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Spring 2015

RECOVERY

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Please contact me on **recovery@r3.org.uk**.

From the editor

There have been some interesting developments affecting insolvency practice in recent weeks. Our outgoing president, Giles Frampton, mentions several as he reflects on a busy year in office on page 6. Mike Cherry of the Federation of Small Businesses gives an external perspective on page 47.

The Insolvency (Amendment) Rules 2015 were published on the day I wrote this editorial. Readers may not be aware either how close we came to the abolition of time costs as a payment mechanism for IPs or of the speed with which what Giles refers to as the Government's final proposals have been enacted. Estimates and caps will be a defining feature of IPs' fees from 1 October this year although not in VAs or MVLs.

Most readers will be aware of R3's successful *Jackson Campaign*, which extended the exemption from the ban on recovery of CFA uplifts and ATE premiums that had been due to expire in April 2015. As Giles says on page 6, *'We have not reached the end of the campaign'*. We only have an extension of time. While many of us think it right that the exemption be made permanent in due course, Peter Sharp's article on DBAs at page 32 looks at how we might fare without an exemption.

R3 has, in my view, done a great job establishing the creditor microsite at www.creditorinsolvencyguide.co.uk. IPs directing unsecured creditors to somewhere that helps them understand insolvency processes from their own perspective will be valuable in encouraging creditors to engage. No panacea perhaps, but engaged creditors will be needed if caps in fee estimates are to be raised.

It is not just domestic legislation that affects IPs. We have all got used to the European Insolvency Regulation, but now there is to be a new one. At the time of writing, a draft, which is expected to be reasonably final, is available on the website of the European Council. Jennifer Marshall explains its implications on page 7.

Interest rate hedging product mis-selling remains on the agenda with the FCA recently having extended the redress scheme to caps. Sam Roberts explains on page 40 some recent developments in the courts – even relating to the limitation problem – that suggest there may be more mileage in some of these claims than perhaps have yet been identified.

Congratulations to the successful JIEB candidates listed in our supplement. Insolvency work is just as challenging and somewhat more exciting when you leave the examination room!

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

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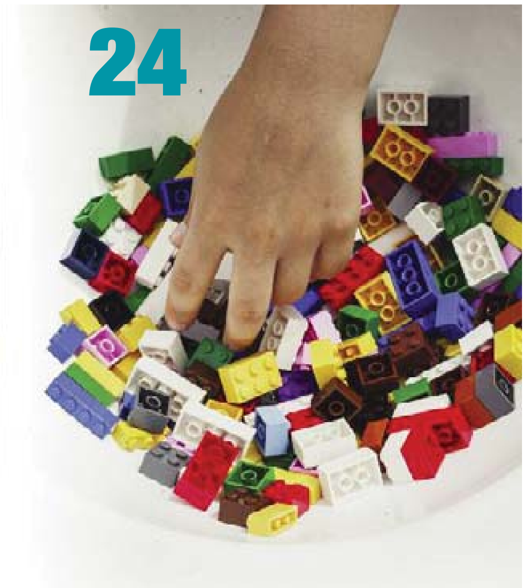

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Maximum sentence for fine wine investment scam director

The man behind Bordeaux Fine Wines Ltd (BFW), Kenneth Jean Pierre Gundlach, has been banned from acting as director of a limited company until 2030 after The Insolvency Service discovered he conducted a lavish lifestyle at the expense of his investors. Mr Gundlach failed to purchase and store £9m worth of wine he had sold to investors. Instead he took dividends of more than £10m from the company, spending the money on racehorses, private jet hire, performance cars, designer clothing and bespoke jewellery. An office Christmas party cost the business £38,500.

As part of its investigation a specialist unit within The Insolvency Service discovered that more than £19m worth of wine – nearly 3,200 cases – was sold to members of the public as an investment. However, only 780 cases were found stored at BFW's bonded warehouse. They were sold by liquidator, David Ingram of Grant Thornton UK LLP, for £1,513,150 before costs. At the time of going to print Mr Ingram had received claims from investors and creditors totalling £57,697,885 (including a claim from HMRC for £15,875,210), which are yet to be adjudicated. Investors and creditors who have not submitted a claim in the proceedings should email the liquidator's office: matthew.d.vines@uk.gt.com.

Bans for directors of payroll service provider company

Brothers who paid a connected business before their creditors as their company failed have been banned from acting as directors. Stephen and Martin Melville, directors of Anderson Beckette Ltd, transferred nearly £1m to a connected company, even though they owed close to £11m to other creditors and knew a resolution had been agreed to place Anderson Beckette into liquidation. Their Glasgow-based company, which operated as a payroll services provider, was wound up with debts of more than £4.5m following a petition by HMRC. Stephen Melville (48) was banned for nine years, his younger brother, Martin Melville (46), for eight years at Glasgow Sheriff Court.

Group leader of Insolvent Investigations North, Robert Clarke, said: 'Directors who put the financial interests of connected parties above those of third party creditors damage confidence in doing business and are corrosive to the health of the local economy. This ban should serve as a warning to other directors tempted to help themselves first; you have a duty to your creditors and if you neglect this duty you could be investigated by the Insolvency Service. The length of the disqualification sends a clear message to others about how seriously such misconduct is considered by the Secretary of State.'

Paper manufacturer in administration

Aylesford Newsprint, the Kent-based paper manufacturer and recycling firm has gone into administration. Back in 2012, when Aylesford Newsprint was bought by the Martland Holdings Company, it boasted revenues of around £143m. As the UK's leading producer of recycled newsprint Aylesford Newsprint employed 300 people.

New chief executive at The Insolvency Service

Sarah Albon has started her role as the new chief executive at The Insolvency Service this month. Ms Albon, who was previously director of strategy and change at HM Courts & Tribunals Service, said she was looking forward to working with industry partners and across government as they sought to deliver changes debated in Parliament.

Buyout of construction company secures 70 jobs

Seventy jobs have been secured at Minshall Construction after the firm was sold as a going concern to a new company, Minshall Construction (UK). However, 30 roles had been lost prior to administrators being appointed. Cash flow issues were blamed for the difficulties faced by the firm, which supplied agricultural steel buildings and structural steelwork from its Market Drayton base.

Arvindar Singh-Sall, director and joint administrator at FRP Advisory, said he was delighted to have secured the future of the Shropshire business while also ensuring minimal disruption to customers and suppliers.

President's column

Giles Frampton reviews his year in office.

As I have written on these pages before, this Parliament, which has coincided with my time as chairman of the R3 General Technical Committee and membership of the R3 executive, has seen a deluge of new legislation, reviews, and consultations affecting the insolvency profession.

Jackson exemption

One particular topic that has been with us throughout the five years of the Parliament is the legal funding changes triggered by the Jackson Report, which was published shortly before the last election, and the subsequent 2012 Legal Aid, Sentencing and Punishment of Offenders (LASPO) Act.

As you will no doubt be aware the exemption for insolvency litigation that had been due to end in April 2015 has been granted a further unspecified period of exemption. While this is excellent news it is not the end of the campaign – the Ministry of Justice has said that the extension is to allow the profession more time to adapt. We must therefore be prepared to reiterate our arguments about the benefits of the exemption and to provide further evidence. If you have a case that has only been viable because of the existing exemption please share it with the team at R3.

The fact remains: exempting insolvency litigation from the LASPO Act achieves what the Jackson Report intended. Until there is a permanent exemption, we need to keep up the pressure on government.

The change in stance from the government has followed months of increasing pressure. In February, business minister Dame Neville-Rolfe promised to take the issue up with the Ministry of Justice; in the Commons, over 60 MPs signed an early day motion (effectively a parliamentary petition) calling for a review of the government's position. The motion was the result of R3 members' meetings with MPs in the North East and many of the signatures to the motion are from those MPs contacted by R3 members throughout the country.

May I record our thanks to all those who have helped achieve this result.

Continuity of key supplies

Another project that has required R3's attention over the course of this Parliament has been our 'Holding Rescue to Ransom' campaign to ensure the continuity of key supplies during business rescue procedures. This campaign has grown from a suggestion at R3's Policy Group to being enshrined in legislation; the changes were introduced in the 2013 Enterprise Act and will come into force from October this year.

Although the final legislation does not go as far as we'd hoped, and indeed, could be undermined in practice by the requirement for office-holders to provide a personal guarantee that supplies will be paid for, it is an achievement to get these changes on to the statute book. We will keep a close eye on how the legislation works in practice and will put pressure on government to review if needs be.

Fees

In a double dose of important news in early 2015, we now have the final proposals from the government on updating insolvency fees. Again, this is a topic that has been with us from the beginning of this Parliament with an Office of Fair Trading report in 2010, the Kempson Review in 2013, initial proposals from government in 2014, and now, a year later, the final government proposals.

> "There will be some bumps to iron out, but it will be up to the profession to make the new system work."

Compared to what was presented by the government last year, the requirement for IPs to provide creditors with an estimate of time-costs is a practical and acceptable proposal. A ban on time-costs in certain situations, as was put forward, would have been unfair to both IPs and creditors. It would not have worked.

The Insolvency Service's willingness to listen to feedback on fees over the last year has been encouraging, and I think the up-front estimate system is a positive outcome for the profession. There will be some bumps to iron out, but it will be up to the profession to make the new system work – the status quo on fees was unacceptable as far as the government (and others) was concerned. The profession has an interest in making the estimate system work – I doubt we would like the potential alternatives.

Pre-pack pool

There is another long-running policy issue still to wrap-up; the 'pre-pack pool' proposed by Teresa Graham. As with fees, the proposal has required (and still requires) much refining, but progress is being made as we wait for an official launch.

One of the most striking aspects from the Graham and Kempson reports is the number of positive things they had to say about the existing insolvency regime alongside suggestions for improvement.

Criticism comes with the territory as an IP and a profession – and there are improvements that we can make to how we work – but the work we do is valuable and that value is increasingly recognised.

New website

An important factor in having this value recognised and maintaining confidence in our regime is to ensure that it is as transparent and accessible as possible. Creditor engagement is important to fee-setting and the process generally but creditors sometimes 'lack knowledge and understanding of the insolvency process and their rights' (Kempson). It's important that we help address this knowledge gap, which is why R3 has launched a new website designed to help unsecured creditors navigate their way through the insolvency process. You can find it at www.creditorinsolvencyguide.co.uk.

I am also delighted to welcome Encompass – a new R3 key sponsorship partner for 2015. We are very pleased to have the organisation on board as it begins its UK launch within the insolvency sector.

Time to hand over

This is my last president's column so it is time for some valedictory words. It has been a fascinating, enjoyable – and productive – year, and I am honoured to have undertaken the role. R3 is an active and effective organisation and has a first class team at '120' but please remember your continued participation, whether locally or nationally, is also vital.

I should like to thank both members and staff at R3 for all their support and encouragement. Phillip Sykes assumes the presidential chain of office at the AGM on 24 April – it will fit him admirably. I thank him for his support and counsel and wish him well in the task.

GILES FRAMPTON is the president of R3 and a partner at Richard J Smith & Co.

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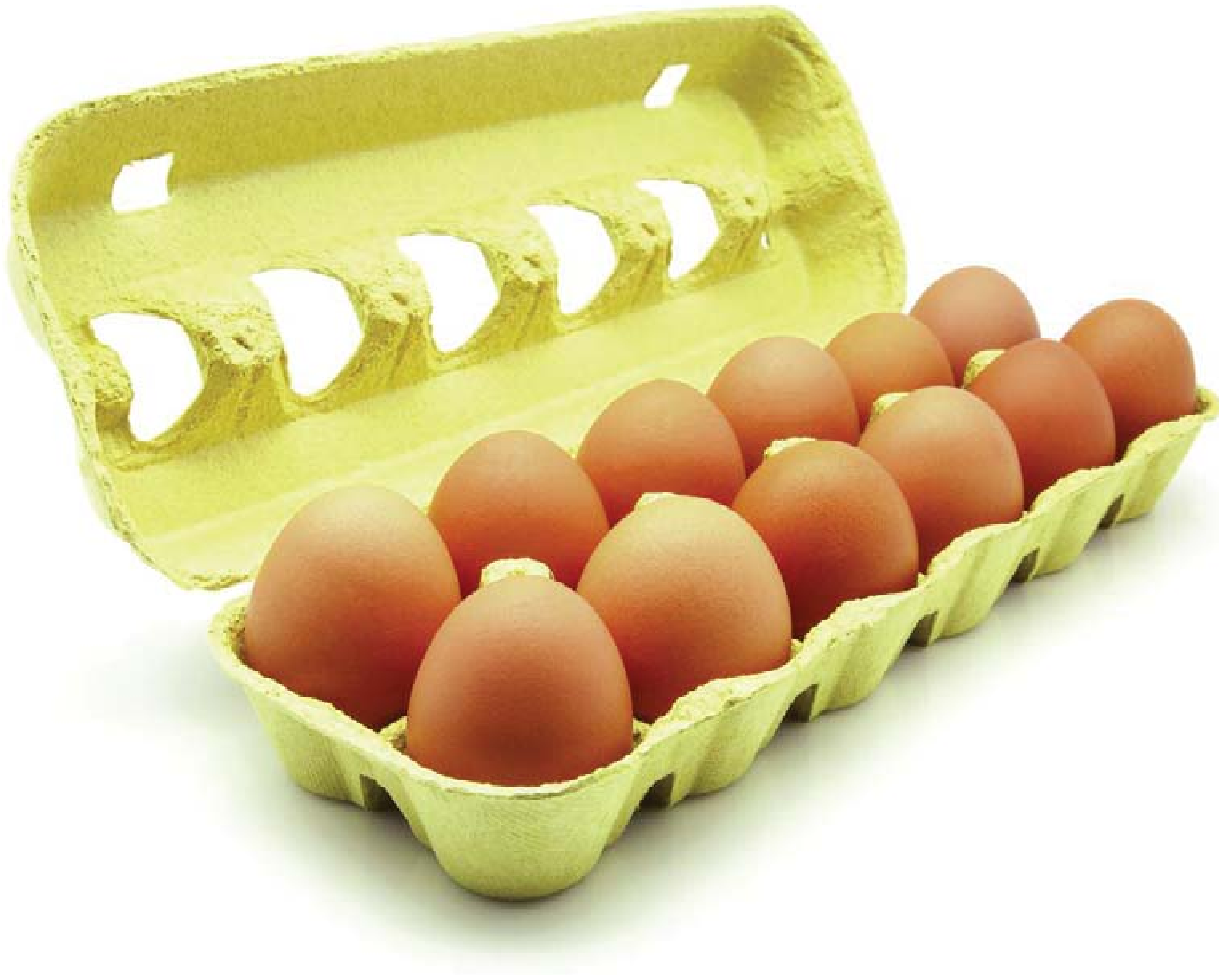

Plus ça change…

Jennifer Marshall asks whether the changes to the European insolvency regulation will make any difference in practice.

After more than 12 years and numerous cases before the Court of Justice of the European Union (CJEU), Council Regulation (EC) 1346/2000 on insolvency proceedings (the regulation) is being overhauled. A recast of the regulation is now going through the final legislative hurdles and is likely to enter into force sometime in the early part of 2017.

> Many UK practitioners were tempted to apply the maxim if it ain't broke, don't fix it.

Negotiations between the European Commission, Council, Parliament and member states were not always smooth but we now have a final text of the recast with changes that are designed to enhance the effective administration of cross-border insolvency proceedings. The intention is that the 'new and improved' regulation will rectify some of the issues that have arisen in practice and help to promote an EU rescue culture.

The regulation, when first introduced, changed the landscape for those conducting EU cross-border insolvency cases. Many UK practitioners were tempted to apply the maxim 'if it ain't broke, don't fix it'. But this was the minority view and changes were inevitable. So what changes are proposed and will these result in an improvement for EU practitioners?

Modernising the scope – but schemes are out

A key element of the regulation is the automatic EU-wide recognition given to insolvency proceedings; a main insolvency proceeding opened in one member state must be recognised by all other EU member states. However, the regulation currently only applies to collective insolvency proceedings that divest management of some or all of their powers and result in the appointment of an insolvency office-holder (essentially the more traditional insolvency processes that may not be aimed at company rescue). The recast will expand the scope to include pre-insolvency or rescue proceedings (ie proceedings that are commenced to avoid insolvency) and certain interim and debtor-in-possession proceedings where existing management is left in place.

> The UK does not intend to list schemes of arrangement in Annex A.

Further, and importantly, where pre-insolvency or rescue proceedings are being used, 'collective proceedings' will be revised to mean proceedings that include all or a significant part of the creditors to whom the debtor owes a substantial proportion of his outstanding debts, provided that the claims of creditors who are not involved remain unaffected. This » will allow proceedings that target the key areas of financial distress to fall within the regulation.

Proceedings within the scope of the regulation will be listed in Annex A to the regulation (which will be definitive as to which proceedings are within scope). The UK does not intend to list schemes of arrangement in Annex A (and a new recital to the regulation providing that 'proceedings that are based on general company law not designed exclusively for insolvency situations should not be considered to be based on a law relating to insolvency' gives force to this decision). Schemes are an effective and flexible tool used in distressed scenarios and can deliver successful restructurings for non-UK companies. An English court need only find that there is 'sufficient connection' with the jurisdiction in order to sanction a scheme. This can comprise of English law governed finance documents; the debtor does not need to have a UK centre of main interests (COMI) or establishment as would have been required if schemes had been listed in Annex A. We have therefore preserved our flexibility re schemes at the price of forgoing automatic EU recognition.

> "Schemes are an effective and flexible tool used in distressed scenarios and can deliver successful restructurings for non-UK companies."

Whether other EU member states are going to be less willing to recognise the English scheme when the changes come into force remains to be seen.

A number of jurisdictions (including Spain, Germany and the Netherlands) have been modernising their composition or rescue proceedings. When these proceedings are given automatic EU recognition as a result of the changes to the regulation, it will be interesting to see whether the English scheme remains the procedure of choice. Much will depend though, on the speed of access to, and flexibility of, the courts in these other jurisdictions. The English scheme has the advantage of being tried and tested; the creditors know what the outcome is likely to be.

Good COMI shifting versus abusive forum shopping

Relocation of a company's COMI caused considerable debate during the negotiations to amend the regulation. While concerns largely focused on individuals relocating their COMI (so-called 'bankruptcy tourism') I have focused on corporate COMI relocation in this article. The regulation applies to a company that has its COMI in an EU member state and main insolvency proceedings can only be opened in the member state where the company has its COMI. COMI is presumed to be located in the jurisdiction of the company's registered office unless evidence is shown to the contrary. Given this rebuttable presumption, businesses have successfully relocated their COMI to take advantage of the insolvency laws of another EU jurisdiction. This has usually been the case where the domestic insolvency laws did not have the tools needed to fix the problem. In particular, a number of successful restructurings have been delivered by shifting the COMI of a company to the UK. This has led to some fairly wild accusations including, for example, that the UK was at risk of becoming the 'insolvency brothel of Europe'. Essentially there was a failure to see that legitimate movements of COMI had helped to save viable companies, preserved value for creditors and avoided job losses.

To address the issue of 'abusive forum shopping' (where a company may attempt to move to another jurisdiction to the detriment of the general body of creditors) a number of 'safeguards' were considered. One proposal was to have an arbitrary three-month 'look back' period for the purposes of determining COMI; fortunately this has not been included in the recast. Instead, where a company's registered office has moved within a three-month period prior to the opening of insolvency proceedings, the rebuttable presumption that its COMI is in the jurisdiction of its registered office will no longer apply. Given that a company's registered office is not usually moved to effect a COMI shift, it is highly unlikely this provision will make any difference in practice. In addition, a new Article 4 (*Examination as to jurisdiction*) requires the court to actively examine the location of a company's COMI. The court can ask for additional evidence to support the COMI finding and, for transparency, must set out the reasons for accepting jurisdiction. Where insolvency proceedings are opened without a court decision – for example, our out-of-court administration or creditors voluntary liquidation (CVL) – the office-holder will need to examine whether the member state has jurisdiction. Office-holders may have concerns about making these determinations and difficult cases may end up before a court. The debtor or any creditor may also challenge the decision on grounds of lack of jurisdiction.

The proposed amendments should not curb COMI shifts designed to ensure a better outcome to stakeholders but ensure that a certain amount of scrutiny is carried out regarding whether a COMI shift is genuine. New recitals to the regulation will expand on the meaning of COMI and the circumstances in which the registered office presumption can be rebutted. These recitals largely reflect the guidance set out by the CJEU in the *Interedil* decision[1] and give significant weight to 'head office functions' in the COMI assessment that, again, will support legitimate COMI shifts. In practice, the UK courts have usually been diligent with respect to 'abusive forum shopping' and the new amendments will provide for more transparency between courts across the EU.

Secondary proceedings – real or synthetic

A secondary proceeding can be opened where a debtor has an establishment. At the moment, secondary proceedings can potentially obstruct the efficient administration of a cross-border estate. For example, currently secondary proceedings can only be liquidation proceedings (so a debtor can only be wound down, rather than rescued) and they can be opened without reference to the main proceedings (where the office-holder may be attempting to rescue the business). There may also be extra costs involved in having dual proceedings, thereby reducing the overall return to creditors.

> "Businesses have successfully relocated their COMI to take advantage of the insolvency laws of another EU jurisdiction."

The amendments aim to deal with these issues in two principal ways:

i. first, to allow for any secondary proceedings to be those that fit best with the main proceedings (so that the aims of main and secondary proceedings can be aligned); and
ii. secondly, any court to which a request is made for secondary proceedings to be opened must give the main office-holder notice of the request; the main office-holder will have the right to be heard and to challenge the opening of secondary proceedings that can also be stayed for up to three months to allow for negotiations between the debtor and creditors, provided suitable measures are in place to protect the interests of local creditors.

