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Spring 2012

RECOVERY

Retail

Touch & try v. click & buy

The changing face of retail
How to make offerings sustainable

Have retail CVAs been left on the shelf?
Are they past their sell-by date?

Retailers: how to respond to cash-flow challenges
Advice on improving retail performance

Sunny places for shady bankrupts: what to do with an asset in Spain
The practical difficulty of realising assets in Spain

Different treatment for different bankrupts?
Is it time for a change?

Interview Philip King, ICM

Plus Legal update, Smaller Practices Group

Advertising feature
No win, no fee, no future?

Careers and professional development supplement
JIEB 2011 examination results

What do you think?

Readers' views are welcome. Got an opinion about a burning issue? Want to comment on articles or *RECOVERY* itself?

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

From the editor

Corporate UK faces a long period of restructuring and insolvencies as over-leveraged businesses struggle to refinance and zombie companies eventually accept reality. For this to happen smoothly and constructively we need to revitalise the rescue culture with a measured and targeted dose of legislative reform.

Amy Gallimore makes the point in relation to administration expenses on page 2 of our Careers and professional development supplement, echoing R3's campaign – mentioned throughout this issue – for reform of the administration expense regime. Another area ripe for attention is highlighted by Chris Harlowe's subheading on page 26, 'Is paragraph 72 a help or a hindrance to the rescue culture when IPs need to act swiftly?', which explores ROT in administrations. There are plenty more examples. One hopes that the drafting of any new legislation is somewhat more effective than those parts of the Act and the Rules that have caused so much unnecessary expenditure of time and money in the *Msaada* and *Virtualpurple* lines of cases (see Joe Bannister's analysis on page 9).

While the rescue culture remains stifled it is all the more important that pre-packs are both encouraged where appropriate and discouraged where not. We should communicate better the value of this rescue tool. R3 leads the charge with the media and politicians but every IP considering pre-packs owes it to themselves and all of us to be transparent and painstakingly communicative with stakeholders in individual cases.

In highlighting the BIS Select Committee's review of the Insolvency Service (page 5), Frances Coulson notes that IP regulation also falls within its purview. Regulation that is, and is seen to be, effective and independent is critical if we are to overcome the opprobrium we often encounter, not least because of misconceptions about pre-packs. Philip King of the ICM comments (on page 46) that 'In an ideal world, there would be a single regulator for the insolvency industry'.

However, our work continues and on pages 17 to 27 there is a staggering wealth of informed comment about retail restructuring and insolvency, including separate perceptive discussions of CVAs from Michael Rutstein, Ian Fletcher of the BPF and Richard Fleming. Enjoy!

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

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RECOVERY

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What do we do with the insolvent trustee?

Grant Jones argues that a separate, new insolvency regime is the answer.

The problem

If we go back to JIEB basics, when it comes to insolvency, charity does not begin at home. Let us take the apocryphal volunteer do-gooder who acts as a trustee (volunteer) of a local unincorporated charitable school, taking fee-paying students (the business). If there is a scandal then recession-hit fee-paying parents drift away and long-standing teachers require unaffordable redundancy payoffs – insolvency can beckon. A trust does not shield the volunteer trustees from bankruptcy. They become liable for the school's debt and a volunteer can now lose their house to pay for teacher redundancy payoffs. Under threat of bankruptcy because of the trust deficiency, a solicitor or accountant volunteer could even lose their

"The problem: a grotesquely unfair collapse of a volunteer's life and an illogical dichotomy between trust and non-trust estates."

practice: personal insolvency, over and above trust insolvency. As we all know, trust assets, in this case the school etc, do not form part of a volunteer's general estate. The opposite does not hold true. Trust creditors (for the deficiency) can have recourse to the volunteer's non-trust assets. The problem: a grotesquely unfair collapse of a volunteer's life and an illogical dichotomy between trust and non-trust estates.

Current mainstream suggested solution

Obviously the first solution is that the school or the trustee incorporates: but trust, tax law and insolvency planning often collide. Second, the volunteer contracts with limited recourse, ie creditors will have accepted in the original contract that they can only have recourse against the trust and not the volunteer's personal assets. This is not creating an agency. The trustee cannot be an agent of him or herself. But if it is merely contractual, it creates a potentially bizarre result. A volunteer would become bankrupt for the school's deficiency, but contractually the school's creditors and hence volunteer's trustee in bankruptcy, could not have access to the volunteer's personal assets.

Theoretically the bankrupt volunteer could remain a billionaire. Obviously this system cannot work for involuntary creditors, for there is no contract. However, these are solutions for *before* the horse has bolted. What happens if insolvency has occurred?

Off-piste solutions: insolvency having occurred

There are three current debtor-led possible solutions to avoiding the volunteer losing their personal assets through bankruptcy, and all these solutions are flawed. As to the first solution, does this 'in receipt of fee-paying students school', look like a business? Does it look like a company in all but name? Can this business be classed as an unregistered company under part 5 of the Insolvency Act 1986? The two big issues here are the extent to which an unregistered company (a) is trading, or (b) is a trust. Obiter in a contested petition argues a trust cannot be an unregistered company. Thus, if there is an uncontested petition (and (a) and (b) are thus not argued) to liquidate the school as an unregistered company, bankruptcy can be stymied. Limited liability prevails.

As to the second solution, there have been occasions when the court has rejected an unregistered company claim; but nevertheless considered it equitable, under its inherent jurisdiction, to liquidate the entity as a company. So, have a go at the 'unregistered company' route, which will probably be uncontested and if it fails, go down the 'inherent jurisdiction' route. Both achieve the same corporate limited liability result. Both, although I advise in favour of them, look like 'try-ons' to me.

As for the third option, the volunteer could seek court directions as a trustee to deal with the insolvency. The court may

"What is needed is clarity: neither the debtor, creditors, nor professional advisers know where they stand."

order that the trust insolvency has a priority order similar to normal bankruptcy. The court may also say that the trust creditors cannot seek redress against the volunteer's personal assets. The problem is, 'may': there are no detailed rules.

All three solutions are mired in uncertainty. What is needed is clarity: neither the debtor, creditors, nor professional advisers know where they stand.

The solution

The solution is to have a specific trust insolvency regime. It's not difficult: new structures, such as LLPs have had their own instant mix-and-match specific regime. Other trust jurisdictions have gone down the trust-specific insolvency route and – with increasing internationalism – the UK may well enforce a foreign trust-insolvency regime. England created the trust. Perversely, England has failed to address its creation's failure.

With government cutbacks, the very topical problems of charity insolvency and trustee bankruptcy will be addressed in a forthcoming R3 seminar.

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President's column

Frances Coulson provides an update on R3's activities so far in 2012.

It's getting close to decision time on many key areas for our profession. In fact, on 26 January the then Insolvency Minister Edward Davey MP announced the welcome news that, 'the government will not be seeking to introduce new legislative controls on pre-packs at this time'. He said he was unconvinced that the benefit of new legislative controls outweighed the overall benefit of sticking to the government's deregulatory agenda. This is a significant achievement for the profession and highlights the effectiveness of R3's communications strategy. It was your concerns over the three-day notice period that we fed back to the government, and they listened. Still, the issue is unlikely to disappear entirely and we will need to ensure confidence in pre-packs only increases from now on.

Meeting with Edward Davey MP

At the start of the year, I met Edward Davey himself and covered this and many other issues. The minister was friendly and relaxed (our meeting was scheduled for half an hour but he gave us an hour) and was already well aware of a number of R3's key issues. The minister appeared supportive of the work we are doing, and I hope we have established a dialogue.

We covered Jackson, and the impact the Legal Aid, Sentencing and Punishment of Offenders Bill will have on IPs' ability to chase dodgy directors, and the problems with administration expenses. I expressed our concerns about the proposed transfer of bankruptcy petitions lock stock from the Ministry of Justice to The Insolvency Service, with the minister stating that he is keen to make petitions an administrative procedure as there will be some considerable cost savings but he agreed that safeguards are vital. Certainly one key area was the ability for either party, petitioner or debtor, to move the issues to a court forum. We covered debt advice and the cost of bankruptcy too. We expect to continue this dialogue with Norman Lamb, MP for North Norfolk, who has just taken over from Edward Davey MP (now Energy Secretary).

The BIS Select Committee

In January, I also made a Select Committee appearance giving evidence at the Business, Innovation and Skills Select Committee inquiry into The Insolvency Service. The review of The Insolvency Service this time around was not just limited to the Service, but also covered much broader insolvency issues. The Committee asked questions on a range of topics from pre-packs and IP fees to regulation and the performance of The Insolvency Service. We highlighted the important role insolvency practitioners play in saving businesses and rescuing jobs and also drew attention to key issues for the profession such as administration expenses and the government's proposals on pre-packs. Later in the week, we also heard the chair of the Select Committee Adrian Bailey MP pointing out the benefits of pre-packs – so it sounds like we got our message across!

Personal Debt Snapshot

At the end of 2011, you may have seen our media blitz on debt problems and payday loans, when our 'Personal Debt Snapshot' became the lead item on the Today programme, not to mention Sky News, BBC TV News and every newspaper in the land. Our research indicated that 3.5 million people in the UK think it is likely they will take out a payday loan in the next six months. We also questioned a smaller group who had taken on a payday loan and asked how they felt about that decision in hindsight.

> "We highlighted the important role insolvency practitioners play in saving businesses and rescuing jobs and also drew attention to key issues for the profession such as administration expenses and the government's proposals on pre-packs."

We did not set out to bash the payday loan companies – our research looked at those concerned by their debt of whatever type. We found that nearly a third of those who take a payday loan couldn't afford to pay it off, so had to take another one. Worse, 68 per cent of those who took a payday loan couldn't get credit anywhere else, while 60 per cent now regret taking one out. Payday loan companies are servicing a need – especially those who are turned down elsewhere – but this need shouldn't necessarily exist in the first instance. Incidentally, in case you heard anyone trying to discredit the poll, then rest assured it was run by ComRes, a polling agency that are good enough for the BBC! The overall sample size was over 2,000 individuals, a healthy number for this type of poll, and I would note that there is very little research published on this topic anyway.

I was also pleased to be profiled in *The Times* for a piece entitled 'Swapping stab vests for jodhpurs' – the article really showed the challenging circumstances we operate in, and how we 'get great satisfaction from getting money back for creditors'. Hopefully our policy of engagement rather than retreat should bear fruit this year. It is certainly back to work at full gallop and we'll keep you updated as the key decisions are announced.

I hope 2012 is a good year for you too and that we clear a few more hurdles before I reach the presidential finishing post. □

FRANCES COULSON is head of Insolvency & Business Recovery and managing partner at Moon Beever Solicitors.

Payday loans

Research by R3 has revealed that 3.5 million adults are considering taking out a payday loan over the next six months. Of those sampled who had already taken a payday loan, 60 per cent regret the decision and 48 per cent believe the loan has made their financial situation worse. Only 13 per cent think their loan had a positive impact on their finances.

R3 has also identified a new group of 'zombie' debtors: one in six are only able to pay interest charges on their debt. Its Personal Debt Snapshot revealed that nearly 60 per cent of individuals were worried about their debt in Q4 2011. This was up 13 per cent on July's figure and 21 per cent on the same time last year.

Precious Plastic 2012, a report by PwC that surveyed 2,000 adults, has also indicated that payday loans are on the rise. Some consumers are unable to borrow from traditional lenders, including credit card companies, but the survey also found that those not denied this route are turning to payday loans as they are 'surprised at the convenient and innovative service they receive from these smaller, more agile providers'.

Payday loans have been heavily criticised for their high interest rates and Labour MP, Stella Creasy, is campaigning for the government to introduce a total cost cap on short-term loans to protect the vulnerable.

R3 welcomes government's announcement on pre-pack regulation

R3 has welcomed the government's decision to reconsider additional pre-pack legislation. The government originally announced it would give creditors a three-day notice period when selling a business to a connected party. This would have had a detrimental effect on pre-packs, which are chosen because of the speed of the procedure and opportunity to preserve the value of the business.

Frances Coulson, R3 president, said, 'We are pleased government has listened to the fact that improvements to the current pre-pack regime can be achieved through tweaks to the existing regulatory framework instead of additional regulatory burdens, which would cause harm to businesses and their employees.'

'We also urge the government to define 'admin expenses,' which would help save thousands of jobs and businesses that enter administration every year.'

Stephen Baister criticises the IS

Stephen Baister, chief bankruptcy registrar and the president of the Institute of Credit Management, has attacked The Insolvency Service proposals to allow civil servants to act as adjudicators in insolvency cases.

Delivering the annual lecture to the IPA, Dr Baister said the suggestion that the current court process be replaced by an online service for petitioning for bankruptcy and winding-up was preposterous. The fundamental flaw in the proposed new system was that it ignored the fact that many 'ostrich' debtors will not respond to the letters, emails and text messages sent by the creditor or adjudicator. The result would be that many more bankruptcies and company liquidations could occur.

Stephen Baister said the industry should give further scrutiny to proposals on how the new approach will deal with the 'concept' of dispute as the new system would mean that the civil servant will decide whether there is a dispute or not, and he believed that that, in itself, was wrong. He added, 'Everyone is entitled to a fair and public hearing. The lack of public scrutiny bothers me. It may be inconvenient to the government… but there is a practical value in a hearing.'

Company insolvency statistics from the IS

There were 4,260 compulsory liquidations and creditors' voluntary liquidations in England and Wales in Q4 of 2011 (on a seasonally adjusted basis). This was an increase of 0.4 per cent on the previous quarter and an increase of 7.2 per cent on the same period a year ago.

During the whole of 2011, there were 16,871 compulsory liquidations and creditors' voluntary liquidations (4,988 compulsory liquidations and 11,883 creditors' voluntary liquidations). This is an increase of 5.1 per cent on 2010.

In 2011 there were also 4,972 other corporate insolvencies, comprising 1,397 receiverships, 2,808 administrations and 767 company voluntary arrangements. In total, these represented an increase of 1.3 per cent on 2010.

Sector insolvencies

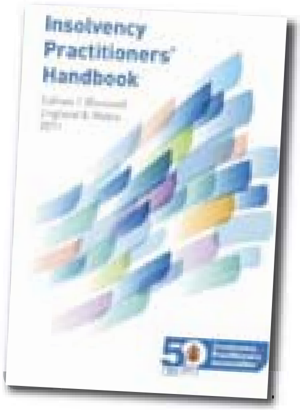
IS figures show that hotels, bars and restaurants, and the retail and wholesale sectors have seen the highest increases in company insolvencies in 2011 compared with 2010. Last year, 1,216 hotels, bars and restaurants became insolvent, a 14.4 per cent increase on the previous year; 2,308 businesses failed in retail and wholesale, an increase of over 9 per cent. Real estate suffered the highest number of corporate casualties in 2011 (5,654) but its year-on-year increase was a more moderate 6 per cent.

FC round-up

Following a court case brought by HMRC, Trevor Birch of PKF will now be the administrator of Portsmouth FC and not UHY Hacker Young. The club has debts of £1.8 million but also owes sums to three other football clubs.

Darlington FC fans have been granted a 'period of exclusivity' by administrator Harvey Madden, Taylor Rowlands, to attempt to raise £750,000 through a share issue by 30 April.

Former Glasgow Rangers' chairman, Alastair Johnston, has asked the IS to investigate the takeover of the club by new boss Craig Whyte after he wiped around £18 million of debts to Lloyds Banking Group when he bought the club for £1.



Insolvency Practitioners' Handbook

The IPA published its first edition of the *Insolvency Practitioners' Handbook* in September 2011 and has subsequently published a revised edition 1, which includes the recently issued SIP9. The publication draws together the Ethics Code, Statement of Insolvency Practice, Insolvency Guidance Papers, help-sheet and other regulatory guidance material in one volume of over 400 pages.

Moving with the times

Joe Bannister provides an update on recent case law.

The Chinese curse 'may you live in interesting times' is perhaps over-used, but it is singularly appropriate when applied to the ever-changing face of insolvency law.

This article provides an update on recent case law developments in relation to two topics covered in recent issues of *RECOVERY*. We begin with a review of two recent ECJ cases (*Zaza Retail*[1] and *Rastelli* v. *Hidoux*[2]) relating to the concept of a Centre of Main Interests (or COMI) under the EU Insolvency Regulation. We then consider two first-instance decisions of the English Courts (*Re Virtualpurple*[3] and *National Westminster Bank* v. *Msaada Group*[4]), which reach conflicting conclusions on one of the key issues raised initially in the *Minmar*[5] case regarding the requirements for the valid appointment of an administrator.

COMI under the EC Regulation on Insolvency Proceedings (Regulation 1346/2000) (the Regulation)

***Zaza Retail (Area of Freedom, Security and Justice)* (Case C-112/10) [2011] EUECJ** – requirements for opening territorial proceedings in another member state before primary proceedings have commenced in the debtor's COMI are to be interpreted restrictively.

This case concerned the interpretation of article 3(4)(a) and (b) of the Regulation. Article 3 gives the courts of the member state where a debtor's COMI is located jurisdiction to open main insolvency proceedings.

Secondary proceedings, opened after the commencement of main proceedings, and territorial proceedings, opened before the commencement of main proceedings, can only be opened against a company in a different member state from that in which the company has its COMI if that company has an establishment in that member state. They can only take effect in relation to assets situated in that member state.

