be mediated at an early stage but they often pave the way for a second mediation or a later exchange of views on a without-prejudice basis, which leads to cases settling rather than going through the courts.

Adjudication

The fourth and most recent development has been the introduction of statutory adjudication following the Housing Grants Construction and Regeneration Act 1996. This act brought in an option for either party to commence an adjudication at any stage during or after a construction contract.

The basis of adjudication is that the party may issue a Notice of Referral and, within seven days, the relevant nominating body will have appointed an adjudicator. From that point the whole adjudication process takes 28 days, although it can be extended by 14 days if the adjudicator requires and the referring party agrees.

Although the procedure was introduced initially to assist cash flow in the industry and address small issues during the currency of a contract, adjudication has now become a significant business resolution and many very large disputes have been referred to adjudication.

The purpose of adjudication is to make an award that is binding upon the parties – but only on a temporary basis – unless and until one or other of the parties refers the issues to litigation or arbitration for a further determination. It has been very rare for issues addressed in an adjudication to be taken either to court or arbitration.

The TCC has developed a fast-track procedure whereby adjudicator's awards can be processed through the TCC in a very short period of time, often less than two weeks.

The relevance to the insolvency industry

In the past, insolvency practitioners have been loathe to commence litigation or arbitration proceedings on the basis that these are not only time consuming but also very expensive.

Clearly mediation offers a fast and cheap procedure. If the parties can agree to mediate, it is often possible to arrange this in a short period of time and for relatively little cost.

Given that statutory demands are rarely successful in the construction industry as the defending party will often have some defence, adjudication is more appealing to insolvency practitioners. This leaves the question as to how and at what cost an insolvency practitioner can commence adjudication?

The how, is straightforward; this is something that a construction lawyer or a claims consultant can advise on. Usually it requires a short notice of referral setting out the issues, followed by a lengthy statement of case. It is normal for the defendant party to put in a response after which the referring party has the option, which is often exercised, to put in a reply to that response. Experts' reports and witness statements have to be produced in advance and served with the referral papers. Occasionally the adjudicator requires a short hearing or a site visit.

In order to achieve some costs' certainty the insolvency practitioner can seek to agree a cap on costs or at least obtain an estimate of fees. He can also get a fairly good idea from the complexity of the dispute, how long the adjudicator would need to spend and what costs might be payable in this respect.

Furthermore, most adjudications are governed by standard forms of agreement, which provide that the parties bear their own costs. The adjudicator often has the power to award his own costs. These normally follow the event so that, if the adjudication referral is successful, the defending party will be ordered to pay the adjudicator's costs. Alternatively the costs could be spilt equally between the parties.

The upshot of these recent developments is that insolvency practitioners, for the first time, now have a number of options available to allow them to seek to recover debts within the construction industry in a quick and cost efficient manner. □

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Metronet: the first PPP administration

Mind the gap! Susan Moore describes the Metronet case, which is the first time that the special PPP administration process has been used.

The Metronet project was the brainchild of Gordon Brown, during his tenure as chancellor. As part of the government's PPP (public-private partnership) initiative, three companies were granted 30-year contracts by London Underground (LU) to service and upgrade the tube network, together worth upwards of £15 billion. Two of these companies were the Metronet companies, and the third was an unrelated consortium, Tube Lines.

Theoretically, a PPP transfers financial risk in connection with public sector assets to private companies. The PPP project for the tube, which cost about £500 million just to put in place, was pushed through by the government in the face of opposition from Ken Livingstone, who lost a High Court challenge against it. In the event, the (current) mayor now has ultimate control of the Metronet business, and the matter has been a source of embarrassment and considerable expense to the government.

> "Significantly, there is no provision that requires a PPP administrator to act in the best interests of creditors."

The statutory framework

The Greater London Authority Act 1999 (the GLAA), which established the office of mayor, deals with the arrangements for the tube. The contracts with Metronet (and Tube Lines) are designated as PPP agreements and some of the applicable provisions in the GLAA are:

- Matters arising under the PPP agreements may be referred to the PPP arbiter, an independent expert appointed by the secretary of state.
- Certain protections exist for key system assets, which broadly are assets required for the running of the tube. Among other things, no security can be granted over these assets.
- A special PPP administration regime applies to PPP companies, geared towards the survival of the business crucial to the running of the tube, with other interests being secondary.

PPP administrations

The Metronet case is the first time that the special PPP administration process has been used. The legislation that governs a PPP administration is the Insolvency Act 1986 (the 1986 Act) as amended and supplemented by the GLAA, and the PPP Administration Order Rules 2007 (which came into force four months after the Metronet administration orders were made).

The purposes of a PPP administration are:

- the transfer to another company as a going concern of such of the company's undertaking as necessary to ensure that the relevant activities may be properly carried on, and
- the carrying on of those relevant activities pending the transfer.

The relevant activities are those carried out by the company in performing the PPP agreement.

Significantly, there is no provision that requires a PPP administrator to act in the best interests of creditors. All that is required is that he or she manages the affairs, business and property of the company for the achievement of the purpose of the order in a manner that protects the interests of members and creditors. So the rights of creditors are probably diluted, if one compares the position with a normal administration. This is also illustrated by the rules governing the administrators' proposals to creditors: while PPP administrators are required to make proposals, there is no vote on them. Therefore, it is not clear where creditors stand if they disagree with the proposals.

Certainly, it is open to a creditor or shareholder to challenge any decision of a PPP administrator under s27 on the basis of unfair prejudice. However, given that the primary focus of a PPP administration will be achieving a transfer of the business, this remedy may also be diminished, especially if the matter complained of is a step towards the achievement of the statutory purpose.

The potential for a PPP administration to undermine the rights of third parties is also illustrated by the special mechanism available for the transfer of the business. The GLAA provides for a scheme whereby the property, rights and liabilities of a PPP company can be transferred to a third party, irrespective of restrictions on transfer – such as contractual limitations on transfer. This regime is no doubt designed to cut through competing rights in complex contractual structures such as those in the Metronet case, in order to achieve a transfer of the business, and so keep the tube running. However, a contractual counterparty who thinks that it has entered into arrangements that cannot be transferred without its consent would be mistaken.

Metronet: what went wrong?

Metronet was responsible for around three-quarters of the underground lines under its two PPP agreements. It was funded by a combination of debt and equity provided by its five shareholders, and a mixture of bank and bond debt provided by a group of finance creditors. In addition, the companies received infrastructure service charges from LU for their performance of the PPP agreements.

Prior to its insolvency, Metronet fell behind the programme of work and experienced significant cost overruns. The cause of these problems was disputed: Metronet considered that LU had altered the required volume of work, whereas LU alleged that it was due to inefficiencies on the part of Metronet.

One of the Metronet companies, BCV, sought additional costs under the PPP agreements by referring the matter to the arbiter for extraordinary review. BCV sought an additional £992 million for the first seven-and-a-half-year period of its contract and an interim adjustment of £551 million while the review was taking place. The arbiter issued a draft direction in mid-July 2007 indicating that payments should increase by just £121 million over the following year, falling about £400 million short of the interim adjustment requested.

> **“The arbiter issued a draft direction in mid-July 2007 indicating that payments should increase by just £121 million over the following year, falling about £400 million short of the interim adjustment requested.”**

This result, coupled with the fact that the finance creditors were no longer bound to advance further funds due to the cost overruns, meant that Metronet would exhaust its funding in the short term, and so the mayor decided that administration orders should be sought. PPP administration orders were made on 18 July 2007.

Politics and publicity

The procedure itself has a substantial political element: as well as being the only person who can apply for a PPP administration order, the mayor must approve the terms of any scheme for the transfer of the business. In addition, the Metronet case attracted substantial media and political scrutiny, including the enquiry by the Transport Select Committee.

Achieving a transfer of the business

As well as having to cope with the public spotlight, there were many issues that the administrators needed to resolve to achieve a transfer of the business:

1) Funding and state aid

Transport for London (TfL), owner of LU, was the obvious party to provide the third-party funding required for the administrations. They did this through:

- a working capital facility, repayable as an expense, which meant that, as a practical matter, TfL had control of the purse strings and could exert significant influence, and
- an unsecured trust facility available to pay unsecured claims, which meant that TfL decided which creditors should remain unpaid. The unpaid creditors had no ground for complaint about this: by causing the payment of unsecured creditors using this facility, the administrators were simply swapping one set of unsecured creditors with another.

These funding arrangements gave rise to state aid considerations. Broadly, state aid is any form of state financial assistance or economic advantage that favours a particular company or industrial sector. In November 2007, the European Commission authorised a rescue aid package of £879 million granted by TfL.

2) The marketing process

The assets of Metronet were the PPP agreements (whose value might be increased depending on the outcome of any extraordinary review). Early in the administrations, LU specified conditions for it to consent to any transfer of the agreements to a third party. These conditions, coupled with the fact that TfL was interested in acquiring the businesses, caused the administrators to conclude that the businesses would be unsaleable to the private sector.

During the marketing process, the arbiter published his initial thoughts on the potential range of outcomes of the BCV extraordinary review, commenting at the same time on the other Metronet company, SSL. He considered that additional sums between £370 million and £1.07 billion might be recovered for the first seven-and-a-half-year period of the agreements. LU contested this and the extraordinary review did not proceed because of the proposed transfer to LU.

In October 2007, the administrators obtained a direction that they were at liberty not to take further steps to market the businesses, and subsequently they negotiated terms with TfL. The purchase price was £50 million cash, plus an assumption of most administration expenses, subject to an overall cap of £650 million.

3) The finance creditors

Metronet had granted a debenture in favour of these creditors containing fixed and floating charges. This meant that the assets could not be transferred without either (i) the creditors' consent, (ii) a successful application under s15 of the 1986 Act authorising the administrators to dispose of fixed charge assets, or (iii) the administrators seeking automatic release of the security under provisions of the GLAA concerning key system assets.

However, at the time of the financing, an option had been put in place whereby LU could be required to purchase most of the outstanding debt and, essentially, step into the shoes of the finance creditors vis-à-vis Metronet. The put option amounted, in effect, to government support for around 95 per cent of the finance creditors' exposure. The option was exercised and LU paid around £1.8 billion too, and replaced the finance creditors as secured creditor. This paved the way for the business transfer to proceed.

4) The transfer schemes

Under the GLAA, the following persons have to approve a transfer scheme:

- the mayor,
- the existing appointee (Metronet),
- the new appointee (the transferee), and
- any other appointees.

This latter term is defined as any company (other than the existing or new appointee) that may be affected by the transfer scheme. The administrators obtained a direction that this definition should be construed so as to refer only to any other PPP company affected by the transfer scheme, and not *any* third party company.

Interestingly, this result raises a question as to whether new appointees should similarly be restricted to PPP companies. The LU nominees to which the Metronet businesses were transferred are not PPP companies, but this point was not raised when the court appointed the date upon which the scheme should take effect.

> **“In October 2007, the administrators obtained a direction that they were at liberty not to take further steps to market the businesses, and subsequently they negotiated terms with TfL.”**

The outcome

There was a happy result for Londoners: the tube continued running throughout the administrations save only during a two-day strike by RMT members, and the Metronet businesses were transferred to LU in May. There was a less happy outcome for the unsecured creditors who were not paid out of the TfL unsecured trust facility: the prospect of a distribution to them is remote.

The reader can decide whether the result was a happy one for the mayor: although Mr Livingstone was in office long enough to approve the transfer scheme, he was replaced by Boris Johnson just three weeks before the transfer became effective. □

Susan Moore is a partner at Denton Wilde Sapte.

Step-in rights: theory in practice

How stakeholders manage a failing construction project is crucial if value for all creditors is to be maximised. Here, the operation of step-in rights is outlined and the options explored.

Project finance transactions must reconcile two conflicting priorities. Commonly, project companies will be constructing and maintaining assets that remain within the ultimate ownership of the public sector. The public sector will pay service charges to the project company during the project term. During that term, a project company will provide the facilities to which the project relates. It therefore often follows that the most valuable asset for the funders of projects is the income generated from the fees payable by the public authority (the beneficiary) for the project services.

This article considers the interrelationship between two means through which lenders may seek to protect their position. The first is through the use of step-in rights and the second is the more limited right of a funder to appoint an administrative receiver. Once again, this is an area where substance is more important than form.

Step-in rights

Step-in rights are invariably contained in one or more direct agreements between a project funder and the project company's main contractual counterparties. These will include the project promoter (eg a local authority) and may include key subcontractors or other providers.

Step-in rights limit the ability of the beneficiary or other counterparty to terminate its agreement with the project company. The funder is then given a period of time – the step-in period – in which it may, either itself or through a nominee, step-in and take the place of the project company.

In the step-in period, funders may seek to remedy breaches of the project agreement together with any underlying operational problems. Alternatively, the funders may novate (transfer) the agreement to a new project company. For the protection of the relevant counterparty, direct agreements may impose preconditions on the identity of any transferee, typically related to its operational capability standards and financial resources.