In addition to broadening the scope of what qualifies as a secondary proceeding and providing for mandatory cooperation and communication between the courts and office-holders across jurisdictions, the amendments also allow for local creditors to be protected without the need for formal secondary proceedings by introducing so-called 'synthetic secondary proceedings'. Main proceeding office-holders will be able to offer, with approval by a qualified majority of local creditors, an undertaking to protect local creditors in other member states. The undertaking will be to respect any local priority rights as if (but without) local secondary proceedings being opened. While this codifies the approach taken by English administrators and courts in insolvencies such as *Collins & Aikman* and *MG Rover* it does so with additional hurdles and complexities. Given that this power was already available under English law, the undertaking is likely to be more relevant in European jurisdictions where, prior to this amendment, the main proceeding office-holders could not have adopted this approach.

While the changes help promote cooperation and rescue by reducing the importance of secondary proceedings, there remains a concern that the interests of local creditors are given too much weight when compared with the interests of creditors as a whole. For example, synthetic secondary proceedings (with qualified majority voting) allow local creditors (but not creditors in the main proceedings) to choose which set of distribution priorities they prefer, those in the main proceedings or those in the secondary proceedings.

Group coordination proceedings

The potential introduction of a group insolvency regime was the subject of much debate. While the European Commission had initially suggested a flexible and light touch framework for the better coordination of group insolvencies, the European Parliament favoured a mandatory group coordination regime. The recast regulation is a compromise, introducing a voluntary regime for the insolvency of a group of companies. This involves the appointment

> "The UK was at risk of becoming the insolvency brothel of Europe."

of a group coordinator who, among other things, can propose a group restructuring plan. Individual group companies will have the right to opt out of the 'group coordination proceedings' if it is not in the interests of their particular creditors. Equally, insolvency office-holders of participating group companies are only obliged to consider the recommendations of the group coordinator when conducting their insolvency proceedings; the recommendations are not automatically binding on participating companies. Given the voluntary nature of the group coordination proceeding, the added layer of complexity and costs that such proceedings will entail (together with the potential delays to the resolution of individual company proceedings) it is unclear whether such proceedings will be useful in practice.

Applicable law – the missed opportunity?

While some useful clarification has been provided in relation to where assets are located for the purpose of the regulation, it is disappointing that the recast does not address a number of issues that come up in practice in relation to applicable law (primarily in relation to Articles 5–15 of the

regulation). It is understood that amendments in this sphere were placed in the 'too difficult' box – so it is left to the courts to provide assistance here.

By way of example, guidance has recently been provided by the Court of Justice of the European Free Trade Association states (the EFTA Court) on Article 30 of directive 2001/24/EC on the reorganisation and winding-up of credit institutions (CIWUD) regarding transaction avoidance. Article 30 provides a defence where a transaction is vulnerable pursuant to the law of the state where the insolvency proceedings have been commenced provided that the transaction is incapable of being challenged pursuant to the law that governs the transaction (the applicable law). While the EFTA court's decision concerned CIWUD, the guidance will also be useful when considering the equivalent Articles 4(2)(m) and 13 of the regulation as the provisions in CIWUD are substantially the same as those in the regulation.[2]

The EFTA Court confirmed that, where the act detrimental to all the creditors is capable of challenge in principle (but not in fact) under the applicable law (for example where the act could be challenged as a transaction at an undervalue but, on the facts, the hardening period has expired) then the Article 30 defence may be available. It is necessary to consider the facts of the case in question, including any procedural laws that mean that the avoidance claim would, for example, be time barred. Therefore even where the act may be challenged in principle under the applicable law, it will be sufficient for the defendant to prove that the requirements for such a challenge are not fulfilled in the specific case in hand.

Further, the EFTA court emphasised the broad manner in which Article 30 is drafted. One key issue for practitioners has been how the phrase 'any means' should be reconciled with the words 'in the case in point'. For example, if a transaction is challenged as a preference in the main proceedings, is it only necessary to consider the equivalent preference provisions under the applicable law or could other provisions of the applicable law be taken into account (including non-insolvency specific provisions)? The EFTA Court has confirmed that, as long as the act is regarded as detrimental to the entire mass of creditors, it does not matter whether a possible challenge under the applicable law is classified as part of the insolvency law. This indicates that, when considering 'any means' of challenge, all grounds of challenge should be considered, both insolvency and contractual (and potentially wider).

…and finally

CIWUD has been amended by the directive establishing a framework for the recovery and resolution of credit institutions and investment firms (BRRD). These changes extend the scope of CIWUD to investment firms and confirm that resolution tools and powers under BRRD will be reorganisation measures for the purpose of CIWUD.

> "It is necessary to consider the facts of the case in question, including any procedural laws that mean that the avoidance claim would, for example, be time barred."

BRRD and the changes to CIWUD have now been enacted into UK law and it is fair to say that there will be some challenges ahead in the future untangling some of the legislation. As a starter for ten, for example, there now appear to be scenarios involving 'banking group companies' where CIWUD and the regulation may apply at the same time! Hence although the recast of the regulation may have resolved some of the uncertainties, there will still be plenty of fun and games for EU practitioners in the years to come.

1. C-396/09.
2. A decision of the EFTA court is not binding in EU member states. However, generally, such decisions are seen as highly persuasive, and it is expected that the CJEU and EU member states' courts will have regard to the EFTA court's decision when considering the relevant provisions under CIWUD and the regulation.

JENNIFER MARSHALL is a partner at Allen & Overy LLP.

The past, the present and the future

Eileen Blackburn, chair of STC, considers its work and looks forward to the work it will do in the future.

In this, Scottish Technical Committee's (STC) 20th year, it seems appropriate to look back at the valuable work it has carried out for the wider Scottish insolvency and recovery community during that time.

STC is essentially a subcommittee of the General Technical Committee (GTC). R3 has no physical presence in Scotland in terms of premises and staff and as such, R3 entered into an agreement with the Institute of Chartered Accountants of Scotland (ICAS) to provide the secretariat to STC. This arrangement is well established and over the years I have been fortunate enough to work with ICAS staff Anne Bryce and Ann Condick who are both now retired, Setutsi Van Lare and, more recently, David Menzies who has just been appointed as full-time insolvency director having completed a fixed-term, part-time contract at ICAS at the end of December 2014. The support of ICAS over the last 20 years has been essential to the performance of STC. We are also grateful to the on-going contribution of GTC and John Francis who as technical director of R3 sits on STC and provides valuable technical and cross-border input.

Over the years we have been involved in various ad-hoc pieces of work as well as a number of on-going projects, including 'Scottifying' the Statements of Insolvency Practice (SIPs), drafting help sheets and creditor guides, responding to consultations, liaising with the Scottish government and the Accountant in Bankruptcy (AiB), and liaising with the Scottish Courts' Administration and the Sheriffs' Association.

The practice has been for the SIPs to be drafted for England and Wales and then for STC to produce a Scottish version. The SIPs are then approved by JIC and then issued by the respective RPBs.

> "The last 18 months have been particularly busy for the committee with multiple Holyrood and Westminster consultations to consider."

Under the leadership of its first chair of STC, Neil McNeill, now retired and formerly of BDO, I recall being drafted on to the subcommittee that worked on the first version of SIP 9 (Scotland). This work has remained a work in progress and we have recently set up a sub-committee to look at revisions to SIP9 following legislative changes in Scotland.

Neil was followed by Gordon Christie in the role of chair and I took over from the longest serving incumbent, Rachel Grant in March 2013. Rachel served for more than ten years, and surely deserved to shed the responsibility after such a lengthy period in office.

One of the most significant consultations we responded to was the review on Scottish devolution led by Sir Kenneth Calman. The commission began its work in 2008 and published its final report on 15 June 2009. The committee provided written evidence and Rachel Grant as chair of STC and Eileen MacLean as council member for R3 provided oral evidence to the commission. We provided examples of the practical difficulties caused by part of corporate insolvency being devolved and part being reserved to Westminster and recommended re-reservation of corporate insolvency to Westminster with suggestions about how this might be achieved.

The last 18 months have been particularly busy for the committee with multiple Holyrood and Westminster consultations to consider as well as (together with ICAS and the IPA) engaging with the AiB on a regular basis to resolve on-going practical insolvency issues. Latterly we have been in dialogue with the AiB in relation to establishing a level playing field among insolvency practitioners in the calculation of equity in the debtor's family home, and how it is

dealt with in protected trust deeds. We are also actively involved in the re-drafting of the AiB's notes for guidance for trustees and new notes for guidance on the preparation of trustees' accounts.

Along with ICAS and the IPA we gave written and verbal evidence to the Scottish Parliament on the Bankruptcy and Debt Advice Scotland Bill 2013 in October of that year. Subsequently in collaboration with ICAS we were able to influence a significant number of amendments being made to the bill to make the final Act more workable. The bill is due to be enacted on 1 April 2015.

More recently we commented on the BADAS Regulations that were laid before the Scottish Parliament in September 2014 and which come in to force on 1 April 2015.

STC has been represented on the SIP 16 Working Group, which has been looking at a revised SIP16 and which considered Teresa Graham's recommendations in her report to the UK government on her review into pre-packaged administrations. At this time we know that the recommendations have been accepted and applications are being invited for membership of the 'pre-pack pool' (IPs need not apply!).

We also fed in to the R3 response to the draft De-regulation Bill on the issue of partial licensing of insolvency practitioners. An amendment was made to the draft bill to recognise the differing legal status of Scottish partnerships as opposed to the UK position.

2014 was an exciting year for Scotland. We had the Commonwealth Games in Glasgow, with an opening ceremony featuring Tunnocks' Tea Cakes and other national treasures including Karen Dunbar and John Barrowman not to mention an army of Scottie dogs as mascots to the teams. We also had the Ryder Cup with another success for the European team (though no repeat of Andy Murray's Wimbledon success unfortunately).

Putting to one side international sporting events, by far the biggest event of the year was the independence referendum, and did that not produce some surprising consequences? Additional powers promised for the Scots, the on-going debate on the Barnet formula and of course the West Lothian question being thrust into sharp focus.

> "The Scottish rules require a wholesale overhaul and are not fit for purpose."

The Smith Commission, chaired by Lord Smith of Kelvin was set up to make recommendations to bring some sense to the promises made in the immediate pre-referendum period and to comment on scope for further devolution of powers.

STC wrote to the Smith Commission stating members' position on the prospect of further devolved powers for Holyrood in relation to insolvency matters. Quite simply we feel that it was appropriate to restate our position as it had been advised to the Calman Commission, and that there should be no further devolution of power in relation to corporate insolvency matters. Given that the responses to the Smith Commission were expected to suggest which areas may benefit from further devolution and how this might be achieved, it was no surprise that there was no mention of insolvency within the report when it was issued. The Scottish rules require a wholesale overhaul and are not fit for purpose. This issue has been dragging on for some considerable time now and we do need to see some progress being made. We have now been advised that work cannot start on the Insolvency (Scotland) Rules until after submission of the England and Wales rules to the IRC. We understand the England and Wales rules are to be laid in October 2015 and it may still be possible to 'catch up' with the Scottish rules being introduced in 2016 along with the England and Wales rules.

And as for the future – I am sure we will continue to be presented with technical and practical challenges in the coming year. I am not quite ready to hang up my spurs yet and it is my sincere hope that I do not reach retirement before the long-running saga that is the revision of the Scottish Corporate Rules is resolved but we will just have to wait and see.

EILEEN BLACKBURN is head of business recovery at French Duncan LLP.

Preference and priorities

Harriet Dillistone explains the new two-tier system of preferential debt.

The Banks and Building Societies (Depositor Preference and Priorities) Order 2014 came into force on 1 January 2015, creating a new two-tier system of preferential debt. The changes are mainly effected through amendments to Schedule 6 of the Insolvency Act 1986 (the Act) and apply to insolvency proceedings opened on or after 1 January 2015.

Ordinary preferential debts and secondary preferential debts

The new provisions distinguish between ‘ordinary preferential debts’ and ‘secondary preferential debts’. Debts in the same tier rank equally among themselves but ordinary preferential debts rank ahead of secondary preferential debts.

Ordinary preferential debts include all the previous categories of preferential debt in the Act, namely contributions to occupational pensions schemes, employee remuneration and levies on coal and steel production, but also a new category: deposits that are eligible for compensation[1] under the Financial Services Compensation Scheme (FSCS) and are within the recoverable £85,000 limit. In a bank or building society insolvency, the FSCS compensates depositors up to a maximum of £85,000 and is then subrogated to the rights of the depositors.

> “The UK adopted depositor preference because it was required to do so under an EU directive.”

Previously, the FSCS ranked as an unsecured creditor in respect of deposits to which it was subrogated. Now, it will rank as an ordinary preferred creditor and is thereby elevated in the order of payment priority.

Secondary preferential debts include two types of deposit placed by a customer with a bank or building society.

- The first is where a depositor is eligible to claim from the FSCS but his claim exceeds the £85,000 limit. Here he will rank as a secondary preferential creditor for the excess.
- The second is a deposit that would have been eligible for compensation from the FSCS had it been made through an EEA branch of an authorised EEA credit institution, but was actually made through a non-EEA branch.

Comment

Depositor preference reduces the risk of the FSCS only recovering a pro rata share on the amounts it pays out. The risk is lower not only in an insolvency, but in a bank resolution featuring bail-in because the claims of shareholders, subordinated debt holders and unsecured senior creditors would be bailed in to absorb loss before the FSCS would be called upon in an ultimate bank failure.

The UK adopted depositor preference because it was required to do so under Article 108 of the Bank Resolution and Recovery Directive EU 2014/59 (the BRRD). EU member states needed to implement the majority of the BRRD’s provisions by 1 January 2015. The EU Commission initially proposed two options for structuring depositor preference: (a) that only deposits covered by the FSCS up to the statutory limit would be preferred; and (b) that both deposits covered by the FSCS and deposits in excess of the statutory limit would be preferred. The final text of the BRRD went a step further than the initial proposals since even deposits that are ineligible for FSCS protection are now preferred.

The BRRD aims to establish a regime for resolving failing banks outside of normal insolvency procedures and contains resolution objectives that are reflected in Article 108. These include avoiding significant adverse effects on the financial system, minimising reliance on public financial support and protecting depositors. Aside from the obvious advantage to the public of protecting depositors, depositor preference should increase depositor confidence and promote the stability of deposits as a source of bank funding. The rationale is assumed to be that if depositors are more likely to recover their money (even where it exceeds the £85,000 FSCS limit) the likelihood of a run on the bank may decrease, thereby reducing the risk of market contagion.

The downside of depositor preference is that lenders to banks are ranked lower in the insolvency hierarchy and consequently may require higher returns on a riskier investment, increasing funding costs for banks. Conversely, it is possible that depositors may experience lower returns as a trade-off for their elevated ranking. If so, the cost of reducing the FSCS’s exposure may ultimately be borne by depositors.

The recent changes raise the question of whether we can expect further modifications to the preferential debts regime. Remuneration of employees is one category that is ripe for review. The Insolvency Proceedings (Monetary Limits) Order 1986 set a cap on the amount of remuneration (owed to an employee on an

> “It is possible that depositors may experience lower returns as a trade-off for their elevated ranking.”

employer’s insolvency) that can rank as preferential debt. The cap was set at £800 in 1986 and has not been raised since. It is difficult to see how this figure continues to be appropriate today, almost 30 years later. However, it remains to be seen whether the UK government will make changes to this category of preferential debt without the impetus of an EU directive. □

[1] Only certain depositors are eligible to claim under the FSCS compensation rules, namely individuals, micro-enterprises, small enterprises or medium-sized enterprises. Large enterprises are generally excluded.

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Recent case summaries

Latest insolvency update from **Matthew Weaver**.

Personal insolvency

***Horton* v. *Henry* [2014] EWHC 4209 (Ch)**

Facts: Mr Henry was born on 7 October 1954 and was aged 60 at the date of the hearing. He was declared bankrupt on 18 December 2012. As at the date of his bankruptcy, Mr Henry had four different pension policies that did not form part of his bankruptcy estate. Mr Henry's trustee in bankruptcy, Mr Horton, applied under section 310 of the Insolvency Act 1986 (the Act) for an Income Payments Order (IPO) in respect of the pension policies. While Mr Henry had not sought to draw down on any of his pension policies and was not receiving any income from them at the time of the application, the terms of his pension policies entitled him to draw down on them from his 55th birthday onwards. Such a drawdown could be done in a number of different ways, producing various amounts of lump sum payments and income streams. The trustee sought an order for a payment from Mr Henry of sums equivalent to 25 per cent of the pension policies (the maximum sum that was currently able to be drawn down tax free) together with any further income as might be derived from the policies for the following three years (the maximum duration for an IPO). Mr Henry opposed the application and stated that he did not intend to crystallise his pension benefits in the foreseeable future.

> “The judge concluded that no evaluation of what is fair and reasonable as between the competing interests of a bankrupt and his creditors ought to be conducted.”

The Deputy High Court Judge, Robert Englehart QC, observed that he was being asked to cause the bankrupt, Mr Henry, to exercise his rights to crystallise his pension policies in a way determined by the trustee contrary to Mr Henry's wishes. In refusing the application for an IPO, the judge acknowledged that he was departing from the decision in *Raithatha* v. *Williamson* [2012] 1 WLR 3559, a decision of Bernard Livesey QC, sitting as a Deputy High Court Judge, in which a very similar application was granted.

The judge concluded that no evaluation of what is fair and reasonable as between the competing interests of a bankrupt and his creditors ought to be conducted; only the determination of what surplus is available to a bankrupt from income to which he is entitled or will become entitled after deduction of reasonable domestic needs. The judge considered previous cases, academic commentary and the underlying statutes, both the Act and the Welfare Reform and Pensions Act 1999 (the WRP Act), and concluded that while payments received by bankrupts from pension policies can form the basis for a proper application under s310 of the Act, a bankrupt is not and does not 'become entitled' to payments under an uncrystallised pension policy until he elects to draw down on them. As such, no IPO can be made in respect of uncrystallised pension policies notwithstanding that the bankrupt has the right to draw down on the same at his election (as Mr Henry did) but has chosen not to do so.

The judge went on to conclude that the court had no apparent power under s310 of the Act to decide in what way a bankrupt should exercise his right to crystallise a pension policy. Nor was there any obvious right for a trustee in bankruptcy to do so, particularly in light of the provisions of the WRP Act, which specifically exclude rights under a pension policy from a bankruptcy estate and, therefore, the control of a trustee. An argument that s333 of the Act provides such a right was rejected by the judge.

This decision is the subject of an extant appeal to the Court of Appeal, which, it is hoped, will provide clarity to the two conflicting first instance authorities.

Corporate insolvency

Re *Harvest Finance Ltd* [2014] EWHC 4237 (Ch)

Facts: The joint liquidators of the company issued an application under sections 234 and 236 of the Insolvency Act 1986 (the Act) requesting delivery up of documents held by the respondent firm of solicitors and individually named solicitors. The documents concerned conveyancing transactions handled on the company's behalf by a predecessor firm of solicitors, which the respondents held and which either belonged to the company or could provide information concerning the company to the liquidators. The liquidators had requested such documentation in correspondence from around May 2012, had issued the application for delivery up in February 2013, and an order for delivery up was made by Mr Registrar Jones on 10 May 2013 subject only to an issue regarding legal professional privilege. This issue was determined by the court and an order to deliver up the relevant documents was made by the Registrar on 27 September 2013, which the respondents complied with.

The respondents claimed that complying with the order had incurred circa £40,000 of costs, which the respondents sought payment of from the liquidators, relying primarily on s236 of the Act and the rules associated to that section.

Registrar Jones observed, from a detailed consideration of the Act and associated rules and the apparently conflicting authorities concerning applications under s236 of the Act, that s236 imposed a public duty on those classes of persons caught by the section to provide information or attend for examination in order to aid office-holders in their own duties. As such, he noted that such a public duty could be said to be incompatible with an order to pay the costs of compliance.

> “The respondents claimed that complying with the order had incurred circa £40,000 of costs.”

While rule 9.6(4) of the Insolvency Rules 1986 provided for *'other costs falling upon* [the respondent to a s236 application]' to be at the court's discretion, this did not create a presumption in favour of awarding the costs of compliance to respondents but did provide a mechanism for doing so if appropriate.

The Registrar concluded that the fact that s236 of the Act creates a public duty to provide information to office- holders, created a strong reason not to award the respondents the costs of their compliance. He observed that the payment of costs, in cases such as this one where the costs were made up largely of professional time costs of the respondents, would turn a public duty into a professional service and would impose a financial burden on the liquidators caused by the fact that the documents were not easily accessible (which was, obviously, not the fault of the liquidators).

As such, the respondents' application for the costs of complying with the order under s236 of the Act was rejected.

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Legal voice

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

Legal Q&A

Michelle Bajcar answers your insolvency queries.

I am the former administrator of a company that has gone into creditors' voluntary liquidation (CVL). The proposals gave a deadline for the company to be placed into CVL within six months. My investigations surrounding the company took longer than anticipated. I also commenced litigation against a debtor, contrary to the wishes of the creditors' committee. The company entered CVL after ten months. The creditors' committee is now refusing to agree to my costs for the period after the company ought to have gone into CVL pursuant to the proposals. Am I able to apply to the court for my remuneration to be fixed under Rule 2.106 of the Insolvency Rules 1986?