Furthermore, territorial proceedings can only be opened if either (a) proceedings cannot be opened in the COMI member state because of the conditions laid down by the law of the COMI state, or (b) the proceedings are opened by a creditor of the debtor and that creditor is located in the jurisdiction where the proceedings are to be opened.

Zaza Retail was an insolvent Dutch company with shops in Belgium. No steps were taken to commence insolvency proceedings in the Netherlands. Accordingly, the Belgian Public Prosecution Services (PPS) tried to do so in Belgium, on the basis that Zaza met the requirements for the commencement of territorial proceedings.

> "The ECJ found that the opening of territorial proceedings under article 3(4)(a) was intended to be restricted to situations in which legal conditions in the COMI state made it impossible to bring main proceedings."

The Belgian court asked the ECJ for a preliminary ruling on several key questions, including:

- Whether the term 'the conditions laid down' in article 3(4)(a) of the Regulation included conditions relating to the capacity or interest of a person to request the opening of insolvency proceedings, or whether it related only to the substantive conditions; and
- Whether the term 'creditor' in article 3(4)(b) could be interpreted to include a national authority that acted in the public interest and as a representative of all creditors, so that such an authority could validly request the opening of territorial insolvency proceedings.

The ECJ found that the opening of territorial proceedings under article 3(4)(a) was intended to be restricted to situations in which legal conditions in the COMI state made it impossible to bring main proceedings, and not merely where they exclude a specific party from being able to bring them. Other creditors in the Netherlands were legally able to bring proceedings; they had simply chosen not to do so. On that basis, the main proceedings were not incapable of being opened for the purposes of article 3(4)(a).

Similarly, the conditions under article 3(4)(b) had to be interpreted restrictively. In the absence of any claim of its own in the debtor's estate, a public prosecution service was not a creditor. Public authorities that were not intervening either as or on behalf of creditors therefore cannot request the opening of territorial insolvency proceedings. The Belgian PPS had no standing to open territorial proceedings.

There have been few cases concerning the interpretation of the Regulation in relation to territorial proceedings and so this ruling provides useful clarification of the criteria that have to be met before such proceedings can be opened.

***Rastelli Davide e C. Snc* v. *Jean-Charles Hidoux* [2011] EUECJ C-191/10** – intermixing of assets does not move COMI.

This case concerned proceedings brought by the liquidator of a French company requesting that an Italian company (Rastelli) be joined to the French insolvency proceedings on the grounds that although the two companies were incorporated in different jurisdictions, they operated a single enterprise, the property of the two companies was intermixed and so the estates of both companies should be dealt with in the French liquidation.

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The Cour de Cassation referred the matter to the ECJ for a preliminary ruling on two key questions:

1) **Joinder**: whether a court of a member state that has opened main insolvency proceedings against a debtor whose COMI was located in that state could, under a rule of its national law, join to those proceedings a company whose registered office was in another member state solely on the basis that the property of the two companies had been intermixed; and
2) **Intermixing determining COMI**: if not, whether the fact that the two companies' property had been intermixed was sufficient to establish that the company to be joined had its COMI in the first member state.

The court answered both questions in the negative. Under article 3(1) of the Regulation a company's COMI is presumed to be the place of its registered office. This presumption will only be reversed if an overall assessment of all the relevant factors allows it to be established, in a manner ascertainable by third parties, that the actual centre of management and supervision of the company is elsewhere. Each company will have its own COMI.

> "The French court had established that the two companies' property was intermixed on the basis of intermingled accounts and abnormal financial relations between them."

In this case the French court had established that the two companies' property was intermixed on the basis of intermingled accounts and abnormal financial relations between them – not factors that could easily be ascertained by third parties. In addition, intermixed property does not always mean a single centre of interests as joint property arrangements can be organised from management and supervision centres in different member states.

The court held that (a) a company could only be joined to insolvency proceedings commenced in a member state if that company's own COMI was within that member state; and (b) the mere finding that the property of the two companies had been intermixed was not necessarily sufficient to establish that the COMI of the company was also situated in that other member state.

Appointment of administrators

***Minmar* and beyond** – conflicting views in *Msaada* and *Virtualpurple*.

These cases both consider the question, first raised in *Minmar*, of whether and to whom notice of intention to appoint has to be served by directors where there is no charge-holder with the right to appoint an administrator or administrative receiver (a QFCH). Unfortunately they reach conflicting conclusions, creating uncertainty as to whether notice is required in these circumstances and what the practical impact of a failure to serve a notice of intention might be.

The discrepancy arises from varying interpretations of the requirement, set out in paragraph 26(2) of schedule B1 to the Insolvency Act 1986 (the Act) that, in addition to giving notice of an intention to appoint administrators (a notice) to a QFCH, a person proposing to appoint an administrator shall give a copy of 'such notice as may be prescribed to such other persons as may be prescribed'. Paragraph 26(3) also requires any such notice to be in the 'prescribed form', which rule 2.20(1) of the Insolvency Rules 1986 (the Rules) tells us is form 2.8B. The 'other persons' who must be served a copy of this notice are set out in rule 2.20(2) of the Rules. They include enforcement officers, distraining landlords, any supervisor of a voluntary arrangement, and the company (where the appointment is not made by the company itself). However, a debate has arisen as to whether a copy of the notice is still required to be served where there is no QFCH to receive the original notice.

In *Virtualpurple* Norris J took a holistic approach to the inconsistencies that arise between the Act, the Rules, and the prescribed Forms. He looked pragmatically at the provisions in the context of the overall aim of the Act to facilitate business rescue. Norris J also noted the advice issued by The Insolvency Service saying that, read together, paragraph 26(2) of schedule B1, rule 2.20 and form 2.8B did not create a stand-alone requirement to give notice: the Rules require a copy of the notice to be delivered, and this can only be given where an original exists. Taking all of these factors into account, Norris J concluded that directors appointing administrators through the out-of-court route were not obliged to give separate prior notice of intention to appoint to the company of which they were directors. Moreover, even if the directors *were* required to give notice to the company, a failure to give it would not automatically invalidate the appointment. This is consistent with the approach taken in *Hill* v. *Stokes*[6], but it differs from the approach of the Chancellor in *Minmar* (which decision, quoting Norris J, was contained '...in an *obiter* passage…' in the decision).

In *Msaada Group* Warren J declined to follow *Hill* v. *Stokes*, opting for a more formalistic approach in line with the Chancellor's decision in *Minmar* (which the judge thought was not *obiter* but an alternative ground). This case concerned a partnership, so considered the statutory provisions applicable to partnerships. A partnership voluntary arrangement was in place at the time the partners decided to appoint an administrator, so it fell to the judge to determine whether the joint supervisors of the PVA were persons on whom notice of intention to appoint an administrator was required under paragraph 26(2) of schedule B1, and whether a failure to serve the notice invalidated the appointment. Warren J noted the inconsistencies between the Act, the Rules and Forms, but did not believe it was legally correct to use either the Rules or the Forms to interpret the Act itself. He cautioned against speculation on the reasons why notice was required. Ultimately, Warren J agreed with the Chancellor that, in light of the ambiguities within the legislative provisions, the words of schedule B1 of the Act should be followed literally. This leads to the conclusion that all of the prescribed people

> "Norris J concluded that directors appointing administrators through the out-of-court route were not obliged to give separate prior notice of intention to appoint to the company of which they were directors."

(including the company itself and the PVA supervisors) must be given notice, and also that the appointment will not have been validly made unless those notice requirements have been complied with.

The *Virtualpurple* and *Msaada* judgments reach opposite – and irreconcilable – conclusions on the same question. Practitioners may still prefer to err on the side of caution by delivering notices to all of the potentially relevant parties, whether or not there are qualifying charge-holders. A decision from the Court of Appeal, clarifying the position, would be welcomed!

1 *Zaza Retail (Area of Freedom, Security and Justice)* (Case C-112/10) [2011] EUECJ
2 *Rastelli Davide e C. Snc* v. *Jean-Charles Hidoux* [2011] EUECJ C-191/10
3 *Re Virtualpurple Professional Services Lts* [2011] EWHC 3487 (Ch)
4 *National Westminster Bank plc* v. *Msaada Group (a firm) and others* [2011] EWCH 3423
5 *Minmar (929) Ltd* v. *Khalastchi and another* [2011] EWHC 1159 (Ch)
6 *Hill and another* v. *Stokes* [2010] EWHC 3726 (Ch)

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Technical update

Technical update on the consultation on petitions, a major TUPE decision and a review of the EU Insolvency Regulation.

Consultation on reform of the process to apply for bankruptcy and compulsory winding up

In 2009 The Insolvency Service issued a consultation that put forward the suggestion that debtors' petitions should be dealt with administratively rather than by the judiciary. This seemed to be quite a good idea: debtors' petitions are non-contentious so why should judicial time be 'wasted'. As ever the devil lay in the detail: how would issues of COMI and potential abuse of process be dealt with properly; who would be qualified to act as the 'decision maker' and where should the decision maker sit? On analysis, it appeared that someone with skills similar to that of a judge sitting independently from the Department of Business, Innovation & Skills, with the capability of examining the debtor and overseeing a more efficient application process (online with suitable authentication checks) would be sensible. In other words, make the existing process more efficient but ensure that the decision maker is expert and independent of government.

The Insolvency Service has now issued a second consultation on the subject, which is based on the premise that not only should debtors' petitions leave the judicial orbit but also creditors and compulsory winding-up petitions should be dealt with administratively by the decision maker (who is now to be called the 'adjudicator'). The basis for this proposal is the assertion that most (95 per cent) creditors' and compulsory winding-up petitions are, in effect, non contentious. With a view to ensuring that this is the case the consultation proposes that there should be a sort of pre-petition protocol.

The consultation proposes that the adjudicator should sit in The Insolvency Service but would be divided from the Official Receivers' activities, presumably by suitable Chinese walls. Where a dispute remains the creditor or debtor may take the matter to court. The consultation also envisages that the adjudicator will contact neither the debtor nor the creditor, making the decision solely on the content of the application. The savings arising from this new scheme are predicted to be substantial. The range is between £64.2 million and £80.1 million per annum.

> "The principle that the determination of a dispute should be made by someone who is independent and seen to be independent is important."

While we welcome a review of the existing system and favour a streamlining of the debtors' petition process (particularly if it leads to a cost saving) we think that taking creditors' petitions for bankruptcy and winding up away from the judiciary is misguided.

Ending a financial life, whether individual or corporate, is a serious step that should be taken under the aegis of someone with acknowledged expertise, particularly where there is any possibility of dispute. It is also of considerable importance that the judge/adjudicator is independent and seen to be independent. While the proposal was restricted to debtors' petitions a location within The Insolvency Service appeared to be reasonable so long as there was a clear separation from the Official Receiver. Where there is a breath of a dispute the independence of the judiciary is of fundamental importance.

We also have some difficulty with the estimate of savings set out in the Impact Assessment annexed to the consultation document. Does it really take a court clerk an average of over three half-hours to deal with a debtor's petition and make the order? Does HMRC really pay lawyers an average of £1,100 per bankruptcy petition? Will the new system lead to the elimination of HMRC's legal costs? It is not the purpose of this article to examine the Impact Assessment in any detail but such points as these cast substantial doubts over the estimate of savings.

There is potential for a compromise solution that has the following features:

- make the adjudicator a judge
- ensure that the adjudicator/judge is an expert in insolvency
- locate the adjudicator/ judge in the court service
- limit the number of courts where there are adjudicators/judges to ensure expertise
- streamline the application process for debtors' and creditors' petitions making it possible to petition online.

In effect, adopt most of the changes proposed but keep it within the court service where independence and judicial expertise lies.

Is this of importance to IPs? Well yes: the principle that the determination of a dispute should be made by someone who is independent and seen to be independent is important and, from a practical point of view, any change that makes it more likely that an appointment as trustee in bankruptcy or as liquidator might be flawed is clearly undesirable.

EU Insolvency Regulation – more change on the way

Each new year sees the publication of an important document, which is eagerly scrutinised by EU-watchers – the Commission Work Plan for the coming year.

This document, which perhaps is not as widely read as it should be, sets out the Commission's views on the challenges facing the Union, its major policy objectives, and an outline of the likely legislative programme.

The Work Plan for 2012 is subtitled 'Delivering European renewal', and in section 2.2 ('Securing sustainable public revenue', which is otherwise mainly concerned with VAT, tax evasion and tax havens) we read:

'To respond to the challenges faced by European companies due to the economic crisis, the Commission is carrying out an in-depth evaluation of the need to reform the Insolvency Regulation. Based on its conclusions, the Commission will develop future options for more efficient cross-border insolvency rules, including for groups of companies.'

The Commission began its review of the Regulation in the new year, and must submit a report concerning the application of the Regulation by 1 June 2012, following which it will make legislative proposals to the Council and the European Parliament. As part of this exercise the Commission has published a 'road map', which sets out the policy objectives of the review in the following terms:

'to improve efficiency and effectiveness of cross-border insolvency proceedings, to increase legal certainty and predictability of jurisdiction and applicable law rules, to avoid unfair forum shopping, to strengthen and modernise judicial co-operation means.'

In parallel with this, the European Parliament has, of its own motion, adopted a resolution to make recommendations to the Commission for the reform of insolvency law. The resolution has no legislative force; it merely calls on the Commission to give consideration to its suggestions[1].

The recommendations include suggested amendments to the Regulation, together with a Directive, to cover a number of issues, including:

- Introducing a definition of 'centre of main interests' (COMI) formulated in such a way as to prevent fraudulent forum shopping.
- Changing the definition of 'establishment'.
- Imposing a duty of communication and co-operation between office holders and courts in different jurisdictions.
- The insolvency of groups.
- Harmonising various aspects of insolvency law, such as:
  - opening of proceedings
  - filing claims
  - avoidance actions
  - the qualification and work of office holders
  - restructuring plans.
- Creating an EU register of insolvencies.

The perceived evils of forum shopping seem to be at the forefront of the minds of both the Parliament and the Commission. This may prove to be a contentious issue, in view of the willingness of the English courts to accept the right of foreign companies to move their COMI to the UK in order to take advantage of the UK's insolvency and restructuring regimes. The obvious solution would be to bring European insolvency law into line with the UK.

Only time will tell if any of the Parliament's other recommendations find their way into the Commission's eventual proposals. In all probability the Commission will form its own conclusions independently in the light of its review.

TUPE in administrations – some certainty at last

On 20 December 2011, the Court of Appeal handed down a judgment that would appear to remove any ambiguity in respect of the application of TUPE to transfers from companies in administration.

Regulation 4 of TUPE provides that on the transfer of an undertaking contracts of employment automatically pass to the transferee, and regulation 7 stipulates that a dismissal made in connection with the transfer will automatically be unfair. However, regulation 8(7) disapplies regulations 4 and 7 where '… *the transferor is the subject of bankruptcy proceedings or any analogous insolvency proceedings which have been instituted with a view to the liquidation of the assets of the transferor and are under the supervision of an insolvency practitioner*'.

> "The Court of Appeal held that the absolute approach upon which the nature of the insolvency process itself should determine the applicability of regulation 8 is the correct one."

In *Key2Law (Surrey) LLP* v. *De' Antiquis* [2011] EWCA Civ 1567, the Court of Appeal considered the construction of TUPE and the relevant EU Directive. The Court considered the possibility of two approaches, each of which had been adopted in previous EAT decisions. One is a fact-based approach upon which all circumstances should be judged individually; the other is an absolute approach upon which the nature of the insolvency process itself should determine the applicability of regulation 8. The Court of Appeal held that the absolute approach is the correct one. Regulation 8 should be construed by reference to the purpose of administration generally. The purpose of administration is set out in paragraph 3 of schedule B1, the default purpose being the rescue of the company, not the liquidation of its assets (even though, in the event, that may be the purpose that is ultimately achieved). Accordingly the exemption provided by regulation 8(7) will not apply.

The full text of the judgment is available on the British and Irish Legal Information Institute website at: **www.bailii.org/ew/cases/EWCA/Civ/2011/1567.html**

[1] See Article 225 of the Treaty on the Functioning of the European Union for the Parliament's ability to do this.

Technical Bulletin

Technical Bulletin 98 was issued in February, and deals with the new Practice Direction on Insolvency Proceedings, including the full text of the Direction.

Technical Bulletin 99 was issued in March. Its contents included:

- Administration expenses – Court of Appeal decision in *Nortel* and *Lehman* cases
- Invalid administration appointments – further developments in the High Court
- The anti-deprivation rule – Supreme Court guidance on its contemporary application
- The Rule Against Double Proof – Supreme Court Decision
- Court of Appeal guidance on assistance to be provided to foreign courts
- Matrimonial home – important Supreme Court Decision regarding jointly-owned domestic properties
- Trustee in bankruptcy – cost implications when assigning a cause of action
- Overpaid benefits are a bankruptcy debt – clarification from the Supreme Court, with Update
- Unincorporated association – director held to be personally liable for association's debt
- Administrations and TUPE – important decisions from the Court of Appeal
- Employee Rights Act – increases in statutory limits from 1 February 2012
- Distribution of capital outside of formal winding up – enactment of ESC C16
- Statutory Forms Available to Members in Editable PDF Documents.