> “It is difficult to gain a clear picture of the way that step-in rights operate in practice. Experience has nevertheless shown that lenders to a troubled project company will normally exercise one of four options.”

The operation of step-in rights in practice

Funders and beneficiaries of projects that become distressed do not, for obvious reasons, tend to advertise these issues. It is thus difficult to gain a clear picture of the way that step-in rights operate in practice. Experience has nevertheless shown that lenders to a troubled project company will normally exercise one of the following four options.

Negotiating a settlement

This is likely to be the most common example. Recent examples have included the provision of additional rescue refinancing together with a reduction in the equity return for the project. This may be achieved through a debt for equity swap. The financial restructuring of the Jarvis group is one example of this.

Transfer the project to a third party

Through the exercise of rights, this will result in the direct agreement. Transfers may be achieved through a sale of the business and assets of the project company to a third party. Alternatively, the transfer may take place through a transfer of the shares in the project company to a third party. In one recent example, the lenders to a distressed hospital project acquired the shares in the holding company of the project company.

Depending on the circumstances, but normally where a project has reached an advanced stage, the project and funding agreements will entitle the beneficiary to terminate the project agreement on the payment of compensation to the funders. Compensation payments will often be calculated through an actual re-tendering process or through the use of a desktop valuation. In some cases, funders will be entitled to receive a guaranteed minimum compensation payment. The termination provisions in the Metronet project agreements are one example; the lending group was entitled to receive at least 90 per cent of their debt. (See article on page 20.)

Wait and see

In some cases, equity investors to a project company may decide to invest further funds as a means of salvaging some return on their investment. In practice, equity investors will be very unlikely to provide additional funds where the sums payable by beneficiaries for the project are insufficient to generate an acceptable return on the investment.

Step-in rights and administrative receivership: two mutually exclusive remedies?

On 15 September 2003, the Enterprise Act 2002 largely abolished the rights of a secured creditor to enforce that security and recover sums owed to it through the appointment of an administrative receiver under the Insolvency Act 1986 (IA). The restriction of administrative receivership stemmed from concerns that the rights given to the holder of a floating charge to appoint a receiver to enforce its rights were unfair and destructive of value in the way they failed to recognise the interests of all creditors.

The result is that secured creditors may now only appoint administrative receivers to enforce rights in connection with certain types of highly structured financial transactions. The fourth such exception – set out in section 72E IA 1986 is the project finance exception. Under section 72E(2) IA 1986, a project is financed if, under an agreement relating to the project, a project company incurs (or when the agreement is entered into it is expected to incur) a debt of at least £50 million for the purpose of carrying out the project.

“The court had no difficulty holding that the Cabvision scheme amounted to a project. It was accepted that the term project should not be limited to a venture involving construction and engineering operations.”

Under paragraph 6 Schedule 2A 1986, a project has step-in rights if a funder of that project is conditionally entitled under an agreement to (a) assume sole or principal responsibility for carrying out all or part of the project; or (b) make arrangements for carrying out all or part of that project.

In *Feetum and Others* v. *Cabvision Limited* [2005] All ER (D) 313 (*Feetum*) the Court of Appeal reviewed the scope of this exception. It is now clear from *Feetum* that it will be read strictly and applied narrowly. It is now also evident that the mere existence in a project agreement of the right to appoint administrators or administrative receivers will not of itself amount to step-in rights.

In *Feetum* Cabvision Limited purported to appoint administrative receivers to a limited liability partnership, Tower Taxi Technology LLP (TTT). The court had to consider whether this appointment was within the project finance exception and thus valid. Cabvision had granted TTT an exclusive, royalty-free licence to use Cabvision's technology. TTT sought to fund itself as to 25 per cent by subscription from investors and as to the remaining 75 per cent by bank loan. If all available subscriptions were taken up, the aggregate finance available to TTT would be £90 million. £67.5 million of this sum would be loan finance.

“The nature and terms for the exercise of step-in rights have become highly standardised in UK government PPP transactions. The way in which lenders and other stakeholders protect their position will, by contrast, be most unlikely to follow a standardised route.”

On the closing date for subscriptions, it became apparent that the number and level of subscribers was materially below expectations. This reduced the maximum available bank borrowing to approximately £20.3 million. The loan agreement was signed after the closing date for subscriptions. Cabvision purported to appoint administrative receivers. TTT challenged this. One of their grounds for challenge was that the project finance exception was inapplicable.

The court had no difficulty holding that the Cabvision scheme amounted to a project. It was accepted that the term project should not be limited to a venture involving construction and engineering operations. Cabvision's right to appoint administrative receivers therefore depended upon Cabvision establishing that its work was a financed project. Cabvision thus had to demonstrate that when an agreement relating to its project was entered into TTT was expected to incur a debt of at least £50 million. Cabvision had submitted that the terms of the transaction established that TTT was likely to incur a debt of at least £50 million.

The Court of Appeal rejected Cabvision's submissions and ruled that Cabvision was not entitled to appoint an administrative receiver to TTT. It held that the words 'expected to incur' related to the anticipated amount of the debt to be assumed by TTT. Applying this test to the facts, Cabvision's venture with TTT fell outside the financed project definition in section 72E IA 1986. On the day TTT executed its facility agreement with Cabvision, there was no prospect of TTT's debt to Cabvision ever reaching £50 million. This was the result of the low level of subscriptions collected by TTT.

The Court of Appeal then considered the meaning of the phrase step-in rights. It accepted that it was not possible to lay down an exhaustive definition of the kind of rights that fell within that term. The court held that it was inconceivable that the power to appoint an administrative receiver amounted to step-in rights. This right did not of itself guarantee that the project would continue under the control of Cabvision as lender. Any administrative receivers would be the agents of TTT. Those receivers could make up their own minds as to whether to carry on with the project. The agreements contained no express right for Cabvision as financier to step into the shoes of TTT or to transfer the contract to a third party. Cabvision's purported appointment of administrative receivers to TTT was thus ineffective.

Step-in rights: conclusions

The nature and terms for the exercise of step-in rights have become highly standardised in UK government PPP transactions. The way in which lenders and other stakeholders protect their position will, by contrast, be most unlikely to follow a standardised route. The feasibility or otherwise of project transfers and additional equity investments as project exits will depend upon the nature of a project and its level of indebtedness. The willingness, or otherwise, of beneficiaries to renegotiate contractual terms will also be critical to the future viability of a distressed project. It is also clear, after *Feetum*, that the substance of project agreements and direct agreements rather than their form will ultimately determine the availability or otherwise of administrative receivership within the tool kit of remedies available to project stakeholders. □

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Company Voluntary Arrangements

The hallmark of a CVA is the strength it derives from its flexibility. John Verrill examines the case law and finds that the outcome is usually a fair and reasonable compromise.

What is the true scope of a CVA?

The scope of CVAs is determined by the case law on unfair prejudice and it establishes what can and can't be done within a CVA. The lack of any prescription in the Insolvency Act gives the CVA flexibility. That was the intention of the legislators when the Act was being framed, and is clear from the *Cork Report*.

Limits on interference with the rights of secured and preferential creditors and a limit on the scope of modifications are the only statutory restrictions on flexibility. These rights can be adjusted, but with consent. (S4, and paragraph 31 of schedule A1 of the Act.)

Differential treatment and non *pari passu*

There is no limit on what can be proposed as regards unsecured creditors and no positive requirement that they must be provided for *pari passu*, as *Sealy and Milman* comment in the 9th edition.

"The crucial difference with a CVA is that there is just one meeting of creditors. That means that there may be sub-groups who would constitute separate classes for a s425 scheme and who could block the proposal but not a CVA."

In *Re a Debtor (No 101 of 1999)* [2000] BPIR 998 Ferris J considered whether an IVA should be set aside on the grounds of unfair prejudice where the Inland Revenue was treated differently from other creditors. On the facts he found that there had been unfair prejudice, but held that differential treatment was not, of itself, a reason to set aside an IVA:

> *"Differential treatment which is not assented to by a creditor who considers that he has been less favourably treated may well give cause for inquiry but I do not think it necessarily proves unfair prejudice. There may well be an explanation for the differential treatment which shows that there is no such prejudice."* (at para 1006).

This approach was followed by Lightman J in *IRC* v. *The Wimbledon Football Club Ltd* [2004] EWHC 1020, where he held that full payment to football creditors (out of third party funds) ahead of preferential creditors did not infringe the provisions of section s4(4)(a) of the Act. He held that unequal or differential treatment of creditors of the same class will not of itself constitute unfairness, but again may give cause to inquire and require an explanation. He also decided (at para 18) that differential treatment may be necessary to secure the continuation of the company's business and may be regarded as supportable.

The Court of Appeal [2004] EWCA Civ 655 upheld Lightman and stressed the fact that a CVA was an *additional* remedy that was intended to be flexible and quoted the *Cork Report*, (at para 364(2)):

> *"the proposed system has far more flexibility than is available in a creditors' voluntary winding up with regard to the type of proposal capable of being submitted to and accepted by the creditors or some of them. Unless such flexibility exists, the advantages accruing to the creditors from the provisions of third party monies or from any after-acquired property of the debtor will be lost."*

A CVA's departure from the statutory scheme and in particular *pari passu* sharing will depend on the bargaining positions of the creditors and the commercial realities. It is entirely legitimate, in appropriate circumstances, for an arrangement to do so. If it does so illegitimately the appropriate remedy is for those who have standing to challenge the CVA on the grounds of unfair prejudice.

In *SISU Capital Fund Ltd* v. *Tucker* [2006] BCC 463 Warren J held (at para 573) that one factor that a person formulating an arrangement can take into account (effectively if he has no choice) when adopting unequal sharing, is the negotiating strength of particular creditors:

> *"if a person, whether or not a person who is himself a creditor of the company, has some bargaining position (as did the Football Association [sic] in the Wimbledon FC Ltd case) he is not prevented from using it."*

If it's fair it's acceptable

The first 'unfair prejudice' decision was *Re Primlaks (UK) Ltd (No 2).*

In *Wimbledon*, Lightman J summarised the principles, which have been established since *Re Primlaks* as follows:

1) '… the unfair prejudice complained of must be caused by the terms of the arrangement itself;
2) … unequal or differential treatment of creditors of the same class will not of itself constitute unfairness, but may give cause to inquire and require an explanation;
3) … it is necessary to consider all the circumstances including, as alternatives to the arrangement proposed, not only liquidation but the possibility of a different, fairer scheme;
4) … differential treatment may be necessary to ensure fairness (see *Cazaly Irving Holdings Ltd* v. *Cancol Ltd* [1996] BPIR 252 (at para 269–270) and *Sea Voyager Maritime Inc* v. *Bielecki* [1999] 1 BCLC 133 (at paras 148–149, 154), [1999] 1 All ER 628 (at paras 642–643, 647); and
5) …differential treatment may be necessary to secure the continuation of the company's business which underlies the arrangement: (consider *Re Business City Express Ltd* [1997] 2 BCLC 510).'

CVAs are now being compared to schemes of arrangement.

In *SISU* Warren J decided that the test of unfairness is the same as the test for sanction of a s425 scheme (at para 72–74). David Richards J recognised this in *T&N* [2004] EWHC 2361 (at para 81). There can be a departure from the statutory scheme in a s425 scheme (*Re BCCI (No 2)* [1992] BCC 715 (at para 735 F).

In *T&N*, David Richards J considered the approaches to fairness taken in the context of s425 schemes and CVAs. Quoting Buckley on the Companies Acts he stated that:

> *"In exercising its power of sanction the court will see, first, that the provisions of the statute have been complied with, second that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, and thirdly, that the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve…*
>
> *…the court will be slow to differ from the meeting, unless either the class has not been properly consulted, or the meeting has not considered the matter with a view to the interests of the class which it is empowered to bind, or some blot is found in the scheme."*

The crucial difference with a CVA is >>

that there is just one meeting of creditors. That means that there may be sub-groups who would constitute separate classes for a s425 scheme and who could block the proposal but not a CVA. In considering unfair prejudice, the court will have regard to the different positions of creditor groups.

He continued:

"I find it very difficult to envisage a case where the court would sanction a scheme of arrangement, or not interfere with a CVA, which was an alternative to a winding-up but which was likely to result in creditors, or some of them, receiving less than they would in a winding-up of the company, assuming that the return in a winding-up would in reality be achieved and within an acceptable timescale: see In re English, Scottish and Australian Chartered Bank [1893] 3 Ch 385."

Precisely this point was made in the *Cork Report* (at para 378).

The judgment in *SISU* supplements the *Wimbledon* fairness principles as follows:

1) The prejudice must be prejudice as a creditor of the debtor and not in some other capacity.
2) A consideration of all the circumstances and the alternatives available and the practical consequences of a decision to confirm or reject the arrangement is necessary.
3) The *unfair prejudice* rule is aimed at disproportionate prejudice on one side or the other.
4) If the reasonable and honest man in the same position might reasonably have approved the CVA being challenged, the challenge fails.

