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RECOVERY

Business rescue
Alternative restructuring tools

Planning a CVA
10 key factors you need to consider

Pre-packs
The backdoor to UK insolvency regimes?

Schemes of Arrangement
The relative attractions of alternative restructuring tools

Provisional liquidations
Kill or cure?

Frances Coulson
Her view of her recent experience at the Treasury Select Committee

The doctor will see you now
Ian Gray examines the development of turnaround

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Interview with Anne Willcocks
The Insolvency Service's external affairs director on pre-packs, new legislative frameworks and keeping the faith with IP regulation

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

From the editor

Corporate insolvency remains quiet, with numbers down again in Q2 2014. As Phillip Sykes, R3's vice-president, said when the figures were released, 'The past few years have been the same story: low interest rates and lenient lenders. An interest rise could cause some businesses extra problems, but it would have to be more than a couple of quarters of a percentage point to make any real difference.' The balance of opinion at the time of writing is that interest rates will not start to rise until 2015, and all commentators concur that any rise will be slow and gradual.

Many R3 members thrive on corporate insolvency – not, of course, at the expense of creditors, but because it is the epicentre of their skills and expertise – and in a declining market insolvency practitioners need to use tools and techniques that the users of our services are prepared to countenance. The theme of this issue, Business Rescue, is deliberately broad and there is much to read and consider in the following pages on schemes of arrangement, CVAs, ABL funding, turnaround, pre-packs and even provisional liquidation as a rescue mechanism.

However, our usual technical updates largely highlight corporate insolvency developments, showing that the field is far from moribund. A year ago the column from R3's general technical committee gave prominence to employment issues, not least in relation to the requirement to consult on business transfers and particularly on proposed redundancies. This important subject is still very much alive due to the recent Insolvency Service reference of the Comet administrators to their regulator. Interestingly, in a case where the administrators are said to have faced conflicts of interest, the secretary of state – who is ultimately responsible for insolvency and business rescue legislation, for the redundancy payments service (which had to pay most of the protective awards in the case) and for insolvency practitioner regulation – has already chosen to criticise the administrators publicly.

Given the government's reserved power to appoint a single regulator, the ICAEW's response to the Comet reference will be watched closely. Scrutiny of IP regulation by The Insolvency Service and by the profession (in all sorts of cases) should ensure that it is increasingly effective and has the full confidence of IPs and the public.

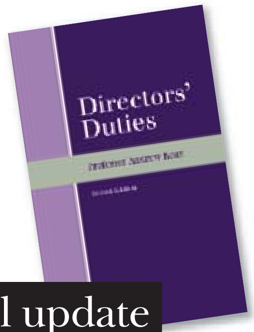
CHRIS LAUGHTON is editor of *RECOVERY* and a partner at Mercer & Hole.

Regulars

Regulars

46

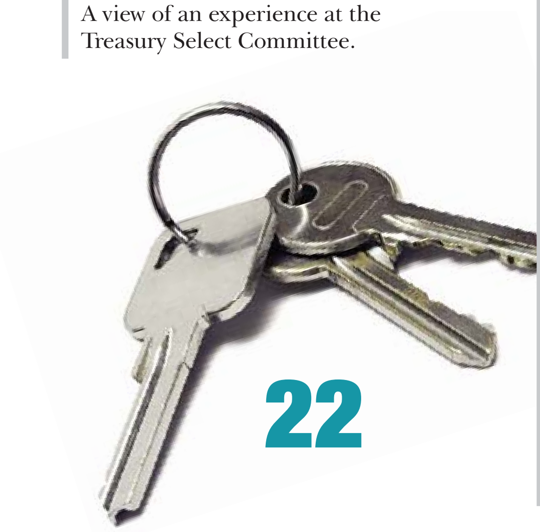
12



Legal update

Features

Business rescue



22

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Editor
Chris Laughton, Mercer & Hole

Publishing manager Sandra Kessell
Tel: 01491 828939, sandra.kessell@groupgti.com

Advertising manager Brendan McGrath
Tel: 01491 826262, Fax: 01491 833146
brendan.mcgrath@groupgti.com