New Practice Direction

A new Practice Direction on Insolvency Proceedings has been issued by the Chancellor of the High Court, and came into effect on 23 February 2012. It replaces all previous Practice Notes and Practice Directions relating to insolvency proceedings.

The text of the Practice Direction is available on the R3 website. By the time this issue of *RECOVERY* is published it should also be available on the Ministry of Justice website at **www.justice.gov.uk**.

GILES FRAMPTON is a partner at Richard J Smith & Co.

JOHN FRANCIS is the technical director at R3.

Recent case summaries

Corporate and personal insolvency update from **Dawn McCambley**.

Corporate insolvency

***Re Kaupthing Singer and Friedlander Ltd (in administration) and another* [2011] UKSC 48**

Facts: Singer & Friedlander Funding plc (Funding) was a wholly owned subsidiary of Kaupthing Singer & Friedlander Ltd (KSF). Funding issued £230 million floating rate notes pursuant to a trust deed between HSBC trustee (CI) Ltd (the trustee), KSF and Funding. KSF guaranteed payment in respect of the notes and in turn, Funding gave an indemnity to KSF. Funding then advanced monies to KSF by way of an unsecured loan.

Both KSF and Funding went into administration. Their obligations under the trust deed came into immediate effect and the trustee duly submitted proofs of debt to the administrators of both companies. Funding also submitted a proof in the administration of KSF.

KSF's administrators gave notice of their intention to make a distribution. However, it was unclear whether the trust deed excluded the equitable rule in *Cherry* v. *Boultbee (1839) 2 Keen 319*, which effectively provided that a person who owed money that would swell the assets of a fund was bound to make his or her contribution to the fund before taking a share out of it.

KSF's administrators therefore issued an application for directions. The chancellor acknowledged that he was bound by the decision *In re SSSL Realisations (2002) Ltd* [2006] EWCA Civ 7, wherein it was held that the equitable rule and the rule against double proof could both apply in a double insolvency. The rule against double proof prevented two proofs being submitted against the same estate for what was, in essence, the same debt.

Permission was granted for a leapfrog appeal to the Supreme Court.

Appeal: The leading judgment was given by Lord Walker who held that although the equitable rule may be said to fill the gap left by the disapplication of statutory set-off, it did not work in opposition to it. If some cogent principle of law required one claim to be given strict priority over another then the equitable rule should not apply. The rule against double proof was one such principle. It would be 'technical, artificial and wrong' if the rule against double proof was powerful enough to defeat legal set-off, but not the equitable rule.

It was held that the equitable rule in *Cherry* v. *Boultbee* was excluded by the rule against double proof in a double

> "The decision in *SSSL* was incorrect and the trustee had to be paid in full before KSF could submit a proof against Funding."

insolvency. As such, the decision in *SSSL* was incorrect and the trustee had to be paid in full before KSF could submit a proof against Funding. The appeal was unanimously allowed.

Commentary: Lord Walker commented that much of Chadwick LJ's reasoning in *SSSL* was difficult to follow. The concern was that *SSSL* would lead to uncertainty, as any attempt to achieve a fair balance between the competing rights of guarantors and creditors would inevitably be fact dependent. *Singer & Friedlander* therefore strives to provide greater clarity in this respect. It also ensures that guarantors will be prevented from unfairly benefiting in a double insolvency as against other creditors.

Personal insolvency

***Hunt (Trustee in Bankruptcy of Janan Harb)* v. *Harb and another* [2011] EWCA Civ 1239**

Facts: The appellant was allegedly married to the late HRH the King of Saudi Arabia (the King). She also claimed she had orally agreed terms with the Prince regarding the withdrawal of an application against the King. However, as the Prince did not comply with his obligations, she believed she had a claim against him (the claim).

The appellant was subsequently adjudicated bankrupt whereupon the claim vested in her trustee in bankruptcy (the trustee). The trustee issued proceedings against the Prince; however, they were subsequently discontinued as he was unable to provide the necessary insurance.

The appellant successfully applied to set aside the trustee's decision to discontinue and the proceedings were adjourned to enable the trustee to invite offers for the claim. Paragraph 9(i) of the order recorded that the trustee could reject any offer that effectively provided for the net proceeds of a successful claim to be paid to him, if he continued to be at risk of liability for costs.

The appellant appealed against paragraph 9(i) and claimed the order should have recorded that there was *no* risk of the trustee being liable for adverse costs if the claim was assigned to her and she pursued it unsuccessfully.

Held: If a trustee wishes to pursue a claim that had previously vested in the bankrupt, they must do so in their own name. As the trustee would be a party to such proceedings, they would also be liable for any associated costs.

The attraction of an assignment would be reduced if a trustee could not be certain that no adverse costs' order would be made against them. However, the court's discretion regarding costs was famously wide and flexible and the apparent costs risk was no reason for curtailing a trial judge's discretion.

It was therefore inappropriate to grant pre-emptive costs' relief regarding the assigned claim, particularly before the court was even aware of the details of any potential offers.

The appeal was dismissed although paragraph 9(i) was nonetheless discharged.

Commentary: The court left open the question of whether it had the jurisdiction to grant the appellant's suggested order where the court was fully aware of all the offers that a trustee had received, and it was just to do so. It therefore remains conceivable that a trustee could obtain protection against adverse costs connected with an assigned claim in certain limited circumstances.

DAWN MCCAMBLEY is a barrister at 11 Stone Buildings.

Legal Q&A

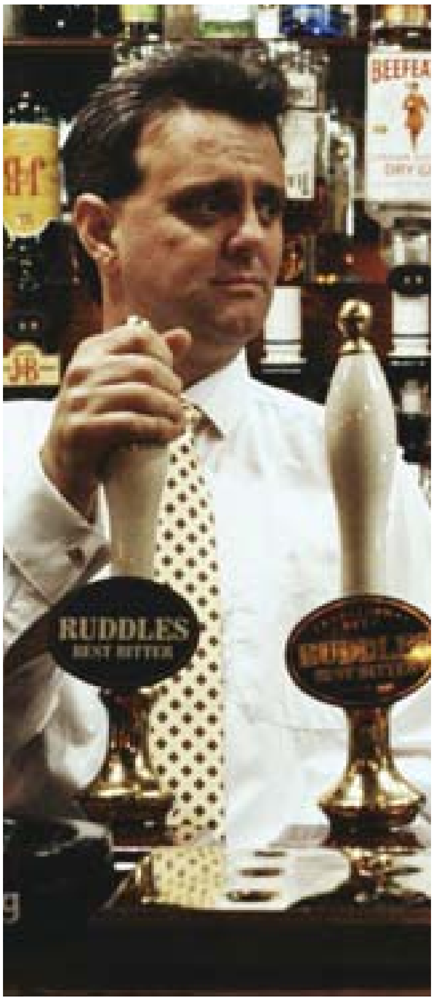
Oliver Nelson answers your insolvency queries.

Q I have been instructed in connection with a proposed voluntary arrangement for a company that owns and operates several pubs. If the voluntary arrangement is approved by creditors what will be the effect on the premises licences held by the company?

This area is governed by the Licensing Act 2003 (the Act), principally sections 27, 47, 48 and 50. While a personal licence survives the insolvency of the personal licence-holder, a premises licence will lapse if the holder becomes insolvent or is dissolved. It is important to note that the definition of insolvency in the Act includes, in relation to a company, 'the approval of a voluntary arrangement proposed by its directors'. The premises licences will therefore lapse if a company voluntary arrangement is approved. Incidentally, this also applies to individual voluntary arrangements.

If the premises licences are allowed to lapse and the pubs continue to trade without the benefit of premises licences, then the pubs could be forced to close by the council and the directors could face imprisonment for a term not exceeding six months, or a fine not exceeding £20,000, or both. This could result in a negligence claim against the supervisor.

It is vital, therefore, that steps are taken to protect the licences. There is a 28-day period that runs from the day after the insolvency occurs, ie the date on which the voluntary arrangement is approved by creditors, during which period the premises licences can be reinstated by means of an interim authority notice. This is 28 calendar days and does not make any allowance for weekends or public holidays. The interim authority notice can be made by someone who has a prescribed interest in the property, ie a person or entity that has a legal interest in the premises as a freeholder or leaseholder. The notice must be served on the chief office of the police within the initial 28-day period, who then has two working days, from receipt, to give the relevant licensing authority their objections (if any). Where a notice of objection is given, the authority must hold a hearing and cancel the interim authority notice, if that is considered necessary (which results in the premises licence lapsing). If no objection is received, or the objection is discounted, the premises licence is reinstated from the time the notice was received by the relevant licensing authority. The person who gave the notice is, from that time, the premises licence-holder. The interim authority notice will lapse three months after the date on which it was served unless, before the end of that period, a transfer application is made to the relevant licensing authority.



> "If the premises licences are allowed to lapse and the pubs continue to trade without the benefit of premises licences, then the pubs could be forced to close."

The alternative (and in most cases this will be the more desirable option) is for an application to be made for the transfer of the premises licences. This must, however, be made, as above, within 28 days of the voluntary arrangement being approved as otherwise, again, the licences will lapse.

Q I am acting as the trustee in bankruptcy of B's estate. The principal asset is B's jointly owned house. I am aware that the petitioning creditor obtained a charging order against B's interest in the house before petitioning and has informed me that he intends to rely on his security. Is the petitioner now entitled to rely on its security?

The first thing you need to do is obtain a copy of the statutory demand and the bankruptcy petition. The standard form bankruptcy petition provides two options for creditors with security in accordance with section 269 of the Insolvency Act 1986 (IA):

1) for the petition to contain a statement that the petitioner is willing, in the event of a bankruptcy order being made, to give up its security for the benefit of all the bankrupts creditors;
2) for the petition to state that it is not made in respect of the secured part of the debt and to contain an estimated value of the security at the date of the petition.

If the first option has been selected by the petitioner, then the trustee can proceed to realise the property without reference to the charging order, although the petitioner could make an application to the court to request that its discretion be exercised to permit an amendment to the petition. In circumstances where there has been a genuine mistake and the debtor has suffered no prejudice, permission may be given to amend the petition to correct the mistake, but this will depend very much on the circumstances of the case.

Where the second option has been selected rule 6.115 IA will apply. Whereas a secured creditor may, with the agreement of the trustee (or the permission of the court), at any time alter the value put on the security in its proof of debt, where the secured creditor is the petitioner, it may only re-value the security as stated in the petition with the permission of the court. If no reasonable steps were taken by the petitioning creditor at the time to value its security, and particularly in a situation where in fact it appears likely that the petitioner was fully secured, then the court may be reluctant to permit a re-valuation. □

OLIVER NELSON is head of the restructuring and insolvency department at Ford & Warren.

The changing face of retail

Richard Hyman charts retail trading history and suggests that current and future offerings have to be multi-channelled if they are to be sustainable.

UK retail is at a major crossroads and the debt crisis is only responsible for part of what is happening. Once the debt crisis is over, the huge strategic issues now beginning to emerge will still be exerting a fundamental influence on the market.

Demand and supply

The past 30 years or so have been very kind to retail. The UK market was physically immature and for businesses able to manage the key cost components and finance space expansion, top and bottom line growth has followed. Trading in the slipstream of rising real incomes and growing demand helped to propel many retailers forward. It also managed to paper over the cracks of some tired, irrelevant models that may have been losing market share but still managed to achieve year on year growth.

Even without the internet, capacity growth was clearly becoming an issue. Decades of relentless expansion brought saturation nearer, a process that has been accelerated and magnified by the emergence of online as a major retail channel.

> Decades of relentless expansion brought saturation nearer, a process that has been accelerated and magnified by the emergence of online as a major retail channel.

The phoney economic downturn we have seen since Lehmans has now given way to the real thing. Lower interest rates compensated for the economic slowdown as far as disposable incomes are concerned and while things were subdued, the retail economy was not in recession. To all intents and purposes, we are now. As the austerity measures have started to percolate through the economy, disposable incomes have been hit and, therefore, spending.

So today, we have weaker demand because the consumer has less money to spend. Spending behaviour is also changing, not just because budgets are constrained but also due to price inflation. As our supply chain of goods has moved increasingly East, we were able to import lower prices meaning consumers could buy more items for less each year. This virtuous

circle has been put into reverse gear and we are now importing price inflation. After decades of living in a retail world that was driven by volume growth, the opposite is now true.

On the supply side of the equation, the years of relentless capacity growth are now coming back to bite. UK retail is now a saturated market and the law of diminishing returns is kicking in.

Business models are out of kilter

All this adds up to a fundamental change in the economics of retailing. The relationship between supply and demand is changing and we are seeing the symptoms of this right across the industry. Retailers have business models designed for what was, not for what is today, and they will become more so. And retail is a relatively high fixed-cost, low-margin business. So although costs are at least where they were forecast to be, if not a little higher, sales are lower and margins are being squeezed.

The typical retailer will have a store estate built over a number of years. Inevitably, some of those stores will trade better than others. The tail of poorer performing stores will have lengthened, and the extent to which they are a drag on performance will have grown. The majority of UK retailers have simply got too many stores. While lease commitments make it difficult to shut stores quickly, around 25 per cent of high street and shopping centre leases are due to expire between now and 2013. Many of these will not be renewed and we are likely to see a very significant contraction of total trading floorspace.

The floorspace that does survive will have to work harder. Online retailing has already captured around 11 per cent of total UK retail sales. Stripping foods out, the non-food share rises to 18 per cent. Online retailing has not made the spending pot any bigger but has cannibalised sales that would have gone through stores had the internet not been invented. Having an integrated multi-channel offering is fast becoming the only really sustainable route to market.

The role of the store is changing and needs to add more value. Retailing is becoming less commoditised and more about selling a look, a lifestyle, a story. Stores are, in some ways, supporting online as places to collect after the customer has clicked to purchase. They are also places to see, touch and try on the full story (it maybe an outfit, a designed kitchen, a designed living room), which you then buy online. In effect, a store becomes showroom.

Survival of the fittest

In the short term, however, the key element in the equation has become cash. Some businesses are profitable on an underlying basis but because of the pressure on margins, cash flows are falling short. Banks are nervous about further exposure to an industry clearly under pressure and demand for restructuring and insolvency is growing.

> Those retailers with strong customer propositions and management teams able to adjust to this new competitive landscape will do very well.

There has never been a more challenging time for retail. This year and next will be the toughest seen for generations and, as discussed, there will be quite a few casualties. This will make room for the stronger to prosper. In this market, growth can only come from capturing market share from rivals. Those retailers with strong customer propositions and management teams able to adjust to this new competitive landscape will do very well.

RICHARD HYMAN is a strategic adviser at Deloitte Consumer Business.

The West Lothian question in voluntary arrangements

The thorny issue of the role of disinterested creditors in the approval process: the challenge of democracy.

As the question of Scottish independence resurfaces, the West Lothian question remains embedded, thorn-like, in the side of British politics and democracy 35 years after it was first posed: how is it that Scottish members of parliament with no apparent interest in a matter applying only to England and Wales are entitled to vote on it? An identical question arises with voluntary arrangements: why should a creditor who is to be paid in full have the right to vote on a proposal that compromises the claims and rights of others? The increasing popularity of company voluntary arrangements (CVAs) gives some urgency to the resolution of this question. In this article, we will look at whether CVAs can be used to treat one creditor differently from another and, if they can, what legal issues should be borne in mind. The issues discussed here apply equally to individual voluntary arrangements but, for brevity, we restrict our discussion to CVAs only.

CVAs

Unlike schemes of arrangement, where creditors must be divided into distinct classes to ensure sufficient protection of their divergent interests, CVAs require only the support of 75 per cent of the total mass of creditors (and 50 per cent of the total mass of unconnected creditors) to be passed (rule 1.19 of the Insolvency Rules). Where a CVA proposes to treat a class of creditor differently from all the others, there is a clear danger that if the differentiated class holds under 25 per cent of the voting rights, it will be powerless to prevent other creditors voting through the debtor's proposal.

> "There are only two grounds of challenge: material irregularity and unfair prejudice"

The small number of sections of the Insolvency Act (which as every school boy and girl knows begin with section 1) and the associated Rules speak of creditors as a collective. Thus, the debtor's proposal and notice of creditors' meeting must be sent out to all creditors, and all creditors must be invited to attend the meeting and vote on it. There is no scope for excluding a category of creditor on the grounds that it has no interest in the proposal or that it has no economic interest in the debtor (as is the case with schemes).

One may, perhaps, then have inferred that a CVA proposal must provide for all creditors to take the pain (or if you prefer, 'haircut') such that their treatment and recovery rate contemplated by the debtor's proposal must be the same. However, voluntary arrangement practice soon established that a debtor's proposal could offer a derisory or no return at all to creditors and, if creditors voted for it, it was binding. It was a matter for creditor democracy to establish whether creditors were prepared to accept a debtor's offer of compromise, however uncommercial its terms might be. It was then not too big a step for debtors to start differentiating between categories (or classes) of creditors in terms of treatment and recovery under a CVA.

The landmark case of *Re Cancol* [1996 1 BCLC 100] established that, under a CVA, a debtor could legitimately offer a different deal to landlords of premises:

a) it wished to continue to occupy for its future business; and
b) it wished to vacate.