A CVA must be capable of implementation

In *SISU* Warren J remarked:

"If an administrator or liquidator puts forward a proposal which he considers to be fair then, unless it is established that he acted other than in good faith or that he is partisan to the interests of only some of the creditors, the court should not speculate about what other proposals might have gained acceptance and been capable of implementation (an essential element, since there is not much point in gaining approval unless the resulting arrangement can be implemented)."

A CVA must disclose any third party advantage

In the *Somji* case, the proposal was that S's father would contribute $US380,000 to the IVA over two years, a dividend of about five cents in the dollar. The proposal stated that, apart from this contribution, no third party property was proposed to be included in the arrangement.

To try to secure approval, a friend of S approached several creditors offering to acquire the debts owed to them in return for support. Two creditors, whose votes would swing the approval, entered into agreements with the friend, which provided for them to receive about five times the expected IVA dividend.

The proposal was then approved despite the opposition of Cadbury, which was owed $US1.7 million and had been secretly offered $US250,000 to sell its debt. Cadbury applied under s262 of the Act for the IVA to be revoked for unfair prejudice, and issued a bankruptcy petition.

The judge unravelled the IVA and made a bankruptcy order. There was long-standing authority (which he cited in detail) imposing a requirement of complete good faith between a debtor and his creditors that continued to apply to CVAs.

On appeal Robert Walker LJ said:

"it would be likely to make a material difference to the way in which the creditors would have considered and assessed the proposed arrangement if they had been told that two of their number were being promised additional payments on the side in return for their agreement."

Somji was followed by Lewison J in *Re Trident Fashions (No. 2)* [2004] 2 BCLC 35:

"It seems to me the real question is: would the revelation of the truth have made a material difference to the way in which the creditors would have considered the terms of the CVA itself?"

There must be a composition or a scheme of arrangement

In *IRC* v. *Adam & Partners* [2000] B.P. I.R. 986 a proposal that sought a moratorium, but which offered nothing to creditors, was found not to be a composition. The arrangement proposed a moratorium on the prosecution of claims by creditors for three years. Although creditors were unlikely to receive anything under the arrangement it was anticipated that the bank would receive a better return than under any alternative insolvency procedure. The proposal was approved. The Revenue, who voted against the proposal, applied to the court for a declaration that the proposal was not a 'composition in satisfaction of the company's debts' or a 'scheme of arrangement' of the company's affairs within s1 of the Act.

It was held that the absence of any prospect of a dividend to unsecured creditors did not prevent the proposal from being a CVA. The IRC appealed, arguing that the scheme was a 'composition in satisfaction of the company's debts' if creditors received no payment at all, and it was not a scheme of arrangement because it did not involve any genuine element of exchange or 'give and take': the real purpose was to provide the bank with a more cost-effective way of realising its security.

The Court of Appeal decided that the proposal was not a 'composition in satisfaction of the debts' of the company within the meaning of s1(1) of the Act. It had no effect as no payment was to be made to the preferential and non-preferential creditors under the proposal.

However, the moratorium did not prevent the Revenue and other unsecured creditors from subsequently asserting rights as creditors after the moratorium ended. The scheme thus had the requisite element of give and take as between creditors to qualify as an effective scheme of arrangement.

> **"The Court of Appeal decided that the proposal was not a 'composition in satisfaction of the debts' of the company within the meaning of s1(1) of the Act and had no effect as no payment was to be made to the preferential and non-preferential creditors under the proposal."**

Can a CVA affect third parties?

The Powerhouse CVA was promoted to facilitate P's decision to close 35 of its under-performing shops (the closed premises) and to continue trading from 50 other stores. The CVA impacted only closed premises' creditors, leaving other creditors of Powerhouse to be paid in full from trading. Most landlords of closed premises (CPLs) had guarantees of Powerhouse's obligations from PRG, its parent.

The CVA provided that the CPL's claims against Powerhouse were to be valued according to a valuation mechanism and share in a CVA fund of £1.5 million to be provided by PRG. The CPLs were to receive a capped dividend of 28 pence in the pound.

The CVA sought to compel the CPLs not only to release Powerhouse from claims against it but also to release PRG from guarantees provided to CPLs.

Following approval the CPLs challenged the CVA.

The first issue was whether the guarantees granted by PRG (a) had been released or (b) ought to be treated as having been released by the CVA. If so, was it unfairly prejudicial to CPLs?

Release

Both sides conceded that the reservation of rights clauses in the subject guarantees effectively prevented discharge of the guarantees (as between PRG and the CPLs), notwithstanding the compromise in the CVA of the guaranteed debt owed by Powerhouse to the CPLs.

In *Johnson* v. *Davies* [1999] Ch 117, the Court of Appeal had held that, in the absence of effective reservation of rights wording, a compromise in a CVA as a matter of law discharged the liability of a third party co-debtor or surety. As a result of the concession on reservation of rights, this point was irrelevant in *Powerhouse* and challenge by the CPLs at the hearing was unnecessary.

The CVA sought to release the

guarantee but benefit PRG. Since the CVA was a compromise of Powerhouse's obligations it could not affect third party rights such as between PRG and CPLs. It was held that such a release is ineffective in a CVA since a CVA is a *bilateral* agreement between the company and its creditors. Only the company and not any third party has the benefit of, and can enforce, the rights and obligations conferred by the CVA.

The effect is that the guarantee continues in existence. The CVA between Powerhouse and the CPLs could not release PRG. This is consistent with Australian authority on the same point: *Andersens Home Furnishing Co Pty Ltd* (ACN 009 733 617). This also limits what many argued was the effect of CVAs after *Johnson* v. *Davies*.

The judge in *Powerhouse* also refused to imply a term that the CPLs had agreed with Powerhouse that they would provide a release of the guarantees in favour of PRG. Such a term was neither 'obvious nor necessary'.

Indirect release

The CVA also provided that the guarantees should be treated as having been released. The judge decided that this was, in principle, enforceable by Powerhouse as an obligation of the landlords not to claim against PRG under the guarantees. It was, in effect, a covenant by the CPLs not to sue PRG, which was enforceable by Powerhouse.

If Powerhouse had no interest of its own that it needed to protect by preventing the landlords from suing on the guarantees, it would have had no standing to enforce the obligation. Would Powerhouse suffer any loss for breach of that obligation?

The CPLs contended that PRG had in the CVA given up its right to seek a contribution from Powerhouse if PRG was sued on the guarantees.

Powerhouse would suffer no loss if PRG was successfully sued under the guarantees. As a matter of law in such circumstances the covenant not to sue is not enforceable by Powerhouse: a CVA cannot directly confer benefits on outsiders but a properly drafted CVA can contain covenants enforceable by the company that the creditors will not sue guarantors.

Unfair prejudice (again)

It was also held that the CVA was unfairly prejudicial to the CPLs because the guarantees were taken away with no compensation. All non-compromised creditors were to be paid in full and the CPLs were to be discharged at a fraction of their value to enable this.

In liquidation the CPLs would have the benefit of guarantees but other unsecured creditors would have received nothing. The votes of those who stood to lose nothing from the CVA drowned the CPLs and unfairly disadvantaged them.

In summary

Unequal sharing is permitted, side deals are not. CVAs must be capable of implementation and must contain a compromise or scheme of arrangement. Third party rights cannot be affected, but enforceable bilateral covenants having the same effect are permitted. Introduction of third party money is permissible if disclosed.

The overriding principle is one of objective fairness and reasonableness and nominees ignore that at their peril. ☐

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Applications under section 213 of the Insolvency Act 1986

Stuart Adair examines the section 213 jurisdiction and the distinction between fraudulent and wrongful trading.

In addition to increasing the number of insolvent liquidations that are dealt with by insolvency practitioners, an economic downturn tends to result in the uncovering of fraud that might otherwise have gone undetected. For this reason it may be worth casting an eye over one of the less frequently used weapons in a liquidator's armoury: an application under section 213 of the Insolvency Act 1986. Section 213 provides that, where the business of a company has been carried on for a fraudulent purpose, a liquidator may apply to the court for a declaration that a person, who has knowingly been party to the carrying on of the business of the company for that purpose, is liable to make a contribution to the assets of the company.

The jurisdiction

A company need not be insolvent for a liquidator to make an application under section 213 and the remedy is not confined to applications against directors or officers of the company. Such an application may be made in the course of any form of winding up and may be made against any person who was knowingly party to the carrying on of the business of the company for a fraudulent purpose. Thus, such an application may be made against a third party, who has never played any role in the management of the company.

Carrying on the business of the company

At the risk of stating the obvious, the business of a company does not consist of one transaction. It follows, therefore, that for the business of a company to have been carried on with fraudulent intent, there must have been a course of fraudulent conduct going beyond a single transaction and the defrauding of a single creditor.

In *Morphitis* v. *Bernasconi* [2003] Ch 552 Chadwick LJ stated that 'not every fraud or fraudulent misrepresentation perpetrated by a company amounts to fraudulent trading under section 213'. He made clear that the fact that a fraud on a creditor is perpetrated in the course of carrying on business, does not, necessarily, mean that the business of the company is being carried on with intent to defraud creditors.

Intent to defraud creditors

Fraudulent intent may be inferred by the court from the circumstances of a particular case. In the well known case of *Re William C Leitch Brothers Ltd* [1932] 2 Ch 71 Maugham J stated that if a company continues to carry on business and incur debts at a time when the directors know that there is no reasonable prospect of the creditors being paid, it is a proper inference that the business is being carried on with intent to defraud creditors. However, this generalisation was disapproved of by the High Court of Australia in *Hardie* v. *Hanson* (1960) 105 CLR and by Lord Hoffmann in *Aktielskabet Dansk Skibsfinansiering* v. *Brothers* [2001] 2 BCLC 324 (PC). Lord Hoffmann made clear that for fraud to be inferred there must generally be 'something else' such as:

> *"a misrepresentation to creditors of the company's position or their prospects of payment or a dishonest intent to gain some personal advantage."*

"It is suggested that the requirement for 'something else' marks the distinction between fraudulent trading under section 213 and wrongful trading under section 214."

It is suggested that the requirement for 'something else' marks the distinction between fraudulent trading under section 213 and wrongful trading under section 214. Section 214 provides for an application for a contribution to be made against a director where, despite that director knowing that insolvent liquidation could not be avoided, the company has continued to trade at the risk of creditors.

Any fraudulent purpose

It is important to recognise the width and adaptability of the remedy under section 213. In *R.* v. *Kemp* [1988] QB 645 the court held that the phrase 'for any fraudulent purpose' could not be wider and should not be construed in any limiting way. In the light of this decision it is difficult to imagine any form of fraudulent conduct that would not be caught by section 213.

Fraud and dishonesty

The burden of proving fraud is a heavy one and any potential applicant under section 213 must bear in mind the subjective nature of the test applied by the court. In *Derry* v. *Peek (1889) 14 App Cas 337* Lord Herschell made clear that where a man genuinely believes that a statement he makes is truthful, the absence of reasonable grounds for holding that belief does not render him guilty of fraud.

It is well established that a finding of actual dishonesty against a respondent is necessary if liability is to be established. The test of dishonesty is a two stage test and the court must first consider whether the respondent acted dishonestly by reference to the standards of ordinary honest people before going on to consider whether he was aware that he was acting dishonestly by those standards (*R* v. *Ghosh* [1982] 1 QB 1053; *Twinsectra Ltd* v. *Yardley* [2002] 2 AC 164).

Party to carrying on the company's business

It would appear that to be 'party to' the carrying on of a company's business some positive act is required. In *Re Maidstone Building Provisions Limited* [1971] 1 WLR 1085 Pennycuick VC. made clear that for a person to be 'party to' the carrying on of a company's business that person must take a positive step to be involved in the business.

Knowledge

The requirement for a party to have been 'knowingly' party to the carrying on of the business in a fraudulent manner raises a question as to the precise nature of the knowledge required.

In *Bank of India* v. *Morris* [2005] BCC 739 it was held that, for purposes of section 213, 'blind eye' knowledge was adequate. However, for a respondent to be fixed with such knowledge an applicant under section 213 must show that the respondent had a suspicion or belief and deliberately refrained from making relevant enquiries (*Manifest Shipping Ltd* v. *Uni-Polaris Company Ltd* [2003] 1 AC 469).

Attribution of knowledge

Where an application is made against a third party company, the court must be satisfied that the knowledge of the natural person or persons through whom the company acted is properly to be regarded as the knowledge of that company.

In *El Ajou* v. *Dollar Land Holdings* [1994] 2 All ER 685 the Court of Appeal, having considered the rules relating to the attribution of knowledge to a company, stated:

> *"First, the directors of a company are, prima facie, likely to be regarded as its directing mind and will whereas particular circumstances may confer that status on non-directors. Secondly, a company's directing mind and will may be found in different persons for different activities."*

In *Meridian Global Funds Management* v. *Securities Commission* [1995] AC 500 Lord Hoffmann observed that in certain exceptional cases the primary and general rules of attribution will not provide an answer and it is necessary for the court to fashion a special rule of attribution to deal with a specific rule of law. This approach was followed by the Court of Appeal in *Bank of India* v. *Morris*. In its judgment it observed that, for the purposes of section 213, the attribution of knowledge to a company will depend on the particular facts of each case, but stated that relevant factors will include:

1) the seniority or importance of the agent
2) his freedom to act independently
3) the extent to which the company's board of directors is kept informed or put on inquiry.