You are able to make an application to court pursuant to Rule 2.106(6) of the Insolvency Rules 1986, which confirms that, in the event that the creditors' committee is unable (or unwilling) to fix the administrator's remuneration, you are able to apply to the court, provided that such application is made within 18 months of your appointment being made.

You are entitled to do this even if the work carried out by you was done so after a deadline set by the proposals or the creditors committee, or if such work was against their wishes. This was confirmed in the recent High Court case of *Brilliant Independent Media Specialists Limited* [2014] ALL ER(D) 111 in which Registrar Jones confirmed that while the opinion of the

> "Care should be taken, however, when you make such an application."

creditors' committee should be taken into account, the conduct of the administration is ultimately a decision for the office-holder, whose decision making will involve commercial decisions on how best to achieve the purpose of the administration, and they should be remunerated accordingly.

The registrar held that the court's jurisdiction under Rule 2.106(6) to fix remuneration for the entire duration of the administration remained, even if the work fell outside the scope of the approved proposals, although such facts would be taken into account when fixing or refusing remuneration. The registrar was, however, clear that the administrator was unable to

claim remuneration for the period after he vacated office, even though such work was undertaken at the request of the newly appointed liquidator.

Care should be taken, however, when you make such an application, to ensure that you comply with the Insolvency Proceedings Practice Direction and that consequently the court has sufficient, clear information to enable them to accurately assess the work carried out. The court will take care to ensure that the amount fixed is fair, reasonable and proportionate. In the above case, the administrator was particularly criticised for over-manning tasks, involving high-charging partners unjustifiably, and providing insufficient narrative relating to the time incurred. As a consequence, the court reduced the amount claimed by over one third. The costs claimed in making the application itself were reduced from £90,000 to £7,500. The burden to justify your remuneration claim is on you as administrator. If the court is in any doubt, your claim is likely to be reduced.

I am the trustee in bankruptcy of a discharged bankrupt who has issued a harassment claim against her ex-husband under the Protection from Harassment Act 1997 for harassment that took place over a prolonged period of time, both before the bankruptcy, during the period of bankruptcy and after her discharge. If an award for damages is made, will it vest in me as her trustee and therefore form part of her bankruptcy estate for distribution to her creditors?

This issue was recently considered by the High Court in the case of *Hayes* v. *Butters and others* [2014] EWHC 4557 (Ch).

In this case the court first considered the nature of harassment under the Protection from Harassment Act 1997 and held that a cause of action is complete once sufficient actions had taken place, and those actions had caused damage. Each subsequent act by the same perpetrator created a new cause of action, if it caused damage to the claimant.

The conduct complained of took place before the bankruptcy order was made, during the period of bankruptcy, and well beyond the date of discharge. The court confirmed that the damages being sought for the harassment incurred before the date of the bankruptcy order, which consisted of both personal and financial loss, was a hybrid claim that would vest in the trustee in bankruptcy on appointment.

This followed the case of *Ord* v. *Upton* [2000] Ch 352, which held that in hybrid claims the bankrupt remains the beneficiary of any damages awarded for personal loss (although held by his trustee on trust) but any award of damages for financial loss would form part of his bankruptcy estate, and would consequently be distributed for the benefit of creditors.

> "The conduct complained of took place before the bankruptcy order was made."

The court held that the element of the claim that took place after the discharge from bankruptcy could be split, and that any damages awarded for that portion would remain with the bankrupt, and not become vested in his trustee. This was the first reported case where the court ordered that a hybrid claim be split.

The damages awarded to your discharged bankrupt are therefore capable of being split. The proportion of the award relating to the financial loss caused by the harassment, which occurred before the date of the bankruptcy order, will have vested in you upon appointment. The element of the award relating to the period after the discharge will, however, remain vested in the former bankrupt. □

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If you are a lawyer and would like to write for Legal Q&A please contact: Sandra.Kessell@groupgti.com.

Wrongful trading

Bree Taylor asks why there aren't more claims.

Section 214 of the Insolvency Act 1986 (the Act) was introduced on the recommendation of the Cork Committee because the law was seen at the time to be inadequate to deal with irresponsible trading by company directors. The prevailing view was that the introduction of s214 and the concept of 'wrongful trading' would be used widely by liquidators and could even render redundant the concept of 'fraudulent trading', which already existed prior to the Act and continues to exist as s213 of the Act, with its additional burdens of proving actual dishonesty and moral blame.

What is wrongful trading?

Section 214 provides one of the rare means by which a court can deprive those who run businesses irresponsibly of the privileges of limited liability. The section operates so as to make directors personally liable to contribute towards the company's debts where they have continued trading beyond the point where they knew or ought to have known that the company had no reasonable prospect of avoiding going into insolvent liquidation.

The formulation of s214 is curious in that despite the section title, it does not refer to 'wrongful' or 'trading'. Indeed there are relatively few technical requirements to be established to bring a case within the scope of s214. Only that:

1. The company is in liquidation;
2. The company has become insolvent; and
3. The director was a director of the company at the relevant time.

> "One of the most notable things about s214 is how seldom it is used to achieve a recovery for the company's creditors."

Beyond this, liability under s214 depends on two main factors:

a) that the director knew or ought to have concluded (at some prior point) that there was no reasonable prospect of the company avoiding liquidation; and

b) that the director did not take every step he ought to have taken with a view to minimising potential loss to creditors.

Is wrongful trading under-utilised?

More than a quarter of a century on, one of the most notable things about s214 is how seldom it is used to achieve a recovery for the company's creditors, or at least how seldom it is used in cases that proceed to trial. There are no official statistics on claims brought successfully (or at all) under s214 but the perception of many IPs and lawyers practising in the area is that there seem to have been very few cases over the last 25 years, notwithstanding that most practitioners have seen numerous examples of hopelessly insolvent companies trading on for extended periods. One Queen's Counsel in a top ranking commercial set who I contacted to ask about his experience of s214 cases said *'I haven't seen a wrongful trading case in over 10 years!'*. The purpose of this article is to examine the possible reasons for this and to ask the question: Why aren't there more claims? Is there something wrong with the concept of 'wrongful trading'?

I carried out an unscientific survey of barristers, solicitors and IPs with experience of bringing or defending (or settling) s214 claims. Some of the reasons given to me for s214 cases not proceeding to trial or not being pursued at all are as follows.

Settlement

A number of practitioners I spoke to have been involved in advising liquidators and directors at the pre-action stage. It seems to be common for liquidators to investigate directors for wrongful trading and to engage to a greater or lesser extent with the director to test the justifications given for a period of trading while insolvent. This tends to suggest that there could be a substantial number of instances of wrongful trading where a settlement is achieved before trial or even before proceedings are commenced. Anecdotal evidence confirms this. One Queen's Counsel said: *'A lot of the claims I have advised on are claims specifically designed to extract a settlement out of the director or their insurers at an early stage, and they tend to achieve this'*.

> "There seems no reason to conclude that claims under ss212 or 239 are in principle any more clear-cut than claims under s214."

Alternative claims

A significant number of the IPs I spoke to thought that where there is evidence of misfeasance (s212) or a preference (s239), these tended to be easier claims to pursue than claims under s214 because they are *'more clear cut'*.

But consider what the liquidator does **not** need to prove under s214:

- dishonesty
- some particular intention or purpose
- desire to bring about a particular effect
- insolvency as a result of some act/omission.

There seems no reason to conclude that claims under ss212 or 239 are in principle any more clear cut than claims under s214. Both s212 and 239 have additional elements not present in s214: a breach of a specific legal duty in the case of s212 and a desire to prefer a particular creditor in the case of s239. The perception that s214 is less clear-cut than other types of claim might arise from the fact that s214 is perhaps unique in imposing on the court the need to make a qualitative assessment of a business person's judgement in complicated and difficult circumstances. The same exercise needs to be done in misfeasance cases based on a breach of a duty of care, although of course, with the benefit of 80 years of case law on how to assess the standard of care for negligence. The court's task in s214 cases is not always an easy one.

Andrew Clutterbuck QC represented the liquidators in one of the handful of successful claims under s214 in the last few years, *Singla* v. *Hedman* [2010] BCC 684. He commented that, leaving aside cases where the directors have engaged in blatant wrongdoing, it is extremely difficult to predict whether the judge will conclude that the director's conduct has fallen below the requisite standard. These are not the sorts of cases where the judge gets to see and reply upon the evidence of expert witnesses in the relevant field. After all, who could qualify as an expert in the field of whether a business was likely to survive in particular circumstances? Even if such a person could be found, the real question is not whether the business was likely to survive but whether the director should have reached a particular conclusion having regard to a certain level of knowledge, skill and experience. This has to do with knowledge and judgement. Judges recognise that, in general terms, the best people to make difficult decisions for a business facing difficulties are the people running the business. This arguably weighs in favour of the director who of course is entitled to put the liquidator to proof on the case on a balance of probabilities.

There are a number of examples of cases where the judge has specifically referred to the difficult and finely balanced decision processes directors sometimes needed to follow in the real world, before deciding to give directors the benefit of any doubt. One example can be seen from the comments of Park J in *Re Continental Assurance Company of London plc (in liquidation)* [2001] BPIR 733: *'An overall point which needs to be kept in mind throughout is that, whenever a company is in financial trouble and the directors have a difficult decision to make whether to close down and go into liquidation, or whether instead to trade on and hope to turn the corner, they can be in a real and unenviable dilemma'*.

Problems over funding legal costs

Most practitioners agree that there are no longer many insolvencies where the company has significant cash or liquid assets sufficient to fund litigation. Many of the IPs I spoke to considered that funding and/or ATE insurance was easy enough to obtain for good claims and that this should not really be a contributing factor to any reticence on the part of liquidators to pursue s214 cases.

The key words here are 'good claims'. Section 214 cases can be unpredictable and very much influenced by the testimony of the director at trial. Needless to say, neither funders nor creditors like putting their money on the line for litigation that is unpredictable or where the advice from counsel starts with *'On one hand…'*.

Credit risk

Some of those I spoke to highlighted the issue of credit risk: the risk that even if the liquidator wins at trial, the director is impecunious thus leaving the insolvent company with large legal bills and no recovery. This is a hazard for claimants in all sorts of cases, not just wrongful trading cases. One insolvency practitioner I spoke to pointed out ruefully that unsophisticated company directors who fail to understand their duties and neglect to take any proper advice are the best targets for wrongful trading cases. But they are often also the ones who cannot afford to satisfy judgments. There is no way of ascertaining what percentage of recoveries are made in successful wrongful trading claims. Of all those I spoke to, one practitioner was prepared to say that despite achieving a success at trial, recovery was fraught and ultimately fruitless.

Alternative means of redress

One barrister I spoke to expressed the view that creditors called upon to fund litigation might feel less inclined to take the costs risk of pursuing recalcitrant directors in wrongful trading actions given that directors can be censured under the Company Directors Disqualification Act 1986 (CDDA), which at least achieves a sort of moral redress for aggrieved creditors. Under s10 of the CDDA, a director can be disqualified by the court following the making of an order under s214 for wrongful trading.

> "The court's task in s214 cases is not always an easy one."

Disqualification proceedings under the CDDA are a well-known and oft-used tool in achieving a financial settlement in wrongful trading cases. *Murphy and Hyde* v. *O'Sullivan*, *Re D O'Sullivan Skip Hire Limited* (unreported, 20 November 2013, Deputy Registrar Garwood) is a good example of a case where the director's undertaking under the CDDA was put into evidence by the liquidators and referred to by the judge in reaching the view that the director *'was completely lacking in the knowledge, skills and experience required of a director generally'*. Evidence of a CDDA undertaking is not always influential. In *Re Hawkes Hill Publishing Co Ltd* [2007] BCC 937 Lewinson J referred to the disqualification undertakings that had already been given by the directors but reached the view that there were pragmatic reasons for the directors declining to contest disqualification proceedings, namely not having the money.

»

Disqualification numbers have been in decline since 2009/10. Of the various statutory provisions under which disqualification orders can be sought, the most commonly used one (by far) is s6 of the Insolvency Act 2000, which provides for disqualification by undertaking. There have been **no** disqualifications under s10 since 2009 out of a total of 7,088 total disqualifications in the five-year period. This might tend to suggest that wrongful trading claims pursued off the back of disqualification proceedings are settled with a payment of compensation as part and parcel of the disqualification undertaking.

Evidential difficulties

Barristers David Alexander QC and Adam Goodison referred to the evidential difficulties facing liquidators with potential s214 claims. They believe that these difficulties could account for claims that seem promising to the liquidator but ultimately are not pursued:

- Section 214 is a claim that only a liquidator can bring;
- By the time a company enters liquidation (perhaps following an administration) and the liquidator has conducted some enquiries, a great deal of time has often passed. Directors and employees have moved on, recollections have faded and documents might have been lost;
- The liquidator needs to build a case based on whatever information is available. Board minutes, accounts and answers given to directors' questionnaires may assist but these might not reveal much about what directors believed or why they believed it at the crucial point in time;

> "The best people to make difficult decisions for a business facing difficulties are the people running the business."

- The liquidator will often find it difficult to find anyone who can or is willing to give evidence for the liquidator about the decision-making processes of directors;
- Above all, despite having a case that seems to tick all the boxes, the story may look rather different once the oral evidence of the directors is given in court.

Notwithstanding what might be very good reasons for the relatively few cases under s214 which make it to trial, there are examples of cases that will reinforce many practitioners' views that the line to be drawn between reasonable conduct and unreasonable conduct is difficult to define and thus s214 involves a gamble for both sides. One barrister in a leading insolvency set reminded me of the ghost of *Re Continental Assurance* (supra), a case that he said *'appeared to be cast iron, only to turn out to be built on sand'*. Taking this and other recent cases where the liquidator has failed to make out the claim under s214 the following wisdom can be gleaned:

a) Do not rely on hindsight. Just because new investment did not materialise and just because profit projections were not achieved, it does not necessarily mean that the directors were being overly optimistic about the company's prospects at the time. (*Re Langreen Limited (in liquidation)*, unreported, 21 October 2011, Registrar Derrett).

b) Pick a realistic date as the date from which the directors ought to have concluded that the company could not avoid insolvent liquidation. An earlier date might translate to a higher award of compensation for the net deficiency that came about after that date, but if the liquidator cannot show that the directors' conduct fell below the requisite standard at that date, the claim will fail. There have been cases where the liquidator 'nominated' the date of insolvency on a cashflow test as the date at which the director 'knew or ought to have concluded' that the company would not avoid insolvent liquidation. Cases such as *Re Hawkes Hill Publishing Co Ltd* [2007] BCC 937 remind us that just because the company was in fact insolvent, this does not mean the directors are bound to conclude that liquidation is inevitable. It is important to note that if the liquidator fails to establish the requisite knowledge at the nominated date, he is unlikely to be allowed to substitute a later date at trial (*Re Sherborne Associates Ltd* [1995] BCC 40).

> "One practitioner was prepared to say that despite achieving a success at trial, recovery was fraught and ultimately fruitless."

c) If the company has the sort of business where ceasing trading means a major loss of value in the business, the judge may well give the directors the benefit of the doubt if they have pressed on in the hope or expectation of improving the situation and preserving that value for creditors (*Re Continental Assurance* (supra)).

d) Choose your defendant carefully. If the complaint boils down to a failure to realise the seriousness of the company's financial position because of inadequate or misleading financial accounts, it might be only the finance director whose conduct fell below the requisite standard.

Let's now turn to wrongful trading claims that have been successful and look at what appears to have been influential. Three practical tips:

1. Get the measure of the directors. Liquidators have ample opportunity to and the means of meeting with and assessing the accuracy and credibility of what directors have said about the failure of the business, for example by using their powers under ss234–236 of the Act. If the directors seem like astute or cautious professionals, this is probably how they will come across in the witness box. If they are tricky, evasive or chaotic, the same applies. (See for example *Singla* v. *Hedman* (supra) and *Murphy and Hyde* v. *O'Sullivan* (supra)). One barrister I spoke to who has enjoyed success in a wrongful trading case said that the claim was technically quite difficult but the single greatest contributing factor to the liquidator's success at trial was the poor performance of the directors in the witness box – their evidence was 'disastrous'.
2. Have the directors benefitted from what they have done? This is not a requirement of s214. However, if a director has enjoyed, for example, a large salary or benefits while supposedly struggling to save the business, it might make it difficult to convince the judge that every step was taken to minimise the loss to creditors. If the directors have caused the company to lend money to third parties without security or if they have transferred property for consideration that is not in fact received, then quite aside from potential claims under s238 (transactions at an undervalue) could have been found to have traded on and damaged the position of creditors knowing perfectly well that the company would end up going into liquidation (*Re DKG Contractors Ltd* [1990] BCC 903; *Re Bangla Television Ltd* [2009] EWHC 1632 and *Rubin* v. *Gunner* [2004] EWHC 316).
3. Can you show that the directors 'closed their eyes' to the reality of the company's situation? If so, you will have much better prospects of success than in a case where the directors have identified the problem and taken some steps – even misguided steps – to turn things around. The hallmarks of 'closed eyes' are things such as:

a) failing to address problems over obviously inadequate accounts and management information;
b) failing to make changes in the business plan;
c) failing to list and review options; and
d) in more extreme cases, failing to read post or engage with creditors making demands for payment.

Conclusion

I do not think s214 is under-utilised or that reform is required to bring about a situation where we see plenty more final judgments imposing personal liability on directors. It is in the public interest that, as anecdotal evidence suggests, many claims under s214 are designed to and do extract settlements from directors whose conduct has fallen below the requisite standard. If early settlement is one of the main reasons so few s214 cases come to trial, then the section has fulfilled a purpose; creditors have increased their dividend without having had to take on the costs and risks of the litigation process. It is also important for creditors and advisers not to leap to the conclusion that business failure equates with irresponsible conduct by directors. As Lewinson J put it succinctly in *Re Hawkes Hill Publishing* (supra): *'Of course, it is easy with hindsight to conclude that mistakes were made. An insolvent liquidation will almost always result from one or more mistakes. But picking over the bones of a dead company in a courtroom is not always fair to those who struggled to keep going in the reasonable (but ultimately misplaced) hope that things would get better'*. ◻

“If the directors seem like astute or cautious professionals, this is probably how they will come across in the witness box.”

BREE TAYLOR is a partner at Memery Crystal LLP.

Transparency and confidence

Claire Mowbray revisits pre-packs... again

The number of businesses that go through a pre-pack is actually relatively small. The Graham review into pre-pack administration, published in June 2014 (the Graham review), states that in 2013, 2,365 companies in the UK went into administration, and of these, some 600 underwent a pre-packaged deal. Despite this, creditor concerns and lack of confidence in the transparency of the pre-packaged administration procedure have resulted in wide reporting of the pre-pack as an unnecessary evil of the English insolvency regime.

Statement of Insolvency Practice 16 (SIP 16) sets out the principles and compliance standards to which administrators should adhere when undertaking a pre-packaged sale. The Joint Insolvency Committee recently published a revised version of SIP 16, incorporating the recommendations of the Graham review.

> "The public perception of pre-packs is that they are often to connected parties."

What is a pre-packaged sale?

While insolvency professionals may be clear as to what a pre-packaged administration sale is, many other people have a pre-conceived idea of how a pre-pack works, and what effect it may have. Pre-packaged sales are not defined anywhere in statute, and have developed over time as market practice. The practice of pre-packing has increased since 2003, when the Enterprise Act amendments to the Insolvency Act made administration cheaper and more accessible to smaller companies.

SIP 16 defines a pre-packaged sale as:

'an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an administrator and the administrator effects the sale immediately on, or shortly after, appointment'.

The purchaser is sometimes, but not always, a new company set up by the directors of the insolvent company. Following the sale, the insolvent company will usually be left as a shell retaining only its liabilities and the proceeds from the sale.

Why are pre-packs so controversial?

The public perception of pre-packs is that they are often to connected parties, and that they effectively allow 'phoenix' companies, run by the same directors, to shed the liabilities of the insolvent company and cherry pick the assets they want to retain, to the detriment of creditors.

There is a lack of transparency in the process, as negotiation of the terms of a pre-pack sale of necessity occurs in secret, prior to the administration, and without consultation with creditors, customers or employees. Often there is very little (or no) marketing prior to the sale, and creditors question how administrators can be confident that they have achieved the best price for the business.

Others argue that pre-packs disadvantage solvent, competing companies in the same market by allowing the insolvent business to resume trading without the shackles of its pre-administration debts, and to undercut its rivals.

What is the timing of a pre-packaged sale?

There is sometimes misunderstanding about the timing of pre-packaged sales. A pre-pack is never completed before the administration begins. It will always be executed by the administrator, following his appointment.

Who does the administrator act for?

The insolvency practitioner who eventually becomes the administrator is likely to have acted as adviser to the company prior to his appointment. To an outsider, it may appear that the administrator has acted in several roles, which may conflict, especially where the pre-pack is to a connected party. SIP 16 states that the insolvency practitioner should be very clear about the nature and extent of his role as adviser in the pre-administration period. Where the sale is to a newco set up by the existing directors, the directors should be encouraged to receive independent legal advice.

What duties does an administrator have to creditors?

An administrator's powers devolve from statute, and he is under a duty to act in the best interests of creditors as a whole. He also acts as agent of the company over which he is appointed, and this gives rise to fiduciary duties including the duty to act with reasonable skill and care, and to take reasonable steps to achieve the best price for the company's assets.