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This line of reasoning has been refined, and in more recent times has been adopted with considerable success by retail chains overburdened by long-term, onerous, solvency-busting leases. They have used CVAs as a way of retaining leases at profitable sites (perhaps on varied terms) and escaping from unprofitable sites by leaving landlords to claim a dividend calculated in accordance with a specified formula from a pot of money reserved for them. JJB Sports is one of the most high-profile companies to have used a CVA to this effect, not once, but twice. There has, however, been no challenge made to one of these CVAs. If there had been a landlord disgruntled with differential treatment compared to non-landlord creditors, what could the poor fellow have done about it?

Grounds of challenge

There are only two grounds of challenge: material irregularity and unfair prejudice. Although ostensibly protected by section 6(a) of the Insolvency Act 1986, challenging the terms of a CVA as unfairly prejudicial has proved difficult for creditors. As held by Ferris J in *Re a debtor* [No 101 of 1999] the mere existence of differential treatment is not enough to support a finding that a dissentient creditor has been unfairly prejudiced. Further, even if a class of creditor would have been able to vote down a scheme of arrangement, that does not necessarily mean that a CVA proposal can, on the same facts, be successfully challenged as unfairly prejudicial.

In considering whether a CVA is unfairly prejudicial, the court will consider the dissenting creditor's position as against the other creditors (the 'horizontal position'). However, it will also place substantial weight upon the return that the creditor might expect on a winding-up (the 'vertical position'). While the *Powerhouse* ruling (*Prudential Assurance* v. *PRG Powerhouse*, 2007 EWHC 2170) confirms a CVA will be unfair if the creditor would be in a worse position than in a winding-up, where this is not the case, the courts have been minded to overlook an imbalance in the recoveries of creditors, swayed by the desire to let a CVA proposal, which has been approved by its creditors, stand.

HMRC v. CVAs?

Though utilitarianism may be the reason the court is prepared to overlook an unevenness of treatment under a CVA, it is not hard to see the uneasiness that might be felt when a CVA is approved by the weight of votes of those creditors who have nothing to lose by the CVA and who are in the happy position of saying: 'It's not my money at risk, so why not vote yes?'.

The court considered this very situation in *HMRC* v. *Portsmouth City Football Club (in administration)* [2010 EWHC 2013], where HMRC objected to the participation in the vote of 'football creditors' who, pursuant to Premier League and Football League rules, have to be paid in full through a CVA if the Premier League or Football League is to renew the membership of a football club that is subject to an insolvency procedure. Whether you love or hate the taxman, HMRC deserves a medal for its determination to overturn CVAs that it sees as disadvantageous to its interests even though its history of success has – how shall we put it? – not been crowned with glory. Not one to give up without a jolly good fight, HMRC challenged the football club's CVA both on the material irregularity and the unfair prejudice grounds.

By drawing an analogy between a CVA and a scheme of arrangement, HMRC initially looked to the former ground as a means of challenging the football creditors' exercise of voting rights. However, Mr Justice Mann rejected this argument, ruling that as the provisions for voting in CVAs do not require, or indeed allow, for separate classes of creditors, there could not be any irregularity. This decision makes clear that 'irregularity' refers only to a digression from the statutory provisions and not a complaint of inherent unfairness.

> "HMRC deserves a medal for its determination to overturn CVAs that it sees as disadvantageous to its interests even though its history of success has… not been crowned with glory."

Minority creditors are, therefore, left to run an unfair prejudice argument if they wish to challenge the participation of West Lothian creditors in the 'yes' vote. This line of argument was similarly rejected in *Portsmouth*, albeit on a factual basis. The judge held that the football creditors did in fact have an interest in the CVA being approved. If the CVA were not approved and a liquidation followed, then their contracts of employment would come to an end. In contrast, were they to continue after the approval of the CVA then the balance of their existing contracts would be honoured.

Notwithstanding his factual ruling *vis-à-vis* the players, the judge did note that, *'if it were the case that these creditors had no real interest in the CVA at all then there might be something in it. Why should those with no interest in the CVA at all, and who were being paid outside it, be entitled to force unwilling creditors into a CVA which is not approved by a requisite majority of that smaller class?'* Interestingly, the judge did not apply this line of analysis to the non-employee football creditors, such as rival clubs, owed transfer fees by the insolvent club.

Although the battle is lost, the war might yet be won by the launch of a separate campaign. HMRC has brought proceedings against the Premier League to challenge the validity of the football creditor rule.

Unfairness and an abuse of creditor democracy

Although the West Lothian question has thus far arisen only in the idiosyncratic world of football insolvency, it is not inconceivable that West Lothian creditors may appear in a more typical commercial context, for example, where a creditor is able to recover in full outside of the CVA (such as by way of a third-party guarantee that will not be discharged by the CVA). It is apparent that there is a friction between the freedom that the Insolvency Act gives to a debtor to craft their proposal in whatever way they wish (subject to certain safeguards) and what we might grandiosely call the laws of natural justice. The authors' humble view is that the courts have correctly interpreted the statutory regime for voluntary arrangements. It appears to have embodied the West Lothian question in favour of the Scottish MPs into English insolvency law. Whether that result was intended by parliament is another matter and we can see that the result, however commercially convenient, does lead to unfairness and an abuse of creditor democracy. The football creditor rule also rankles and it is not hard to see the force of the argument that it breaches the golden rule of English insolvency law – that all unsecured creditors must be treated equally. We await the outcome of HMRC's proceedings with great interest in the hope that it will rule on the validity of the football creditor rule once and for all and throw light on how to resolve the West Lothian question with respect to voluntary arrangements.

MICHAEL RUTSTEIN is a partner at Jones Day.

LUKE JOHNSON is a trainee solicitor at Jones Day.

CVAs: the pros and cons

Ian Fletcher suggests that CVAs can be beneficial to property owners – but they could be improved.

No one likes losing money and landlords are no exception. However, British Property Federation (BPF) members appreciate that times are tough, particularly in the retail sector, and often it is in their best interests to support company rescues. Such support is not unconditional though. Most prime property these days is ultimately owned by you, me and the wider British public, through our pensions and life assurance policies. With any rescue, therefore, a landlord must weigh up the direct impact that a company voluntary arrangements (CVAs) will have on those future pension and other investors' receipts.

Landlords are also very conscious of the precedents that any rescue sets and how these may be used against their interests in other contexts. We are very fortunate in dealing with many of the best insolvency practitioners in the country, who would normally also be members of R3. A cursory typing of 'CVA' into Google elicits a host of websites, some of which offer very professional advice. However, others seem to promise the earth to those companies wanting to escape their commitments but make little mention of the impact on, or interests of, creditors.

> "CVAs have, on the face of it, several merits for landlords."

The merits of CVAs

CVAs have, on the face of it, several merits for landlords. If done well they provide significant transparency on the affairs of the business that is seeking help. The outcome for landlords is also very much in their own hands in that they get to vote on the proposal. Arguably, when weighting is taken into account it is not exactly true democracy for any individual landlord, but certainly far better than being presented with a *faît accompli* under existing pre-pack regulations.

Our experience has also been that insolvency practitioners are willing to modify proposals in light of discussion with landlords, which is very welcome. For example, as CVAs evolved during 2010/11 landlords became keen to see clawback arrangements in some CVAs to ensure that for taking the brunt of the pain in some rescues they should benefit if there was a resultant and sustainable gain. While not wishing to see that as standard terms, because every CVA is different and it is not in our interests to tie the hands of an insolvency practitioner, landlords will, I think, increasingly want such arrangements.

So far as critics of CVAs go, landlords are probably outnumbered by retailers, rivals of rescued businesses, who do not like the absence of market testing in a CVA and see any concessions given as unfair competition, which again raises the issue of 'precedents' for landlords. Landlords also sometimes feel that they are putting up most, if not all, of the rescue finance for the ailing business, while secured creditors and the owners are not making similar commitments. A CVA that is therefore backed by additional debt and equity raising is far more likely to gain our members' support. To coin the political phrase of the moment, at present it doesn't always feel like 'we are all in this together'.

I am sure at some stage we may want to press for a review of the effectiveness of CVAs, particularly in light of recent failures, but these are exceptional times and now is not the time to get into deep policy reviews, but to make the best of what we have.

The frustrations of the administration expenses regime

From our perspective in any case, the policy intricacies of CVAs rank in our second tier of priorities. The current major issue our members voice is the frustration with the tactical serving and reissuing of notices of intention, which allows tenants to avoid timely rent payments for property they will invariably still be using, and ranks rental payments missed during the notice of intention period as a low priority, because it is only once the insolvency practitioner is appointed that rent is seen as an expense of the administration. I know R3 members also share frustrations with the administration expenses regime and hopefully that will provide some common cause in looking at reform over the coming years.

> "At some stage we may want to press for a review of the effectiveness of CVAs, particularly in light of recent failures."

My members really appreciate the tough job that R3 members perform in trying to pull off what are often finely poised negotiations. They won't be supportive of every rescue for the reasons I have set out. Working constructively over the past couple of years, however, has I hope created a climate in which the members of R3 and the BPF are willing to engage and that we are all a bit more mindful of each others' challenges. □

IAN FLETCHER is the director of policy (real estate) at the British Property Federation.

Have retail CVAs been left on the shelf?

Richard Fleming argues they are not past their sell-by date.

The festive season is a long-fading memory and most high street retailers have come to the end of their post-Christmas discounting. However, rather than enjoying the traditional festive boom, many retailers have found the past few months to be extremely challenging. A number have already fallen victim to the difficult trading conditions and more casualties can be expected.

The difficulties that retailers are experiencing are not surprising, particularly given declining consumer confidence during 2011 on the back of higher unemployment, high inflation and the increased concerns in Eurozone. Weak consumer confidence is likely to be a feature of 2012 and difficult trading conditions will continue to expose weaker trading models particularly when accompanied by excess leverage.

Are CVAs still a valuable tool?

The last notable retail CVA was entered into by JJB Sports in March 2011. In sharp contrast, since 1 December 2011 (and up to the time of writing), we have seen seven large retail businesses (each with more than 250 stores) enter into administration with several being handled by ourselves. Indeed, one of these retailers was Blacks Leisure, which, despite successfully implementing a CVA in 2009, was ultimately unable to avoid administration.

This has caused me to consider whether CVAs remain a valuable tool for restructuring professionals working with retailers, or whether CVAs are no longer capable of delivering lasting solutions in this sector.

Administration has always been a favoured route for the insolvent retailer, particularly just after Christmas. The reasons behind this will be well known to this readership and often include:

- management have had their heads in the sand and the business is out of time
- secured creditors who want to exit the business can crystallise their positions at a time when lending levels are generally at their lowest (following the receipt of festive sales revenue)
- the position for secured creditors is often further improved when the company trades for a period under a notice of intention to appoint, lodged in court prior to rent quarter day
- the stakeholders, including the purchaser or new money provider, prefer a sale of business and assets via a pre-pack
- it is considered to be the most efficient means of realising the business and/or assets of a retailer whose business or operating model is fundamentally damaged or flawed and therefore could not be rescued.

> “No other mechanism can combine achieving significant reductions in footprint and occupancy costs with long-term security of tenure in such a short timescale.”

Turning to CVAs it is important to reconsider some of the essential ingredients for success. Again the obvious ones include:

- core business capable of saving
- appetite for new money – equity and/or debt
- secured creditor support for continuity
- backable management team
- broader stakeholder support – particularly suppliers and landlords
- a robust communication plan to support the above.

Three mitigating factors

There are, however, three other factors that are not so obvious but are hugely relevant.

Firstly, most of the successful CVAs to date have been supported by bilateral debt facilities or small syndicates – in other words getting consensus from the lenders has been relatively straightforward. It is more difficult to gain consensus in situations where the debt structure is complex and multi-layered with different lenders often in different layers of the debt structure – particularly when time may be of the essence.

Secondly, and perhaps most importantly, the CVA needs to emanate from the boardroom – lenders or other stakeholders cannot impose a CVA on management. It follows that management need quality advice from company-side advisers to give them the confidence that a CVA can work and once an initial assessment is completed, the confidence that the wider stakeholder group will support it.

Lastly company-side advisers themselves need to have confidence and a little courage to advocate the use of this mechanism. The confidence bit can be a little tricky in the absence of previous direct experience. I have been involved in a situation recently where management were briefed against a CVA to the extent that planning for a possible viable CVA did not get off the ground.

Keep it in your toolkit

Indeed it is not unusual to hear the counter that a pre-pack offers more certainty, as the transaction completes immediately, and that the working capital acceleration associated with a pre-pack is lower than a CVA. My own view is that the transactional uncertainty around a CVA is largely limited to the short period given for the notice of the creditors meeting (17 days including posting) and can be mitigated by an appropriate communication plan. A pre-pack does give certainty of transactional execution but then promises certainty of uncertainty to the purchaser and the business as it grapples with getting suppliers and landlords (who have legally been cast adrift) on board.

As for the working capital point, my experience suggests the exact opposite as appropriate communication with suppliers, particularly when they have the opportunity to maintain their position, has to date produced excellent results.

What is not open to debate is the extent of structural change taking place within the retail sector that will require many retailers to reduce their footprint and enhance their e-tailing operations. Such structural changes are often extremely difficult to implement and more businesses and management teams will fail to adapt quickly enough.

We have proved that the CVA deserves its place in the retail restructuring toolkit – no other mechanism can combine achieving significant reductions in footprint and occupancy costs with long-term security of tenure in such a short timescale. Given current economic conditions if we don't see any retail CVAs this year we, as restructuring professionals, will have failed.

RICHARD FLEMING is UK head of restructuring at KPMG LLP.

The retail landscape in 2012

Slower, lower, weaker? In an Olympic year, **Ian Gray** describes the prospects for the retail sector and how it has to change.

The Christmas and New Year period is one where the media take a detailed interest in the health of UK retail. Often for want of other news, reporters are sent to the largest shopping malls to take straw polls of those seeking sale bargains and conclusions are drawn about the health of the industry well before any figures are published. Prognostications are usually of the 'doom and gloom' variety, but how is the retail landscape actually looking in the early weeks of 2012? In addition, will the twin diversions of the Queen's Jubilee and the Olympics keep potential shoppers away from the tills as did last year's Royal Wedding?

Tesco's poor Christmas trading update wiped £5 billion off the company's stock market value in what is being dubbed a 'Black Thursday' for retail. *The Grocer* reported a 2.3 per cent slowdown in like-for-like sales in the six weeks to 7 January 2012 in its worst trading statement for 20 years. Is this an indication of the fundamental changes that are taking place in retail?

The current picture

Firstly, the signs from 2011 are not good. In a recent report, business advisory firm Deloitte indicated that retail businesses going into administration rose by 11 per cent year-on-year and, more worryingly, that the increase in Q4 was 25 per cent up on 2010. Big names such as Barratts and D2 went down this path in December and Deloitte's findings have prompted the British Retail Consortium to warn that this trend is likely to continue, with the increase in business rates in April just one element making life even more difficult on the high street in 2012.

I want to paint a picture of the current retail landscape and then suggest some fundamental actions that all retailers should be considering if they want to survive. Why are things so tough for this sector? Let me run through some of the major factors.

1) Many businesses are both operationally and financially highly geared. Moreover, many retail enterprises agreed leveraged financing deals between 2006 and 2008; they are not performing to plan and have no prospect of doing so without major financial and operational restructuring.
2) We are in a long recessionary period with limited availability of credit from banks and a lack of capital for investment and growth. As the cost of borrowing has remained low throughout the recession companies should be wary of increasing interest rates. Many businesses have managed their working capital to meet banking covenants but this cannot be sustained in the longer term as underperformance eventually erodes reserves. These conditions have already seen off famous names such as Woolworths, TJ Hughes and Focus.
3) There is a structural shift in the market as digital delivery draws customers from traditional retail outlets. We have already seen profound effects on book shops, newsprint, and high street retail. This means that organisations will have to find and embrace new ways to trade. Retailers need to have a different focus on the consumer and that means a multi-channel strategy.
4) A reduction in consumer confidence is leading to less spending in the high street. Potential customers are suffering from a lack of discretionary income – many businesses have not given pay rises for years, taxes have risen (eg VAT) and costs such as transport, food and energy have increased significantly. This means that people are often tackling their debts rather than indulging in new spending. Rising unemployment will not help this trend, especially in the under-25s, a mainstay of many retail outlets. John Lewis is predicting that consumer spending will be tight and so in this climate any improvements in sales and profit will come from winning market share from others.
5) There are many cost challenges facing retail businesses in 2012, including ever increasing input price pressures, such as minimum wage, imported inflation and business rates. Most companies have reduced their cost base to a point where they can go no further while seeing substantial increases in the purchase price of goods due to developments such as wage inflation in China, and increased transport and raw material costs.

> "Those organisations that manage their costs well and focus on being flexible towards their customers have a real chance of taking permanent market share from their floundering rivals."

When VAT increased by 2.5 per cent in 2011, it appears that only half of this was passed on to customers, meaning that around 1.25 per cent has had to be reflected in reduced margins and profitability. For a retailer with sales of £100 million that is a £1.25 million reduction in profit.