It is important to bear in mind that the knowledge of an agent of certain facts will not be imputed to a company if that company did not have a duty to inquire into those facts (see *El Ajou* v. *Dollar Land Holdings*).

The quantification of the contribution

As far as the quantification of any contribution is concerned, the wording of section 213(2) is identical to that used in section 214(1) and provides that the court may declare that the respondents to an application are:

> *"liable to make such contributions (if any) to the company's assets as the court thinks proper."*

In both cases the contribution is to be made to the assets of the company and is for the benefit of all the creditors of the company. In *Morphitis* v. *Bernasconi* Chadwick LJ made clear that the purpose of any contribution order is compensatory and that there is no jurisdiction to include a punitive element in the sum that any respondent is ordered to pay.

Where wrongful trading is established it is well established that the correct measure of the contribution is the sum by which the net deficiency of the company has been increased by the wrongful trading (*Re Purpoint Ltd* [1991] BCC 121). Similarly, the quantum of any contribution that is ordered under section 213 is to be calculated by reference to the effect that the fraudulent trading has had on the assets of the company in question (see *Morphitis* v. *Bernasconi*) and must reflect the amount by which the fraudulent conduct of the respondent has served to diminish the assets of the company.

The advantages of section 213

A liquidator making an application under section 213 bears the onerous burden of establishing dishonesty. Where the prospective respondent is a director and the company is insolvent, there will rarely be any good reason to proceed under section 213 rather than section 214. The advantages of section 213 are:

- that it provides a remedy against parties who were not directors
- that remedy is also available where the company is solvent. ☐

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Claims against advisors of companies that have been used as a vehicle for fraud

The decision of a recent case is examined and the impact on the ability of insolvency office-holders to bring claims against advisors of companies that have been used as a vehicle for fraud is assessed.

The facts

Stone & Rolls Ltd (S&R) was a company that was owned and managed by a Mr Stojevic. It was claimed that he used S&R as a vehicle for fraud by procuring the presentation of false documents by S&R to a Czech bank. Funds amounting to approximately US$90 million were paid out by that bank to S&R on the basis of those false documents. A substantial proportion of the funds were then transferred by S&R to other parties connected to the fraud.

The bank was unable to recover those funds and brought proceedings against S&R and Mr Stojevic in deceit. At trial, it was found that the documents presented to the bank by S&R were false to the knowledge of both S&R and Mr Stojevic. Accordingly, judgment was entered in favour of the bank against both parties.

That judgment led to the entry of S&R into compulsory liquidation. The liquidators subsequently commenced a claim for damages against the former auditors of S&R, Moore Stephens. The essence of that claim was an allegation that Moore Stephens had been negligent by failing in the course of various audits to detect the dishonest behaviour of Mr Stojevic and therefore prevent the fraud from being perpetrated in the future. The losses claimed were the payments made by S&R following the fraudulent acquisition of funds from the bank.

Moore Stephens denied that they had acted negligently but sought in any event to strike out the claim by S&R. This was on the basis that the claim was barred by the principle of public policy expressed in the maxim *ex turpi causa* (no court will lend its aid to a man who founds his cause of action on an immoral or an illegal act) (*Holman* v. *Johnson* (1775) 1 Cowp. 341). It was argued that S&R should be prohibited from seeking an indemnity from Moore Stephens in respect of liabilities S&R had incurred by reason of its own fraud.

> “Applying that test, Langley J accepted the argument that S&R was a ‘one man band’ and held that the role of S&R was ‘as clear an example of the “directing mind and will” as is perhaps likely to exist’.”

Illegality principle

The maxim *ex turpi causa* has been held to apply to claims in which the claimant was required to plead or rely on his own illegality (*Tinsley* v. *Milligan* [1994] AC 340) or where that claim arose out of or was inextricably linked to the illegal conduct (*Cross* v. *Kirby,* 18 February 2000, unreported).

It was accepted on behalf of S&R that the claim relied upon and arose out of the fraud that was perpetrated by Mr Stojevik on the bank. Nevertheless, it was argued that the claim should not be barred by application of the *ex turpi causa* principle because (i) S&R should not be attributed with the knowledge and wrongdoing of Mr Stojevic (such that S&R could not be said to be relying on its own illegal act) or because (ii) the court had a discretion to permit an offending claim to continue in circumstances where the prevention of the illegal act in question was ‘the very thing’ that the defendant had been retained to do (*Reeves* v. *Metropolitan Police* [1998] 2 All ER 381).

Decision at first instance

These arguments were considered at first instance by Langley J. He held that S&R should be attributed with the knowledge and wrongdoing of Mr Stojevic. The starting point for this decision was the test laid down in *Lennards Carrying Co Ltd* v. *Asiatic Petroleum Co Ltd* [1915] AC 705, which stated that the knowledge of a director would be attributed to a company if he was its 'directing mind and will'. Applying that test, Langley J accepted the argument that S&R was a one man band and held that the role of S&R was 'as clear an example of the "directing mind and will" as is perhaps likely to exist'.

As an exception to the general rule, the knowledge of a director will not be held to be that of the company where the director is committing a fraud upon the company itself (*Re Hampshire Land Company* [1896] 2 Ch 743). This principle was expressed in *Belmont Finance* v. *Williams Furniture* [1979] 1 All ER 118 in terms that knowledge should not be attributed to a company where the company was the *victim* of the improper conduct of its officers. Counsel for S&R argued that it was a victim of the fraud and therefore fell within this exception. This was rejected by Langley J who held that S&R was not the victim of the fraud but its perpetrator. The real victim was the bank that had paid monies over as a result of the fraudulent misrepresentations.

Notwithstanding the conclusion that S&R should be attributed with the knowledge of Mr Stojevic, Langley J dismissed the application to strike out the claim. This was based upon an assumption that the *ex turpi causa* principle involved an element of judicial discretion and that otherwise offending claims may be allowed to continue where the defendant owed the claimant a duty to prevent that illegal act from occurring (in this case a duty of care, which it was assumed would have revealed the fraud had it not been breached). Applying this discretion in favour of S&R, Langley J held that 'I do not think that the conscience of the ordinary citizen would find anything so repugnant in S&R pursuing this claim which would justify ruling it impermissible by use of the unforgiving and uncompromising operation of the *ex turpi* maxim.' Accordingly, the application to strike out the claim on the basis of illegality was dismissed. Moore Stephens appealed that decision.

Court of Appeal decision

In *Stone & Rolls Ltd (in liquidation)* v. *Moore Stephens* [2008] All ER (D) 225 (June), the Court of Appeal agreed with Langley J's finding that S&R had been the perpetrator and not the victim of the fraud. In deciding this issue, it was held that the task was to consider at whom the fraud was directed. If it was directed at the company, then the company could properly be considered a victim and the exception would apply. Counsel for S&R argued that the fraud, even if directed against the bank, also had materially damaging consequences upon S&R (ie in terms of its exposure to liability to the bank) to make it a real victim as well. This argument was rejected. While the fraud in which S&R was engaged resulted in its incurring liabilities of its own to those it defrauded, this did not make it a victim for the purposes of the relevant principle. The reason why S&R was exposed to liability to the bank was because it was the perpetrator of the fraud and not the victim of it.

However, the Court of Appeal found that Langley J had adopted a wrong approach to the *ex turpi causa* principle and held that there was no discretionary element to its application. Once it was established that a claimant was relying on or pleading his own illegality, the claim was bound to fail irrespective of whether the defendant owed a duty to prevent the illegal act from occurring. Accordingly, the appeal was allowed and the claim against Moore Stephens was struck out.

Consequences for creditors

For creditors of insolvent companies, the consequences of the decision of the Court of Appeal in *Stone & Rolls* are unattractive and unsatisfactory. In the context of frauds, those primarily responsible will often have dissipated their assets or otherwise made themselves judgment proof. Attention will therefore focus on the professional advisors who had assumed responsibility for the prevention or detection of wrongful conduct. Save in exceptional circumstances, a creditor of an insolvent company will have no direct cause of action against an advisor on the basis that no duty of care exists (as was accepted in *Stone & Rolls* in relation to the ability of the defrauded bank to bring a claim against the auditor). Therefore creditors will often be reliant on claims brought in the name of the company for the purpose of generating recoveries for subsequent distribution. However, if the fraud has been perpetrated by an individual through his own corporate vehicle, claims by liquidators of that entity are likely to fail in the event that the alleged liability of the advisor is inextricably bound up in the illegal conduct (as will invariably be the case in relation to losses resulting from the primary fraud). This is irrespective of the level of negligence attributable to the advisor in question.

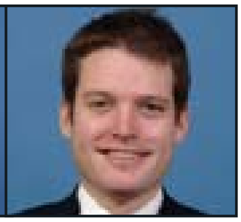
In the narrow confines of a client and advisor relationship, this appears to be a fair result and it would contradict common sense to hold an advisor accountable to a client for failing to detect or prevent a fraud perpetrated by that same client. In the context of commercial fraud, this view and the underlying illegality principle is based on a desire to ensure that the ultimate perpetrators do not take advantage of their wrongful conduct. However, it will invariably be the case in insolvency scenarios that the defrauded creditors, and not the perpetrator of the fraud, will be the real beneficiaries of the fruits of litigation. This appears to have been the rationale behind the decision of Langley J in *Stone & Rolls*: 'I think the objective of the maxim can indeed properly be fulfilled by precluding any recovery which would enure to the benefit of the individual perpetrator or perpetrators of the impugned conduct, in this case Mr Stojevic'. Unfortunately, this reasoning was not accepted by the Court of Appeal who confirmed that the illegality principle was strict and the claim must fail because S&R was deemed to be relying on its own fraudulent conduct.

S&R was deemed by both Langley J and the Court of Appeal to have been one of the perpetrators, and not one of the victims, of the fraud. However, the misappropriated funds were dissipated by the individual responsible for the fraud and S&R was left with no assets and with substantial liabilities. On this basis, it is arguable that S&R was, in fact, as much a victim of the fraud as the bank and that it therefore should not have been attributed with the knowledge of Mr Stojevic.

“ The reason why S&R was exposed to liability to the bank was because it was the perpetrator of the fraud and not the victim of it. ”

It is also submitted that the law is wrong not to include a discretionary safeguard in the application of the maxim *ex turpi causa* without which unfair and incompatible results can be reached. In the case of *Stone & Rolls*, it is likely that a claim against the auditor would have been allowed to continue if Mr Stojevic had defrauded S&R out of its own money (such that S&R would be deemed a victim and not a perpetrator of the fraud). As it was, the auditor had an absolute defence simply because the fraud was perpetrated through S&R on a third party. Protection should be afforded to the ultimate victims of fraud so as to ensure that those parties in breach of a duty to detect or prevent that very fraud can be made accountable. There is understood to be an appeal pending to the House of Lords whose decision on these issues will be of great interest to creditors and liquidators alike. □

Sion Richards (left) is a partner and **Steven Richards (right)** is a senior associate in the Business Restructuring and Reorganisation Team at Jones Day.



The British film industry – worth a look?

Justin Stephenson believes there is a sizeable business opportunity in the British film industry and urges recovery professionals to seek the silver lining behind the silver screen.

The size of the British film industry

Few people realise how big the British film industry is and even fewer realise the depth of the difficulties it currently faces.

The most recent statistics compiled by the industry date back to 2005. At that time 31,000 people were employed in the business, it contributed £3.2 billion to GDP and, to put it into context, it was slightly larger than the British machine tool manufacturing industry.

> “Any one of those problems would have a significant impact on the viability of some of the industry but the combination of all of them at the same time has left no part of the industry unaffected.”

The recent level of film production in the UK has been approximately 100–120 films a year. These range from large-budget films being made by US studios but in the UK, to micro-budget production (under £1 million) being made by independent UK film producers using only British cast and facilities.

In terms of the consumer market for films, Britain is the third largest market in the world after the USA and Japan. In 2007 the largest grossing film in the UK (Harry Potter) made just under £50 million at the cinema box office.

The problems

The British film industry is in serious difficulties. It consists of many parts: film production companies; studio facilities; post-production facilities; equipment hire companies; sales agencies; film investment vehicles. Every part of the industry is suffering. A summary of the current problems is:

- over-capacity
- under-capitalisation and ‘hot’ money
- tax subsidies and price sensitivity
- technology and digital downloading
- investor relations and fraud.

Any one of those problems would have a significant impact on the viability of some of the industry but the combination of all of them at the same time has left no part of the industry unaffected.

Over-capacity

There are too many films being made. In 2007, there were 518 films released in the British cinemas. In the same year, the worst performing film achieved gross box office receipts in the UK of just £95. It would have been cheaper not to release that film at all.