An administrator is also an officer of the court. His actions are subject to the scrutiny of the court, and any creditor can challenge the actions of the administrator if they believe he has acted unfairly to harm their interests (although this is expensive). A creditor can also report an administrator to his recognised professional body via The Insolvency Service's complaints gateway.

> "There is a lack of transparency in the process, as negotiation of the terms of a pre-pack sale of necessity occurs in secret, prior to the administration."

Taking these duties into account, a pre-pack should not therefore be an asset-stripping exercise as some reports have suggested.

Of course, an administrator's duty extends only to current creditors of the insolvent company. He is not obliged to act in the best interests of competitors of the insolvent company. Thus the impact (whether real or imagined) of the administration and pre-pack on the insolvent company's competitors is not a matter for the administrator to consider.

Would a trading administration or liquidation give a better return?

It is commonly forgotten in reports on pre-packs that it is not the pre-pack itself that results in creditors being unable to recover in full debts owed to them by the insolvent company. Unsecured creditors will invariably be 'out of the money' upon an insolvency, and this would have been the same whether the business was pre-packed, traded during administration pending a sale, or liquidated.

Indeed, the Graham review found that many pre-packaged deals included deferred payment terms, which can result in the creditors of the old company receiving increased dividends. Many of the press reports criticising pre-packs forget that, without the pre-pack, most unsecured creditors would receive very little, or even nothing, in a liquidation, since liquidation will result in an immediate erosion of asset value, closure of the business and loss of all jobs. It is difficult to see how this could ever be seen as a preferable option.

> "Creditors can challenge the actions of the administrator if they believe he has acted unfairly to harm their interests."

A trading administration may also have detrimental effects. Suppliers may be reluctant to trade with the company in administration, and employees may feel insecure in their positions. In addition, funding a trading administration is difficult.

Thus the Graham review acknowledged that the inherent secrecy of pre-pack negotiations may be a 'necessary evil' if it delivers the best offer for the business and/or assets.

Does pre-packing preserve jobs?

Yes. A pre-packaged sale of the insolvent company's business will enable many, if not all, jobs to be maintained. By contrast, if employees lost their jobs following a liquidation, there would be an increase in the likely value of preferential and unsecured creditor claims against the company.

What areas for improvement were highlighted by the Graham review?

The Graham review made it clear that it did not recommend the banning of pre-packs, while acknowledging that there were aspects of pre-packs that did require improvement. These are reflected in the proposed amendments to SIP 16. The report noted the following issues in particular:

- secrecy and lack of transparency
- insufficient marketing
- insufficient explanation of the valuation methodology
- insufficient consideration of the future viability of the business

What recommendations did the Graham review make?

The Graham report advocated six key recommendations:

1. The creation of a pre-pack pool;
2. The introduction of viability reports;
3. That SIP 16 be redrafted according to the draft annexed to the report;
4. That all marketing of businesses to be pre-packed comply with six principles of good marketing, and that any deviation from these be brought to creditors' attention;
5. That valuations must be carried out by an independent valuer with professional indemnity insurance; and
6. That monitoring of SIP 16 statements should be taken over by the recognised professional bodies, rather than The Insolvency Service.

What is the 'pre-pack pool'?

The pre-pack pool will consist of a pool of experienced business people whose role it will be to opine on connected party pre-packs. At the request of the purchasing entity, a member of the pre-pack pool will review the specific pre-pack proposal, based on information given by the purchasing entity. It is proposed that this will take no longer than half a day.

The advertisement for members of the pre-pack pool asks that applicants are business people with more than ten years' experience at board level, and able to act promptly when allocated a potential pre-pack. Direct experience of pre-packing or even of insolvency generally, is not essential.

How effective is this likely to be?

The Graham review states that the pre-pack pool proposal will create independent scrutiny of the deal, yet retain overall secrecy before the event.

However, the statement provided will not be binding, and a negative statement will not therefore prevent the pre-pack concerned from going ahead. However, it will need to be disclosed by the administrator with his SIP 16 statement, which is sent to all creditors within seven days of the sale. A negative report will add justification to any concerns creditors may already have. By contrast, a positive report will provide comfort to the administrator (who should in any event have given careful consideration to whether the deal was appropriate or not).

The approach to the pre-pack pool is made by the connected party purchaser on a voluntary basis, and it remains to be seen how widely the pre-pack pool will be used.

What is a viability report?

A connected party purchaser may complete a 'viability review' on the new company, detailing how the new company will survive for the next 12 months. If the new company fails, the statement would be made available to the old company's administrator to consider when assessing whether to take any actions against the directors.

Again, the review must be disclosed by the administrator with his SIP 16 statement, although the administrator will not be required to comment on the review.

How effective is this likely to be?

Again, this is on a voluntary basis. However, if a review is not completed, the administrator will have to state that they asked the new company for a review, but that it had not been completed. The Graham review expresses a hope that the market will come to expect a viability review to be completed in all connected party pre-pack cases, thus ensuring a meaningful take-up of the proposal.

Marketing

The appendix to SIP 16 now contains six principles of good marketing, which have been largely welcomed as uncontroversial, and reflecting existing good practice. In essence, marketing must be proactive, as wide as possible, and undertaken independently of any prior marketing undertaken by the company. Any deviation from the principles must be explained by the administrator in his report to creditors.

> "The appendix to SIP 16 now contains six principles of good marketing, which have been largely welcomed as uncontroversial, and reflecting existing good practice."

Valuations

The Graham review noted that some independent valuations undertaken prior to pre-packs were 'desk-top' valuations only, with the purchase price in sales to connected parties often exactly matching the valuation figure. This understandably gives rise to the suspicion that the price is an indicator of the amount the connected purchaser is prepared to pay, rather than being a proper indicator of market value. In addition, there were sometimes no proper valuations of assets such as intellectual property and goodwill.

The redrafted SIP 16 requires any valuer to be independent, and details of the rationale behind any valuations must be set out in the SIP 16 report to creditors. Any valuers used must have professional indemnity insurance.

Conclusion

The new measures have been met with a mixed response from the insolvency profession. While the provisions in relation to marketing and valuation have been welcomed by most, many insolvency professionals have complained that as administrators they are already subject to the supervision of the court, and the pre-pack pool and viability report proposals add another, unnecessary, layer of control. It also remains to be seen how far the proposals will go to allay public perception of the pre-pack as unfair and, in some cases, even dishonest. □

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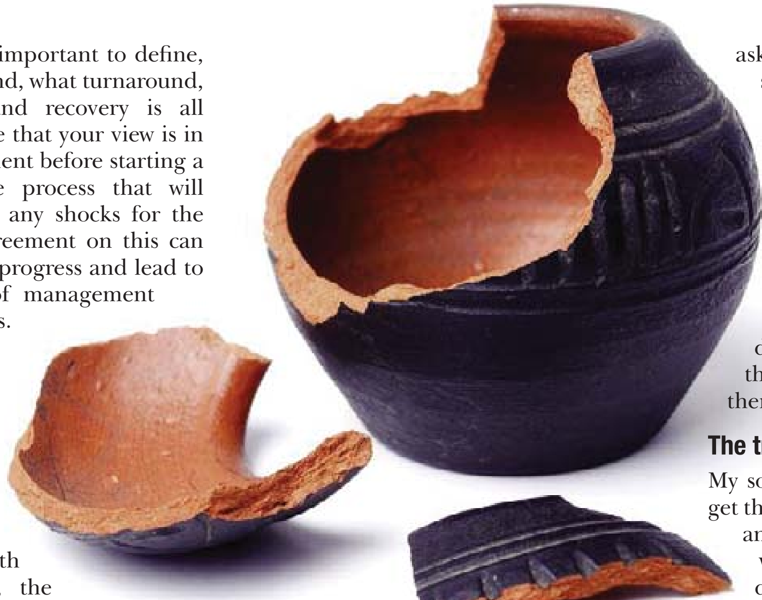
Before you try to fix what's broken

Ian Pegler considers what directors should do in a crisis and why IPs should bring a multifaceted approach to turnaround.



I think it is very important to define, in your own mind, what turnaround, restructuring and recovery is all about and agree that your view is in line with that of the client before starting a project. Describe the process that will ensue, so as to avoid any shocks for the client. Absence of agreement on this can cause major delays in progress and lead to the disillusionment of management and staff in the process.

Look at it all

My view on how a turnaround should be effected, in order to gain sustainable growth, is that it needs to be 'holistic'. This process deals with not just one aspect, the financial re-engineering of a company, but follows a multifaceted approach that brings the company back to full health.

All companies benefit from some form of financial restructure but not all turnarounds have benefited from the rigour and intense scrutiny of the processes surrounding the holistic approach. In this, the major functions – marketing, human resource and training, information technology, purchasing, financial administration and logistics are examined in minute detail with a view to improving performance, at every level. Measurable output is what we are looking for.

> "Sustainable profit growth comes from using every tool in the box."

Sustainable profit growth comes from using every tool in the box and the danger is that by only fixing the financials, the financials are fixed but not the company. If the company does not get fixed then maybe the financials will have to be re-fixed again, a couple of years down the line.

So, to conclude this part:

- It is really important to get your thinking straight on what turnaround really means for you.
- Decide on whether you are just engaging in a financial restructuring, an operational fix or both.
- Communicate to the client your understanding of what is needed to bring the company back to full health.
- Gain agreement from the client that the process and the predicted outcome, meets their requirements. At least for now. Things change.

Next – I believe that business is only about two things: people and process.

People

Most of us would go for process first. For a start it's easier; it's what we were all taught from the very beginning of our careers and we are used to it; it gets quick results and in the main will get us performance improvement.

However, by engaging with people in a big way, from the beginning, the performance improvement can be almost doubled when aligned with process, because even with the best processes, if the people can't or won't make them happen then performance will not be maximised. The problem is that most people in the professions were never taught, at university or in their employment, how to manage, motivate or understand people. I was lucky, as my career in Marks and Spencer equipped me well for managing the aforementioned.

So the best advice I can give, in the absence of people training, is to put yourselves in the place of the workforce, by asking them how they feel about the situation they find themselves in, and treating them how you would like to be treated yourselves. Most staff in broken companies feel a mix of anger, disillusionment, isolation, fear and cynicism, with a very few being elated that the old guard have gone or that things can only get better.

Obviously these sentiments are damaging to the turnaround, therefore it is imperative to counteract them quickly, from day one if possible.

The truth, the whole truth

My solution, in all ten turnarounds, was to get the key directors and managers together and tell them the absolute truth in eye-watering detail and to answer all questions honestly and then tell them that they have one week to come to me with any other queries, because after that the negatives were over and we were moving forward.

The next bit was to give them hope. Plans for the future, even if they were not fully formed, rough timescales and that responsibilities and accountabilities would be given to them soon. This sets the tone and gives excitement and anticipation of good things to come, with their involvement. From this create a communication strategy. Daily, weekly, monthly; devised so that it reaches all levels of the business.

> "Put yourselves in the place of the workforce."

Be open; communicate the good, the bad and the ugly, delivered in both a structured and informal manner. This will help to motivate and keep people on side and feeling involved and valued. Honesty is the byword, though.

Process

I think it is essential that you get into the detail. Most chief executives and financial directors don't. What happens from the top of a company normally gets replicated further down. One of the reasons why companies fail is that nobody is looking at the detail across the company and how that detail interacts across the various functions.

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Profit and loss accounts are rarely examined, in detail. Get the detailed working sheets behind the P&L and examine each line with both the finance department and the operator/function head. You will be amazed at the opportunities you find to improve profit and efficiency. Budget holders are rarely challenged on their performance to budget. Nor are they held to account. Ensure that regular monthly reviews are presented in full detail by the holders.

> "Tell them the absolute truth in eye-watering detail and answer all questions honestly."

Unbelievably, gross margin was never mentioned in any of the turnarounds I have been involved with. As the first line of profit, it is staggering that it is given less attention than any other line on the P&L. We all know that small positive increases in gross profit can dramatically affect the profit so it deserves priority in the investigations.

Look at the payroll

The biggest number is usually the payroll. This needs careful examination and in a multisite business benchmarking is essential and provides many opportunities for cost saving and efficiencies. A payroll audit is essential and often throws up fraud in the guise of ghosting and consultants who have been on the books for years and nobody knows what they still do (particularly large public sector entities).

Obtain the return on investment of the marketing spend, it's normally a big number. Don't accept the excuse that it's hard to measure. Insist that a measure be found that is credible.

Worst of all, nobody challenges the accounts department, as the assumption is that it's got to be alright, because all they do is put numbers in boxes. In all ten turnarounds nobody was ever responsible for collecting the debts!

This is a small sample of what goes on. But the important point is that they all involve people.

So I go back to one of my original points. Treat the people and the process in equal measure; in fact give more emphasis to the people, make them feel valued but be clear on their responsibilities and make them accountable and the output will delight you.

Oh, one other thing; the client is a person too.

The results of this approach were double, treble and even quadrupling of earnings before interest, taxes, depreciation and amortisation (EBITDA) in many cases, plus a £6m turnaround in EBITDA in nine months.

Ian Pegler

Ian Pegler's principal career has been in retail, working with blue chip companies such as Marks and Spencer and Dixons Stores Group where he held senior positions in store and regional management, strategic buying and operations. This was followed by five years as executive director within Forte – initially turning around and repositioning Happy Eater, where he gained the largest share of development capital in the group to facilitate the turnaround. This was a success and led to his move to Little Chef, which was the cornerstone of Forte's profits with 330 Little Chef restaurants and 100 Forte Travelodge hotels.

Ian then left Forte to pursue an independent career in the turnaround field and has turned around eight businesses in FMCG – mobile telecoms, exhibition and conferences, NHS, private equity healthcare, roadside restaurants – with two of the turnarounds delivering quadruple sales and profits. He also acquired 26 per cent of two businesses on behalf of Orange and made substantial savings for an NHS Trust. Turning around Little Chef a second time was a highlight: it went from loss to profit in nine months. Bringing Heston Blumenthal into Little Chef and completing four TV programmes resulted in a 25 per cent uplift in sales overnight.

IAN PEGLER is the chief executive of Distinctive Visions Limited.

Life is all about options

Will Wright talks about the changing approach in the restructuring market.

Many of us have seen first-hand the step change in the way businesses and their stakeholders have dealt with financial stress and distress over the last ten years. While a slight generalisation, the 'old model', as I refer to it, was formulaic, lacked flexibility and used valuable time to explore a limited range of options.

Typically, the first sign of financial difficulty would trigger a lender to instruct an independent business review (IBR). While this would provide insight into the root causes of underperformance and help secure short-term bank support, it often did little to move the corporate towards finding a long-term solution. If the IBR highlighted issues sufficient for the incumbent lender to lose confidence, or if during the IBR process itself other adverse issues presented themselves, time would often become tight and the options available reduced. As a result, insolvency was a far more common outcome. However, things have changed and the pace of that change has meant that for many restructuring practitioners, their role has changed beyond recognition.

From bank-led to corporate-led

Many factors have been at the heart of this movement. Significantly, increased sophistication and consensus have been driven in part by the increasing importance of business 'morality'. A consensual solution following a period of detailed negotiation across stakeholder groups is now far more common than it was only a few years ago; the rise in the use of company voluntary arrangements (CVAs) being an example. This step-change has been helped by a shift in attitude from lenders in favour of a more supportive approach, perhaps fuelled by a very difficult period where many of them came under public scrutiny.

Lenders today remain focused on protecting their positions, but are more receptive to businesses using the time available to explore credible options. In most cases, the directors retain control of the situation and can defend the request for an IBR, providing that panel-approved restructuring advisers are engaged and a credible plan is articulated.

> "For many restructuring practitioners, their role has changed beyond recognition."

In acting for the corporate rather than the lender, it is the role of the adviser to develop a bespoke process that maximises the use of the time available and that, crucially, has been designed with the positions of major stakeholders in mind. If that plan cannot clearly articulate a commercial rationale for the stakeholders' continued support, then it will likely fail before it starts. However, time will always be the most defining factor.

So what are the options?

These can range from selling the business, refinancing with an alternative funder or asset based lender, right through to entering into formal or informal arrangements with creditors. However, often with limited time available, directors would be wise to explore as many of these in parallel as possible. In fact, our experience shows that it is often unnecessary to narrow down the options prior to commencing a process. Instead, we let the market tell us what the available solutions are, and we rarely prescribe the deal structure we're looking for in advance. We regularly see full equity sales, carve outs of non-core or underperforming divisions, management buy outs and refinancings. Every stressed situation is different, but the evolution of the market has opened up options that were previously only available to stable businesses and as part of more traditional mergers and acquisitions (M&A) processes.

Stakeholder management

Embarking on an options process requires the directors to seek support from the company's key stakeholders. As well as providing the bandwidth to explore various options in parallel, the role of an adviser is to bring multiple stakeholders into the process and create trust and open lines of communication. This forms the basis of a process where all parties can see the options develop and assess the impact of any solutions on their positions.

Directors also need to recognise that 'stakeholder' does not just mean the lender. We regularly involve shareholders, customers, business critical suppliers and HMRC to deliver solvent outcomes. Sometimes bringing these parties into the process can be a very difficult decision, but directors need to balance the risk of business failure against the risk of any adverse reaction from stakeholders.

It's about time

If only we had more time. This is perhaps the most common thought when reflecting on an insolvency event, and is often the case where 'Plan A' is for the directors to implement a turnaround. Directors need to ask themselves – critically, before it is too late – what their Plans B and C are as, without these, the outcome is binary: either Plan A or insolvency. It may be difficult for directors, particularly those who are also shareholders, to explore other options, due to the potential for erosion in equity value. But it's not just about planning for scenarios B and C; we would argue it is vital to find these and run with them right up until the day of execution of the preferred option.

> "Every stressed situation is different, but the evolution of the market has opened up options that were previously only available to stable businesses."

The rise of the turnaround investor community

The last decade has seen the rise of the turnaround investor community and, more recently, has also seen acquisitive corporates and mainstream private equity develop the skills needed to transact in the restructuring arena. Investment approaches differ across the sector and it is this diversity that allows creative solutions to be unearthed in a short time frame.

From approximately 30–40 established turnaround investors in 2008, KPMG's Early Options database now comprises more than 130 parties that are actively seeking opportunities. It is the diversity of this community – which includes special opportunities equity funds, debt providers, family offices, high net worth individuals and corporates – that enables solvent solutions to be found, value preserved and businesses saved. Furthermore, the turnaround market understands the nature of the early options process and that directors can, and often do, abort processes to pursue an entirely different option – an often entirely appropriate outcome where the process has achieved its objective of maintaining optionality.

Clearly, this can disappoint an increasingly crowded and hungry turnaround market, but participants are fully aware that circumstances change quickly and deals fall away. The only solace they have is that at least they have burnt weeks rather than months in pursuing a deal, which is sometimes the case when operating in the mainstream M&A environment.

Risk of wrongful trading

While pursuing alternative solutions, directors also need to be mindful of their obligations under the Companies Act. Directors owe a duty of care to the company and its members but, as insolvency risk increases, their focus shifts towards the creditors of the company. The risk of carrying on business as usual, and the potential of being exposed to personal liability as a result of wrongful trading, means that the easiest option might be to appoint an administrator. It is often a more difficult decision to continue to trade and manage wrongful trading risk while trying to find a solution that is better for the company, its creditors (and members) than an insolvency.

Wrongful trading risk can often be managed by adopting a consensual approach with key stakeholders. A restructuring adviser will typically support the directors and provide cash flows and collateral assessments so that lenders can understand the implications of supporting an options process. As options develop and become realistic, deliverable solutions, the adviser will prepare an outcome analysis to support the directors and the stakeholder group in their decision making.

Every process is run in a compressed timeframe to help mitigate the risk of wrongful trading. The consequence of this is that options can change very quickly and, as a result, KPMG advises that regular board meetings are held to document the decisions that are being taken. This is an essential part of any process. A responsible and well-briefed board should be convening meetings at least weekly and full board attendance is important. These meetings should update each board member on the options process, current trading, cash and creditor pressure and any other matters that are relevant to the decision to continue trading. The board needs to balance this information with the likelihood of achieving an outcome that is better for creditors than insolvency. If, after due consideration, the board feels that achieving such solutions are remote, then appointing an administrator should be considered.

The need to take care

In many cases, a solvent solution is preferable to a rescue via an insolvency process. However, directors need to objectively assess the solvent options available to them. Key questions include:

- Is the business plan fundamentally viable – either as is, or post-restructuring?
- Does the solution stabilise the business or does it kick the issue down the road?

An example of a questionable solution would be an expensive bridging loan. While it may buy time to find a longer term solution, if any such solution is unlikely to be achieved, then the directors need to consider whether their actions are detrimental to unsecured creditors. If the chances of a new plan succeeding are low, perhaps the hardest decision of all is to appoint administrators.

This also brings forward the issue of antecedent transactions. Directors need to be mindful that any actions taken to allow the company to survive may be challenged later by a liquidator. The directors should ensure that the justification for any transaction is recorded in the company's board minutes and independent legal advice obtained. A properly executed options process that obtains multiple offers for an asset can help support the board's decision but obtaining valuations prior to entering into a transaction is also recommended.

Successful outcomes

Our experience in the last 12 months shows that the vast majority of early options processes lead to solvent solutions such as a sale to a trade competitor or turnaround investor, a refinancing or a combination of both. The prolonged depression of the global economy has seen a number of new entrants enter the restructuring area and stay there. Critically, it has given corporates the time to develop the skills necessary to compete in the accelerated M&A space. As such, we are seeing a surplus of funds available to chase current levels of activity in the market. The environment for achieving positive outcomes could not be better.

> "Wrongful trading risk can often be managed by adopting a consensual approach with key stakeholders."