The two largest overheads in retail are wages and property. While generally there is downward pressure on wages, when the majority of staff are on minimum wage an organisation has no control over such costs as increases are dictated by government. On the property front there is some good news: rent increases are few at present (although it could be argued that they should be reducing). With stores, however, the question should be asked what constitutes nationwide coverage? These days a retailer needs far fewer outlets to satisfy demand. Excluding niche businesses, it has been reported that national coverage can be achieved with as few as 50 stores. However, leases are a long-term commitment and terminating the lease before the end of its term can be expensive.

The above makes the landscape a pretty bleak and inhospitable one. However, these conditions are the same for everyone and, as always in business, those organisations that manage their costs well and focus on being flexible towards their customers have a real chance of taking permanent market share from their floundering rivals.

What should retailers be focusing on?

The golden rule is to identify your customers and listen to them. This means more than assuming you know what they want, it involves a little talking and a lot of listening – to customers and store staff alike. They often know what the locals want, and will value being asked. When you have this information, make sure you use it and provide what's really needed. Then look at how to differentiate what you do. The physicality of retail offers endless opportunities to offer customers benefits that cost little. Add some emotion to the tangible, face-to-face experience of retail shopping that an interaction with a laptop and mouse can never give. You have the opportunity to create theatre for your target customers – get it right and they'll know they're in the right place.

Retailers need to look for more sales channels to survive, with the obvious candidates being online, catalogue and international. However, the internet cannot be a half-hearted add-on. It is a specialist area that requires a proper strategy. You need to be able to answer the following questions:

- How will your e-commerce offering interface with your retail one?
- What are your online conversion rates?

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- How do you assess the customer experience?
- How will you keep in touch with online customers versus catalogue or high street ones?
- How smart will your communications be? Don't annoy a customer by suggesting that as they bought item X they may like item Y (when the initial purchase was for granny not for them).
- Should you have an app?
- How will you use social media such as Facebook and Twitter?
- How will you keep up with changes in legislation such as Payment Card Industry (PCI) compliance?
- How should you split your marketing budget to support your online presence? It is very easy to spend a fortune on search engine optimisation (SEO) and pay per click (PPC).

It's not enough to have a pretty front end to a website, your back office will have to cope with new ways of handling products. It must be functional and able to deal with single picking for despatch, returns etc. This whole area requires focus, expertise and expenditure, but ignoring the internet is unlikely to be an option.

Companies should have clarity in their reporting and information. Consider the following and see how you can improve your position:

- Do you have too much money tied up in working capital? How would you know, and what criteria would you use?
- Do you avoid stock taking unit proliferation and gain control over the ranges you offer?
- Look at the lifetime margin of your products, their return on investment and return on space (per square foot or linear metre). Do you have a dynamic 'open to buy' stock replenishment system?
- Look at your buying. Are there products that perform well for your suppliers with other outlets that you do not stock?
- Would store refurbishments improve trading?
- Do you have loss-making or underperforming outlets? Identify the performance of your stores by having profit and loss accounts for each.
- Can you get help from your landlord? This could be through rent relief, rent-free periods, contributions to refurbishment and monthly rents.

Be creative. Can you make better use of the space you have – by hosting other retailers for example? You could offer a 'store within a store' concept or a concession to improve your returns.

Be lean and focused

By looking at the areas outlined above, and then making some hard decisions, retailers can become leaner. More focused organisations are not only able to survive the downturn but are equipped to start eating into others' market shares.

Do not rely on an upturn in the market any time soon. Frequently I hear senior managers say 'We just have to batten down the hatches for another year and then it will be fine'. Identify your customers and what they want. Address both your cost base and your capital structure. Look ahead to the challenges you may face and have a clear strategy.

2012 will be a year of celebrations in many areas of public and sporting life. However, a retail organisation that does not adapt to the new rules of the game is unlikely to survive in the longer term.

The report from Deloitte indicates that retail businesses going into administration rose by 11 per cent year-on-year in 2011 and… that the increase in Q4 was 25 per cent up on 2010.

IAN GRAY is director at Baronsmead Consulting Limited.

Retailers: how to respond to cash-flow challenges

Revan McKinnon identifies the areas to address when performance flags and outlines how they should be tackled.

Most retailers see dramatic movements in their annual cash flow. Cash-flow stress can be caused by increased funding requirements to build stock or other factors such as sluggish sales, aggressive discounting, reduced credit terms, excess stock and unplanned capital expenditure. Seasonality increases the variability. We have identified several ways in which retailers can respond to these challenges on a daily, weekly and monthly basis.

Most stressed or distressed retailers do not have good visibility of their daily cash flow and lack understanding of how unforeseen changes impact cash requirements. Finance directors will develop annual and monthly cash flows based upon operating budgets, not on underperforming reality. They know peak seasonal funding requirements and work with bankers or shareholders to ensure the required funds are available to manage those peaks. The challenge arises when performance falls below budget due to factors such as lower sales and/or aggressive discounting. The challenges are practical – lower cash than expected, but also emotional – how do I cope when everything is going wrong? Getting help on both counts is critical.

> “Retail is detail, as the old saying goes.”

As initiatives to improve sales and margin will differ company by company, this will focus on common factors in how retailers can respond to cash-flow challenges.

Responding to the challenges

The first step is to gain visibility of short-term cash requirements based upon real-time trading. The business should develop a daily, rolling 13-week cash flow, which is flexible, based upon sales and margin performance and other risk areas. The cash flow should ideally break out sales receipt by type, payments between stock and non-stock suppliers, opening and closing cash balances and associated headroom within existing financing. This cash flow and the subsequent cash headroom of the business should then be reviewed on a daily and weekly basis. Retail is detail, as the old saying goes.

In the short term, the most effective way for retailers to control cash is to manage intake and stock. It is crucial to foster open communication between the commercial and finance teams regarding funding peaks, even on a daily and weekly basis. Commercial and finance teams need to:

- Manage intake through a WSSI (weekly sales, stock and intake) and Open to Buy. If sales are sluggish and cash management a challenge, commercial teams must adjust their stock intake. This is more difficult with overseas suppliers due to longer lead times; however, UK suppliers and agents are often willing to delay delivery or reduce the number of items delivered after a frank discussion regarding trading and forecasts. If sales are significantly below budget, consider cancelling or amending orders from overseas suppliers and paying the associated penalties.
- Discuss extending payment terms with suppliers for the short term.
- Develop clear processes to ensure commercial and finance teams communicate agreed rebates, retrospective discounts or special one-off arrangements. Often, these commercial agreements are not reflected or checked against invoices, essentially draining cash from the business.
- Clear underperforming or terminal stock and turn it into cash. Run special promotions or even sell to a third-party wholesaler.
- Chase down outstanding debtors. Consider using a factoring company.

Longer term

In the longer term, we advise management teams to focus on other areas that impact cash flow, including:

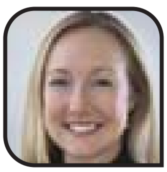
- **Rent**: discuss current rent levels and options to move from quarterly to monthly rent payments. Focus on opportunities for turnover versus fixed rents. Exit underperforming locations.
- **Store and central overheads**: review store and head office overhead costs. Tender services when due for renewal. Consider having the finance director discuss the importance of cash management with each department to build a general awareness and accountability. Certain third-parties also identify and implement cost savings on a percentage of success basis, which means no up-front or expensive consulting fees.
- **Capital expenditure**: reduce or eliminate all non-essential capital expenditure. Weigh decisions carefully against any associated sales increases (ie investments in transactional websites, new stores, or new sales channels). Discussions with current vendors and suppliers often flag up creative ways to manage cost and still deliver projects on time.
- **Sourcing**: reconsider sourcing locations and supply chain flexibility. Do the benefits of shorter lead times warrant changing suppliers or locations? Many UK retailers are assessing local sourcing options to reduce minimum-order quantities, reduce time to market and gain flexibility to manage intake on a weekly or monthly basis based on sales.

> “The finance director should discuss the importance of cash management with each department to build a general awareness and accountability.”

- **Surplus assets**: consider selling property, equipment, or underutilised trademarks and intellectual property.
- **Hidden cash**: commence a review for hidden cash in areas such as duplicate payments, recoverable VAT that remains unclaimed and incorrect duty payments due to mis-classification of imports. These areas are often overlooked and can produce significant cash upsides.

Use the ‘checklist’

Using the above as ‘checklists’ on a regular basis will help firms to focus on areas where both short- and long-term adjustments can control cash flow better and reduce the chances of problems building up. □



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Career progress

The 2010 JIEB award winners talk about their career progression and the restructuring sector.

Chris Huzal

Associate director at Baker Tilly Restructuring and Recovery LLP. **Insolvency Practitioners' Association Prize for First Place and ICAEW Prize**

How important was the JIEB in your career progression?
Having trained in business recovery and reorganisation, I always knew that passing the JIEB exam would be an important step as it would permit me to follow a key part of my career path and take formal appointments, in addition to performing business reviews. While I have reached my current position without it, future advancement would not be possible and having avoided taking professional exams for a number of years, I felt that 2010 was the year to face them once again!

Having passed the JIEB exam, I am now able to move forward to the next stage in my professional development and equally importantly, by being JIEB qualified, I provide increased credibility to my colleagues, clients, funders and other professionals with whom I work.

Amy Gallimore

Solicitor at Speechly Bircham LLP. **Insolvency Lawyers' Association Prize**

What development would benefit the insolvency sector?
There have been a number of recent judicial decisions relating to the classification and extent of administration expenses that could affect the viability of certain administrations.

In particular, the High Court's decision in *Goldacre* in relation to leasehold expenses has led to concern that non-rental liabilities such as dilapidations could also rank as an expense of an administration, and last year the Court of Appeal upheld the *Nortel* and *Lehman Bros* decisions that the costs of complying with a Financial Support Direction made by The Pensions Regulator should also rank as an expense.

At a time when there is considerable public pressure on office-holders to achieve the 'right' result for stakeholders, parliament should introduce legislation to strengthen the current administration expenses regime, consistent with the rescue culture it is keen to foster.

James Cresswell

Insolvency manager at Begbies Traynor Group. **Leonard Curtis Prize for Third Place and Association of Chartered Certified Accountants' Prize.**

What do you enjoy most about your job?
It is the variety of working as an insolvency professional that I find enjoyable. A range of skills are required when dealing with insolvent businesses. A strong financial knowledge is necessary to understand where profitability can be found. A broad understanding of the legal implications is important, not just insolvency law but also wider aspects of commercial and employment law. In addition to technical skills, commercial negotiations are just as important. Variety is also created with the clients you work for. Any industry or sector may experience financial difficulty and each will bring its own set of challenges. You also deal with interesting characters and find that people do strange things when desperate, which keeps you on your toes.

Stuart Preston

Associate director in Recovery & Reorganisation at Grant Thornton UK LLP. **Institute of Chartered Accountants of Scotland Prize**

What are the key skills necessary to become an IP?
The recovery market is changing with an increasing requirement for IPs to apply their skills to a much wider scope of assignments, but the core skill base remains the same. Being pragmatic and commercial are key, as is the ability to work quickly and under pressure. The timescale for identifying and implementing practical solutions and effective strategies for distressed or insolvent companies is often limited, and therefore an ability to avoid unnecessary distraction and getting straight to the point is necessary. In such situations the parameters can move quickly, and being able to adapt to sudden and unexpected change is essential. In addition, open and timely communication with key stakeholders is critical to understanding and meeting their expectations, and a strong leadership ability is required to ensure effective results.

Joint Insolvency Examination – November 2011

Congratulations to all the successful candidates.

A

Ainge J (8277) Shipley
Akehurst R (8069) London
Avery-Gee E (8221) Altrincham

B

Bailey V (8091) Hoddesdon
Bailey V (8119) London
Barber A (8319) Nottingham
Barr L (8017) Hamilton Hill
Bastick S (8009) Edinburgh
Batchelor S (8140) London
Bennett J (8138) Hamilton
Blackwell V (8093) Brighton
Bray M (8185) Stourport-on-Severn
Brown K (8263) Leeds
Butcher L (8316) Leicester

C

Cannell L (8299) Alresford
Cherry R (8124) Chelmsford
Clarke L (8057) Greenhithe
Collins D (8253) Leeds
Cook M (8120) Colchester
Cooke S (8213) Chorley

D

Davenport A (8266) Sheffield
Davies A (8192) Nassau
Doherty M (8203) Liverpool
Dolliver A (8030) Belfast
Dunton A (8095) Slough

E

Edwards S (8133) London

F

Francis C (8156) Marlow
Franklin S (8287) Ringwood
Fretwell S (8173) Birmingham

G

Gardner R (8279) Leeds
Gaster B (8322) Nottingham
Gildernew M (8032) Dungannon
Goldstein M (8105) London
Goodwin H (8054) London

JIEB 2011 prizes winners

Insolvency Practitioners' Association Prize for First Place
Helen Wheeler-Jones

PricewaterhouseCoopers Prize for Second Place
David Shambrook

Leonard Curtis Prize for Third Place
Benjamin Peterson

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

ICAEW Prize (awarded to the ICAEW member with the highest mark)
Helen Wheeler-Jones

Insolvency Lawyers' Association Prize (awarded to the lawyer with the highest mark)
Linda Barr

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

BPP Prize (awarded to the candidate with the highest mark in the Personal paper)
Helen Wheeler-Jones and David Shambrook

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

H

Hanley R (8210) Warrington
Harding C (8248) Wakefield
Harper A (8241) Manchester
Hawksworth S J (8326) Faversham
Haynes C (8076) Greenhithe
Hotham R (8284) Taunton
Howarth T (8232) Manchester

I

Ion L (8199) Wirral
Iwu G (8130) Barnet

J

Johns C (8211) Manchester
Johnson A (8176) Walsall

K

Keay K (8059) London
Kennedy V (8134) Mitcham
Khan W (8269) Leeds

L

Lancaster S (8225) Leek
Leeds M (8068) London
Longley L (8259) Pudsey

M

Mann L (8063) London
Marchant E (8049) London
Miller J (8247) Huddersfield
Milnes A (8243) Huddersfield
Mirza O (8164) Birmingham

N

Neumegen M (8271) Driffield

O

Oates T (8250) Ilkley
Orsini D (8204) Stockport
Orum K (8305) Pontyclun

P

Paice B (8067) London
Paterson A (8008) Dundee
Perkins D (8127) East Grinstead
Peterson B (8317) Melton Mowbray
Powell H (8304) Cardiff
Preston C (8084) Welwyn Garden City
Price G (8086) High Wycombe

Q

Quinn Y (8702) Glasgow

R

Richards S (8296) Wimborne

S

Shambrook D (8064) London
Sherry S (8111) Surbiton
Shipperlee S (8090) London
Siddall R (8252) Sheffield
Smith P (8267) Leeds
Starkins R (8126) London
Stevenson D (8002) Edinburgh

T

Taylor D (8070) Reading
Titchmarsh S E (8109) London

W

Walker B (8303) Cardiff
Warburton S (8220) Bolton
Webb D (8163) Birmingham
Wells J (8060) Reading
Westney S (8089) London
Wheeler-Jones H (8320) Wigston
Whitney T (8098) London
Wigfield K (8318) Chesterfield
Wilcox G (8170) Birmingham
Wilkinson R (8323) Nottingham
Williams J (8198) Manchester

Analysis of November 2011 results

Papers sat	Papers passed				
	3	2	1	0	Total
3	62	23	15	22	**122**
2		33	24	35	**92**
1			58	46	**104**
Total	**62**	**56**	**97**	**103**	**318**

R3 Education, courses and conferences committee

The ECC provides an important service for the education and training of the R3 membership and delivers essential CPD. **David White** explains.

Aside from membership fees, course income is the principal revenue generator for R3 and plays an important part in contributing to the costs of the organisation.

The Education, courses and conferences committee (ECC), currently chaired by David Chubb of PwC, is responsible for organising the annual course programme offered by R3. Members of the committee are drawn from across the profession and, currently, the committee comprises 22 individuals from a mix of insolvency practitioners, barristers and solicitors.

Role of the ECC committee

Members of the committee act as course directors and are responsible for designing the course content, appointing and briefing speakers and overseeing the progress of the series aided by David White and the excellent full-time R3 courses and conferences team.

A key challenge for the ECC committee is reaching across all the representative regions within the membership. A recent development is that some regions have appointed ‘observers’ to the committee who can liaise between the ECC and their local regional committee. This enables a direct conversation that minimises repetition within regional meetings and ensures suitable educational content is provided to the regions.

> “A recent development is that some regions have appointed ‘observers’ to the committee who can liaise between the ECC and their local regional committee.”

The committee oversees a wide range of courses each year with a mix of half-day, one-day and two-day courses and conferences. These are also supplemented by our introductory programme, breakfast briefings and webinars. The webinars, which are new to our programme, will be recorded and available for download from the R3 website making CPD points and technical updates even more accessible to members in the same way as our course DVDs.

The annual conference

The ECC committee also supports the planning committee for the annual conference, which is the most prestigious event in R3’s training calendar. This year’s conference is being held on 16–18 May in Barcelona and bookings are already well advanced.