As a result of this over-supply many films never achieve a public release. It is not unusual for a quarter of British films made in any one year still not to have been released to the public two years later: not even on DVD.

The division between box office success and failure becomes ever wider. A very few successes hide a much larger number of complete commercial failures. A few months ago, there was an analysis of 59 British-made films that were released in the UK cinema in 2007. One film, *Hot Fuzz*, made more than three times its production budget at the UK cinemas alone. By way of contrast 35 out of the 59 films made ten per cent or less of their production budget at the UK box office. It is unlikely that most of those 35 films will generate any returns for their investors.

The advertising budget for films has increased dramatically. In the USA it is now estimated that a standard advertising budget for a film being released on a national basis is $30 million to $40 million. Any less than that and the film will have little chance of success.

There are far too many studio facilities in Europe. With unfavourable exchange rates and an expensive labour force, the UK film industry simply cannot match the price that facilities in Eastern Europe and other parts of the world can offer. Pinewood Studios has responded to this pressure by announcing a major investment programme. If it cannot compete on headline pricing it can compete by offering better quality film production facilities that will enable films to be made quicker, better and possibly cheaper than at studios offering low headline prices.

Other studios have responded by offering to invest some of their fees into the film as quasi-equity investors. This is highly risky, it certainly affects cash flow significantly and studios facilities do not have expertise in picking box office winners. We are already seeing studio facilities fail.

Post-production companies have identical problems. They have responded in two ways to this over-capacity: there has been a spate of mergers and takeovers and they have increasingly converted their fees into equity positions in the films. As with studios, this is a highly risky strategy and inevitably post-production companies have got into severe financial difficulties as a result of this.

Under-capitalisation and ‘hot’ money

Very few companies in the UK film industry have significant levels of retained capital. In part this is because the film industry operates by raising investment on a project-by-project basis.

The lack of retained capital means that many companies have very little to fall back on when cash flow slows down. This is made worse by the fact that the way films are financed has been changing over the last three to four years. Traditional sources of finance have been replaced by hedge fund money. With the global credit crunch that source of money has shrunk. The net effect is that, for many films, finance is not available and even for those films where it is, the finance is taking longer to close and is more expensive. This affects not only the film producers but also the rest of the British film industry, which relies on a steady flow of films being made.

Tax subsidies and price sensitivity

The film industry is highly mobile and very price sensitive. If a film can be made more cheaply in one country than in another, film producers will move. Canada has benefited from this over many years as it has been considerably cheaper to film there than in much of the USA.

> “The film industry is often very lax at completing paperwork on time. Actually working out what rights to revenues a company may have, never mind what happens in formal insolvency, can be a major problem.”

Part of the calculation that film producers make in deciding where a film is to be made is the availability of tax credits or subsidies. The UK’s problem is that it is expensive to film here. Labour and location costs are higher than in many other countries and this has been made worse by the dollar/sterling exchange rate. To make life even more difficult, the UK government changed the tax break for films in 2006–2007 so that qualification for the tax benefits was more restrictive and, crucially, the tax benefit was set at a level that is totally uncompetitive with the UK’s major competitor countries.

Technology and digital downloading

Technology gets more powerful and cheaper every year. Post-production facilities consist of a number of film editing suites, which are basically rooms filled with technology. You can now buy a computer and software that is as powerful and flexible as many film editing suites for under £10,000. An HD cinematic-quality camera costs under £5,000. By filming using digital cameras rather than 35mm film stock a producer can significantly reduce the cost of filming. Cinema chains are moving to digital projection, massively reducing the cost of distributing films to the cinemas. These changes have benefited film makers and distributors.

There is a downside. Existing business models are being broken – why pay a post-production facility for use of a film editing suite when you can do the work yourself at home on an Apple Mac. Conversely, film viewers expect better and better special effects, which require greater use of post-production companies. Digital downloading of films is already impacting on DVD sales, which have been the mainstay of the film industry for many years; the public is simply not prepared to pay a large amount for a digital download and piracy is a major issue.

Investor relations and fraud

The film industry has consistently shot itself in the foot over many years in its relations with investors. Investors are constantly told how successful films can be but, while it is true that a global success on a low-budget film can produce returns that are spectacular, unfortunately these are very rare. For independently produced films, were it not for tax incentives, the vast majority of such films would be heavily loss making. Even where investment is linked to tax incentives such that the actual success of the film is irrelevant to investors, there have been many schemes that have failed to deliver the anticipated returns due to over-aggressive tax planning and inadequate administration.

As with many industries suffering from financial difficulties, fraud is increasing. The film industry has never had a good reputation with investors – there are far too many stories over numerous years of creative accounting. And we are now seeing an increase in situations that go beyond this to simple theft of investor funds and film revenues.

Issues for the recovery professional

The British film industry is a big business with major problems. It is also a business that loves disguising reality by using jargon. However, there is nothing unique about the problems of the film industry and recovery techniques that are successful, for example, in the property industry can be applied to film.

There are a few pitfalls: the film industry has few tangible assets and revenues are typically dependent on ownership of contractual rights. If a formal insolvency process allows another entity to terminate a key contract, that may destroy any hope of recovery. Also the film industry is often very lax at completing paperwork on time. Actually working out what rights to revenues a company may have, never mind what happens in formal insolvency, can be a major problem. It is also easy to overlook the fact that the film industry is a people industry. In virtually every single aspect of the film industry it is the experience and reputation of the people working in a company, not the company itself, which is crucial. In dealing with the rescue of a film-related company it is imperative to identify the key people and retain them.

As long as the, usually obvious, pitfalls can be avoided there is nothing esoteric about the British film industry to make a recovery professional avoid it. Indeed, over the next few years, it is and will be an interesting business opportunity for all those engaged in the profession. □

Justin Stephenson is a partner at Jeffrey Green Russell.

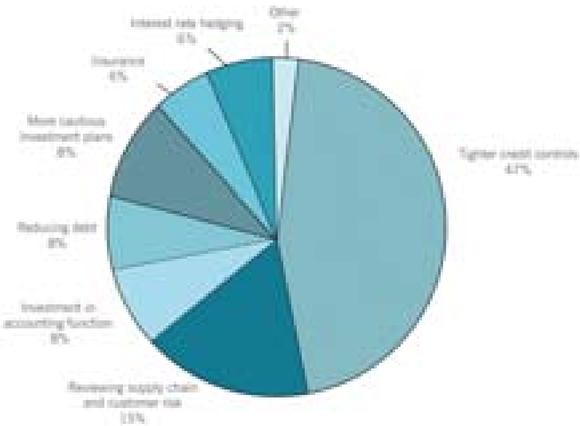
Credit crunch survey

An independent survey suggests that SME companies are taking steps to stem the decline in profits due to the credit crunch, although some of them fear the worst.

Graph 1

Credit controls are the priority to reduce risk in April

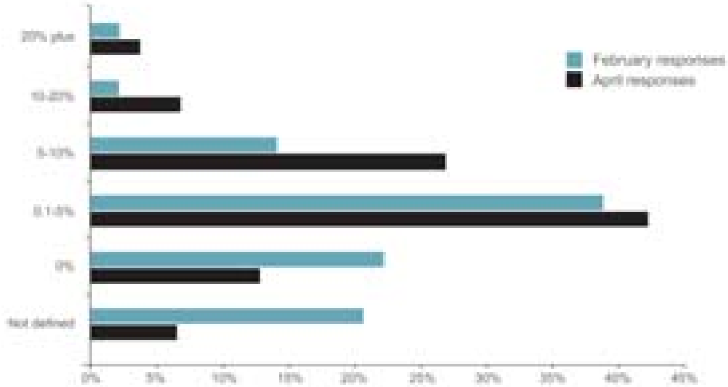
What risk management controls are you putting in place?



Graph 2

Finance directors revise bankruptcy estimates upwards in April

What percentage of your customers/suppliers are at risk of bankruptcy over the next 12 months?



British businesses are now reacting to the effects of the credit crunch after months of uncertainty regarding the impact on companies outside the financial sector. A recent survey[1], initially carried out in February and repeated in April, found that a cross-section of businesses adjusted their outlook on the UK economy downwards during March, becoming more focused on cutting costs in the light of an expected drop in earnings. In addition, the number of companies bringing in additional risk controls tripled as the effects of the credit crunch deepened and widened. Interviews were undertaken with the finance director or equivalent of over 100 listed and owner-managed companies with turnovers of between £20 million and £250 million.

Key findings

Reactions to the credit crunch

- A third of respondents (32 per cent) said that the credit crunch was beginning to impact more on their business during March. Nearly two-thirds of these (60 per cent) said that they were experiencing a decrease in their profits, and a quarter (23 per cent) said that they were finding problems with financing.
- The biggest change during the month was in attitudes to risk. By the beginning of April, nearly two-thirds (64 per cent) were implementing risk management controls compared to just over a fifth (22 per cent) a month earlier. This largely consisted of implementing tougher credit controls and assessing customer and supplier risk. See graph 1.
- The importance of financial forecasting grew by 11 per cent from February to April, with 44 per cent of finance directors saying that the credit crunch had made it more important to their role.
- The number of companies considering cutting their costs nearly doubled during March – rising from 26 per cent to 45 per cent by the beginning of April. The biggest area for potential cost savings was seen in head count – one in four companies (25 per cent) was looking at limiting recruitment; one in six (15 per cent) was considering redundancies; while 10 per cent of those surveyed were looking at changing their remuneration policies.
- The perceived threat of bankruptcy among suppliers jumped markedly between the two survey dates. In the first survey, under a fifth (18 per cent) thought that 5 per cent or more of their suppliers were in danger of going bankrupt, this rose sharply to more than a third (38 per cent) at the beginning of April. See graph 2.

Growth plans

- The vast majority of companies (75 per cent) are continuing their growth strategies this year. This is only an 11 per cent drop on the first survey.
- A third of these companies (33 per cent) expected that the growth will come from acquisitions, while a third foresee continued organic expansion despite the credit crunch.
- Surprisingly there was only a small change in sentiment on listing. Of the 15 per cent of those that were considering listing, 60 per cent would do so irrespective of the economy. This is only a 15 per cent drop on the previous figure.

Economy

- The majority of companies (95 per cent) felt the economic growth would be substantially lower in 2008 than 2007, with 38 per cent citing the second half of 2009 as the turnaround period for the UK economy.
- Companies became much more pessimistic about the economic outlook during March. A third of companies (33 per cent) in the later survey felt that the UK economy would only recover in 2010 and beyond, this compared to a quarter (23 per cent) in the earlier survey.
- Over half (60 per cent) of finance directors were at loggerheads with the prime minister over whether the economy was in a good position to survive the global crisis. Just under a third (30 per cent) agreed with his analysis, while 10 per cent did not know. ☐

[1] *Mind the crunch*, a credit crunch survey was carried out for Baker Tilly by the independent marketing consultancy Stormark Limited. To receive an electronic copy of the report please contact: Catriona Wright **catriona.wright@bakertilly.co.uk**.

Recruitment survey

RECOVERY's recruitment survey suggests some of the questions practices might wish to ask a recruitment consultancy but it also indicates that demand for new staff is not yet paramount.

In the current economic climate of uncertainty, *RECOVERY* has conducted a survey among recruitment companies specialising in the insolvency, restructuring and turnaround sector to ascertain if professional organisations are gearing up in anticipation of an upturn in business.

Respondents indicated that large national organisations had the highest number of jobs availalable, with SMEs ranking second and international organisations coming third. However, there was not a large difference between the number of jobs offered in each type of organisation.

The analysis below gives a snapshot of the industry at a point in time when the global economy is balanced on a knife edge. Which way does the insolvency, restructuring and turnaround sector think things will go?

The answers are expressed as a percentage of the total number of answers returned.

How many candidates do you place in a year?

100–1,000 ....86%
1,001–3,000 .... –
3,001–5,000 ....14%
> 5,001 .... –

What is the average time a candidate has remained on your books in the last year?

1 day – 1 month 14%
1–3 months 71%
3–6 months....15%
6 months – 1 year .... –

How long have you been in this sector?

≤ 1 year .... –
1–5 years 58%
> 6 ....42%

How many offices do you have in the UK and Northern Ireland?

1–10 ....71%
11–20 .... –
> 21 ....29%

How many offices do you have abroad?

0–10 ....70%
11–20 ....16%
> 21 ....14%

How many recruiters do you have in this sector?

1–10 ....57%
11–20 ....43%
> 21.... –

Place in order (1, 2, 3) the type of organisation in which you have most jobs available:

	1st	2nd	3rd
International organisations	43%	–	57%
Large national organisations	57%	43%	–
SMEs	–	57%	43%

Do you offer candidates help with their CVs/applications?

Yes....100%
No .... –

Do you offer interview training?

Yes 100%
No .... –

Do you provide career planning advice?

Yes 100%
No .... –

What percentage of the candidates you place are 'repeat business'?

1–10.... –
11–20 ....43%
> 21 ....57%

Do candidates provide good, clear information about themselves?