Of these solvent solutions, and despite all the talk of the increasing importance of the turnaround investor community, the majority of early options processes end in some form of trade ownership. This can be advantageous to the business as it will be supported by a stronger capital structure and, if synergies can be extracted, improve its competitive position. However, the turnaround investor community should not be underestimated as they are able to act quickly in very compressed timetables and, post transaction, can provide a wealth of commercial, operational and financial experience to the benefit of the business. With a number of potential solutions available, the choice for an early options process over an IBR or bank-led process could not be clearer. ◻

WILL WRIGHT is a partner in KPMG's Deal Advisory practice, leader of the Early Options team and an insolvency practitioner.

The world of D&O insurance

Tim Moynihan explains how directors' and officers' liability insurance can affect IPs.

The last 20 years have seen a profound shift in global business culture. There has been a conscious effort by government and regulators to tighten corporate governance in response to the corporate scandals of the 1990s and 2000s. In parallel there has been an increase in awareness and proactivity among shareholders where directors appear responsible for a company suffering financial loss or collapsing.

The combined result of this has been to make it increasingly difficult, and potentially riskier, to act as a company director. Naturally, directors have sought to mitigate exposure to such risks as evidenced by the rapid growth of the director and officer insurance sector.

> "Despite growing into a market commanding in excess of $10bn of annual premiums D&O insurance remains an area that is little understood."

Despite growing into a market commanding in excess of $10bn of annual premiums it remains an area that is little understood but one that can have a significant bearing on the conduct of an insolvency by the office-holder.

Why D&O insurance?

It is commonplace for a company to indemnify its directors against any financial loss suffered by them in the performance of their duties. However, there are statutory limits upon the scope of that indemnification.

Section 232 of the Companies Act 2006 (CA2006) forbids a company from indemnifying its directors in respect of claims the company itself might bring. Therefore an indemnity can only be given of liabilities incurred to third parties (s234 CA2006) and even then subject to exclusions for matters such as criminal fines and regulatory penalties.

The statutory position therefore creates continuing exposure for directors to:

(i) losses from claims brought by/on behalf of the company and
(ii) losses arising from excluded liabilities.

Further, directors are protected only to the extent to which the company is willing and/or able to honour the indemnity it has given.

It is into this gap that D&O policies fit and that is best explained by considering the structure of a typical policy. A standard D&O policy has two 'sides' of coverage known as 'Side A' and 'Side B':

Side A. The director is the insured. The coverage is of those losses from which the company cannot indemnify the director due to the CA2006 prohibitions set out above. There is usually no excess to be paid by directors on these claims.

Side B. The company is the insured. The coverage is to reimburse the company for any indemnification of a director's financial loss.

It is perhaps easiest to think in terms of Side A being protection of the personal assets of the director while Side B is protection of the company's balance sheet.

> "Irrespective of the definition used, the cover provided will only apply to the extent that the director is acting in his capacity as such."

Who is covered?

Coverage under a D&O policy will extend to the actions of all current and former directors of the company as well as any directors appointed during the term of the policy.

The policy wording will define who is regarded as being a 'director' or an 'officer' but it will usually extend to cover non-executive directors, company secretaries, senior management and in-house lawyers. In essence it will be those individuals that are involved in directly managing the affairs of the company. The policy terms may also be extended to include subsidiaries.

Irrespective of the definition used, the cover provided will only apply to the extent that the director is acting in his capacity as such. No cover will exist for actions taken *qua* member or where the director is providing professional services or advice.

What is covered?

Coverage will differ between policies but in essence D&O insurance protects directors from financial loss arising out of 'wrongful acts' committed in the discharge of their offices and the company from any costs of indemnifying such loss.

"A review of possible claims will be an essential part of an IP's work."

A D&O policy operates in a similar fashion to professional indemnity insurance; namely, that it operates on a 'claims made' basis. Therefore, the policy will respond only to claims that are made (or notified to the insurer) while it is in force. It will also typically cover all claims that relate to events prior to inception of the policy.

Typical claims on D&O policies

- Claims by the company: as stated above, a company cannot indemnify a director for liabilities owed to it. Therefore the director will be required to rely on Side A coverage. These claims will typically be for breaches of trust/directors duties or negligent conduct.
- Derivative claims: where the members bring a claim on the company's behalf the same exclusion of indemnity will arise meaning that the director is in the same position as if defending a claim brought by the company and he will need to rely upon the policy's coverage.
- Insolvency specific: a D&O policy can respond to claims brought against directors during insolvency proceedings. The classic example would be in wrongful trading.

What is not covered

A D&O policy will not respond to any fraudulent activity by the director. However, it will usually cover any costs incurred by him until a formal determination of fraud is made. It will also not respond where the loss arises from a director taking illegal remuneration or where other forms of insurance should apply (eg professional indemnity and public liability).

The policy will also likely have a number of standard exclusions. As noted above, cover will be excluded in the event of fraudulent or dishonest conduct by the director. The final exclusion that is for '*insured* v. *insured*' claims. This removes coverage where for a claim by the company against a director where he himself is a member and so would benefit from a successful claim. It is thought that this exclusion does not arise where the claim is being brought by the company acting through a liquidator. This is on the basis that the claim would be for the benefit of creditors rather than members.

Insolvency practitioners

As a matter of insurance law an insolvency event will not, in itself, terminate a D&O policy or otherwise bring coverage to an end. The consequences of insolvency will depend upon the policy wording with the provision relating to the company's insolvency often being among the most heavily negotiated before inception of a policy.

As stated above D&O policies operate on a 'claims made' basis meaning that absent agreement to the contrary the ability to make a claim ends upon expiry/termination of the policy. However, that is subject to operation of the discovery period; this is the agreed period following the end of the policy during which claims can still be made or circumstances that might give rise to a claim notified to the insurer. The effect of making a claim or notification during the discovery period is to preserve cover under the policy in respect of that event.

It is also worth noting that the involvement of an insurer can be beneficial to the claimant as it creates a 'professional defendant'. The policy will usually provide for the insurer to assume conduct of any claim and it will have a more pragmatic (and financially motivated) approach to the defence of a claim.

Therefore, upon appointment, an IP should be taking the following steps in respect of a D&O policy:

1. Policy review. The IP will need to satisfy himself that the policy remains in force, what the effect of his appointment is upon the policy and the duration of any notification period. The IP must also ensure that he takes no steps to vitiate the policy while in office or to prevent a successful claim due to a breach of terms.
2. Review of potential claims. A review of possible claims will be an essential part of an IP's work. Clearly, any claim is only worth pursuing where there is a recovery and a claim against directors will depend heavily on their ability to satisfy any judgment obtained or settlement reached. For this reason an IP will be more comfortable where a D&O policy is in place that will facilitate a successful recovery.

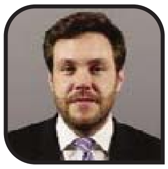
"A D&O policy can be a valuable asset to an IP in his pursuit of recoveries into an estate."

3. Timely actions. The IP will be keen to ensure that he is able to claim against any D&O cover. He will therefore need to make a notification to the insurer at the earliest opportunity of any facts that might give rise to such a claim. This will preserve the coverage.
4. Disclosure of policy information. It is possible that third party claimants may seek details of a D&O policy from IPs under s2(1) of the Insurers (Rights Against Third Parties) Act 1930. However, where the company is not a party to any such claim there will be no obligation upon it to disclose the policy. Rather it will need to consider the benefit to the estate of disclosure particularly the possibility of removing a claim against the company itself.

Conclusion

A D&O policy can be a valuable asset to an IP in his pursuit of recoveries into an estate. Not only can it be a source of funds to settle a successful action but it will also include the insurer in the defence process as a more predictable and pragmatic opponent than the company director.

However, it is important that the IP ensures that he takes no steps that prejudice the company's rights under the policy, be that failing to act during the disclosure period or, where the policy survives appointment, breaching its terms. □



TIM MOYNIHAN is an associate at Reynolds Porter Chamberlain LLP.

Private prosecutions in corporate insolvencies

Direct access barrister and authorised litigator **Mark Smith** on the advantages of seeking a private criminal prosecution in a recovery process.

IPs should not overlook the role that a well-founded private criminal prosecution can play in the recovery process, in both administration and liquidation. These proceedings, in comparison to the civil routes available, have several advantages:

1. **Speed** A criminal case will normally be completed in less than 12 months, unless it is very complex, in which case could last up to two years. Both of these timescales still compare favourably to lead times in most civil processes.
2. **Power** The threat of conviction, confiscation, disqualification or even imprisonment will motivate many a dishonest director to cooperate, and the powers of the court if cooperation is not forthcoming are extensive.
3. **Cost** The practice of the court is to order costs in favour of a prosecutor from state funds, even if no conviction resulted, so long as the case is not deemed unreasonably brought. A successful prosecution with a confiscation order can increase the yield to the creditors at very low net risk of cost.

The powers of the IP

The process begins when suspected criminal conduct is encountered in preparation for, or the course of, a corporate insolvency. The duties to report suspected criminal conduct to the Secretary of State do not bar the institution of proceedings by the IP independently. The Prosecution of Offences Act 1985 makes provision for both companies and individuals to bring private prosecutions against offenders. An administrator has the power under IA Schedule 1 para 5, and a liquidator has the power under Schedule 4 Pt II para 4.

Types of conduct covered

The Insolvency Service estimated that nearly one-third of insolvencies investigated in Q1 of 2014 contained suspected criminal wrongdoing by directors. The types of conduct relevant, where committed by directors or shadow directors, include:

- False representations by a director or shadow director to obtain member or creditor approval of a CVA (even if it is not approved).
- Fraud in anticipation of winding up. This encompasses concealment or removal of company property in the 12 months before a winding-up begins.
- Transactions in fraud of creditors, in the five years before winding up company property has been gifted or sold at undervalue, with intent to defraud creditors.
- Misconduct in course of winding up, failing to deliver property, records and information to the liquidator, or attempts to create a false expense claim.
- Falsification of company's books.
- Material omissions from compulsory statement relating to company's affairs.
- False representations to creditors to obtain consent to a step in the winding-up.
- Fraudulent trading under s.993 CA 2006, carrying on business with intent to defraud creditors or for any fraudulent purpose, by anyone concerned with the management of the company, whether or not any formal insolvency process has begun.

The procedure

Once the IP has firm evidence of such conduct it can be placed before a specialist private prosecution lawyer. If the prospects of a successful outcome are good then the preparation of the evidence to place before the court (witness statements and paper exhibits) begins, and the charges are then

> "The whole process from inception to verdict is normally complete within 12 months."

laid at the magistrates' court. The stage of being ready to lay the charges can take anything between two to eight weeks after the go-ahead is agreed. If the allegations are denied then a trial will take place in either the magistrates' or Crown Court. The whole process from inception to verdict is normally complete within 12 months, and can of course be far quicker.

Purpose

The purpose of deploying this process in the context of an insolvency is that the court has power to order compensation to be paid by those convicted in their personal capacity. There is no hiding behind the 'corporate veil'. The 'victims' for this purpose can be either the company or the general body of creditors, and so the proceeds of such order will be of benefit to the recovery process. The court can also utilise its powers under the Proceeds of Crime Act (POCA) to order that a detailed investigation of the convicted person's assets be undertaken, with a view to a confiscation of criminal proceeds hearing. This process could result in even greater yield to compensate any losses caused, as the powers of investigation under this Act are draconian and the scope of what is recoverable is widened significantly. (Readers may well have acted as POCA receivers under orders of the court).

Cost

There is an initial legal fee to bring the case to the stage of laying the charges once the decision has been made to proceed, normally of the order of £2,000–£4,000 plus VAT. Once the case has been accepted by it, the court has power to award legal costs of the prosecution whether or not there is a conviction, and in practice will order that those costs are met from central funds even if the accused person is acquitted, so long as the case is not deemed to have been 'unreasonably brought'. This test would be passed so long as there is a reasonable body of evidence, and no improper motive for launching the case. There will also be allowances in any event for travelling, subsistence, and loss of earnings for the IP and witnesses. This means that in such circumstances the process is cost-neutral overall, which should help to convince in cases where sanction is needed to embark on legal action.

In the event of conviction the court can make an order that costs be paid by the convicted person, and this amount can include an element for the investigative and preparatory work by the IP on the criminal case.

Charles Ranby-Gorwood of CRG Insolvency and Financial Recovery in Grimsby, an enthusiastic user of the service, has commented that he hopes to be able to build it into more cases in which creditors could be helped in the funds recovery process.

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Career progress

Two of the 2013 JIEB award winners offer tips about their study methods and talk about their career progression following their successes.

TIM ARMSTRONG, who won the IPA and ICAEW prizes, found routine and the support of his firm, PwC LLP, helped him study and revise in the run-up to his exams.

Tell me a little about what work you're doing at the moment.
Since taking the JIE, I've been working on a really wide variety of projects. This has covered the more 'traditional' restructuring projects such as trading insolvencies and lending reviews, but also running AMAs and advising companies on cash flow forecasting and working capital improvements.

I am really enjoying the variety of work that I can get involved with, and being JIE qualified is helping me to be a more rounded restructuring adviser.

How important is the JIE to your career progression?
The JIE is really important to my future career progression. I have wanted to take the exams for a little while and was very pleased to get the opportunity to do so. Although I'm keen to experience a variety of work, I am looking forward to the opportunity to take appointments in the future.

How did you manage your workload and work/life balance with studying? And what are you doing with the extra time you have now you're not committed to so much studying?
The exams were really tough as they are time pressured and such a wide range of topics could be covered. I was fortunate enough to be supported by my firm who gave me some time off for study in the lead up to the exams. Having said that, I started studying in April and tried do one day of study each weekend, which I think put me in a reasonably good place by September time when revision courses began.

I'm definitely enjoying having my weekends back and, since taking the exams, I have married and bought a new house – both of which have helped to fill the time gap left by study!

How did you celebrate winning the IPA and ICAEW prizes?
Having left my twenties behind this year, the celebrations these days are a little more relaxed than when I was studying for ACA a number of years ago! The results were released in the afternoon and I took time off work to get my results at home. I was obviously delighted to see I had passed and then found that I had won the prizes. Once I got over the shock of that, I went out for a couple of drinks with friends in Norwich to celebrate in the early evening and then headed out for a meal with my wife, Eleanor.

What tips do you have for current and future students?
My most productive day of revision was when my wife managed to lock me in our house while she went off to work in Ipswich! I'm not sure that this is a 'tip' or 'revision technique' per se, but certainly ensured I got through quite a few hours of practice papers!

I think it's really important to find a method of revision that works for you as an individual. It's definitely a marathon not a sprint in terms of the work over the course of up to a year for learning and revision and I think unless you settle into a routine, the workload will become unmanageable. For me, it was getting up early to get some revision done before the day really began and never finishing later than around 6pm, then making sure that I took one day off per weekend and not taking any revision with me on holiday!

LEE GREEN passed his JIEB last year and became a licensed IP at Larking Gowen, where he runs the Norwich insolvency team. He won the Leonard Curtis prize and the R3 SPG prize.

What work are you doing at the moment?
I'm actively involved in approximately 100 live cases of varying types. Recent cases include the voluntary liquidation of a mobile platform services company and a compulsory liquidation involving the recovery of a six figure sum from a European lawyer operating out of Switzerland. I have also been heavily involved in overseeing compliance reviews, allowing me to use technical knowledge from the JIEB qualification.

How important is your JIE success to your career progression?
It has been instrumental. Shortly after passing I was promoted to manager within the firm and obtained a non appointment taking licence. I hope to start taking appointments next year, which will be a big step in my career progression. Ultimately the success may allow me to achieve my ambition of becoming a partner within the firm.

The JIE papers are notoriously tough – how did you manage your workload and work/life balance with studying?
At the outset I found it very difficult to be motivated to study after a day at work. I found it easier to come into work an hour early, one or two days a week. I continued playing sport on Saturdays, but I would study for a few hours in the morning so that I could have a break later that night. Sunday would be similar and I usually saw family later in the evening.

What are you doing with the extra time you have now you're not committed to so much studying?
I made a point of not changing my lifestyle too much, but I'm now playing squash again and have also started freestyle skiing lessons at my local dry slope.

How did you celebrate winning the Leonard Curtis and R3 SPG prizes?
On the day of the results our whole team went out for food after work and celebrated with a few bottles of champagne. Then in June I attended the JIE awards ceremony at the British Medical Association to receive my certificate and prizes. It was a prestigious event, followed by a drinks reception in the enclosed gardens. I stayed until the very end, before heading to a nearby bar with a few other attendees to watch the Netherlands vs Spain World Cup game – the atmosphere was great. With the prizes I bought myself a new iPad and I went away for a week in the sun with my partner.

What tips do you have for current and future students?
Learn to love the *Butterworths Insolvency Law Handbook*. Colour coded tabbing for the exam is essential, although you need to limit the amount of tabs or I doubt it's effective. Book time off before the exam. I was lucky to get four weeks' study leave, added to the time I spent on revision courses, plus some of my own holiday entitlement. In the month leading up to the exam I had a full schedule of what I would be studying each day, and found it beneficial to do a few days together of the same syllabus. I also scheduled in mock exams and stuck to doing them in exam conditions as best I could. Lastly, don't over study, and allow time to socialise – otherwise you'll resent study.

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Joint Insolvency Examination – November 2014

Congratulations to all the successful candidates.

JIEB 2014 prize winners

Insolvency Practitioners Association Prize for First Place
Russell Simpson

PricewaterhouseCoopers Prize for Second Place
Rachel Lai

Leonard Curtis Prize for Third Place
Tania Kallis

Association of Chartered Certified Accountants' Prize (awarded to the ACCA member with the highest mark)
Rachel Lai

ICAEW Prize (awarded to the ICAEW member with the highest mark)
Luke Wiseman

Insolvency Lawyers' Association Prize (awarded to the lawyer with the highest mark)
Helen Fairhead

Institute of Chartered Accountants of Scotland Prize (awarded to the candidate in the Scottish papers with the highest and sufficiently meritorious marks)
Scott Adams

BPP Prize (awarded to the candidate with the highest mark in the Personal paper)
Russell Simpson

R3 Smaller Practices Group Prize (awarded to the candidate with the highest mark from a smaller practice)
Tania Kallis

A
Addley M (8067) Cambridge
Andrew A (8155) High Peak

B
Ball C (8165) Manchester
Bishop G (8232) Caerphilly
Brunt H (8195) Wakefield
Buck A (8241) Newton Abbot
Buckley G (8152) Oldham

C
Carmichael J (8015) Glasgow
Carrington L (8246) Nottingham
Cavanagh N (8153) Altrincham
Clark P (8197) Leeds
Coomber M (8032) London
Cray E (8146) Birmingham
Cusack N (8223) Fareham

D
D'cunha V (8243) Berkhamsted
Dixon S (8208) York
Dobson H (8501) Southampton
Donohoe M (8093) London

E
Edkins D (8118) Rochester
Edwards J (8192) Leeds

F
Fairhead H (8097) London
Farrell A (8500) Paisley
Ferguson C (8236) Newcastle Upon Tyne
Ford L (8235) Newcastle Upon Tyne
Fowler R (8023) Craigavon

G
Gearing J (8049) Grays
George W (8136) Presteigne
Gilks A.M (8193) Leeds

H
Haines R (8115) Reading
Hann M (8071) St Albans
Harper E (8139) Lichfield
Haynes A (8046) Hornchurch
Hichens J (8190) Leeds
Holborow M (8072) Tonbridge
Holloway N (8068) London
Holt M (8174) Todmorden
Holton N (8248) Northampton
Hooper C (8079) Orpington
Howarth G (8207) Leeds
Howarth J.L (8161) Sale
Hughes R (8191) Leeds

J
Jagger S (8078) London
John A (8103) London

K
Kallis T (8083) London
Knott C (8173) Stoke-On-Trent
Kwei C (8234) Cardiff

L
Lai R (8228) Cardiff
Latimer G (8019) Belfast
Lennon M (8157) Manchester
Lewis M (8199) Leeds
Livingstone A (8008) Glasgow
Lloyd C (8113) London
Lockwood K (8180) Manchester
Lysandrou P (8075) Wembley

M
Maddalena D (8213) Bristol
Mantle S (8202) Leeds
Mason K (8218) Bideford
Mitchell E (8237) Newcastle Upon Tyne

N
Nelson I (8163) Manchester
Ng C (8172) Oldham

O
O'Keefe C.N (8086) London

P
Parrott B (8062) London
Piacquadio M (8135) Milton Keynes
Pinder R (8196) Mansfield
Pinteau D (8035) Kingston Upon Thames

R
Raggett D (8002) Edinburgh
Rea S (8042) Guernsey
Reeds M (8221) Poole
Robbins J (8162) Nelson
Roden J (8129) Walsall

S
Savage H (8131) Birmingham
Sharma R (8239) South Shields
Simpson R (8073) London
Sims J (8074) London
Skey C (8502) Knutsford
Steele S (8109) Brighton
Stone A (8170) Manchester
Stratten N (8056) Epsom
Swan K (8137) Birmingham

T
Thompson E (8116) Barnet
Tilley G (8145) Rugby
Todman S (8085) Morden

W
Waldron B (8148) Derby
Wallis D (8060) London
Wentworth L (8215) Tunbridge Wells
Wiseman L (8090) London
Wright O (8169) Manchester

Y
Young R.A (8098) Kent

Z
Zia J (8082) London

Analysis of November 2014 results

Papers sat	Papers passed				
	3	2	1	0	Total
3	52	19	8	24	**103**
2	–	25	22	23	**70**
1	–	–	32	44	**76**
Grand total	**52**	**44**	**62**	**91**	**249**

How was it for you?