The ECC committee is always reviewing the potential for new courses and would be grateful to receive ideas and suggestions for topics from the membership. They are keen to find new speakers for the courses and conferences and also looking for members’ offices in which to hold breakfast briefings or student workshops. If you are interested or able to assist then please contact David White at **dwhite@r3.org.uk**.

If you are interested in joining the ECC committee please do get in touch.

Dates for the diary

International Restructuring	16 March, London
Insolvency Day	20 March, Bristol
SPG Technical Review	27 March, Manchester
Liquidations	29 March, London
SPG Technical Review	17 April, Birmingham
Charities Insolvency	19 April, Manchester
Partnership Insolvency	19 April, Manchester
Insolvency Day	24 April, London

Courses team 020 7566 4234

DAVID WHITE is the training director at R3.

Marketing for minnows

In smaller practices, IPs may need to take on more than one role to help grow their business. **Samantha Hawkins** offers some hints on developing a successful marketing strategy without the back-up or the budget.

Your marketing strategy can mean the difference between survival and failure. Competitors are all chasing the same work so getting the basics right by putting in place a clear and robust strategy is crucial. You need to know your niche intimately, work out the message you want heard and identify who you want to hear it in order to target your potential customers or suppliers successfully.

Marketing is an industry in itself. Larger consultancy and law firms have dedicated marketing departments geared to promoting business development and networking relationships. Many use sophisticated databases that will identify the target and list the employees who know them. The packages used define the relationship along the lines of 'met once' to 'close personal friend'. Firms often designate a client relationship manager (CRM) as a primary point of contact, who is responsible for championing the target internally and overseeing marketing of the firm's services to maintain the relationship.

Databases sort disparate data into a manageable format and an information tree with the CRM at the apex. This method of sorting data and marketing leadership is useful when, for example, someone from the corporate finance team, who has no previous dealings with the target, wants to be introduced to a tax client. An approach can be made through the CRM to set up an appropriate meeting to assist in developing the relationship.

Thinking outside the formal CRM box

In a smaller firm, marketing is very often on a shoestring and highlights your activity to competitors so it needs to be precise to get the most out of any investment, and you need to be focused and canny.

There are a number of drawbacks to formal and structured marketing, as described above, for small firms. As marketing is essentially non-chargeable time, you need to review policies on a regular basis, be that three- or six-monthly. This should be done to ensure that the marketing is working, either in terms of converted sales or reciprocity. Someone who might have been considered a strong target may actually transpire to be fruitless.

This is when genuine personal relationships are vital and small firms can benefit from *not* having a CRM as there is often the time, remit and licence to develop a relationship outside of such formality. This can mean that members of smaller firms will visit other professionals, or work-introducers, and form long-term relationships, some deeper than others. The result is that you have a network of professionals who do your marketing for you. This is especially important when you have a vulnerable debtor or director who might find it difficult picking up the phone to an insolvency practitioner or insolvency lawyer and for whom it may be easier to speak to their trusted accountant or independent financial adviser.

> "Personal relationships are vital and small firms can benefit from *not* having a CRM as there is often the time, remit and licence to develop a relationship outside of such formality."

Quality counts

The key to marketing through introducers from professional firms is to ensure you receive a number of quality leads and, crucially, these don't have to be from the same sector; this means you are permeating all areas of your potential market. When using this method to promote your business you must exercise caution when referring work out. If a trusted contact of yours asks you to speak to one of their long-term clients it is essential the work provided by your firm is of a good quality and fair. If it is not, you risk damaging the relationship and the potential for future referrals.

When referring out to a third party from one of your contacts, you need to be sure the person to whom you're referring your contact's client to will deliver. It can be fatal to a relationship to bring two unknown parties together and be let down by the person you have entrusted with the job.

Again this is where looking at the firm's strategy is crucial to success in marketing. It may help to have a third party objectively review your strategy and appraise your efforts, and tell you what the message is you're sending out. This is beneficial when preparing marketing material, including websites, after all, a debtor or director wants to know you can do the job and not that you enjoy sitting in a lotus asana while contemplating your navel.

Venus and Mars

I've been asked to comment on my experience as a younger woman marketing in a predominantly male, middle-aged and middle-class profession. My experience is rather perverse, very often it is not the men I work with who consider my gender or age to be an issue but female debtors and directors. The men I know and have relationships with in the market are professional enough not to consider the obvious differences between us, after all, my principal calls me his 'right hand man'. However, female clients may be taken aback initially at meeting me, especially if they are used to meeting the stereotypical male IP, but when you're confident in your interpersonal skills and technical abilities you soon gain their trust and allay any fears they may have. Professionalism is what counts.

Samantha Hawkins is a senior manager at David Exell Associates.

R3 events, courses and conferences

	Date	Event	Venue
March	**1**	Liquidations	Cheltenham Chase, Cheltenham
	6	Personal Insolvency 1	Prospero House, London
	6	Personal Insolvency 1	Irwin Mitchell Solicitors, Leeds
	7	Personal Insolvency 1	Deloitte LLP, Birmingham
	8	Trading Insolvencies	Life Conferencing, Newcastle
	8	North West Space NK Event	Space NK, Manchester
	8	Yorkshire Women's Group Meeting	Irwin Mitchell, Leeds
	9	East Midlands Excuse Me Lunch	Trent Bridge Cricket Ground, Nottingham
	13	Business & Options Reviews	CCT Venues Barbican, London
	15	Midlands Regional Meeting	National Motorcycle Museum, Birmingham
	16	International Restructuring Conference	Merchant Taylors Hall, London
	20	Insolvency Day	Marriott City, Bristol
	21	East Midlands New Professionals Quiz Night	Via Fossa, Nottingham
	22–23	Northern Insolvency Conference	Oulton Hall, Leeds
	27	SPG Technical Review	Renaissance, Manchester
	29	Liquidations	Copthorne Tara, London
April	**16**	Eastern Regional Meeting	Ravenswood Hall Hotel, Bury St Edmunds
	17	South West and Wales Regional Meeting	Aztec Hotel & Spa, Bristol
	17	SPG Technical Review	Crowne Plaza, Birmingham
	17	Personal Insolvency 2	Prospero House, London
	17	Personal Insolvency 2	Irwin Mitchell Solicitors, Leeds
	18	Personal Insolvency 2	Deloitte LLP, Birmingham
	19	Charities Insolvency	The Midland, Manchester
	19	Partnerships Insolvency	The Midland, Manchester
	24	Insolvency Day	Copthorne Tara, London
May	**1**	SPG Technical Review	Hilton Tower Bridge, London
	3	Midlands Spring Ball	The ICC, Birmingham
	8	Rescue 1	Prospero House, London
	8	Rescue 1	Irwin Mitchell Solicitors, Leeds
	9	Rescue 1	Deloitte LLP, Birmingham
	9	London and South East Women's Group Event	
	9	Yorkshire Women's Group Event	PwC, Leeds
	10	Charities Insolvency	Cheltenham Chase, Cheltenham
	10	Partnerships Insolvency	Cheltenham Chase, Cheltenham
	16–18	Annual Conference	Hotel Arts, Barcelona
	17	South West and Wales Golf Day	Bowood Hotel, Bristol
	31	Insolvency for Professionals New to the Sector	Bonhill House, London

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 full 2012 programme. Alternatively, call the Courses team on 020 7566 4234 to request a programme by post.

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Proceed with caution: ROT in trading administrations

Is paragraph 72 a help or a hindrance to the rescue culture when IPs need to act swiftly?

Some trading administrators have historically regarded assets supplied subject to retention of title (ROT) as, at best, a distraction from the main business of trading while trying to sell the business and, at worst, an obstacle to ensuring that the stock can be sold to generate working capital for the administration. Although it seems often to have gone unnoticed in practice, paragraph 72 of schedule B1 to the Insolvency Act 1986, introduced by the Enterprise Act 2002, means that any administrator who ignores an ROT creditor could now face a personal claim in conversion for the 'market value' of the ROT goods – and the court might find that the 'market value' is more than the administrator sold those goods for. Paragraph 72 is therefore something that administrators should now consider before taking an appointment: if a business obtains most of its supplies on ROT terms, the threat of paragraph 72 liability may now tip the decision against trading.

Paragraph 72

Paragraph 72 provides that:

1. The court may by order enable the administrator of a company to dispose of goods which are in the possession of the company under a hire-purchase agreement [defined in para 111(1) of schedule B1 to include ROT agreements] as if all the rights of the owner under the agreement were vested in the company.
2. An order under sub-paragraph (1) may be made only:
   a) on the application of the administrator, and
   b) where the court thinks that disposal of the goods would be likely to promote the purpose of the administration in respect of the company.

> "Failure to apply under para 72 could be used to support an argument that the administrator has not dealt fairly with third parties (in this case ROT creditors)."

3. An order under this paragraph is subject to the condition that there be applied towards discharging the sums payable under the hire-purchase agreement:
   a) the net proceeds of disposal of the goods; and
   b) any additional money required to be added to the net proceeds so as to produce the amount determined by the court as the net amount that would be realised on a sale of the goods at market value.

Points to note

- Critically, paragraph 72 means that *an administrator needs the court's permission to sell any goods that are subject to ROT*. Although not expressly stated as such, in practice, the mandatory requirement for permission to sell places on the administrator an obligation to ascertain which goods are subject to ROT before selling them – a reversal of administrators' historical approach of relying on the supplier to advance its claim, assuming that it is invalid or unenforceable until the contrary is shown. This would now seem to require the administrator to analyse the status of every supplier before selling the goods they supplied.
- It is for the administrator to apply for an order, not the supplier.
- An order will only be made 'to promote the purpose of the administration', ie rescuing the company as a going concern, achieving a better result for the company's creditors than would be

achieved by a liquidation, or realising property for the benefit of a secured or preferential creditor, depending on which was the basis of the administration. But if the sale proceeds have to be paid to the supplier, how can it be said that a sale of the ROT goods would 'promote the purpose of the administration' (other than by preserving goodwill), particularly when simply allowing the supplier to collect its goods would save the costs of selling them?

- If authorised to sell, paragraph 72(3) requires the administrator to pay the supplier:
  - the net proceeds of sale; *and*
  - any additional amount the court thinks necessary to achieve 'market value' [defined in paragraph 111 of schedule B1 as '…the amount which would be realised on a sale of property in the open market by a willing vendor'].

  So if the supplier sells an item to the company for £5, the company ordinarily sells it for £10 and an administrator sells for £7, is the 'market value', £5, £10 or £7? If towards the end of the trading period the administrator sells for £4 (as part of a clearance sale), paragraph 72(3)(b) clearly allows the court to order the administrator to pay the seller a 'top up' payment to achieve market value. If it did, would it be £1 (to get to £5), £3 (to get to £7) or £6 (to get to £10)? As yet, this point has not been determined by the court – but it is a critically important one for a trading administrator.
- What is the penalty for selling the ROT goods without a court order? This is the real sting in the tail. Paragraph 72 does not specify a sanction, but it does not need to. A valid ROT clause means that the property supplied always was, and remained, the property of the supplier until paid for (or until all goods supplied have been paid for, for agreements containing an 'all monies' clause). 'Conversion' is commonly defined as 'any unauthorised act which deprives the owner of property without his or her consent'. An unauthorised sale by an administrator of goods supplied on ROT terms has all the characteristics of conversion – and the supplier would undoubtedly rely on the administrator's failure to obtain permission under paragraph 72 as supporting evidence of a failure to discharge the administrator's obligation of honesty and fair dealings with third parties, as required by *Ex parte James*[1].
- Damages for conversion are generally based on the market value of the goods, which is also the restitution payable under paragraph 72 (and thereby suffers from the same uncertainty in quantification).
- A contract including a valid ROT clause must, by implication, give the buyer the right to sell the goods so it can pay for them. A well drafted ROT clause will allow the supplier expressly to terminate the company's (and therefore the administrator's) right to sell on insolvency. The administrators of *Jet Star Retail*[2], which operated as the high street women's fashion retailer *MK One*, traded the company for a short period before selling the business and assets. A supplier subsequently claimed ROT and damages in conversion from the administrators as a result of both the sales during the trading period and of the business and assets. The Court of Appeal rejected the supplier's claim, holding that the supplier's failure to exercise the contractual right to terminate the continuing right of sale meant that the sale of the stock during the administration and subsequently of the business and assets did not amount to conversion. However, that case made no reference to paragraph 72; nor did the supplier seek to make the conversion damages personal to the administrators, but instead claimed them as an expense of the administration. A differently drafted claim would probably have resulted in a different outcome.

> "The administrator's best protection is to apply for an order immediately after appointment under paragraph 72 allowing the sale of ROT stock."

- As demonstrated by *Jet Star/MK One*, paragraph 72 is relevant to both trading administrations and to pre-pack or post-appointment sales where assets subject to ROT are purportedly transferred. It is worth noting that even carefully worded sale and purchase agreements may still not provide the administrator with protection against claims brought under paragraph 72 or for damages in conversion in those circumstances.
- The ultimate buyer is unaffected by the administrator's position. By section 25 of the Sale of Goods Act 1979, they will generally acquire good title from the administrator irrespective of the existence of a valid ROT, or of the administrator's failure to obtain sanction.

An IP may be in a dangerous position

Where does this leave the traditional issues relating to effective incorporation of the ROT term into the supply contract, identification of the goods supplied, intermingling of goods supplied into other goods and so on? These very practical considerations seem to have become less significant as a result of paragraph 72. The obligation to apply for leave to sell appears to require the administrator to assume that a supplier has an effective ROT or to face possible liability to a supplier for damages in conversion for having failed to identify the ROT goods. Having obtained court permission to sell, the administrator can of course still require the supplier to prove its ROT, but if an administrator has to assume that there is an effective ROT in order to protect him- or herself, hasn't the burden of proving an effective ROT been at least in part lifted from the supplier?

Compared with the pre-Enterprise Act position, paragraph 72 places an administrator in an extremely difficult and dangerous position – and one which may be outside his or her professional indemnity insurance. If an administrator can reach agreement with suppliers prior to or immediately on appointment to allow continued sales for a certain price, paragraph 72 considerations should be avoided. In absence of universal agreement, the administrator's best protection is to apply for an order immediately after appointment under paragraph 72 allowing the sale of ROT stock. But if the administrator cannot specifically identify stock that is, or may be, subject to a valid ROT, will the court give a general authority to sell, and how could the administrator persuade the court that selling such as yet unidentified ROT stock will 'promote the purpose of the administration'? And even if the order is given, would it be commercially worthwhile, given the need to pay the supplier the uncertain market value of the goods? Insolvency practitioners contemplating trading administrations where ROT will be a significant issue will want to consider whether there is a net benefit to the company that justifies the risks of trading, or whether a liquidation would provide a more certain, if less profitable, outcome.

The architects of paragraph 72 were clearly trying to redress a perceived imbalance of power between administrators and suppliers, but can this really have been what they intended if the risks to insolvency practitioners result in more liquidations than administrations? □

[1] (1874) LR 9 Ch App 609

[2] 2 [2011]EWCA Civ459.

CHRISTOPHER HARLOWE is a partner at Speechly Bircham LLP.

AMY GALLIMORE is a solicitor at Speechly Bircham LLP.

REUTERS/Henrik Andersen

Lenders beware: poor document handling can render loan and security documents unenforceable

Séamas Gray and **David Alexander QC** report on two recent cases where failures in document processing led to the collapse of the guarantee and warranty claims as well as findings that the principal finance agreements were invalid.

The background to both cases stems from the failure of Esdale Tooling Limited (Esdale), a toolmaker financed by Bibby Financial Services Limited (Bibby) under an invoice discount agreement. Esdale was in trouble and Bibby was exposed. Bibby brought in a consultant, Richard Magson (the first defendant in both proceedings) to assist. However, shortly thereafter, HMRC presented a winding-up petition against Esdale.

Bibby Financial Services Limited & Anor v. *Magson & Ors* [2011] EWHC 2495 (QB)

Given Esdale's financial situation, it was agreed that QCFS Limited (a company owned by Mr Magson and Mr Robert Scott) would buy the business through a pre-pack with a view to ensuring that Bibby's exposure to Esdale was collected out. Mr Magson and Mr Scott met with a representative of Bibby and were provided with personal guarantees and warranties along with the invoice-discounting agreement. The defendants said they briefly went through the (unbound) documents and Mr Magson made some significant shorthand annotated amendments to them and that these amendments were initialled by all present. It was not disputed that the documents were signed as deeds and were handed to the Bibby representative.

A few weeks later the pre-pack completed. Six months later Bibby's exposure to Esdale was collected out and Bibby then decided to exit its relationship with QCFS, ultimately putting QCFS into administration in April 2010. Bibby sought to pursue the defendants under their guarantees and warranties (now bound in their original form without any of the amendments) alleging that QCFS had created 'fresh air invoices'.

Finding for the defendants, the judge said that: 'it was clear that neither of [the defendants] was an idiot, and they would both have had to have been idiots if [the Bibby representative's] account of events… were correct' and that one aspect of the evidence of the Bibby representative 'bordered on the absurd'.

The judge noted that a deed is validly executed only if 'it is delivered as a deed' and determined that: 'The critical thing is that the person who has signed the deed must have separately indicated that he intends to be bound by the deed. Mere signature is not enough. Nor is it enough that what looks like a deed has been given to the person who appears to be the beneficiary of it – the issue is not whether the document has been physically handed over to the beneficiary, but whether the person whose deed it is supposed to be, intended to be bound by it.'