Yes....14%
No .... –
Usually 86%

Do you check references?

Yes....57%
No 28%
Usually 15%

What's the single most common reason organisations give for not selecting a candidate?

Personality fit incorrect 44%
Lack of appropriate experience 42%
Not focused on the company 14%

Do you give feedback to candidates if they do not get the job?

Yes....100%
No .... –
If they ask .... –

Do you give feedback to organisations if a preferred candidate decides not to accept a job?

Yes....100%
No .... –
If they ask .... –

How would you prefer to advertise vacancies?

Online 15%
Print.... –
Both media....85%

Through which medium do you get the highest response to your adverts?

Online 29%
Print.... –
Mix of both....71%

Have you experienced an upturn in business as a result of the credit crunch?

Yes....43%
No .... –
Not yet 57%

Testing the market – online

Matching buyers and sellers in a dedicated online marketplace, explains David Dalton, is the most efficient route to market for IPs under pressure to sell distressed businesses and assets quickly at maximum value for creditors.

In the highly regulated insolvency process IPs have a duty to maximise value on behalf of creditors. There is additional pressure to market businesses and assets within a tight timeframe – sometimes within days or even hours in case essential staff, key customers and vital goodwill might otherwise disappear.

However, there is only one way to be certain that a sale is at the best price reasonably obtainable – that is by testing the market.

Marketing challenges

Tracking down serious buyers in sometimes unfamiliar business sectors can involve labour-intensive and time-consuming research, generating costly disbursements on advertising, telecanvassing, mail shots, marketing materials and so on. An indiscriminate trawl of the market can only add time and costs – inevitably eroding funds available to creditors.

At present it can be difficult to justify the high cost and slow response times of advertising a small or medium sized business and assets in the *Financial Times* or trade journals. Therefore, in many cases, potentially viable businesses are sold on to the former management without the benefit of testing the market or they are simply broken up and sold piecemeal.

Calls for transparency

Increasingly there have been calls for greater transparency in the insolvency process. Negative perceptions have been fuelled by the emergence of pre-packs – the controversial practice of lining up a preferred buyer ahead of the official appointment of an IP. Pre-packs are 'under a lot of scrutiny', Alchemy Partners' Jon Moulton told licensed trade paper *The Morning Advertiser* recently. The forthright private equity firm boss added: 'Not getting the best value back for the assets is the danger.'

In some cases there simply isn't time to market a business and assets using conventional means and so take-it-or-leave-it deals have to be done without testing the market. Surely there has to be a better way – a more streamlined process that exploits the potential of modern technology?

> **"IPs can now test the market cost effectively and feel more confident that the deal being done is the best reasonably obtainable."**

The future of marketing distressed businesses and assets is online.

Transforming the process

That simple thought was the genesis of IP-BID.com – an online service designed specifically for insolvency practitioners that aims to transform the process of marketing business and asset opportunities. IPs can now test the market cost effectively and feel more confident that the deal being done is the best reasonably obtainable.

Matching buyers and sellers in a dedicated online marketplace is the most efficient route to market for IPs under pressure to act quickly and, by creating a convenient one-stop shop for distressed businesses and assets, the service will attract committed buyers looking for specific opportunities.

IP-BID.com opens up new markets and IPs gain instant access to a bigger pool of active entrepreneurs and their professional advisers. A simple posting on this dedicated online service can put IPs in touch with serious buyers across the UK immediately and far more cost effectively than expensive, less focused advertising – for instance, selling a customer list and telephone numbers to a competitor many miles away, who might otherwise be unaware they were available to purchase.

Saving time and resources

A targeted service also reduces the administrative time an insolvency practitioner's team might waste handling fruitless general enquiries from the many tyre kickers out there. Serious interested parties identify their requirements from the outset by creating an online profile.

Registered users receive customised e-mail alerts; this interactive service ensures that they are notified quickly of an appropriate posting. These registered users can then consider the opportunity posted and express an interest – all online. IP-BID.com then automatically sends details of those potential buyers expressing an interest to the appropriate IP – in some cases all in a matter of minutes. This ensures that IPs receive only relevant and focused expressions of interest, direct to their desktops.

Improving perceptions

Whether before or after a formal appointment, testing the market online can provide greater transparency. The online service operates a fair and open marketplace, geared to IPs' timescales, and provides an additional response to criticism that assets might have been undersold.

By casting the net widely among active buyers, via IP-BID.com, insolvency practioners can rest assured that they are taking a further appropriate step in fulfilling their requirement to seek the best possible value. □

David Dalton is chief executive of IP-BID.com.

Occupational Pensions Trusts

Staff in companies that are in dire straits may well lose their jobs but trustees can help to make sure they retain as much of their hard-earned pension provision as possible.

The current solution for any corporate wishing to divest itself of its pension scheme is to use section 75 of the 1995 Pensions Act and arrange for the pension fund to be bought out by an insurance company. However, this route is expensive and not always an option, particularly for businesses in the process of liquidation or in administration.

The PPF assessment period

Many schemes fall into the Pensions Protection Fund (PPF) assessment period where members' benefits are immediately cut back to PPF levels. If the fund can afford to approach an insurer (such as L&G, Prudential or the raft of new entrants) and obtain a better level of benefits for members the PPF will direct trustees to do so. But in practice few schemes already in the PPF assessment period are in a position to do this and therefore the orphaned funds, with insufficient resources, will enter the PPF.

The PPF is a lifeboat

Entering the PPF provides a lifeboat for schemes in large deficit but it is not necessarily the best result for members, as trustees know. Payout to members by the PPF is generally significantly less than the payout they expected, many members will have their pension entitlement cut by 10 per cent and for high earners the haircut might be substantially more than this. This is partly the reason for the PPF's lengthy assessment period; it is an opportunity for trustees to explore their options, although there are frequently other reasons such as data cleansing and legal issues.

Other options

What other options are there? One is to keep the fund running as an occupational pension scheme. The advantage of this is that assets can continue to be invested in return-seeking vehicles (ie equities, bonds, hedge funds, property, commodities etc), in contrast to the PPF or an insurance company, who assume that the assets are invested solely in gilts and bonds. The higher level of expected return should mean an increased likelihood of being able to pay members, benefits in full. Of course, there is still the backup of the PPF in case things go awry, but at least members will have a higher level of benefits in the interim. Currently there is only one company that is able to offer this type of scheme rescue: Occupational Pensions Trusts.

Insolvency and restructuring of pension schemes is a difficult and evolving area where trustees are usually heavily reliant on their advisers. With the recent developments in the pensions buyout market trustees and recovery professionals need to be aware of all the options out there so that they can try and get the best result for the members in difficult circumstances. ☐

Ben Shaw is the development director at Occupational Pensions Trusts.

LPA Receivers – friend or foe?

Denise Ford shows how NARA members can add value to the debt management process.

The credit crunch is now a common term in the public domain and one can hardly turn a newspaper page without reading about doom and gloom.

A number of large institutions are now informing NARA, The Association of Property and Fixed Charge Receivers (formerly the Non-Administrative Receivers Association), that they have closed their books to new lending and are considering alternative action to recover outstanding debt. With the exception of some high profile cases such as Bank of Scotland's appointment of John Gershinson of Allsops as LPA Receiver (Law of Property) over City Lofts Group Ltd's 250 unsold apartments, the decision to appoint LPA Receivers is still viewed by the financial market as a bleak outcome to debt management.

NARA, who in May 2008 changed their name to more accurately reflect the work their members carry out, feel that there may be some trepidation in making the move to appointing LPA Receivers, even when we are in a market that is uncertain and being compared with the recession of the late 1980s and early 1990s, when LPA receivership was fairly commonplace. That may be understandable given that many who experienced and learned from that recession have now moved on.

LPAs are problem solvers

It is important to recognise that LPA Receivers are not just property professionals or number crunchers, they are problem solvers. Bringing an LPA Receiver on board at a very early stage of debt management, along side accountants and IPs, enables lenders to establish more quickly what has gone wrong with the property and to establish how a potentially insolvent company could more effectively manage its property portfolio to recover losses.

Receivers prefer to take an active role in the debt management process and work with those dealing in debt recovery issues from a very early stage. The time to consult with an LPA Receiver is the minute that signals are given to a bank or professional advisers that there may be a problem. If that is done, in many cases, debt is not only recovered for the lender but often borrowers are able to walk away from their property problems debt free or in pocket. LPA receivership offers a cost-effective way of managing debt, providing banks and financial institutions with protection from criticism and bringing positive cash flow back as swiftly as possible. Working with IPs we can ensure that expert knowledge and debt recovery solutions relating to property matters become part of good business practice – before they become debts no longer serviceable by the freeholder.

LPA Receivers are not to be feared, either by the lender or borrower. They are working with both parties, albeit independently of each, to recover the entire debt due. While they can't claim 100 per cent success rate in each case, they are undoubtedly able to offer financial institutions the answers they need to ensure that the credit crunch is exited as painlessly and effectively as possible. ☐

Denise Ford is the managing director at Michael Parks Surveyors and vice-chairman of NARA.

R3 members' quarterly survey

Borrowing being seen as 'simply a way of life' is the main cause of personal insolvencies.

According to a new survey of R3 members, 90 per cent of respondents thought that rises in business insolvencies would hit the UK in 12 months' time. This contrasted to 84 per cent who said that business insolvencies would increase over the next 6 months. Looking back, 67 per cent said they had seen an increase during April, May and June 2008.

The findings come from a profession that is at the coalface of the UK economy, dealing with businesses in financial trouble covering a huge range of sectors. Out of those, construction, retail and leisure are looking especially vulnerable. The fact that nine in ten insolvency professionals in the UK believe that in a year's time they will be dealing with an increase in business insolvencies indicates that the economy is facing a long period of protracted pain. R3's results come out at least one month ahead of official national statistics.

> "According to the survey, 90 per cent of respondents thought that rises in business insolvencies would hit the UK in 12 months' time."

Personal insolvency

The survey also tackled the issue of personal insolvency, with 70 per cent of respondents anticipating an increase in personal insolvency cases over the coming year. This was a slight increase in comparison with the 68 per cent of members who thought numbers would rise within the next 6 months. Thirty three per cent had recorded an increase over the last three months.

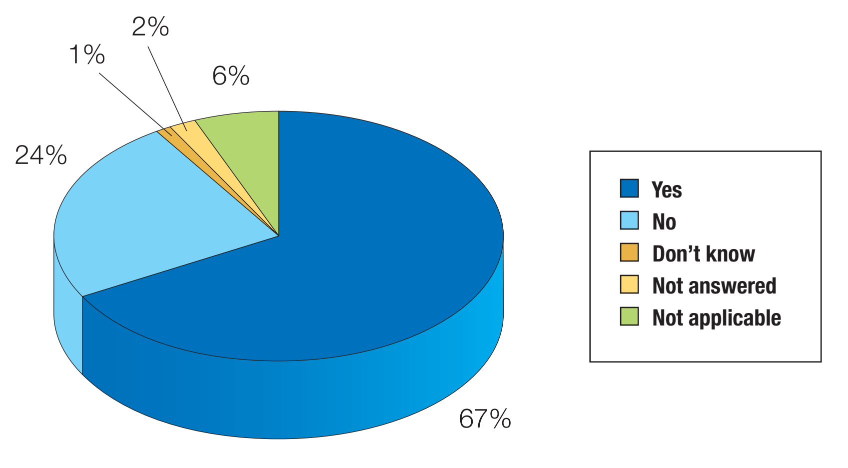
Insolvency professionals were also asked about the causes of this rise in personal insolvency and the highest number of respondents cited the fact that borrowing is seen as 'simply a way of life'. The second and third highest responses were 'irresponsible borrowing', followed closely by 'irresponsible lending from banks'.

The survey indicates that, on the personal insolvency side, debt is no longer just an issue for those in low income brackets. Fourteen per cent of insolvency professionals have had clients with incomes of £30,000 to £39,000, which is well above the national average salary of about £25,000. These are people on good salaries, perhaps working in financial services, and not the 'traditional debtor' at all.

> "The survey indicates that, on the personal insolvency side, debt is no longer just an issue for those in low income brackets. Fourteen per cent of insolvency professionals have had clients with incomes of £30,000 to £39,000."

If borrowing really is 'simply a way of life' then this will be a hard psychological, let alone financial, deadlock to break. Seeking financial advice early from a qualified source such as an insolvency practitioner is the best way to achieve a workable solution. □

Have you dealt with more business insolvencies in the last three months?



The R3 members' survey was sent to 2,037 IPs, all members of R3. The response rate was 19.8 per cent, generally considered high. The survey will be carried out on a quarterly basis.

Will Black is communications manager at R3.