Advertising executive Kym Freedman
Tel: 01491 828920
kym.freedman@groupgti.com

Art director Thomas Gray

Administration Eva Greenford, Paul Hinnell

Printed by Stephens & George

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Tel: 020 7566 4200, association@r3.org.uk, www.r3.org.uk

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New local TV station enters administration

City TV, the Birmingham-based TV station, has entered administration just two years after being awarded an Ofcom licence to broadcast locally. The company behind the station, known as BLTV, called in administrators after failing to secure enough funding to begin broadcasting. A buyer is being sought for the licence, which would allow broadcasts to reach around 2.3 million people within the Birmingham, Walsall and Wolverhampton and Dudley areas.

Ofcom's local TV broadcasting licences were part of a vision bring more local television to the UK, headed by Jeremy Hunt, then Secretary of State for the Department of Culture, Media and Sport. More than 30 licences have been issued and services in Norwich, Glasgow, Nottingham and Grimsby are already on air, with the Brighton station's first broadcast imminent. By contrast, City TV, two years after securing the licence, had no studio, premises or broadcast equipment. A spokesperson from administrators Duff & Phelps said a number of television operators had already expressed an interest in taking over the licence.

Directors banned for disadvantaging creditors

Two directors, whose holding company went into voluntary liquidation owing more than £220,000, have been found guilty of trying to disadvantage creditors by disposing of an asset that should rightfully have been included in the liquidation. The pair have been banned from acting as directors for a total of nine years.

William Paul Downes, aged 59, and Michael Downes, were directors of Liverpool-based company Caber Limited. In the course of the liquidation it was discovered in that a book debt of £250,000 due to the company had been assigned to another company. After an Insolvency Service investigation to uncover the deal in full, court action was required and in total Caber Limited was able to recover only £28,335 of the original debt. As a result of this and the required legal action no dividend was available to pay to the creditors.

Commenting on the disqualifications Sue MacLeod, chief investigator of Insolvent Investigations, Midlands & West at The Insolvency Service, said: 'Directors who make false statements in the liquidation or who put assets beyond the reach of company creditors will be investigated and removed from the business environment.'

William and Michael Downes both gave undertakings to the Secretary of State for Business, Innovation & Skills not to act as a director, manage or in any way control a company for respective periods of 6 ½ years and 2 ½ years.

To read the details in full visit *www.gov.uk/government/organisations/insolvency-service*.

RICHARD TURTON AWARD

Richard Turton had a unique role in the formation and management of INSOL Europe, INSOL International, The Insolvency Practitioners Association and R3, the Association of Business Recovery professionals in the UK. In recognition of his achievements the four organisations jointly created an award in his memory. The Richard Turton Award is an annual award providing an educational opportunity for a qualifying participant to attend the annual INSOL Europe Conference.

In recognition of those aspects in which Richard had a special interest, the award for 2014 was open to applicants who fulfilled all of the following:

- Work in and are a national of a developing or emerging nation;
- Work in or be actively studying insolvency law & practice;
- Be under 35 years of age at the date of the application;
- Have sufficient command of spoken English to benefit from the conference technical programme;
- Agree to the conditions below.

Applications for the award were invited to write a statement detailing why they should be chosen in less than 200 words. A panel representing the four associations adjudicated the applications. The panel members are as follows: Stephen Adamson – INSOL Europe, Neil Cooper – INSOL International, Patricia Godfrey – R3 and Maurice Moses the IPA. The committee received an outstanding number of applications of exceptional quality for the award this year and it was a very close run decision as the standard of applicants was superb. We are delighted that the award has attracted such enthusiasm and response from the younger members of the profession and know that Richard would also be extremely pleased that there had been such interest.

The Committee is delighted to announce that the winner is Anant Khandelwal from India. Anant works for SBI Capital Markets Limited and is part of the debt restructuring and advisory team in the investment bank. He has been involved in some of the country's largest and landmark debt restructuring deals.