> "The judge decided that, since the defendants had not intended to 'deliver' the deeds, the invoice discounting agreement, the guarantees and the warranties were not binding."

Accordingly, the judge decided that, since the defendants had not intended to 'deliver' the deeds, the invoice discounting agreement, the guarantees and the warranties were not binding and said that: 'It also follows that QCFS was not in fact bound by the terms of the [invoice discounting agreement] … [and] there were no obligations on the part of QCFS to [Bibby] for Mr Magson or Mr Scott to warrant.'

The judge also rejected Bibby's assertions as to 'fresh air invoices' and further stated that: 'in any event it was not proved that there had been any breach of warranty in relation to any of the [invoices]'.

Lombard North Central Plc v. *Magson*

This case concerned Esdale's lease of a motor vehicle from Lombard North Central Plc (Lombard), for delivery in July 2008. Mr Magson had signed a suite of documents in May 2008, including a Schedule to Lease Agreement and a Guarantee and Indemnity purportedly personally guaranteeing Esdale's liabilities. After signing, manuscript alterations were made to the Schedule to Lease Agreement and the Guarantee and Indemnity.

The vehicle was ultimately delivered to Esdale in July 2008 and shortly thereafter the winding-up petition was presented against Esdale by HMRC, with Esdale entering administration in September 2008. The vehicle was delivered up to Lombard, sold at auction and Lombard claimed the balance from the defendant.

While dismissing the claim because there was no concluded lease agreement, the judge decided also that, even if there had been an agreement, it was void for material alteration. In this regard it should be noted that a material alteration can be one that is only *potentially* prejudicial and *actual* prejudice does not need to be shown.

Conclusion

Lenders need to ensure that their document handling processes are both adequate *and implemented*. If they fail to do so, customers might not be liable for anything at all!

Séamas Gray and David Alexander QC acted in both the above cases.

SÉAMAS GRAY is a partner of Olswang LLP.

DAVID ALEXANDER QC is a silk at South Square.

Sunny places for shady bankrupts: what to do with an asset in Spain

Jeremy Boyle and **Javier Jurado** look at the practical difficulties of realising assets in Spain, while avoiding the pitfalls of the European Insolvency Regulation.

Imagine you have just received the Official Receiver's handover papers and you see that the bankrupt has a property in Spain. What do you do? The European Insolvency Regulation (1346/2000 (the Regulation)) provides that the law applicable to your bankruptcy is that of the member state in which the proceedings are opened (article 4(1)).

However, one exception to the above rule applies to property. In particular, the opening of the proceedings does not affect 'rights in rem'. These include mortgages, and the Regulation provides that it is the local law, where the property is located, which takes precedence when considering the rights of charge-holders. As trustee, therefore, you will have to follow Spanish law with regards to security.

> "The Spanish land registration system is centralised, but there are 52 local offices throughout the country with two different registers."

So what do I do first?

The Spanish land registration system is centralised, but there are 52 local offices throughout the country with two different registers:

1) the *Catastro* detailing property description etc; and
2) the *Registro de la Propiedad*, which records ownership, any charges (*hipotecas*) and rights or restrictions affecting the property.

Although not technically compulsory, in practice the majority of properties are registered to prove ownership and to expedite a sale.

Initially as trustee you should apply for a *Nota Simple*, which provides particulars of the registered proprietors and charges.

On one case we worked on recently, our search of the *Nota Simple* also provided details of charges registered against the title by the local town hall, which of course affected the equity level!

What next?

The Regulation does not provide for a centralised register and instead protection of your interest is via registration of a notice and is provided for in the Regulation (Article 22(1)) and pursuant to article 24.4 of the Spanish Bankruptcy Law 22/2003 of 9 July 2003. The fee charged by the Spanish National Registry, for registration, is on a sliding scale depending on, among other things, the value of the property but is usually in the region of €250.

Although the above step is relatively straightforward, in our experience it is often difficult to obtain accurate information regarding the value of the property and the sums due under the charges affecting the property. It's therefore of paramount importance that you should use an *abogado* to advise throughout.

As part of the registration process, you need to procure a Spanish Deed. This involves sending translated copies of the Bankruptcy Order and Certificate of Appointment, duly sealed with the Hague Apostille to the Land Registrar.

To avoid geographical difficulties, we often prepare a Power of Attorney for our client trustees.

Things to remember

Notwithstanding the powers derived from the Insolvency Act 1986, enabling the trustee to take possession and sale of the property, pursuant to articles 11 and 18(3) as trustee you must observe local Spanish law relating to the conveyancing process involving the *Contrato Privado de Compraventa* and *Escritura de Compraventa*. It will also involve using a *notario*, a government appointed lawyer, whose function is to ensure that the conveyance proceeds in accordance with the law. They are independent in the sense that they have a neutral role. Their costs will be payable either by the seller or buyer as per the terms of the sale agreement. The function of the *abogado* is to deal with the particular aspects of the conveyancing process and insolvency procedures.

Notwithstanding the structure of the Regulation, in our experience the language barrier remains, and you need to ensure that you have a good relationship with the local bank branch manager and stay in regular contact.

> "As part of the registration process, you need to procure a Spanish Deed."

In another case we dealt with, at short notice, the bank's legal department decided to place the property in an auction (*subasta*) but fortunately, we were able to bring the sale forward.

In another case we discovered that an appointment taker had not registered his interest over the property and a valuable asset was sold without his knowledge. Accordingly if you do receive that call from the Official Receiver, ensure you instruct specialist lawyers promptly.

JEREMY BOYLE is the founding partner of Summit Law LLP.

JAVIER JURADO is an abogado on Summit Law LLP's Spanish desk.

Fraud costs the UK £38.4 billion – but we can fight it together

Stephen Harrison outlines the work of the NFA and new initiatives to counter fraud.

Fraud causes considerable economic and social harm to individuals, businesses and society. It affects us all. The National Fraud Authority (NFA) works with a huge range of stakeholders to focus and co-ordinate the fight against fraud in the UK and aims to reduce the level of fraud, the impact it has and the harm it causes. To enable the counter-fraud community to target its approach to tackling fraud more accurately, we provide a more complete, accurate and meaningful comparable fraud estimate and publish this annually. In our latest Annual Fraud Indicator, we estimated that the cost of fraud to the UK economy was now at least £38.4 billion a year, costing the average adult in the UK £765 per annum whether as a direct victim or through increased prices for goods and services and higher insurance premiums.

Victims of fraud

For too long fraud has been considered a peripheral crime; however, it is important to recognise that it is never a victimless crime. It is clear that victims of fraud are found in all sections of society. Opportunistic criminals and organised crime networks know this and, not surprisingly, they have been taking advantage of the relative safety of fraudulent enterprise. It is vital that we join together to take action to stem the rising tide of fraud and make the UK a more hostile environment for fraudsters to operate in. The Annual Fraud Indicator enables us to gain a perspective and judge the scale of the problem and target our actions accordingly.

Businesses can lose many millions of pounds and suffer heavy reputational damage as a result of fraud. The private sector losses of £12 billion make up 31 per cent of the total annual figure with the financial services industry recording the highest loss to fraudsters at £3.6 billion. Mortgage fraud (£1 billion) and insurance fraud (£2.1 billion) also remain high-loss industries within the private sector. For the first year ever we estimated the loss to small- and medium-sized enterprises (SMEs) in the Annual Fraud Indicator at £780 million, with an average loss of £2,800. Such losses hamper enterprise for small firms, force many out of business and deter online transacting at a time when the government is looking to this sector for economic growth and job creation.

> “The NFA has just expanded the Action Fraud service so that it can now take reports of financially motivated cyber crime, which includes hacking, denial of service and malware attacks.”

Working to prevent fraud

We have been working closely with parts of the private sector to address the harm they are suffering from fraud and place specific emphasis on preventing fraud in the first place. Through our work with the Mortgage Fraud Forum we have increased information sharing across the mortgage community, and improved the co-ordination of industry activity to prevent fraud. We have also helped to prioritise and overcome barriers to more effective action and sustain momentum so that mortgage processes continue to be made more robust.

We recently undertook a project on the misuse of accommodation addresses by fraudsters, which resulted in the creation of the first national list of addresses, including PO boxes used by criminals to reach their victims. The list identified over £500 million of suspected fraud and over 2,000 addresses thought to be involved in potential fraud that might not have previously been detected.

We have worked with the telecommunications industry to identify ways to improve the response to fraud that they are suffering. We have been able to put in place an agreement with several companies to share their confirmed fraud data. This has established an intelligence sharing cycle between the telecommunications industry and law enforcement resulting in the rapid dissemination of industry intelligence and creation of high quality, industry specific fraud alerts. We also created a fraud matrix to raise awareness and understanding of fraud types specific to and affecting the telecoms sector.

Intelligence: Action Fraud

A key weapon in all prevention work is intelligence, shared between sectors and with law enforcement. We established Action Fraud, the national fraud reporting centre, in 2009, providing individuals and businesses of any size with advice and guidance on fraud protection and somewhere to report fraud both online and by telephone. Action Fraud provides alerts on the latest scams and fraud types and feeds all reports to the National Fraud Intelligence Bureau run by City of London Police where it is analysed alongside data from industry, government and banks and used to create fraud intelligence and crime packages for police action. We have just expanded the service so that it can now take reports of financially motivated cyber crime, which includes hacking, denial of service and malware attacks.

Fighting Fraud Together strategy

There is clearly a lot that is already being done. However, there remains a drive from those working in the public, private and voluntary sectors to do more and to develop a stronger counter-fraud culture, which helps to disrupt fraudulent activity across the UK and globally. Tackling fraud will not solely be achieved through more investigation, prosecution and punishment of fraudsters. The NFA leads the implementation of Fighting Fraud Together, a cross-sector strategy, with the ambition that 'by 2015 our country will be demonstrably more resilient to and less damaged by fraud'. It brings together a diverse range of public, private and voluntary sector organisations, 38 in total, united in their commitment to tackling fraud and works with them to deliver its three strategic objectives of awareness, prevention and enforcement. It aims to reduce fraud by promoting greater fraud awareness and self-protection, encouraging organisations to adopt fraud-proof systems, enabling fraud reporting and facilitating better sharing of intelligence on fraudsters. It also aims to get tougher on fraudsters by disrupting and punishing them more efficiently and effectively.

Fighting Fraud Together is working on promoting greater awareness of ways in which individuals and businesses can protect themselves. It is continuing to build up an evidence base that will help others to take pre-emptive action against fraud using segmentation analysis to target very specific sectors of the population with fraud awareness and prevention measures tailored to the particular fraud threats they face. It is working to ensure that, as more and more public services are offered online, robust counter-fraud protocols are designed into these systems making them both safe and secure for the public.

We also recognise the need for a more efficient enforcement response. Fighting Fraud Together is examining other existing approaches such as the opportunity to use civil litigation as a means to disrupt, deny and recover criminal assets. It will also work with individual sectors and institutions to share best practice and support successful investigations in those areas that currently under-report fraud, for instance, through the use of ancillary orders or professional sanctions. All of this work is taking place through collaboration between the counter-fraud partners and takes full account of the views of all sectors.

Joined-up effort is required

Effective counter-fraud work relies on the continued efforts and co-operation of many individuals working across a range of sectors, organisations and departments. Only through joined-up effort between government, the private sector, trade bodies and the not-for-profit sector, each playing their part, will we be able to tackle fraud effectively. A recent example of this can be seen with the police and insurance industry joining forces to create the Insurance Fraud Enforcement Department,

> "The Dedicated Cheque and Plastic Crime Unit (DCPCU), a unique bank-sponsored police unit, has managed to save an estimated £370 million in the nine years since its formation."

a specialist unit to tackle fraud that went live in January this year. Funded by the insurance industry and operated by the City of London Police's Economic Crime Directorate it is providing additional operational capability to the Directorate, focusing solely on tackling insurance fraud, a crime that adds an extra £44 a year to each premium paid by customers. We look forward to seeing the results of this unit, but we have already seen examples of how it can work well with the Dedicated Cheque and Plastic Crime Unit (DCPCU), which is a unique bank-sponsored police unit that has managed to save an estimated £370 million in the nine years since its formation.

IPs and lawyers help too

Insolvency practitioners also play a key role in the fight against fraud and R3 has joined forces with the many agencies and organisations supporting Fighting Fraud Together. In 2010, insolvency practitioners filed over 7,000 reports against directors whom they believed had acted improperly. In many of these cases the director's conduct will have contributed to the downfall of the company and in extreme cases they will have been involved in fraudulent activity. Insolvency practitioners and their lawyers have a duty to alert the authorities when they expect fraud has taken place.

In a recent example, the director of a leading alcohol and tobacco supplier was found to have fraudulently claimed close to £4 million in VAT on liquor purchases. HMRC, working with an R3 member, used provisional liquidation coupled with insolvency offence litigation to shut down the fraud and protect the assets that are to be recovered from the director and his family. They are using a Conditional Fee Arrangement to pursue the director and hope to recover the claim and costs. The more removed from the director in terms of proper reimbursement for costs incurred and damages caused, the less available for him to fund other frauds and continue his lifestyle on the back of taxpayers' money.

Economic Crime Command

With so many challenges ahead I look forward to the creation of the new Economic Crime Command as part of the National Crime Agency, which offers us a great opportunity to provide a more effective, better co-ordinated and intelligence-led response across all economic crime fighting agencies. In the meantime Fighting Fraud Together gives us the means for everyone to play a part in reducing this criminal activity. ◻

STEPHEN HARRISON is the chief executive of the NFA.

Insolvency Service investigations and enforcement

Robert Burns talks about the disqualification regime and other related IS activities.

Enforcement: the very word conjures up images of dawn raids and people being carted off to jail. While this kind of activity doesn't happen often at The Insolvency Service, we take our investigation and enforcement responsibilities very seriously.

The Service seeks to deliver and promote an effective investigation and enforcement regime, through the disqualification of unfit directors, winding up of fraudulent companies, imposing bankruptcy restriction orders on dishonest or reckless bankrupts and by referring cases for criminal prosecution. We work closely with insolvency practitioners (IPs) in some or all of these areas and their invaluable contribution has enabled us to protect the public from unscrupulous operators.

This article concentrates on the disqualification regime, and in particular, on non-compulsory insolvencies, but I want to outline our other activity first.

A: Investigations and winding-up orders	2010–2011	2009–2010	2008–2009	2007–2008
Investigations into live companies	205	268	240	193
Winding-up orders obtained	181	251	115	182

B: BROs and DROs	2010–2011	2009–2010	2008–2009	2007–2008
Bankruptcy restriction orders	1,796	1,948	1,781	1,827
Debt relief restriction orders	8	2	N/A	N/A

C: Disqualifications	2010–2011	2009–2010	2008–2009	2007–2008
Disqualifications obtained	1,437	1,388	1,281	1,173

Investigations, winding-up orders, BROs and DROs

The Service investigates corporate abuse by exercising Companies Act powers, typically into those companies operating some form of scam. Land banking is quite prominent at the moment – in the past we have had wine scams, car buying/selling, timeshares, even scams about ostrich farming. These investigations are fact finding and may result in an application to court for winding up of the company and/or disqualification of directors.

The number of investigations (which may include a number of companies) and number of winding-up orders against individual companies for the last four years is shown in Box A.

We also investigate the conduct of individuals in bankruptcy, and, since 2009–2010 those subject to Debt Relief Orders – see Box B.

The Service also refers potential criminal activity to prosecution authorities, mainly BIS, who prosecute Insolvency Act and Company Act offences.

Disqualification

The Official Receiver covers disqualification of directors of compulsory liquidations. Non-compulsory disqualification work is handled by Investigations and Enforcement Services, which is funded by our parent Department, BIS.

When an IP submits a D1 alleging misconduct it will be considered by The Service, which applies a consistent process to target and prioritise appropriate cases.

The Service must consider each case on its merits and apply the legislation fairly and objectively; section 7 of the Company Directors Disqualification Act states that it must be in the public interest to bring proceedings. Public interest is not defined but considerations include protection of the public, the likely deterrent effect, the duty of the Secretary of State to act fairly and not in an oppressive way (which may include considering the age and/or health of the director), the prospects of success, and the cost to the public purse. Of course, the evidence has to stack up as well! So we consider carefully the information provided in the D1 report to ascertain whether proceedings will be in the public interest, whether an allegation has supporting evidence and whether there is any mitigation.

> "The average length of disqualification last year was 6.1 years."

Once such cases have been identified, they are passed to investigators. The public interest is kept under review throughout the investigation, and if a case is no longer in the public interest, it is concluded. This might be because a satisfactory explanation is obtained; for example IPs may be unable to obtain company records from directors and allege this as misconduct, but when the directors are contacted by an investigator and realise the serious consequences, the books materialise.

In non-compulsory failures, we have no powers to require third parties other than the office-holder to provide information, so it can be difficult to obtain sufficient evidence to 'prove' the misconduct to the appropriate standard.

We have processes to separate out the Secretary of State decision making responsibility. If a case is made out, we will begin the pre-action protocols, which include inviting directors to give undertakings.