R3 events, courses and conferences

Date	Event title	Venue
September		
3	Student Workshop 1	Novotel City South, London
3	East Midlands Young Professionals Group event	Leicester
4	Student Workshop 2	Novotel City South, London
9	Employee Issues and Pensions	Cedar Court Hotel, Huddersfield
9	Buying a Business	Cedar Court Hotel, Huddersfield
9	South West and South Wales Region Meeting	The Bristol Golf Club
17	Student Workshop 3	Novotel City South, London
18	Student Workshop 4	Novotel City South, London
18	Personal Insolvency	Chase Hotel, Cheltenham
18	Smaller Practices Conference	Dunkeld Hilton, Scotland
23	Introductory Programme – Liquidations 1	etc Venues, London
23	Introductory Programme – Liquidations 1	Deloitte, Birmingham
25	Introductory Programme – Liquidations 1	Irwin Mitchell, Leeds
October		
2	Employee Issues and Pensions	Holiday Inn, Bloomsbury, London
2	Buying a Business	Holiday Inn, Bloomsbury, London
2	East Midlands Women's Group Annual Ball	Nottingham
2	R3 SWIG Golf Day	Glasgow
3	R3 Annual Dinner	The Dorchester, London
6	Eastern Regional Meeting	
9	Personal Insolvency	Aldwark Manor, York
9	Midlands Region Annual Quiz	Aston Villa FC, Birmingham
16–17	SPG Forum	Chesford Grange, Warwick
21	Introductory Programme – Liquidations 2	etc Venues, London
21	Introductory Programme – Liquidations 2	Deloitte, Birmingham
23	Introductory Programme – Liquidations 2	Irwin Mitchell, Leeds
30	Scotland Regional R3 Annual Dinner	The Lighthouse, Glasgow
November		
4	South West and South Wales Region Meeting	The Bristol Golf Club
13	Personal Insolvency	Holiday Inn, Bloomsbury, London
18	Introductory Programme – Liquidations 3	etc Venues, London
18	Introductory Programme – Liquidations 3	Deloitte, Birmingham
20	Introductory Programme – Liquidations 3	Irwin Mitchell, Leeds
20	Employee Issues and Pensions	Novotel City, Birmingham
20	Buying a Business	Novotel City, Birmingham
25	Personal Insolvency	Crowne Plaza, Chester

For further information on R3 courses and conferences, please visit the R3 website **www.r3.org.uk**, where you can download the full 2008 programme. Alternatively, call the Courses team on 020 7566 4234 to request a programme by post.

regional events **R3 events**

R3 contacts

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London .... Stephen Grant 01491 725544
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R3 membership benefits

We are constantly striving to provide value for money for all our members. Benefits for full members currently include:

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- an invitation to the R3 annual conference
- a copy of *RECOVERY* every quarter
- the 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
- access to the members' section of the R3 website.

Subscriber membership is open to people who are not insolvency practitioners, lawyers or students but who have an interest in the world of business recovery. Benefits 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
- a copy of the *R3 Directory*.

For more information on R3 membership, please call 020 7566 4238 or e-mail **membership@r3.org.uk**.

Industry announcements

ChantreyVellacottDFK
CharteredAccountants

The Business Recovery Division of Chantrey Vellacott DFK is delighted to announce the promotions of Lee De'Ath and Garry Hacker to Partner.

Lee, previously with Mazars, joins our Colchester office to strengthen the existing team and is committed to expanding our current Business Recovery services throughout East Anglia.

His experience encompasses all types of insolvency and business recovery appointments and complements our Business Recovery Team which provides a pro-active approach in delivering solutions to individuals and companies in financial difficulties.

For further information please contact: Lee De'Ath
Tel 01206 578004 **Email** ldeath@cvdfk.com

Garry, who has worked in the industry for over 20 years, has recently made the move from the firm's Brighton office to launch business recovery services in our existing Croydon office. He works on all types of insolvency and business recovery assignments and is committed to providing a creative approach to the individual needs of the client.

For further information please contact: Garry Hacker
Tel 020 8686 3915 **Email** ghacker@cvdfk.com

www.cvdfk.com

King Sturge LLP is delighted to announce the promotion of Mark Stupples to UK Managing Partner.

The appointment will become effective on 1 November 2008 when Mark will be taking on responsibility for the day-to-day management of the UK operation. He will also retain his role as London Managing Partner.

Over the last 24 years, Mark has been actively involved in providing strategic consultancy and investment, asset management and performance advice to private and public clients. Additionally Mark acts as an adviser to banks, building societies and insolvency practitioners with respect to property-related insolvency and corporate recovery situations. He is also responsible for taking LPA receivership appointments in a personal capacity.

Mark is currently the Chairman of NARA for the second year running. In the past year he has effected the change of name from the Non-Administrative Receivers Association to The Association of Property and Fixed Charge Receivers while at the same time keeping the more recognised brand name of NARA.

Mark Stupples
T: +44 (0) 20 7087 5050
E: mark.stupples@kingsturge.com

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PKF is delighted to welcome new Partner **Charles Escott** to our Leeds office

Charles, previously a partner for seven years at RSM Robson Rhodes, has 19 years' experience in corporate recovery work. He has a wide range of corporate insolvency experience, having undertaken assignments for all the UK clearing banks, together with a wide range of other secured funders, both in formal recovery appointments as well as in turnaround reviews and implementation. Charles' experience also encompasses international assignments where he has been engaged by a number of funders to assist in managing their overseas exposures.

Charles Escott
Tel: 0113 2284122
Email: charles.escott@uk.pkf.com

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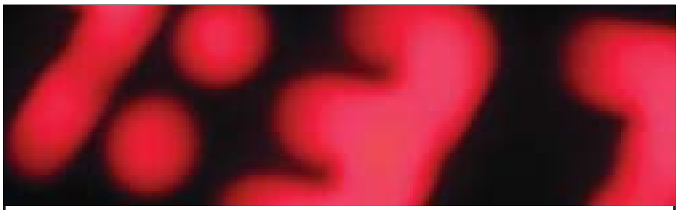

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Please apply by CV to Ian Field, Insolvency Lawyers' Association, Valiant House, 4-10 Heneage Lane, London EC3A 5DQ. The deadline for applications is 28 November 2008.

President: Ian Field
Secretary: Peter Joyce
Vice-President: Stephen Davies QC
website: ilauk.com

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Corporate Recovery Partners/Directors
Manchester/Leeds £Competitive Packages

This top independent firm already has a strong Recovery presence in London and the South and is now looking to build a national presence by establish operations in the North. They are seeking established Partners or Directors with proven business generation skills and strong local contacts. Ideal candidates will currently be working with a 'Big 4' or national practice and seeking a new challenge. Individuals or teams will be considered. Packages will reflect experience and are expected to at least match existing packages via a competitive base salary, equity and an open ended performance related profit share, together with usual compensation benefits.

Restructuring Managers/ADs
Sydney/Melbourne Aus $ Competitive

Exciting opportunities for Chartered Accountants to join a leading international Corporate Restructuring team. You will be responsible for analysing the financial and operational influence of underperforming businesses and establishing valuable strategies to recover and re-establish successful company performance. The role is likely to suit a Chartered Accountants with a sound knowledge of Corporate Restructuring in a strategic advisory manner.

Corporate Recovery Partners/Directors
Glasgow £Competitive Packages

Our client, a leading independent firm, already has a strong Recovery presence in England and is now looking to build a presence in Scotland by adding a Recovery team to its existing Glasgow office. They are seeking established Partners or Directors with a proven track record in business generation, marketing and team development.

Ideal candidates will currently be working with a 'Big 4', national practice or leading boutique with a strong preference for someone with local contacts. Individuals or teams will be considered.

Packages will reflect experience and are expected to at least match existing packages via a competitive base salary, equity and an open ended performance related profit share, together with usual compensation benefits.

Davies Kidd UK and International Recovery Recruitment Specialists

For a confidential discussion on the market or any of these positions contact:
Jeff Davies on 020 7812 6688 or email jeff@davies-kidd.co.uk
Christopher Kidd on 020 7812 6688 or email chris@davies-kidd.co.uk

Mid Markets Manager
Reading £50-65,000 + Car

International firm is expanding its Corporate Recovery operations in the South East and is able to offer a challenging and rewarding career opportunity in the Reading office for a Manager with around 2-4 years Recovery experience. Ideal candidates will be ACA/ACCA qualified with a range of Recovery experience gained in the Mid-Market sector.

Corporate Recovery Manager / Senior Manager No. 2 Role
Surrey £Negotiable

Great opportunity for a Corporate Recovery Manager or Senior Manager to join a growing department of an international firm in a No. 2 capacity. You will ideally be a qualified accountant and/or JIEB with a good range of Mid Market experience. Excellent onward career progression envisaged.

Corporate Restructuring Manager
Germany €Negotiable

Ideal opportunity for a bi-lingual English/German speaking Chartered Accountant or equivalent to join a leading Restructuring team in Northern Germany. You will need at least 3 years Restructuring/Business Recovery experience gained in a recognised professional services firm and should be able to conduct business in both German and English.

Partners/Directors/Teams
Dublin Euros Competitive Packages

This leading UK practice already has a strong Recovery presence in the UK and is now looking to expand operations in Ireland by setting up a Recovery practice in its existing Dublin office. They are seeking established Partners or Directors with proven business generation skills and strong local contacts. Ideal candidates will currently be working with a 'Big 4' or other international practice or recognized local player. Individuals or teams will be considered. Packages will reflect experience and are expected to at least match existing packages via a competitive base salary, equity and an open ended performance related profit share, together with usual compensation benefits.

Corporate Restructuring Executive
Leeds £Competitive

Excellent career opportunity in an international firm for a qualified accountant with previous Recovery/Restructuring experience and the ability to run own varied caseload. Friendly, growing department.

Corporate Restructuring Managers to Directors
Africa £Competitive

Excellent opportunities in a leading international accounting firm for qualified accountants or JIEBs with Corporate Recovery or Restructuring experience who are keen to work in Africa. Ideal candidates will have previous experience of living and working in Africa and should be keen to contribute to the long term development of the practice. Opportunities exist from Manager to Director level in Ghana, Tanzania, Kenya and Nigeria.

Partners/Directors/Teams
Belfast £Competitive Packages

Great opportunity for existing Partners or Directors seeking a new challenge. This top independent firm already has a strong Recovery presence in the UK mainland and is now looking to build a presence in Northern Ireland by establishing a Corporate Recovery team in its existing Belfast office. They are seeking established Partners or Directors with proven business generation skills and strong local contacts. Ideal candidates will currently be working with a 'Big 4' or other international/national practice or recognized local player. Individuals or teams will be considered. Packages will reflect experience and are expected to at least match existing packages via a competitive base salary, equity and an open ended performance related profit share, together with usual compensation benefits.

Corporate Recovery Seniors/Managers
Scotland £Competitive

Expanding Recovery team of an international practice can offer a challenging mix of Corporate Recovery work to qualified accountants who will ideally already have some relevant experience. You will rapidly develop your experience on a broad range of case management and pre-insolvency reviews.

Corporate Restructuring Seniors, Managers, Associate Directors
Singapore – Competitive Packages

Outstanding career opportunities in a leading international firm for qualified accountants with relevant experience in providing advisory services to distressed companies. You are likely to gain exposure to varying industry sectors in a number of countries with involvement in e.g. debt restructuring, cash management, turnaround, company break-up and formal insolvency work.

Recovery Partners/Directors/Teams
South/South West £Competitive Packages

Leading independent firm seeks established Partners or Directors with proven business generation skills to set up a Recovery practice in an existing office covering the South and South West of England. The firm already has a strong London and South East presence in the Recovery market. Ideal candidates will currently be working with a 'Big 4' or other national or international practice or leading specialist. Individuals or teams will be considered. Packages will reflect experience and are expected to at least match existing packages via a competitive base salary, equity and an open ended performance related profit share, together with usual Director/Partner compensation benefits.

Senior Insolvency Administrator
Central London £30-40,000

Excellent opportunity for a part or fully qualified CPI or ACCA with at least 3 years Corporate Recovery experience to join a leading non 'Big 4' practice in Central London. You should be able to handle cases with minimal supervision. The successful candidate will benefit from a good range of Corporate experience in a friendly, supportive team environment with good ongoing career prospects.

Corporate Recovery Senior
Ipswich £Flexible

Leading professional firm offers a qualified accountant /CPI / JIEB the chance to work on a wide range of Corporate Recovery and Insolvency work and assignments including Receiverships, Liquidations, Administrations and Investigation work as well as the opportunity to become involved in marketing work.

Corporate Recovery Director
South East England
Negotiable £6 Figure Package

Outstanding 'Big 4' opportunity for an ambitious Restructuring /Recovery specialist to 'make a name' for themselves in a 'Big 4' office in the South East of England. You are likely to be a qualified accountant and JIEB with at least 7 years post qualification experience and a specialist background in Recovery and Restructuring work, particularly for mid-market clients. You will need a strong history of successful delivery and a proven business development record. This role represents a great opportunity to be part of a growing national team.