Stephen Allinson reviews his first year as chair of the Joint Insolvency Examination Board.

Once again, I am writing this article as candidates await the results of the 2014 examination. All involved in the JIEB take a very active interest in the results and we have a wealth of information available to us, so we can judge how we as a board have done. We take great pride in the examination process and for the students, passing the JIEB is a real achievement.

It certainly has been a baptism of fire for my first year, as I don't think the profession has ever been in the headlines as much as it has in the last 12 months. Clearly, it is important that the JIEB keeps abreast of those developments and changes, as we must ensure that any examination reflects the current state of the market.

It has been a real privilege, however, to develop the board against this background and I believe I can truly say that we are 'fit for purpose' as we move forward.

I want to express my thanks to all my fellow board members. We give our time voluntarily and without any remuneration and often deal with matters 'out of hours' due to the pressures of our day job. Similarly, our whole team of examiners, moderators and markers spend many hours ensuring that the examination runs smoothly. This year we have had a new senior moderator, Steve Treharne, and he has slotted in excellently to the role (he even told me recently that he had enjoyed his first year!).

Reviewing the way JIEB operates

Last year in writing for *RECOVERY* magazine, I talked about responding to the changes in our professional world. In particular, the partial licensing debate was raging and as we know, these will now be brought into play. JIEB has been very much part of the debate (although as we exist through a memorandum of understanding with the RPBs we must hear their views), and I am predicting that this subject will be on my radar in the coming year. As always, we will seek to ensure the examination process responds to the needs of the profession and so I am seeking to move the position forward with representatives of The Insolvency Service at the moment.

The timing of the new Rules (seemingly in 2016) could present an interesting challenge too, with a November examination traditionally not formally examining changes post-April in that year! I have decided to cross that bridge when it comes, so watch this space.

The examination must be more than just a theoretical test of insolvency knowledge and we are always aware as a team of people responsible for it, that we want to seek out, through our questions, those candidates who have a real feel for the practice of insolvency in the professional world.

"I believe passionately in the power and advantages of professional education and I will continue to champion this examination and its processes."

Much has been said about a separate paper on ethics, and as the examination process evolves with the partial licence position, inevitably there will be changes and possibly new papers. However, ethical issues can, and are, examined in all papers and that will always be the case, regardless of the format of separate papers moving forward.

So, how have we reacted to the ongoing developments in the insolvency world? I hope we have, and will, embrace the changes. The examination must always be an accurate test of the up-to-date position in the insolvency and restructuring world we work in.

Last year I mentioned the assessment of future IPs' soft skills and received some interesting feedback on that area. Soft skills are becoming more and more important so it is a debate that I hope continues.

A few general points to finish

First, I and my team, always welcome feedback (positive and negative) on the examinations as set and the overall process. Please feel free to contact me at the email address at the end of this article.

Second, I should announce now, that it is highly likely that the cost of sitting the examinations will have to rise this year to reflect the ongoing and extra costs we are incurring, particularly through our move to e-marking. This year was the first year that it took place for one paper, but we intend to roll that out across the board for the forthcoming examinations.

Third, it is a matter of some disappointment to me that the numbers entering the JIEB are reducing year on year. Is this indicative of how firms are looking at training and career development issues for their staff or is there a bigger picture to consider? I believe passionately in the power and advantages of professional education and I will continue to champion this examination and its processes. Surely as a profession we need to see increasing numbers of young professionals want to qualify as IPs?

Finally, and on a more positive note, I look forward to meeting and greeting those who have passed our examinations at the ever-popular graduation ceremony in June this year. It will be my pleasure to raise a glass with you, for achieving success in the Joint Insolvency Examination is a significant professional honour and one that indeed should be celebrated. ◻

STEPHEN ALLINSON is a consultant solicitor and licensed IP with Lester Aldridge Solicitors.

To give feedback on the JIEB examinations, please contact: steve@allinsonlaw.com

Trust deeds versus trustees

Thomas Robinson details changes in bankruptcy and pension rights under UK and EU pension schemes.

In December 2014 the High Court handed down judgment in *Horton* v. *Henry* [2014] EWHC 4209 (Ch), holding that an income payments order under s310 of the Insolvency Act 1986 (IPO, s310)[1] could not be made in respect of sums that a bankrupt would be entitled to under a personal pension plan on the exercise of his election to take them. In so doing the court declined to follow the reasoning in *Raithatha* v. *Williamson* [2012] 1 WLR 3559.

> The position in bankruptcy is now very different to that regarding third party debt orders.

This article considers the current state of the law as regards the pension rights under a bankrupt's UK pension scheme, before considering the position of bankrupts with pensions administered elsewhere in the EU.

Key points

a) The reasoning in *Horton* is to be preferred over that in *Raithatha*, and the former case gave due weight to the legislative policy behind the amendments to s310 made by the Welfare Reform and Pensions Act 1999 (WRPA 1999).

b) The position in bankruptcy is now very different to that regarding third party debt orders. On an application for such an order the court can access pensions not yet in payment but to which a defendant would be entitled on the exercise of an election (*Blight* v. *Brewster* [2012] 1 WLR 2841). Those advising individuals considering bankruptcy, and those advising judgment creditors, should note the stark difference.

c) The treatment of rights under pension schemes administered outside the UK stands in marked contrast to those under most UK schemes. WRPA 1999 provides at s11 that rights under 'approved pension arrangements' do not vest in a Trustee in Bankruptcy (TiB). This will cover almost all UK pension schemes, but is unlikely to cover those administered elsewhere in the EU. The starting point is that rights under pension schemes administered elsewhere in the EU are likely to vest in a TiB.

d) However, the governing provisions of such a scheme should be studied with care to determine the effect of this. In particular, a 'forfeiture clause' may have been included, providing that in the event of a member's bankruptcy his rights to benefits are suspended or forfeit. Under English law such clauses are of no effect, but English law is unlikely to apply to such schemes. A TiB may find that the bankrupt's rights therefore vest, but are of no value.

Raithatha v. *Horton*

In *Raithatha* the High Court (Bernard Livesey QC) decided that an IPO could be made in respect of entitlements under a personal pension scheme to a lump sum and an annuity, even where the bankrupt had not exercised his right under the scheme to elect to take them. The court considered it sufficient that he was *able* to exercise such a right, by reason of his age and the sums in his pension pot. The pension payments were held to be payments to which the bankrupt had an entitlement, and thus fell within the meaning of s310(7): *'payment in the nature of income which is from time to time made to him or to which he from time to time becomes entitled'*.

> The payments were held to be payments to which the bankrupt had an entitlement, and thus fell within the meaning of s310(7).

Although permission to appeal was given the matter was compromised before any Court of Appeal hearing.

Courts have had real difficulties implementing the decision in *Raithatha*. The author has experience acting for TiBs where complex orders have had to be drawn in order that the relevant pension provider is directed how to give effect to what is in reality the court's election that the bankrupt should draw down pension payments. For example, which units of a personal pension are to be used to fund a lump sum? Are periodic payments to take the form of flexible or capped drawdown, or is the bankrupt to be forced to buy an annuity, and if so on what terms? It is not a situation of simply 'asking for payment' as the court described it in *Raithatha* at paragraph 37.[2]

The court in *Horton* was alive to these difficulties. It was also aware of the legislative background to amendments made to s310(7) in 2000 by the WRPA 1999. These formed part of wide-ranging changes to the treatment of pensions on bankruptcy. In particular, s11 of WRPA 1999 provided that the rights of a bankrupt under 'an approved pension arrangement' were excluded from his estate (thus reversing the decision in *Re Landau* [1998] Ch 223, which had held that a member's 'bundle' of rights under a personal pension scheme formed a chose in action that was property within the meaning of s436 and therefore vested under s306. *Re Landau* was applied to rights to a lump sum and annual payments under an occupational pension scheme in *Patel* v. *Jones* [1999] Pens LR 2003, which was upheld on appeal).

> It is not a situation of simply asking for payment.

As a quid pro quo for this protection for bankrupts, s14 of WRPA 1999 provided that a person's rights under a pension scheme could not be forfeited by reference to his bankruptcy. This referred to the relatively common practice of inserting 'forfeiture clauses' in a pension scheme's governing instrument that provided that if any act occurred whereby a member's benefits would be vested in another, the right to those benefits were forfeit to the scheme.[3]

Against this background the court in *Horton* (Robert Englehart QC, who also heard *Patel* v. *Jones*) construed s310(7). It held that at a time when a bankrupt had not elected to receive payments from his pension, he had not become 'entitled' to them. The word 'entitled' suggested pensions that were in payment, thus already payable. The fact that the court had no obvious power to decide how a bankrupt should exercise his right to elect was described as a 'formidable problem'. Further, the conclusion that the TiB could exercise the bankrupt's bundle of rights under the scheme appeared inconsistent with the intention of WRPA 1999 to exclude those rights from a bankruptcy estate.

The reasoning in *Horton* is persuasive, both as regards the statutory construction and as giving effect to the legislative intention in this area. Being entitled to exercise a right is fundamentally different from 'becoming entitled' to a 'payment in the nature of income'.

As regards statutory construction, the court in *Raithatha* considered that although pension rights did not vest in the trustee, the court had power to make an IPO in respect of a pension entitlement because of the insertion to s310(7) made by WRPA 1999, namely the words in bold: '*the income of the bankrupt comprises every payment in the nature of income… to which he from time to time becomes entitled including… (**despite anything in section 11 or 12 of the [WRPA 1999]**) any payment under a pension scheme but excluding any payment to which subsection (8) applies*'. It is odd to find this insertion being used to cut down the clear meaning of the statute making the insertion. As *Horton* noted at paragraph 26 it is more likely these words are intended to ensure that an IPO could be made against pensions in payment from personal (as opposed to occupational) pension schemes. Such schemes are covered by ss11 and 12 of WRPA 1999, but are not covered by any wording expressly allowing an IPO, unlike s91(4) of the Pensions Act 1995, which allows an IPO in respect of an occupational pension scheme.

It is hoped the Court of Appeal will uphold the *Horton* decision when it hears the appeal later this year.

Third party debt orders

If *Horton* is upheld, there will be a stark difference between the treatment of pension rights on bankruptcy and on an application for a third party debt order. On an application under CPR 72 the court has power to order a third party to pay to a judgment creditor '*the amount of any debt due or accruing due to the judgment debtor from the third party*' (CPR 72.2(1)(a)).

The High Court in *Blight* v. *Brewster* [2012] 1 WLR 2841 (Gabriel Moss QC) held that in order to aid enforcement of a judgment the court could order a defendant to delegate his power of election under a personal pension scheme to a third party (in that case the claimant's solicitor) so that an election could be made on the defendant's behalf to draw down a lump sum, which could then form the subject matter of a third party debt order. If the defendant did not comply the court authorised the claimant's solicitor to write to the pension provider direct, exercising the power of election in the name of the defendant.

Those advising individuals in financial difficulty thus have all the more reason to establish whether judgments have been entered against them, and whether pensions are held.

EU pension schemes

Where a bankrupt has moved to the UK from elsewhere in the EU, he may hold rights under a scheme administered in another member state. Those rights are most likely to vest in any TiB, as such a scheme is most unlikely to be an 'approved pension arrangement' under s11 of WRPA 1999. The main category of such schemes comprises schemes registered with HMRC for UK tax purposes that are (i) *'occupational pension schemes'* (defined in s150(5) of the Finance Act 2004) or (ii) personal pension schemes that are established by persons with permission under FSMA 2000 to establish such schemes in the UK (s154 of the Finance Act 2004).

The Insolvency Service has reacted to this difference in treatment by publishing guidance to official receivers that rights under a scheme that is tax-approved in another EU country should be treated as though they were rights under an approved pension arrangement.[4] This is to be given effect by entering a 'qualifying agreement' with the bankrupt that the rights are excluded from the estate.

However, even if the bankrupt's rights do vest, that only raises the question of what rights a bankrupt member has under the scheme's governing instrument. One issue that may arise here is the validity of any forfeiture clause. WRPA 1999 provides that as a matter of English law rights under

> Those advising individuals in financial difficulty thus have all the more reason to establish whether judgments have been entered against them and whether pensions are held.

occupational and personal pension schemes cannot be forfeited by reference to bankruptcy. However, (i) a scheme administered in another member state is highly likely to be governed by the law of that member state, and (ii) even if English law were to determine the validity of a forfeiture clause in an EU-administered scheme,[5] the definitions of occupational and personal pension schemes used in WRPA 1999 concern UK schemes. The TiB may therefore find that the bankrupt's rights vest, but are of no real value. ◻

The author is extremely grateful to Alaric Watson and other members of 11 Stone Buildings for discussions on the points made in this article. All errors remain his own.

1 References to statutory provisions hereafter are to those of the Insolvency Act 1986 unless otherwise stated.

2 For a court grappling with some of these difficulties see also *Re X* (Application for Income Payments Order) [2014] BPIR 1081 at [52].

3 See the discussion of such a clause, and its validity under the law pre WRPA 1999, in In *Re Scientific Investment Pension Plan Trusts* [1999] Ch 54.

4 www.insolvencydirect.bis.gov.uk/ technicalmanual/ Ch61-72/Chapter61/Annex/FAQ - PENSIONS IN BA.htm

5 Perhaps by reason of Article 4 of the EC Regulation on Insolvency Proceedings 2000 (EC/1346/2000), although this must be arguable.

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A changing landscape

Peter Sharp examines efforts to retain the Jackson exemption.

With the days of the Jackson exemption apparently numbered, the use of conditional fee agreements (CFAs) by practitioners is set to become less attractive. While CFAs will still remain a possible option, it is a good time to explore the limited experience so far of damage based agreements (DBAs). Are they more attractive as a viable mechanism to enable valuable rights to be pursued? This article seeks to identify lessons learned, and point out the structural, financial and ethical difficulties that have so far inhibited their use.

DBAs: the core components

It is worthwhile revisiting the core components. The central concept is straightforward. Instead of a time-based fee, the lawyer is entitled to a percentage of the amount recovered. There is a cap of 50 per cent. Below that cap, there is no guidance concerning what would be the 'right' level for any particular type of case, whatever its simplicity or difficulty.

Practitioners regularly commission commercial litigation, and will appreciate that time charges, while central to the costing exercise, are by no means the only component. The regulations make no provision, nor could they, for the fees of experts, forensic accountants and others.

> “Below the 50 per cent cap, there is no guidance concerning what would be the right level for any particular type of case, whatever its simplicity or difficulty.”

Barristers are now allowed to provide their services on a DBA basis, but that element of expense is not without its problems: a theme that will be revisited later in this article.

Is a DBA right for my case?

So, with a commercial litigation scenario to be pursued, how has the landscape changed for the practitioner looking at their options? There is no doubt that budgetary considerations play a dominant role. In an insolvency scenario, there is of course real cash constraint; the estate has valuable rights, but simply does not have adequate free resources to pursue the claim.

This can particularly be the case in relation to the failure of smaller businesses, which have valuable rights, for example based on anti-trust abuses. The remedies available could transform the outcome for creditors, but the budgets required to take on larger opponents are beyond their reach. For them, the DBA can be a lifeline.

In such scenarios, the willingness of a firm to act on a DBA basis may unlock potentially valuable rights to be pursued. Other factors may bear on the appropriateness of a DBA for any particular case. These can include simplified case monitoring that may be feasible in a DBA scenario. It is no longer of direct concern to the DBA client just how many hours any particular task has taken at the firm. The quality of work is of course of paramount importance, as ever, but the firm now takes the 'risk' that any task will take, say, ten hours when it might have taken five. But an important challenge is the impact a DBA relationship may have on the client/solicitor relationship.

The DBA regulations provide no guidance concerning how case strategy decisions are to be taken. Where there is a range of options with varying time and expense implications, how are those

"It is no longer of direct concern to the DBA client just how many hours any particular task has taken at the firm."

choices to be managed when the cost falls on the law firm, not the client? Where a lowish settlement offer is made, but the client might be interested, how is the difficult decision to be made that the strong case for a high value should be 'sold out' for a small proportion?

Answers to these questions rest with the need for the relationship between practitioner and law firm to be one of transparency and trust, since there are inherent 'conflicts' in these scenarios that are inescapable in a DBA case.

Key areas for reform

The uptake of DBAs in relation to commercial litigation has been very limited. There are several reasons for this. To date, most attention has been paid to the lack of a 'hybrid' option: on a 'pay as you go' basis, the law firm would be remunerated at discounted hourly rates for the work undertaken, supplemented at the end of a successful case by a percentage of the amounts recovered. This is common practice in the United States; however, UK regulations do not permit a hybrid approach. Commentators had expected that a reform could clarify that hybrid structures are permissible, but this was ruled out in a Ministry of Justice statement in November 2014.

The possibility that barristers might now be available on a DBA basis was cited earlier. In practice, however, there may be limited willingness among barristers to embrace the DBA approach. To an extent, this is attributed to concern that the appropriate contractual structure is as yet unclear, and conflict issues integral to a contingency approach left unresolved. This makes it challenging to find the right barrister team for a complex case, on a DBA basis. Meantime, since the rules forbid the firm to charge more than the contingent fee, and wrap the involvement of the barrister team into that, the alternative scenario is for the firm to incur the expense of the barrister team on its own account. For substantial commercial cases, this may be a risk that many law firms are simply unwilling to incur.

This leads us into the problematic area of cost recovery. It is remarkable how challenging this topic has become. Baulking at the notion that an unsuccessful DBA defendant should have to indemnify the claimant in relation to the contingency fee, UK legislators have adopted an approach based on fiction. An unsuccessful defendant in a DBA case will be ordered to pay a hypothetical amount equivalent to the costs that might have been payable, had the claimants' lawyers been working on a conventional time basis.

As a matter of public policy, this may be a tolerable compromise, requiring the defendant to pay something while not punishing them for being unsuccessful at the hands of a DBA claimant. It does, however, mean that the paraphernalia of conventional costs-related activity remains in place in a DBA case, which some might see as an unfortunate inefficiency in the regime.

The difficulty does not stop there. To ensure that the successful firm will not 'over recover' from their client's winnings, the rules require two things: That the 'fictional' fee award should only be recovered from the unsuccessful defendant and no one else, and that the successful claimants' lawyers should be rewarded as regards that amount, only if and to the extent that they are successful in enforcing that costs award.

The bizarre implications of this construct have given the greatest difficulties in working with clients to put in place DBA arrangements in relation to complex cases. They have also dampened the enthusiasm of firms to enter into these arrangements in the first place. For a mid-value commercial dispute, the risk exists that a successful claimant legal team could nevertheless go completely unpaid. To the extent that they are not able to recover the costs award from the unsuccessful defendant, and if the costs on that basis broadly equate to the amount of the contingency fee, there may be no remaining basis on which the claimant is obliged to remunerate their successful lawyers. This in turn leads into difficult issues concerning the allocation of partial payments.

To illustrate this, suppose that the DBA claimant has won a judgment for £5m and that the costs incurred would have totalled (on a conventional basis) £1m. The firm agreed a 30 per cent DBA with their client. Assuming the judgment is satisfied, you would think the firm would be happily expecting to receive a fee of £1.5m, which is a premium over costs on the conventional basis. However, how does this play out if the defendant hands over a

"Practitioners may be despairing of DBAs ever being a useful tool."

lump sum of £3m to the claimant, but is not able to pay a penny more? Thanks to the rules, the successful firm must recover £1m of costs from that defendant. In calculating what they are entitled to recover from their client, they are deemed to have done so. If that £3m payment is all appropriated to the principal amount of the award and not paid in relation to costs, the most the successful firm will be able to earn is £500,000, making a significant loss on its work.

What does the firm do? Do they try to argue with their client that part of the lump sum payment should be appropriated to costs, so that it can go towards paying the law firm's fee? Nothing in the rules helps us with this conundrum. Faced with the issues identified in this article, practitioners may be despairing of DBAs ever being a useful tool, when assessing a potential claimant action. Meantime, their prospective opponents may be thinking that they have nothing to fear since, in the complex commercial dispute world, it is unlikely they will have to confront such a case. For the DBA to take its place as a useful tool that can be used responsibly in appropriate cases, it is clear that much needs to be done, to turn this innovation from a stumbling prototype into a production model.

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Cross-border insolvency – modified universalism or a retreat to territorialism?

In a world where business is conducted on a global scale tensions between the insolvency laws of competing jurisdictions will often arise.

As collapses of companies with international interests have become more prevalent there have been calls for an international convention that seeks to regularise international insolvency and provide a clear road map for cross-border cooperation. From a domestic perspective, these attempts at harmonisation may also be supported by common law principles of judicial cooperation.

There are two competing views on how cross-border insolvency should be approached. Territorialism is the traditional view that insolvency proceedings in one jurisdiction have no application to the assets of the estate located in another jurisdiction. It dictates that parallel insolvency proceedings will need to be opened in other jurisdictions in which the estate has assets, which will then be subject to the local laws applicable to that jurisdiction.

Conversely, universalism is the premise that one set of insolvency proceedings should be recognised automatically and applied worldwide to all of the property and interests of the debtor wherever they may be without the need for parallel foreign proceedings.

> There are two competing views on how cross-border insolvency should be approached.

At the heart of the struggle to adopt a more universalist approach lies public policy considerations and, principally, the expectation of reciprocity between jurisdictions.