The number of disqualifications obtained for the last four years is shown in Box C.

The average length of disqualification last year was 6.1 years.

Restructuring and staff movement across the Service, caused by falling personal insolvencies, will impact on the number of investigations this year, but we now have a stabilised workforce and aim to recover output next year.

Working with IPs

Despite all the effort IPs put into their D1 reports, cases may not be taken forward, either at initial consideration stage or investigation stage, which can lead to understandable frustration. We want to work with IPs to create a better understanding of how we approach cases, and the decisions we make. We have guidance on our website (**www.bis.gov.uk/insolvency**), which is currently being updated. We are also committed to providing advice to IPs at any stage. □

Contact us

To discuss a case, please contact Jeremy Hawksley, head of intelligence: targeting on 020 7291 6818 or Jeremy.Hawksley@insolvency.gsi.gov.uk.

ROBERT BURNS is head of investigations and enforcement at The Insolvency Service.

No win, no fee, no future?

Kevin Rogers takes a look at conditional fee agreements, best practice application and the question of whether or not they have a future within recovery litigation under Jackson.

In all litigation, the tradition was that costs follow the event: the loser pays. Recently that tradition has come into question, and the idea of outcome-based fees has gained ground. It has always struck me as odd that a commercial client and willing solicitor cannot work on the basis that the lawyer gets paid at the end, if successful, and if unsuccessful is paid a lower amount – or not at all. Payment by results existed as a concept long before currency itself ever did, and I struggle to imagine another area of commerce where, win or lose, there is the same financial incentive for the protagonists.

Since the mid 1990s solicitors have been able to offer ‘no win/no fee’ or ‘no win/less fee’ agreements. Properly known as conditional fee agreements (or CFAs) this method of funding is best known in the world of personal injury, but CFAs have been used (albeit more sparingly) in insolvency litigation. The Access to Justice Act 1999 allows for a success fee and after the event (ATE) insurance premium to be recoverable.

Risk assessment and ATE insurance

Not every case brings a seven-figure claim with prospects of success and recovery of over 75 per cent. On a far more frequent basis, IPs need to address mid-range cases and to know that they will be considered and advised at modest, or no cost, to the estate. Effective risk assessment by solicitors avoids the drawbacks of cherry picking, and is a vital part of case management.

Most importantly, this provides a consistent level of service to IPs regardless of case size. Carried out at the outset, it engages all parties in the risk assessment process as soon as possible.

Running any CFA without ATE is folly. Decent insurance allows the solicitor to fund all disbursements, and relieve the burden from the estate, and not cherry picking keeps the premiums down. In my team at QualitySolicitors Wilson Browne we are proud to be the only firm in our county to have delegated authority from Temple Legal Protection Limited, ATE insurers in the often quoted House of Lords case of *Callery* v. *Gray*. In real terms this means that we decide what cases to take on, and insurance naturally flows from that risk assessment. Insurance, whatever its source, is vital. I have also used it to defeat applications for security for costs – a tool often quoted by defendants in insolvency litigation.

Counsel

The perfect CFA approach requires a close working relationship with counsel and counsel’s chambers. My own experience has developed links with Devereux Chambers. We involve counsel as soon as possible, perhaps before the risk

> “A properly run CFA means that the estate bears no costs, win or lose.”

assessment is complete. This is not a sign of weakness, or to say that counsel calls the shots. We work as a team, and the full complement of resources brings an early tactical advantage, opens debate, improves risk management and service provision, and all that can start right after the first telephone call.

Who are the stakeholders in CFA litigation? They are the IP, the solicitor, the ATE provider and counsel, and each must respect the role of the others towards the common goal – a greater recovery than would otherwise have been possible without the CFA regime, and, crucially, at no risk to the estate in terms of legal fees.

A properly run CFA means that the estate bears no costs, win or lose. On a successful case, costs, success fee and the ATE premium are recovered from the paying party. If unsuccessful the ATE policy covers any costs orders in favour of the other party, and will repay the cost of any disbursements carried by the solicitors. The premium for the Temple policy that we use is paid at the end of a successful case, and if unsuccessful the policy is self-insuring – meaning no cost to the estate.

The Jackson report

This report has proposed a shake up to rules relating to CFAs. The main threat is the restriction of the right to recover the success fee and or the ATE premium. While we must wait to see how projected changes may impact on insolvency litigation, it is clear that CFAs still have an important and under-exploited place in the world of recovery litigation.

Where an estate has little or no free cash to pursue a claim, the IP will still discharge his or her duty in considering a CFA. Much may well come down to the figures involved, but that is a common calculation taken by commercial enterprises daily in relation to other business decisions. Larger claims will remain unaffected – it is easy to see that large sums that would not have been recovered but for a CFA model will remain attractive to IPs to pursue.

I know that many smaller cases are perceived as uneconomic to pursue. This need not be the case. Well set up and managed CFA systems, supported by effective risk assessment and carefully drawn up ATE insurance, mean that even the lower value claims remain viable, when all stakeholders work together for early settlement, informed by the IP and supported by early Part 36 offers. Risk assessment and understanding the mechanics of the process will remain vital to running these cases successfully, and in partnership.

Kevin Rogers trained as a costs’ negotiator prior to qualifying as a solicitor and has lectured on civil litigation costs. QualitySolicitors Wilson Browne has six offices across Northamptonshire and Leicester.

KEVIN ROGERS is a partner and head of the Commercial Litigation Team at QualitySolicitors Wilson Browne.

Different treatment for different bankrupts?

Pat Boyden sets out the case for treating different types of bankrupts differently.

History

The treatment of bankrupts has always raised comment. As far back as the late seventeenth century, Daniel Defoe railed against the use of debtors' prisons, partly prompted by his own experiences; and the death penalty, a form of suspended discharge one might say, was prescribed during the seventeenth and eighteenth centuries for certain types of bankruptcy. In contrast, Deuteronomy actually contained a provision for automatic discharge after seven years.

In 1976, a discharge period of five years was introduced, although only if the court thought appropriate. The Insolvency Act 1986 introduced a default period of three years that applied in all cases, except where a bankrupt failed to co-operate with the Official Receiver or his trustee or for second-time bankrupts. Most bankruptcy offences from the 1914 Act remained under the 1986 Act, the usual one being obtaining credit while undischarged.

Before the Enterprise Act 2002, bankrupts were therefore usually discharged after three years, suspensions of discharge only operated for non co-operation, and there was a range of criminal offences. With the aim of promoting entrepreneurship, the EA02 reduced the standard period before discharge to a maximum of one year, suspension remained as before and most offences were decriminalised and replaced by the Bankruptcy Restrictions Order or Undertaking (BRO/BRU). This is broadly the regime that exists today.

Need for change?

The criticisms of the current process are numerous, including the fact that discharge after one year or less may be too lenient, and that the regime does not distinguish effectively between 'honest' and 'culpable' bankrupts. In addition, the period of discharge can still only be extended in cases of failure to co-operate and poor behaviour before bankruptcy can lead only to a BRO/BRU. While this was intended to balance the reduced discharge period and the removal of offences, the downside for creditors is that a BRO will only extend the restrictions, not the period before discharge. While after-acquired assets are not that frequent, they do occur, but can obviously only be claimed before discharge. This causes difficulties for trustees seeking such recoveries for the estate in the short period before discharge occurs. The reduced period also causes problems when considering Income Payments Orders: in difficult cases, the trustee could be forced to make an application on inadequate information purely to protect the estate.

Arguably the stated aim of the EA02 in promoting enterprise has failed, as the vast majority of bankruptcies are now made up of domestic, consumer debtors. Many people, not just creditors, feel that the pendulum has swung too far in favour of debtors. The Insolvency Service sometimes seems inconsistent in its approach with BROs/BRUs being obtained in fairly small cases, and far more complex ones going unpunished. With the proposed introduction of non-court based petitions, there is further concern that debtors may view bankruptcy as an even lighter process than the current one.

> "Returning to the three-year discharge rule would be a start, which could be reduced for the least culpable bankrupts."

Time for change?

Now may be the right time to look back at the first seven to eight years of the EA02 to re-assess the point of the bankruptcy regime and to see if it really does strike the right balance. Should the regime punish 'culpable' bankrupts, provide a return for creditors, provide debt relief, or a mixture of all of these? If it seems that it is too geared towards the bankrupt and debt relief, revisiting the discharge provisions may help redress the balance.

Returning to the three-year discharge rule would be a start, which could be reduced for the least culpable bankrupts. Alternatively, or preferably additionally, tying in the after-acquired property provisions to BROs would be welcome to creditors who may see the BRO procedure as irrelevant to their interests. Provision could be made for the three-year period to be extended by a BRO or BRU, so that length of discharge would depend on pre-bankruptcy behaviour as well as non co-operation. The prospect of any new assets being seized during a period of several years may be more of a deterrent than being unable to borrow money, particularly as a bankrupt's adverse credit rating lasts six years anyway. For an 'honest' bankrupt whose behaviour does not warrant investigation, three years will mean little, but for the irresponsible bankrupt, it is fitting that there is at least a threat of future assets being seized. Trustees could also be given the power, currently only available to the OR, to apply for BROs themselves.

The advantage of these changes is that there is no additional burden placed upon the OR: all that is required is legislative change. Bankrupts may resist BROs or BRUs a little more fervently, but the benefits to creditors should outweigh such considerations.

Bankruptcy is never going to provide anything more than an insignificant return to creditors, but that does not mean that it should be purely a debt relief process. It is time to make sure that the law is appropriate and the balance redressed to prevent another surge in numbers should we return to the credit boom of the last decade.

If members have views on the topics discussed in this article, please send them to R3's Personal Insolvency Discussion Group via Emma Lovell at Emma.Lovell@r3.org.uk.

PAT BOYDEN was formerly a partner at PricewaterhouseCoopers and is a member of R3's Personal Insolvency Discussion Group.

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R3 Smaller Practices Group

SPG Forum 2011

I was really thrilled to see so many of you at November's SPG Forum in Birmingham! Thank you for making it a record attendance, with over 300 delegates. I enjoyed listening to all of the speakers and, most of all, meeting many of you during the breaks and in the bar until the very small hours. No one could ever say that SPG members don't have stamina!

We had a good mixture of technical and practical topics, including sessions on fees, tax and the latest legal and technical updates, which hopefully gave you some useful tips to take home with you. Thanks for all of your feedback; it's really important in helping us decide what to include in future course programmes. As with many things in life, there's always room for improvement. The break-out sessions were really well received, so as well as the usual technical material, we're including some more general practice issues in the SPG Technical Review course this year. We'll also follow up on your other suggestions for course content in October's Forum – so watch this space and be sure to book your spots early!

Committee update

It's been a while since I updated you on what the SPG Committee has been doing, so I thought I'd start 2012 by giving a brief flavour of some of our recent work.

The results of survey questions aimed at SPG members in August were really useful and, as expected, highlighted that technical support and assistance are the most important priority for smaller firms, closely followed by training and operational practice assistance. We will be taking forward some of your suggestions this year and, as ever, we really value your input so please keep the ideas coming!

From the corporate insolvency angle, the debate about pre-pack reform for sales to connected parties is still rumbling on. At our November meeting, the Committee had a lively discussion about possible alternatives to The Insolvency Service's proposed three-day notice period including, among other options, application to court for sanction to complete a sale and a restricted exit route from administrations where there has been a connected party sale. R3 is continuing its dialogue with The Service on the pre-pack issue and the Committee was happy to provide SPG views to feed into this debate.

The Committee also discussed the potential implications of the Paymex VAT ruling on IVAs and HMRC's current position that the VAT exemption will also now extend to CVAs. R3 and some of the RPBs have jointly sought legal counsel's opinion on the implications of the ruling for R3's members who do IVAs and provided more guidance to members in January about the practical implications for their own cases. I'm sure that you will have found this guidance useful.

> "The break-out sessions were really well received, so we're including some more general practice issues in the SPG Technical Review course this year."

As an update on the personal insolvency side, for those of you who do protocol-compliant IVAs, there have been recent revisions to the standard terms and conditions, which will be announced by The Insolvency Service in a stand-alone *Dear IP* edition. We are also exploring the idea of using online valuations of properties in the final year of the arrangement rather than using walk-in valuations in order to save costs and enhance returns to creditors. The British Bankers Association is consulting with its members about the use of online valuations and we hope to have a definitive answer shortly.

There are also likely to be changes this year to the Official Receiver rotas, as The Insolvency Service reduces the number of OR offices and moves towards eight regional centres. A recent membership survey indicated that SPG members' preferred option was a change to regional rotas where the IP has a permanently manned office within that region. On the basis of the survey results, R3's Personal Insolvency Discussion Group, which I am a part of, has agreed that a move to regional rotas attached to the new regional centres would be appropriate and this will be taken forward by The Service later this year.

Keep in touch!

As I am always saying, the SPG Committee and Emma Lovell, R3's SPG manager, can only represent your views and concerns if we know what they are, and that will only happen if you tell us! Please contact Emma (Emma.Lovell@r3.org.uk) if you have any issues or concerns that you would like us to address.

The Committee's contact details can be found under the 'R3 Committees' section of the R3 website **www.r3.org.uk**.

LIZ PYWOWARCZUK is director of Liberta Financial Ltd and chair of the R3 SPG Committee.

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

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

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

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R3 gti

Interview with…
Philip King

Philip King is the chief executive of the Institute of Credit Management. He offers views from the perspective of credit managers but believes that they and IPs should work more closely and openly together.

What does the ICM do and what are its greatest achievements?

The ICM is a professional membership body founded in 1939. It is a registered charity and provides a range of membership services such as training, qualifications, technical help and advice and a magazine. Three of our most significant activities are:

- Promoting the importance of cash-flow and the value of prompt payment via the Prompt Payment Code (PPC). The Code was produced for BIS under the 'cash for businesses' initiative and is hosted on our website. There are over 1,000 signatories to it. It is an attempt to change the culture of business to recognise the importance of prompt payment and making 'paying on time' the norm.
- Supporting and advising businesses by a series of cash-flow guides. These can be downloaded from our website and are aimed, primarily, at small businesses.
- Supporting our members, who are credit professionals working in a diverse range of roles across the credit sector, including insolvency.

How do credit managers perceive the insolvency industry?

Many of our members perceive it with suspicion, and this needs to change. There is a natural tendency to believe that IPs are batting on the other side. IPs need to improve their working relations with credit managers and be more willing to talk to them – and creditors need to understand better the role of IPs. To aid this process, the ICM has been working with R3 on the resent consultation document, and I gave a presentation at the annual IPA lecture. We encourage our members to attend IP events and run a regular insolvency-related article in our magazine.

In an ideal world, there would be a single regulator for the insolvency industry. We are pleased that the IS is pulling out of regulation and think it should be the 'regulator of regulators'. The most important thing is that there should be consistency of approach and standards. We also welcome the idea of a single complaints portal.

What is your relationship with the JIC?

The ICM has recently become a lay member of the JIC and this will foster better communication and broader thinking on both sides. As things get established, more issues can be debated and this is healthy. By being more inclusive, the IS as a regulator and the other regulators can be assured that the JIC is more representative than historically.

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Why are businesses apparently so bad at making credit-risk decisions?

Many businesses are good at making credit-risk decisions and manage debt well – but some still get caught. This may be because their information is not as good as it should be. For instance, there may be gradual signs such as when invoices are paid one day later each month; businesses do an initial credit report but don't continue to monitor customers; you also need to know who your customer's customers are. Small businesses do not always have the resources, or invest them if they have them, to check this, potentially crucial, information.

Are enough bad directors suitably dealt with by The Insolvency Service?

There are certainly more rogue directors than there are disqualifications. The IS needs to be sure there is enough evidence to proceed and, where there is, the IS does well. We would like to be certain that the cuts to the IS don't impact on the pursuit of bad directors – as this is important.

I would favour a qualifying examination before directors could obtain limited liability protection but government is unlikely to impose this. It would be a good move from an insolvency point of view.

People may be good at what they do but not good business managers. One of the ICM's key objectives is to advise people about business management – through our guides and advice. But many seek help too late.

Should there be a prerequisite, minimum capital for small companies before they can acquire limited liability protection?

Yes, absolutely. But, again, it is an aspiration and unlikely to happen. However, as banks are now unwilling to lend unless they have significant safeguards, businesses need to start off with some of their own capital. A director who funds the business by just a secured director's loan is not acceptable. Limited liability can be abused – some businesses have a honeycomb of companies with no capital and can close one down and use another.

Will any of the proposed changes to the pre-pack regime benefit our business rescue culture?

Pre-packs are not all bad; they can be useful to business and employment. Many creditors think they should be banned while IPs think they are good – but both ideas may be flawed.

The three-day notice period would have been a good outcome, although it's not very long. It is an opportunity for creditors to feed information to the IP that could be beneficial to him or her. Getting IPs to say that they are confident that a pre-pack is the right solution before the event rather than after would be good. We need to prevent phoenix pre-packs.

Creditors sometimes criticise IPs over the way they deal with ROT. Is this fair?

It's not always black and white. Openness would do much to eradicate problems. Lack of communication or not allowing an inspection of premises can raise doubts. There is the perception that something is being hidden. ◻

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