Corporate Recovery Senior Manager
Milton Keynes £Competitive

Excellent career opportunity for an established Manager or a Senior Manager to join a leading Recovery team. You will benefit from exposure to a wide range of Corporate assignments and a busy, friendly professional environment. The ideal candidate will be a qualified accountant or JIEB with good all-round Recovery skills including previous exposure to Bank work and a good team player with strong commercial and management skills.

'Big 4' Restructuring/Recovery Opportunities, Manager to Director Level
London/South East £45,000 – Substantial 6 Figures

Our client, a 'Big 4' firm, is experiencing significant growth in its Recovery and Restructuring practice and is consequently looking to make a number of key appointments to its team in London and the South East. They are interested in talking to dedicated specialists at all levels from Manager to Director. At Manager levels ideal candidates will be qualified accountants, JIEBs or equivalent with a strong grounding in Recovery and Restructuring assignments. Senior Managers and Directors will need 5-10 years of directly related experience and should be able to demonstrate a wide range of skills across the discipline, together with strong management and business development ability.

Corporate Recovery Seniors/Managers
Brisbane Aus $ Competitive

Excellent opportunity for newly or recently qualified Chartered Accountants with at least 1-3 years Corporate Recovery experience to join an international firm on the Gold Coast of Australia.

Corporate Recovery Senior
Cambridge £Competitive

Great opportunity for a qualified ACA, ACCA or equivalent with a good professional services training to join an international firm specialising in turnaround, investigation and restructuring work. Some previous relevant experience would be useful and, in any event, you will need a strong appreciation and commercial understanding of the skills required for advising underperforming businesses.

Semi-Senior Administrator
Central London £22-30,000

Exciting career opportunity in a national practice for a part or fully qualified CPI or ACCA wit at least 1-3 years corporate insolvency experience. Someone with a shirt sleeves approach who is willing to learn and progress their career will thrive in this friendly, supportive, team-oriented environment.

Investigation Senior Managers and Managers
London £60-90,000

The Corporate Recovery department of this leading international firm is seeking a number of Managers and Senior Managers to join its busy and expanding Investigations team. Ideal candidates will be qualified accountants, JIEBs or equivalent who can supervise and direct a team of staff on investigation assignments. The work will involve analysing historic trading performance and understanding the key drivers of business performance and operations, understanding the impact of current and projected trading and cash flow on the position and security of key financial stakeholders, preparing detailed assessment of management and their capabilities and coordinating the fieldwork and subsequent report writing on investigation assignments.

Directors & Assistant Directors Mixed Advisory and Formal
London £85,000 – 6 Figures

Recovery department of this leading international firm can offer challenging and rewarding careers to qualified accountants and/or JIEBs with a strong mix of advisory and formal insolvency experience. You are likely to be operating at a similar level in a Big 4, Top 20 or large boutique environment and should be able to add value to the existing team via e.g. an industry sector or service line specialism or strong contacts with work referrers. Good onward career prospects

Corporate Recovery Seniors 'Big 4'
London c£40,000

'Big 4' City based recovery team seeks experienced Administrators for their thriving recovery department. You should have between 2-4 years varied corporate experience gained with a leading practice and excellent interpersonal skills. A market leading benefits package, a structured career path as well as an interesting and varied case load can be expected. Ideally you should hold an accountancy qualification or be studying towards one.

53 Chandos Place, Covent Garden, London WC2N 4HS. Tel: 020 7812 6688

Interview with Stephen Speed

There could hardly have been more challenging economic conditions for Stephen Speed since joining the Insolvency Service eight months ago. During that time he has evaluated the structure, strategy and resources of the Service and made plans for significant changes – some of which are already underway.

How do you view the suggestion by HMCS (Her Majesty's Court Service) of a regulatory regime for Debt Management Plans? Is an IVA Mark 2 contemplated?

There needs to be a strong evidence base for policy making and, at present, it is not there in sufficient weight to come to a view.

> "The failure rate of Debt Management Plans (DMPs) is high, which suggests that maybe something needs to be done, but we need to be clear about the evidence first."

The Insolvency Service (IS) will make certain that there is evidence; it will also guide the direction of policy and help to ensure it is correctly positioned. The failure rate of Debt Management Plans (DMPs) is high, which suggests that maybe something needs to be done, but we need to be clear about the evidence first.

How concerned are you that the major creditors' hurdle rates for IVAs are preventing people from using a way out of insolvency that is approved by statute?

What governments try to do is create markets that work; they don't take a commercial position. In relation to Individual Voluntary Arrangements (IVAs), there is a lot of discontent between the creditors and the providers (many of whom are insolvency practitioners (IPs)) and the customer is being caught in the middle. The IS has taken a strong lead in bringing the parties together and has pushed the IVA process forwards by creating a protocol. This will help to create greater transparency for all parties. For instance, standard terms and conditions came in at the end of January 2008.

The protocol should give the customer more clarity and improve trust in the process. In this way, a government can lubricate a market without having to regulate it. My hope and expectation is that as the protocol starts to take effect financial institutions and creditors will start to see that excessive hurdle rates are not in their interest.

The Directors Disqualification Units only go after the easy cases in order to look good against their targets and tougher, more culpable directors are getting away with it. What are you doing about this?

I haven't seen any evidence that this is the case. And there are two pieces of evidence that suggest that it is not the case.

- Last year we disqualified 1,145 directors and of these 45 per cent were disqualified for six years or more – a very serious disqualification. This is not far short of the population we are going for.
- We also measure the average disqualification we attain. In 2004 it was 5.4 years and in 2007 it was 5.8 years, so it is rising. What is important is that we do need IPs to remain assiduous about submitting their disqualification reports to us within the six-month period.

Does the IS need a larger financial budget from BERR so that it can actively pursue all cases that deserve to be prosecuted?

We feel the funding we get from the Department for Business Enterprise & Regulatory Reform (BERR) is adequate to do the job; that is we are able to go after all >>

the cases we believe need to be gone after. We apply a rigorous public interest test as to whether a case should be pursued through to sanction and we believe that, within the budget, we are pursuing all the cases that merit being pursued.

We follow up the vast majority of cases in-house but pass some out to solicitor agents to pursue after the six-month period. We use agents for two main reasons because:

- the work load goes up and down and it provides a [manpower] buffer;
- some cases are very complex so we may not have the expertise in-house to deal with them. (We have an ambition to develop more expertise in-house as we think we can process the cases more cheaply. Using agents enables us to benchmark costs for this.)

“The protocol should give the customer more clarity and improve trust in the process. In this way, a government can lubricate a market without having to regulate it.”

Are you satisfied that ‘pre-packaged’ administrations are being properly managed by IPs and properly overseen by their regulators? What more might you want done?

Pre-packs are a useful market mechanism, which should give the best deal to creditors. It therefore follows that if we support pre-packs as a concept then we support the role of IPs in assisting with them. However, creditors sometimes complain that they aren’t told what is happening in advance and they can’t be sure that the pre-pack meets their needs. It is incumbent on IPs to think very carefully in the pre-administration stage about the relationship they have with the company they are working with and how transparent what they are doing is to the creditors. This is a regulatory issue but IPs have to be very careful about their reputation in this area.

There are two things coming out of the Joint Insolvency Committee (JIC) that will be of help with this.

A new Statement of Insolvency Practice (SIP) will tackle this point head on. It will be announced later this year and will be a big help.

An ethical code that the JIC is finalising for the IPs and their regulatory bodies will deal with how to avoid getting into positions where their objectivity and integrity could be compromised.

Pre-packs have given rise to some good solutions in which value is retained, jobs are retained and maybe even the directors are retained in a new framework. For the business that was struggling – one bound and it’s free. This can also be good news for creditors.

Do you foresee (and would you encourage) reductions in the number of licensing Recognised Professional Bodies (RPBs)?

You’d need to ask a minister the answer to that one. It is all laid out in statute and regulation. But I recognise that R3 has a position on this and it feels it would be good to streamline the process.

Is it justifiable that the individuals regulated directly by the Insolvency Service undergo ‘a lighter touch’ disciplinary regime than that of IPs who are regulated by other bodies?

I don’t believe our regulatory regime is a lighter touch. What is the evidence? In any regulatory system, people will tend to migrate to the lightest touch they can find but our directly regulated population has remained static for a very long time. If there were a seriously lighter touch regime then we would expect to see some of the people from other regimes migrating – and this is not happening.

However, the regime is different, but not light touch. We do have some quite strong sanctions and do not hesitate to use them. For instance, we can limit authorisation for short periods. If we limit it for less than 12 months then the IP has to pay his or her fees again for the year, and this is not an insignificant sum of money.

“They do a very important job in rescuing, turning around and propping up businesses in financial distress. But they always have to be aware of the perception of the market and be open and transparent.”

There are only 90 people regulated by the IS. This is about one in sixteen IPs. The reason we regulate some people ourselves goes back to the Human Rights Act. We cannot require individuals to go and join another (regulatory) body so we have to regulate them ourselves.

What advice would you give to IPs that would ensure continued, successful development of the profession in an increasingly competitive world?

Do everything you can to maintain and develop your individual professional integrity and the perceived reputation of your profession. There are lots of people out there who think that IPs are vultures hanging around the undertakers. That’s not the case; they have an important piece of the economic infrastructure to deliver. They do a very important job in rescuing, turning around and propping up businesses in financial distress. But they always have to be aware of the perception of the market and be open and transparent.

In this respect, the JIEB is important. You have something that shows that it is actually rather hard to get into the profession. IPs also need to keep up with policy making, and abreast of how ministers and the IS are thinking. They need to influence our thinking. It is important that R3 continues to be a very strong player bringing views and ideas to government and policy workers. For R3 to work, individual IPs need to support R3. We need a unified profession to talk to us as one powerful body.

What are your top priorities for the next 12 months and your longer-term aims for the future?

Since I came here eight months ago, I’ve been absolutely knocked over by the professionalism, commitment and enthusiasm of the IS. It does a good job and it is wonderful to have inherited that platform from Desmond on which to build. Some of the areas we are looking at are:

Strategy. I’m building the capacity at central office to develop a more strategic approach to our planning and also how we engage and communicate with the press. This is high on my list.

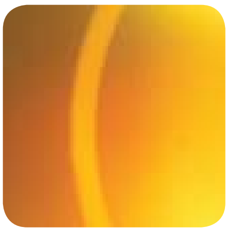
Technology. The big challenge over the next 12 months is to deliver a very large internal change programme called Enabling the Future. This is a 100 per cent revamp of every IT system coupled with new ways of working, for example hot-desking and encouraging more flex-working away from the office. We think our investment will pay off big time over five to six years and make this place more efficient and more economical to run.

Policy. Next April we will be introducing the Debt Relief Order (DRO). This is a brand new insolvency instrument very much in keeping with the government’s wider agenda in dealing with exclusion and financial exclusion. It is essentially a form of bankruptcy for those who need to go into bankruptcy but can’t afford to and for whom an IVA, or any other insolvency process, is not suitable. DROs provide a route into debt relief for people who have very little, through an intermediary such as the CAB.

A new instrument. There will be simplified IVAs. Originally IVAs were aimed at people who were trading but 90 per cent of IVAs are taken out by people who are not trading. There will be two sorts of IVAs to deal with both circumstances.

Other activities. These include policy evaluation (such as the evolution of the Enterprise Act) and sharing information with the insolvency profession. □

Stephen Speed was interviewed by **Sarah Houghton,** the publishing manager of ***RECOVERY.***




Insolvency Specialists

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Administrator – Court Work

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One of the world's largest accountancy firms has an opportunity for you to take responsibility for your own caseload. You will also assist senior staff in performing larger and more complex cases, whilst developing your knowledge through on-the-job experience.

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Accountancy Practice

Business Recovery Manager

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This well-known accountancy practice has a role offering responsibility for the planning, monitoring and review of work in the team. In addition, you will provide support to ensure timely and effective completion. Opportunities to continue developing technical skills will be available.

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Accountancy Practice

Business Recovery Senior Manager

£65,000-£80,000 + car — London

Working in an established firm, the purpose of this role is to provide senior leadership to the team. You will be undertaking business restructuring work including leading and managing cases and deputising for Partners in this challenging role.

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Accountancy Practice

Forensic Services Manager

To £65,000 + benefits — London

A fantastic opportunity has arisen within this famous accountancy practice. You will manage your own caseload of complex cases and be responsible for the timely delivery of services. If you are looking for responsibility on high risk appointments and are able to supervise junior staff, apply now.

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This executive role at a high profile firm will see you working closely with senior members of the team. You will monitor the work of junior staff whilst managing your own caseload of complex cases. You will also be conducting meetings with respondents and third parties in this exciting role.

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Business Recovery Assistant Manager

£45,000-£50,000 + benefits — London

A great role is available with this Top 10 firm. Responsible for undertaking business restructuring work, your role will involve day-to-day responsibility for assignments and supervising junior staff. You will also deputise for the Manager in all areas of review and monitoring and assist with planning.

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For independent and professional advice, our specialist corporate recovery consultant will help your career move in the right direction.

Established for over 28 years, Witan Jardine has strong links with the leading accountancy firms in London, the Home Counties and overseas.

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