There have been various attempts to encourage cross-border collaboration – for example the EC Regulation on Insolvency Proceedings (the EC Regulation). The United Nations Commission on International Trade Law also established a working party to provide a framework for cross-border insolvencies. The result was the Model Law on Cross-Border Insolvency

(the Model Law) which is a form of 'modified' universalism that accepts the premise of universalism but allows local courts the discretion to evaluate the fairness of foreign procedures and to apply a choice of law that best protects the interests of its domestic creditors and other local stakeholders.

The principle of modified universalism, which was described by Lord Hoffman in *HIH Casualty and General Insurance Ltd*[1] as *'the golden thread running through English cross-border insolvency law since the 18th century'*, encourages the English courts to adopt, so far as is consistent with justice and UK public policy, a borderless insolvency regime. The Cross-Border Insolvency Regulations 2006 (CBIR) incorporated the Model Law in Great Britain.

The CBIR provides a mechanism for recognising foreign insolvency proceedings (as opposed to judgments) in England and Wales and permits courts in enacting states to co-operate more effectively with foreign courts in insolvency matters.

However, recent case law suggests a trend among the judiciary to adopt a protectionist approach when interpreting both the Model Law and its ability to provide cooperation at common law.

Rubin

In its greatest leap towards universalism, the Court of Appeal in *Rubin*[2] (following Lord Hoffman's remarks in *Cambridge Gas*[3]) reinforced the view that insolvency orders should be subject to a different set of rules relating to the enforcement of foreign judgments. The motive to develop a unique set of rules is clear to see. In *Rubin*, it had been held at first instance that the New York proceedings were capable of recognition under the CBIR; however, as the judgments that had been made in the US were classified as being *in personam*, they were not enforceable in England unless any of the four cases in Dicey's Rule 36 could be satisfied. The decision in *Cambridge Gas* (which was relied upon in *Rubin*) found a way around this problem by deciding that bankruptcy proceedings were neither *in personam* nor *in rem*, but rather something different altogether. In reaching its decision in *Rubin*, the Court of Appeal extended its powers of assistance under the CBIR to permit enforcement of the US insolvency judgment in England.

> Recent case law suggests a trend among the judiciary to adopt a protectionist approach when interpreting both the Model Law and its ability to provide cooperation at common law.

However, this approach was short lived. The Supreme Court[4], by a majority of four to one, held that no special private international law rules of common law should apply to the recognition and enforcement of foreign judgments in the context of insolvency. The Supreme Court expressed the view that the *Rubin* decision had been too radical a departure from the substantially settled law. The US judgment in *Rubin* was classified as being *in personam* and, accordingly, Dicey's Rule 36 was recognised as the applicable standard for determining whether the judgment was enforceable in England.

Rubin was a setback for the proponents of modified universalism. To enforce a foreign insolvency judgment under English common law the foreign representative will now have to argue that the judgment can be enforced under the usual Dicey Rule 36 principles, open parallel proceedings in England or, if the insolvency is in a country that has adopted the Model Law, bring proceedings under Article 23 of the Model Law if the relief sought is under claw back provisions of the Insolvency Act 1986. The additional costs and expenses of operating and coordinating multiple insolvency or other proceedings will in the first instance be borne by and to the detriment of creditors.

> “The principle of modified universalism was described as the golden thread running through English cross-border insolvency law.”

The English judges have also been slow to embrace the concept of modified universalism in their interpretation of provisions within the CBIR.

Pan Ocean[5]

Article 21(1) of the Model Law (which appears at Schedule 1 of the CBIR) provides that *'upon recognition of a foreign proceeding… where necessary to protect the assets of the debtor or the interests of the creditors, the court may, at the request of the foreign representative, grant any appropriate relief.'* In *Pan Ocean* Morgan J interpreted the expression *'any appropriate relief'* narrowly and rejected a Korean administrator's application for an order to restrain a supplier from relying on an insolvency termination clause in a contract governed by English law.

Under Korean law an administrator is entitled to choose whether or not to perform an executory contract and if he chooses to do so the other side cannot rely on an insolvency termination clause. The contract in *Pan Ocean* was immensely profitable for the company in administration so the administrator naturally wanted to hold the supplier to it and asked the court to restrain the supplier. Morgan J held that the court's power under Article 21(1) was limited to granting such relief as would be available to an English office-holder, and as the termination clause would have been valid in England he had no jurisdiction to prevent the supplier from relying on it. In effect he applied the territorial approach that existed prior to the Model Law.

Saad[6]

In *Saad*, the auditors (PwC) of a Cayman Island investment company (Saad) appealed to the Privy Council.

Saad had already been wound up in the Cayman Islands and the Cayman Islands liquidators had obtained an order. However, they were dissatisfied with the information provided by PwC and opened ancillary proceedings in Bermuda as the jurisdiction in which PwC is registered in order to invoke wider powers of disclosure under section 195 of the Bermudan Companies Act 1981.

PwC appealed against the decisions of the Bermudan courts that the Supreme Court of Bermuda had jurisdiction to wind up Saad and opposed the order for relief under s195 of the 1981 Act.

The Privy Council undertook an exercise to assess the Bermudan court's jurisdiction. PwC were able to successfully argue that the Supreme Court had no jurisdiction to wind up Saad in Bermuda on the basis that Saad was an overseas company without a permit to engage in trade or business in Bermuda and, in fact, it had not traded or carried on any business in Bermuda. Accordingly, the Bermudan winding-up order was set aside and the order for the production of documents under s195 of the 1981 Act was discharged.

Singularis[7]

The case of *Singularis* is similar in its facts to *Saad*. In that case, the Cayman Island liquidators of Saad appealed to the Privy Council against the decision of the Bermudan Court of Appeal that they, in their capacity as liquidators of a foreign company, were not entitled to rely on s195 of the 1981 Act to require PwC to deliver up papers in their possession and answer questions relating to their involvement with Singularis.

PwC had successfully argued before the Bermudan Court of Appeal that there was no common law equivalent to s195 of the Companies Act 1981 and that the court should not make an order in support of the Cayman liquidation where such an order could not have been made by the Cayman court itself.

The liquidators relied on *Cambridge Gas* in support of the proposition that the court should approach the application on the basis of a theoretical Bermudan insolvency and that as the Bermudan courts could make an order under s195 of the 1981 Act in a Bermudan liquidation, it should do so to assist the Cayman liquidator. The Privy Council unanimously rejected this argument and found that, absent of any local legislation on the point, the courts have no power to apply the test of what would happen in a theoretical local insolvency when considering such an application of the foreign liquidator.

The majority of the Privy Council did, however, hold that the concept of 'modified universalism' continued to exist at common law and the courts should assist the foreign winding-up proceedings as far as they properly could. However, as there is no equivalent to s195 of the 1981 Act under the laws of the Cayman Islands it was not a function of the court to give the liquidator powers he had not been given under his own laws.

Conclusion

Cambridge Gas can be regarded as the high water mark in modified universalism. However' subsequent case law has seen a gradual erosion of its main principles. The courts are limiting the degree to which they will assist from a common law perspective and have made it clear that if there is to be any extension to the common law principles that is the function of the legislature. However, even when there is legislation in place, for example, the CBIR, the courts may still give its provisions a narrow interpretation.

> “The English judges have also been slow to embrace the concept of modified universalism in their interpretation of provisions within the CBIR.”

The benefits of a universalised cross-border insolvency regime are clear, but the reality is that without global reciprocity it is unlikely that there will be one regime that can be considered to treat all creditors fairly. As long as there is a risk that domestic creditors might be prejudiced the courts will, understandably, continue to put their home country interests first. □

1 *HIH Casualty and General Insurance Ltd* [2008] UKHL 21
2 *Rubin and Anor* v. *Eurofinance SA and others* [2010] EWCA Civ 895
3 *Cambridge Gas Transport Corp* v. *Navigator Holdings plc Creditors' Committee* [2007] 2 BCLC 141
4 *Rubin and Anor* v. *Eurofinance S.A. and others*; *New Cap Reinsurance Corporation (In Liquidation) and Anor* v. *A E Grant and others as Members of Lloyds' Syndicate 991 for the 1997 Year of Account and another* [2012] UKSC 46
5 *Fibria Celulose S/A* v. *Pan Ocean Co. Ltd & Anor* [2014] EWHC 2124 (Ch)
6 *PricewaterhouseCoopers* v. *Saad Investments Co Ltd* [2014] UKPC 35
7 *Singularis Holdings Ltd* v. *PricewaterhouseCoopers* [2014] UKPC 36

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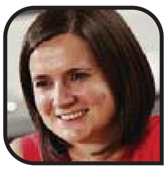

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The EU capital markets

James Hughes identifies challenges and opportunities in the capital markets union.

People often take comfort from the fact that regulation of insolvency law is primarily a national competence. While this has traditionally been the case, insolvency law is coming under increasing pressure to be further harmonised after being identified by Lord Hill, the new European Commissioner for Financial Services, Financial Stability and Capital Markets Union, as an area that may be holding back integration in EU capital markets. This creates a strong possibility that a substantial review of insolvency law may be included as a medium-term objective of the capital markets union.

There has long been an acceptance in the EU that insolvency practices can only be coordinated at the most general level given the patchwork of national laws between member states. The main EU regulation covering insolvency came into force in 2002 and focuses on coordinating how insolvency would be managed for a business operating cross-border. It identifies the competent court and introduces a set of practices that clarify the relation between courts when debtors have interests in a number of member states.

Flexibility

In 2012 the European Commission proposed a revision of the regulation to expand its coverage to include schemes of arrangement and to clarify issues around secondary insolvency proceedings and the treatment of groups of companies. The text was agreed in late 2014 and is expected to take effect in mid-2017. The Commission has proposed a further non-binding recommendation that aims to give more flexibility to the insolvency procedure and specifically allows for firms to establish early restructuring plans that would encourage firms to be rescued before formal insolvency. The Commission has encouraged member states to implement the procedures into national law by March 2015 and will carry out an assessment towards the end of the year on whether member states have adopted the measures before proposing any future action.

The Commission's traditional approach to insolvency has therefore been to respect the diversity of national approaches and to focus instead on supporting coordination of cross-border proceedings. However, over recent months increasing attention has been given to the potential barrier that different insolvency laws may be causing to the further integration of Europe's capital markets. After the new president of the European Commission Jean Claude Juncker announced in July that one of the priorities for his five-year mandate was to create a capital markets union, EU policymakers have been rigorously exploring how cross-border capital markets can be made to work more effectively.

The view that the different national insolvency regimes may be deterring cross-border investments has been gaining ground over the past months. Despite the existence of EU legislation, national regimes differ significantly. Numerous policymakers have argued that the lack of certainty over what happens if a company goes insolvent and the length of time that it could take to get an investment back are sapping investor appetite to invest cross-border. In a speech on the capital markets union in October 2014, Yves Mersch, a member of the executive board of the European Central Bank (ECB), stated that substantially different rights of preferential creditors across member states and the different rules for filing and verifying claims was a significant barrier to investment.

> "There has long been an acceptance in the EU that insolvency practices can only be coordinated at the most general level."

Complexity

The green paper on the capital markets union is widely anticipated to examine the insolvency regime specifically through a review of whether member states have implemented the Commission's non-binding recommendation that was supposed to be implemented by March 2015. Should the Commission find that member states have been slow or unwilling to do so, a legislative proposal can then be expected. The Commission is known to be cautious about the extent to which it can intervene in national insolvency laws due to the complexity of national legal systems. One option being discussed is to use a tool introduced through the Lisbon Treaty known as open method of coordination, to guide member states towards a certain policy objective rather than proposing a new legislative proposal. The procedure could encourage member states to guarantee that all insolvency proceedings must be completed within three years for example, without interfering with national legal systems.

Safe securitisation

Both of these procedures are likely to be slow and fall within the medium to long-term objectives of the capital markets union. However, the link between insolvency laws and securitisation could lead to action being taken sooner. In his October speech, Yves Mersch made the connection, 'The heterogeneity of insolvency rules complicates the creation of homogenous asset pools and therefore the securitisation process.' The link to securitisation is significant because one of the top priorities of the first stage of the capital markets union is to promote the use of 'safe' securitisation. The ECB and Bank of England have recently produced a report on the attributes of safe securitisation and a working group has been established within the Commission to develop a framework for securitisations that can receive more favourable treatment in EU prudential regulation. A consultation on a legislative proposal is expected to be launched in the near future.

Policymakers are convinced that securitisation can be a solution to restoring SME lending, which has become one of the most urgent priorities since the crisis. Securitisations are heavily regulated in the EU compared to the US, where their use is widely credited with having helped the US bounce back from the financial crisis quicker than in the EU. Policymakers believe that banks will be far more willing to lend to SMEs across the EU if they can package the loans into lower risk products and sell them on to investors. If it emerges that despite designing a safe product, uncertainty surrounding the legal process for when an SME becomes insolvent is hampering investor demand, more rapid action can be expected.

The capital markets union presents both challenges and opportunities. The UK insolvency procedure is widely considered among the most reliable and predictable in the EU. An opportunity exists therefore to export UK best practice to other member states. An equivalent risk exists that efforts to harmonise insolvency practices across the EU could imply new obligations in the UK. Active engagement in the capital markets union project will be essential in shaping the direction of future policy. ◻

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The interest rate hedge mis-selling saga: three recent judgments and a pending appeal

Sam Roberts examines the cumulative effect of these three judgments and considers some practical tips for IPs.

The troubling issue of conflicts of interest facing insolvency practitioners in claims relating to the mis-selling of interest rate hedging products (IRHPs) was first raised in an article in the autumn 2013 edition of *RECOVERY* ('Conflicting interests?' by Tina Asgarian and James Clarke, colleagues of this article's author).

At that time, SME claimants were not enjoying much success in the courts – a result of some challenging legal issues, the more promising cases settling, and the less promising ones being cherry-picked by the banks to proceed to trial. Three recent cases, however, suggest that the tide might be turning against the banks, meaning that if a company in administration has a mis-selling claim, the administrator might be sitting on a more valuable asset than first thought. If so, an IP cannot ignore a potential claim, and the prospect that it might have to sue the lender that appointed it begins to look more real.

Basis clauses aren't exclusion clauses…

The judgment in *Crestsign Ltd* v. *National Westminster Bank plc & Royal Bank of Scotland plc* [2014][1] is without doubt the closest that an SME claimant has come to outright victory in the courts in an IRHP mis-selling case against a bank for negligence or bad advice. Considering that the claimant lost at trial, this is saying a lot. Two claims were advanced in *Crestsign* – bad advice and a failure to explain properly or provide information. On the advice claim, Crestsign had a lot going for it. The judge was persuaded that RBS crossed the line into providing advice and thought the advice was negligent. This was no mean feat, given unhelpful prior case law and what the banks suggest is the default position: that they do not owe their customers a duty to advise unless expressly agreed otherwise.

In the end, however, RBS's so-called 'basis clauses' tripped up Crestsign. Basis clauses are provisions which state on their face that a bank has not advised the customer and the customer is not relying on anything the bank has said. The judge found that the effect of these clauses was that RBS disclaimed responsibility for its advice.

Regarding the information claim, the judge found that RBS was within its rights to steer Crestsign towards the IRHP it wanted it to buy, and only needed to explain that product fully, and did not need to explain the full range of available products.

… But they might be soon

For claimants in similar positions, *Crestsign* was a case of good facts and difficult law. The law, however, might soon get a bit better, as some of the judge's findings are being appealed. Foremost among them is the conclusion that RBS's basis clauses are not exclusion clauses and therefore not subject to a standard of 'reasonableness' under relevant legislation.[2] As the judge also found that, were he wrong about them

> "If *Crestsign* opened a window, would-be claimants will have to act fast before it shuts again."

being basis clauses then they fell foul of the 'reasonableness' test.[3] In allowing the appeal to proceed, the Court of Appeal was able to state that this ground of appeal has 'real prospects of success'. At the time of writing, the author understands that *Crestsign* has successfully obtained permission to appeal the judge's findings on the information claim as well, which may add a further string to claimants' bows.

Interested observers should also keep in mind that a key question remains unanswered by *Crestsign*: whether a basis clause is still a basis clause if a customer only sees it after entering into the IRHP. In *Crestsign*, multiple documents containing these clauses were sent to the company's representatives two days ahead of the IRHP transaction. It makes sense, however, that a company that had not been given the opportunity to discover that it was not, according to its bank, being advised until after the transaction about which it was advised would be better positioned. As it was not part of the factual background in *Crestsign*, it is doubtful that the Court of Appeal will answer this question either.

The clock is ticking

If *Crestsign* opened a window, would-be claimants will have to act fast before it shuts again. Interest rates plummeted to their current levels in late 2008 and early 2009, which means that the general six-year limitation period will very shortly result in many IRHP mis-selling claims becoming time-barred, if they are not already. The second court judgment covered by this article demonstrates, however, that this may not be so clear cut.

In *Kays Hotels Ltd* v. *Barclays Bank plc*,[4] Barclays applied early on in the case to strike out the claim on the basis of time bar. As the IRHP had been sold at some point in 2005 and proceedings were not issued until November 2012, at first blush it might appear that the claim was started as much as a year too late and was therefore time-barred.

In negligence claims, however, there is an alternative three-year period that runs from the date when, broadly speaking, the claimant becomes aware he might have a claim.[5] On the facts it might appear that the claimant should have thought something was amiss by early 2009 when interest rates dropped and its payments increased. This was several months before November 2009, which was as early as the alternative three-year limitation period could stretch back to. The court found, however, that what the claimant actually knew was factually sensitive and must be determined at trial. Barclays' application, therefore, failed. Although Barclays might ultimately establish that the claim is time-barred at trial, by defeating the strike-out application the claimant bought itself time and a fighting chance.

Administrators may have to assign IRHP mis-selling claims

If good claims coupled with expiring limitation periods sound like a recipe for professional negligence (and they do to lawyers), then administrators occupying the hot seat will want to pay attention, because the final case considered in this

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article, *Hockin & Others* v. *Marsden & Another,*[6] turns the spotlight on them.

Mrs Hockin and her husband were the ultimate beneficial owners of a company that was sold an IRHP by RBS. After entering administration, the company's administrators not only decided not to pursue a potential mis-selling claim against RBS, but also refused to assign it to the Hockins. This was despite the Hockins offering to pay the administrators for the assignment. Mrs Hockin, a creditor of the company, applied successfully to court to force the administrators to assign the claim.

The Hockins certainly did not have an easy time of it. Before ordering the assignment, the court first had to be satisfied that the claims were not *'frivolous or vexatious'*. This might sound like a low bar, but only one of the three claims advanced by the Hockins survived the court's examination – and this was only because the judge noted that it would be open to Mrs Hockin to argue that the bank's basis clauses were exclusion clauses (and, remember, void if found unreasonable). As this case pre-dated *Crestsign*, one has to wonder whether the outcome would have been different had it come later. What if games aside, however, the claim is now in the hands of the Hockins.

What should IPs do?

If the Court of Appeal gives IRHP mis-selling claims a shot in the arm, and the time bar is not clear cut, IPs cannot disregard them as totally without merit. In these circumstances, it would not take a brave lawyer to agree to take on a case against an IP for negligently failing to pursue a mis-selling claim and allowing it to become time-barred. Since the courts have shown that IPs can also be forced to assign those claims, it is hardly far-fetched to imagine that an aggrieved shareholder (who may well bear a strong grudge about the demise of his business) might consider bringing a claim against the IP for damages for loss of a chance to successfully sue the bank.

> "When making a counteroffer, the IP must be prepared for the possibility that the assignee will accept it."

For IPs in this situation, the cases do offer some guidance as to how to approach these issues.

In *Hockin*, the court felt obliged to adopt as the price for the assignment the amount offered by the Hockins (£5,000 and ten per cent of any recoveries), as it was the only offer that had been made. The court found that an administrator who has already declined to pursue a mis-selling claim, and refused to assign it, has already 'played his hand' by showing that he thinks the claim is worthless.

In contrast, any offer at all from a would-be assignee is a boon to the assets available to the administrators. Even a derisory offer improves the position of creditors over abandoning the claim. Savvy IPs should therefore consider ensuring that a low-ball offer from a prospective assignee is not the only one on the table, or make a counteroffer. When making a counteroffer, the IP must be prepared for the possibility that the assignee will accept it.

Conceivably, an IP who is a particularly skilled negotiator could persuade the bank itself to bid on an assignment. IPs need, however, to be very wary of possible conflicts of interest, which it is their duty to avoid. Maximising recoveries for the company is the administrators' job. As administrators typically offer to assign claims on terms that they receive a percentage of any recoveries, assigning a claim to someone who realistically will not pursue it (the bank itself) looks dubious compared to assigning it to someone who will pursue it with vigour (an aggrieved shareholder).

Ultimately, the example provided by *Hockin* – and possibility that an assignment might be ordered if it is not offered, with the concomitant waste of the company's assets on lawyers' fees – might be just what is needed by IPs looking to maximise assets, evade the conflict issue and preserve their commercial relationship with the lender.

As always, IPs should tread carefully and take legal advice. ◻

1 [2014] EWHC 3043 (Ch)
2 Section 3(3) Misrepresentation Act 1967 and Unfair Contract Terms Act 1977
3 Paragraph 119 of the judgment
4 [2014] EWHC 1927 (Comm)
5 Section 14A Limitation Act 1980
6 [2014] EWHC 763 (Ch)

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Restaurant resilience

Mike Finch considers the strengths and challenges associated with the restaurant sector.

The UK restaurant sector has generally proved resilient to the economic downturn, with established brands in particular performing well. McDonald's is a notable example, having reinvented itself and its fortunes by updating its restaurants, modernising its menu and introducing traceability to its supply chain. Chains such as Pizza Express have also maintained strong business through promotional offers, although this can become a double-edged sword if customers become addicted to, and can't be weaned off, promotional pricing.

New trends in eating out – pop-up restaurants, street food, single dish restaurants and celebrity chef chains – highlight the innovation and vibrancy of the UK restaurant sector.

Recent mergers and acquisitions activity demonstrates the strength of the restaurant sector. Just three examples include Hutton Collins' acquisition of Byron Hamburgers, CBPE Capital's purchase of Côte, and Tesco's acquisition of Giraffe. Private equity and corporates clearly see value in the sector.

Looking back

However, the last 12 months have not been easy. Restaurant insolvencies rose by 12 per cent which was against the general trend as overall business insolvencies fell by 4 per cent. A variety of reasons may explain the abnormal level of restaurant failures, not least the extremely bad weather of last winter, with heavy flooding throughout key trading periods of Christmas, New Year and Valentine's Day. Restaurants have also faced increasing cost pressures with average food prices having increased by approximately 4.5 per cent a year since the financial crisis.

> "Many restaurants struggle due to being in the wrong location, where footfall is low or competition is too fierce."

Consumer spending on eating out has risen in real terms by only 0.8 per cent over the past year, despite the rapid fall in unemployment. Nevertheless, the fact that consumers are still willing to spend money on eating out (when many have not seen wage rises) is a good indicator of the particular strength of the UK restaurant market – estimated to be worth £40bn a year. When hotels, pubs and cafes are considered as well, around £80bn a year is spent on eating out in the UK. Eating out has become an established leisure activity: 90 per cent of consumers have eaten out at least once in the last quarter. Younger age groups (18 to 24-year-olds) eat out the most, but spend less than those aged 55-plus.

Challenging times

The restaurant sector is highly diverse, ranging from high-end, fine dining, to low-priced, fast food. Alongside big brands and chains sit many small independent businesses, and it is these that are most likely to face difficulties.

Many restaurants struggle due to being in the wrong location, where footfall is low or competition is too fierce. Regeneration of new areas can result in a once fashionable area becoming second best.

Poor management can also be an issue, sometimes demonstrated in a resistance to change. For example, consumers are increasingly using social media to research and review restaurants and to comment on their experience in real time – 78 per cent of negative tweets about restaurants are made while diners are still eating their meal. Restaurants that don't engage with such media savvy consumers – even by simply apologising for mistakes – risk alienating not only current but prospective customers.

Poor management information and controls are also common. Restaurants should know and track basic details such as the number of covers and spend per head, as well as core costs relating to staff, food and property. Without this information, early warning signs of trading difficulties can be missed.

Problems can even arise before a restaurant's opening if fit-out or refurbishment costs are not controlled, with overspends eating into working capital and delayed openings leading to lost sales and unutilised staff.

Once a restaurant is open, high staff turnover can lead to increased recruitment and training costs. Customer rapport can also be damaged, as regular customers often like to see a familiar face, especially in key front-of-house and chef roles. Addressing such issues is important for putting restaurants on a sure footing so that they can capitalise on the sector's opportunities.

Five things to look out for when dealing with restaurants in distress

1. **Staff** – identify and retain key staff. This is particularly important when dealing with fine dining restaurants where customers are familiar with front-of-house staff and the menus of the resident chef. Tips can be key to staff retention, so understand how they are controlled and distributed.
2. **Cash** – make sure proper procedures are in place to handle and deposit cash with the bank. Are security measures sufficient? Is insurance cover adequate? Such issues are particularly important when dealing with fast-food and other low-price restaurants.
3. **Suppliers** – take necessary actions to keep key suppliers on board. The traceability of food has become a key feature of restaurant menus and many independent restaurants tend to work with a small number of often locally based suppliers. Maintaining good relationships with such suppliers is therefore key to a successful business.
4. **Landlords** – secure leasehold premises. Understand the terms of the lease and be prepared to negotiate terms with the landlord to support the business.
5. **Compliance** – monitor regulatory matters. Most restaurants sell alcohol and must comply with licensing requirements. The premises must be licensed and the sale of alcohol must be supervised by a licensed individual (the licensee). Restaurants must also comply with health and safety and food safety regulations.

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Should collection of interest on late payments be made mandatory?

With the potential cost and benefit of pursuing a claim for late payment interest, **Jonathan Robinson** considers whether this is something IPs should be doing.

There is a hot topic of conversation emerging within the insolvency market as practitioners finally begin to consider and quantify the 'off balance sheet asset' under their control and what to do about it. The hot topic in question is the interest available under the Late Payment of Commercial Debts (Interest) Act 1998, as amended by the Late Payment of Commercial Debt Regulations 2002 and 2013.

The legislation

The legislation was passed in 1998 to combat large businesses that were forcing unfair trading terms upon smaller businesses. In 2002 the Act was amended and it became applicable to all businesses irrespective of size. From 2002 companies that wanted to claim late payment interest could also charge compensation for having to take the time and trouble to collect the interest.

Interest is claimed at the rate of eight per cent over the Bank of England base rate, while compensation can be claimed at the rate of £40, £70 or £100 per invoice – depending on the original invoice value. According to recent government figures, businesses in the UK are subjected to circa £31bn in late payments.

Has the legislation worked?

The Act was passed to encourage businesses to pay each other within agreed credit terms or in the absence of agreed terms within 30 days of their invoices being rendered. It is fair to say that it has not worked for two reasons:

1. Companies are simply unaware of the existence of the Act or how to apply it.
2. Those that are aware of the Act are loath to implement it for fear of upsetting the business relationship with their customers.

An insolvency practitioner on the other hand will be aware of the Act and in most cases will not have to consider any ongoing business relationships. The real question therefore is: if late payment interest is a real asset, then should it not be mandatory for the insolvency practitioner to look to recover the asset?

What does the Insolvency Practitioners Association have to say?

While there is a statutory right to interest on overdue accounts, it does not have to be billed as it accrues, even when payment is received, as it was recognised in the drafting of the Act that this could affect relations with key customers. In the case of an insolvent business, this may not be too great a concern and the opportunity exists for insolvency practitioners to swell the funds available to creditors. The Secretary of State for Business Innovation & Skills asks that claims for interest should be made as a matter of course.

> "The costs of extracting, analysing and cleaning up the data from source can be a monumental task and should not be taken lightly."

The long-term answer is that software companies should develop a late payment interest facility in their software. This would mean an insolvency practitioner could very quickly identify where monies could be recovered, and the true extent of the company's assets and liabilities. The opportunity is potentially significant. An average SME company trading at £200,000 per month, receiving £100,000 a month late (which is not an unusual situation), could have an off balance sheet asset of interest due of £57,039.04.[1]

What does the Secretary of State for Business Innovation & Skills have to say?

The supplier has a legal right to the interest and compensation for debt recovery costs and, if necessary, to seek enforcement through the courts for non-payment. To avoid litigation, if any interest and/or compensation for debt recovery costs are legally due and have been claimed, they should be paid.[2]

Cost versus benefit

The major consideration when considering whether or not to pursue a claim for late payment interest is the cost to the estate when weighed against the potential benefit. The benefits can be sizeable, as any late payment made to the company in the six years prior to the claim being issued is subject to interest. This can mean literally thousands of transactions to consider. However, the costs of extracting, analysing and cleaning up the data from source can be a monumental task and should not be taken lightly.

Many practitioners are finding that the way to minimise any risk is to outsource the work via an assignment or even outright sale of the rights to collect the interest and compensation under the Act. An outright sale would mean no direct cost or risk to the estate, and is certainly the simplest and most cost effective way forward.

The conclusion so far

As is often the case with a question such as this, the answer is neither black nor white. And in the absence of any firm guidelines from the various licensing bodies, it will remain grey and very much a decision to be made by the insolvency practitioner on each individual case.

But if outsourcing the problem while retaining the benefit through an assignment or sale of the asset, with the latter at no cost or risk, is the question then: why would any responsible insolvency practitioner not try to recover this forgotten or ignored asset?

1 Source: Insolvency Practitioners Association, February 2003 Bulletin

2 Source: A User's Guide to late payment legislation, published by the Secretary of State for Business Innovation & Skills

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SAVE THE DATE
20–22 May 2015
R3 Annual Conference
Grand Hyatt, Berlin

R3 events, courses and conferences

Month	Date	Event	Venue
March	19	North West Women's Group Quiz Night	Revolución de Cuba, Manchester
March	26	Webinar – Scheme of Arrangement	Online
March	26–27	Northern Conference	Oulton Hall, Leeds
April	14	Webinar – The Relationship between Deceased Estate Law and Insolvency Law	Online
April	14	South West & Wales Regional Meeting	Bond Dickinson, Bristol
April	16	East Midlands New Professionals Ghost Walk	Cross Keys, Nottingham
April	23	West Midlands Spring Ball	ICC, Birmingham
April	23	Northern Ireland Annual Dinner	Ulster Museum, Belfast
April	23	Southern Regional Meeting	The Nuffield Theatre, Southampton
April	27	Eastern Regional Meeting	Ravenwood Hall Hotel, Bury St Edmunds
April	30	Joint R3 & INSOL Europe's International Restructuring Conference	Hilton Tower Bridge, London
May	7	Property Law for Insolvency Practitioners	Crowne Plaza, The City, London
May	12	SPG Technical Review	Crowne Plaza, Manchester
May	12	South West & Wales Golf & Archery Day	St Pierre Golf Club, Magor
May	14	Joint Midlands Regional Meeting with IFT	Birmingham
May	20–22	R3 Annual Conference	Grand Hyatt, Berlin

Regional events

R3 events

For further information on R3 courses and conferences, please visit the R3 website www.r3.**org.uk**, where you can download the 2015 Spring – Summer programme.

Alternatively, call the Courses team on 020 7566 4234 to request further details.

PR and marketing guidance for smaller firms

Get it right and get ahead of the game.

The R3 Smaller Practices Group will shortly be publishing an accessible guide to public relations and marketing, aimed at helping smaller firms to navigate an area often seen as foreign and difficult to 'get right'. Here, we will endeavour to give you a brief introduction to some of the top tips offered by the guide, with a view to whetting your appetite for the fully detailed document's imminent publication.

Search engine optimisation

Search engine optimisation (known as SEO) refers to the cost-free process of improving your website's ranking in search results – an important tool, as approximately 75 per cent of Google searchers only click on the top five search results. Though it may seem like a veritable quagmire of technical jargon, there are a few simple steps you can take towards conquering this area – with great benefits to your business!

The overarching principle in SEO is content optimisation – your main priority should be ensuring that your website answers the kinds of questions that potential clients are searching for. To this end, you can get to know your audience and what they might be searching for (thus the kind of content your website needs to provide) by browsing forums, using web analytics tools to track various aspects of a particular keyword (how many times people searched for it, for example), or by typing a search term into Google and allowing it to autocomplete – these autocomplete suggestions are based on accurate representations of what people are commonly searching for.

You should also aim to produce fresh content regularly – creating 'FAQs' and 'hot topics' sections on your website is highly recommended. By understanding your audience and tailoring your content to provide what they are looking for, you will organically improve your search ranking over time (improving your own website in the process)! Best of all, this process is completely free apart from your own time and effort; alternatively, if your marketing budget allows it, you can hire an SEO expert to do the hard work for you.

Pay per click advertising

SEO should not be confused with pay per click (PPC) advertising. This is where Google shows your result in advertisement form (rather than as an organic search result) when someone searches for the keywords you have selected, and you pay Google every time your advert is clicked on. PPC ads appear along the top and sides of the organic (ie the non-paid for) search results.

There are risks involved in using PPC advertising – if you choose the wrong keyword(s) to place your ad against, this could result in users clicking on your ad but not finding your website very useful; they then return to the results page to continue their search. This means that although you will pay for every click on your ad, the web users doing the clicking might not be commercially useful – they are very unlikely become a client. Thus, unless you choose the correct keywords to place your ad against, you could receive a very low return on your investment. We recommend approaching one of the many advertising agencies available for help with a PPC campaign, as this can be a tricky area to navigate on your own! That said, it can be a very useful tool when used correctly – if your keywords are targeted correctly, the conversion rate of 'internet searcher' to client tends to be very good.

> "It may seem like a veritable quagmire of technical jargon."

Bad online reviews

Over the past few years, online review services have become increasingly popular, with Google reviews and Yelp providing customers across all industries with an outlet for venting their frustrations (or heaping their praises). Sometimes these unfavourable reviews are justified, but other times an angry client can give a scathing review that is completely unwarranted. Arguably, this is an inherent risk in the insolvency arena due to the sensitive nature of an IP's work – a 'disgruntled party' is a real possibility. Recently, an area of keen interest for SPG members has been the issue of how to deal with a bad review.

Unfortunately there is no easy way of doing this; the best way is to combat the bad review with good reviews. If this is possible, it will actually provide a more 'believable' landscape for future clients (seeing bad mixed in with the good makes the good reviews more credible) – the bad review can actually become an asset. However, we recognise that it is often difficult to encourage good reviews due to the nature of your work – it might be tough to convince clients to rate your services when this means they must publicise their own financial difficulties. There are a few other (limited) ways of combatting a bad review, for example by responding publicly on the review website. In an extreme case, where you consider the review to be defamatory in nature, you might want to consider legal action. Of course (as with any litigation) this would be an expensive and time-consuming process, so the decision should not be made lightly.

However, one ray of light in this area is where the bad review has been left by a competitor – many review websites do not allow competitors to leave reviews and if notified they will remove the review!

Conclusion

Hopefully you have found this article to be a useful introduction to a few PR and marketing concepts available to you, and we hope that the upcoming guidance document will prove a handy guide for those of you promoting your own business! Please keep an eye out for its publication on the R3 website, as it is a treasure trove of useful tips – many of which we haven't touched on in this article. In addition to more detailed information on the areas discussed above, the guidance document covers: Google Alerts; using RSS feeds; media monitoring services; social media; and other forms of paid-for (online and offline) advertising. Finally, it will also give advice on promoting the insolvency profession generally, including responsible advertising practices and how to deal with queries from your local MP.

In the meantime, if you have any questions don't hesitate to get in touch.

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

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- Technical bulletins and releases
- Access to the members' section of the R3 website
- An invitation to the R3 annual conference
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Full members are invited to contribute to the development of insolvency, business recovery and turnaround professions at both local and national levels. Benefits include: use of the designatory letters MABRP and a certificate of membership, inclusion in the *R3 Directory* and a copy of it, membership of INSOL International.

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

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

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

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Interview with…

Mike Cherry

Mike Cherry is the national policy chairman for the Federation of Small Businesses. His role is to make sure small business issues are understood and represented in Westminster, Whitehall and Brussels.

Mike Cherry

A woodworking engineer by training and trade, Mike Cherry took over the running of the family manufacturing business, W.H. Mason & Son Ltd, in 1983. He has wide experience across many areas of business, including sawmilling, construction, exporting, skills and management – much of which he has gained in his role as a company director.

In his elected role with the FSB he is totally committed and passionate about small business issues and relishes being able to lobby government at the highest levels to ensure the issues that affect FSB members are understood and that the FSB offers constructive solutions to those issues.

Away from work, Mike supports Woodland Heritage and its call to plant more woodland and manage it properly.

The Enterprise Act 2002 was designed to give entrepreneurs a 'second chance'. How hard do you think it is to find the balance between giving directors a second chance and preventing directors from harming other businesses?

It is difficult to find a balance between offering a second chance while making sure that directors who have acted improperly are always dealt with effectively. It is damaging when a business unnecessarily becomes insolvent and has to be wound up, but it is equally damaging if directors who have been deliberately reckless are not taken to task for their improper behaviour.

> "It is important that the UK's insolvency system does try to maintain a sensible balance between reform and deterrent."

Small businesses are often the victims of the latter and the effects on a small business can be devastating, in some circumstances beginning a chain reaction of further insolvencies.

No regime will ever be perfect but it is important that the UK's insolvency system does try to maintain a sensible balance between reform and deterrent.

R3 suggests that 20 per cent of insolvencies are caused by late payment. What are the specific challenges of late payment for small firms and what does the FSB think should be done about it?

Almost one in five FSB members were paid late in 2013 and late payment can sometimes be severe enough to put small firms out of business. Being paid late is an obvious cash flow concern, because small firms are left unable to make loan repayments (incurring penalties), plan future investment, or pay their staff and creditors. Also, when a small firm experiences an unplanned reduction in cash flow, this can affect other creditors in the supply chain.

There are issues that can lead to poor payment practices, which we would like the government to address. Some large companies use retrospective discounting to preserve their own margins, paying suppliers less than agreed in breach of payment terms and forcing them to absorb the cost. Some firms also deliberately wait until close to the due date of an invoice before challenging it, thereby resetting the payment process and leaving the supplier out of pocket for longer.

A third issue is caused by companies that extend their existing payment terms beyond what could be considered 'prompt'. The EU Late Payment Directive defines this limit as 60 days, but we have heard from our members of companies extending theirs up to as many as 90 or 120 days. In all of these situations the small business has little choice but to absorb the cost, or risk losing a large customer.

> "We'd like to see a full and independently led review into poor payment practices."

In order to address this problem once and for all, we'd like to see a full and independently led review into poor payment practices. This should make clear recommendations, which the next government should act on. The government must also toughen up the prompt payment code, and mandate that all government suppliers be signatories to it.

The Small Business, Enterprise and Employment Bill (SBEEB) is making its way through Parliament – what are the main proposals the FSB has been supportive of and issues where you might have concerns?

The Small Business Bill is the first bill specifically designed to address the needs of small businesses. We were involved at a very early stage, proposing ideas for a potential Small Business Bill last year. We wholeheartedly support this intention and many of the proposals in the bill. For example, in the area of regulation, the FSB has successfully argued that the process for examining departmental impact assessments should be put on a statutory footing. We are very pleased to see the bill will implement such a system.

Two key areas for FSB members that the bill seeks to address include issues such as late payment and small business lending. We welcome measures to force companies that pay late to explain why they are doing so. We are also pleased that measures are being introduced to share SME credit data with lenders other than the big established banks, which should allows small firms to be approached by alternative lenders. This will give them more choice in the market.

There are also measures in the bill aimed at creating a better deal for pub tenants. It is not fair that small pubs pay substantially higher prices for beer because they are tied to a larger company, so the creation of a statutory pubs code and the introduction of an adjudicator is a positive step. The success of the cross-party Fair Deal For Your Local campaign in winning a key Commons vote, now means that tied pubs will have the option to go free-of-tie with an independently assessed market rent, helping them to be more competitive and adopt a wider product range.

The FSB and R3 agree that the proposal in SBEEB to abolish the power of the officer-holder to call a physical creditors meeting should be dropped with the FSB stating that it would be 'detrimental to small businesses in some cases'. What do your members say about physical creditor meetings?

The FSB is concerned about the proposed changes to creditor meetings in the Small Business Bill. It is important that creditors have a chance, where necessary, to be able to challenge the directors of an insolvent firm about its insolvency. The creditors' meeting was a key opportunity to do that. We would not like to see changes made that would make it harder for creditor meetings to be held.

What do your members say about insolvency? If there were any changes to the insolvency regime, what would your members like them to be?

The UK's insolvency regime has been through significant change in the last decade or so. The FSB would like to see the full range of changes, including the considerable number proposed in the Small Business Bill, properly bed in before further significant change is contemplated.

> "It is important that creditors have a chance, where necessary, to be able to challenge the directors of an insolvent firm about its insolvency."

However, one complaint from our members about the current insolvency system is that because most FSB members tend to be unsecured creditors, their chances of getting anything back when a customer of theirs goes into insolvency are often felt to be small. This is often a well-founded concern. In turn, not receiving any assets from the insolvent company can send small supplier companies 'to the wall' as well. A vicious circle can be created.

Do you think that R3's microsite will be useful to small businesses?

The FSB has supported the creation of the R3 creditor microsite. We were pleased to be able to input into its development, in a small way, and hope that it will raise awareness and increase understanding among smaller unsecured creditors in particular about the insolvency process. We would like to see the site periodically reviewed and traffic monitored to ensure it is as useful as possible for users, and for the site to be tweaked where necessary in light of experience. But otherwise we wish it well.

What are the FSB's views on pre-packs? Do you think that the 'pool' will make a big difference?

The FSB supports the intentions behind pre-packs, trying to ensure business activities can continue where possible. This will allow them to save jobs and economic value for the UK.

However, like many organisations, the FSB had a number of concerns about pre-packs. These were the same as the numerous well-known issues that Teresa Graham investigated in her recent report.

> "We would like to see the new R3 microsite periodically reviewed and traffic monitored to ensure it is as useful as possible for users."

We wait eagerly to see whether the proposed improvements to the pre-pack process recommended by Ms Graham do in fact reduce some of the concerns identified with the operation of pre-packs. And if not, we will be interested in seeing what further changes might be made to reduce some of the negative aspects of pre-packs while maintaining the positive elements.

R3 is delighted that the FSB supports our 'Jackson' campaign. Can you explain why the issue matters to small businesses?

This issue matters to small businesses because not keeping the exemption (at least for a period until a proper review can be carried out) will mean that public interest litigation against directors who have acted improperly will be less likely to be taken forward. In turn this is likely to lead to less money being returned to small unsecured creditors like FSB members. It will also mean that directors who bring disrepute on the business community by acting improperly are able to more easily get away with such conduct. This will lower the reputation of business in the eyes of the public and do little to deter such people from repeating such actions in the future.

NAOMI OSINNOWO is the publishing assistant on *RECOVERY* magazine.

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