As part of the award Anant is invited to attend the INSOL Europe Conference due to be held on the 9-12 October in Istanbul, Turkey. He will be writing a paper that will be published in summary in one or more of the Member Associations' journals and in full on their websites. We would like to congratulate Anant for his excellent application and also thank all the candidates who applied for the award this year. There were many excellent submissions and the judges task was particularly difficult this year.

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Networking Success for R3 London and South East Women

The R3 London and South East Women's Group have been busy hosting a series of successful networking events. With over 200 ladies in attendance, the 'Lunch at The Langham' had one of the highest turnouts for a regional event and looks set to become an annual feature. Comedienne and motivational speaker Deborah Frances-White not only provided excellent tips on how to network and boost your career in a male dominated environment but also provided a barrel of laughs for those attending.

R3 Women in Business West Midlands spring ball

The committee were pleased to see a record number of 464 people enjoying a relaxing and fun night and dancing into the small hours in Hall 4 of the ICC. The event was sponsored by Jones Lang LaSalle (JLL) and flower decorations were partly sponsored by Direct Legal Collections Limited and provided by the Flower Gallery of Wombourne.

The photo booth proved to be very popular on the evening and will feature again at next year's ball to be held on 23 April 2015 at the ICC.

THE HOTEL COLLECTION

Hotel group in administration

The company behind The Hotel Collection, UK Group of Hotels, has called in administrators from Duff & Phelps to help it restructure its banking facilities.

Paul Clark, David Whitehouse and Paul Williams will be working on restructuring to allow staff to keep their jobs and help The Hotel Collection to honour existing bookings. The portfolio of 21 hotels was rebranded two years ago after Spanish firm Barcelo exited the UK hotel business and the group was taken over by the former Puma Hotels Plc.

In a statement the management said: 'This development in fact leaves The Hotel Collection well positioned to optimise its market position, initiate strategic investments to upgrade its portfolio and pursue targeted growth opportunities.'

New owners expected at The Gherkin

Foreign investors look set to buy City of London landmark 30 St Mary Axe, known as The Gherkin, after joint fixed charge receivers Phil Bowers, Neville Kahn and Alex Adam of Deloitte LLP put the building up for sale. Savills and Deloitte Real Estate were jointly instructed to sell the iconic office space, which was designed by Lord Foster. The 40-storey skyscraper, which opened in 2004, is currently multi-let to around 20 tenants including Swiss Re, Kirkland & Ellis International LLP and ION Trading. Investors were invited to register their interest in the property by mid-August.

Wine investment company in liquidation

Creditors may be owed as much as £3.8m by wine investment company Encarta Fine Wines Ltd after it went into liquidation. Stock valued at around £1.7m is being held, a creditors' meeting was told.

The company, which was sent up five years ago, blames its bank, HSBC, for freezing its bank account earlier this year while investigations were undertaken.

The liquidator, Nedim Ailyan of Abbott Fielding, said: 'Because of concerns about the level of commodity fraud I believe that the Financial Conduct Authority has been asking banks to investigate commodity asset investment companies that might have suspicious transactions.'

Abbott Fielding is also handling the liquidation of several other wine investment companies unrelated to Encarta.

More information about the liquidation is available at **www.decanter.com/news.**

President's column

Giles Frampton on the search of a fairer and more effective business rescue process.

One of the most rewarding aspects of my involvement in R3 is seeing policy ideas proposed by our committees and individual members taken up by the policy team, campaigned on and eventually turned into actual legislation. Practitioners can and do have a real opportunity to make a lasting impact on the regulation and legislation that affects them.

The past few months have seen several R3 policy proposals get just that little bit closer to becoming law.

First and foremost, July saw the government finally launch its consultation on amending the rules governing the continuity of supply for insolvent businesses – the plan is to prevent utilities and other key suppliers (including IT suppliers) from unreasonably changing terms of supply to businesses in business rescue procedures. As I am sure many IPs can attest, 'ransom payments', 'termination clauses' and revised terms and conditions can be a real business rescue killer.

The proposals being consulted on were first put together by R3's Policy Group back in 2010 and, following the R3 'Rescue to Ransom' campaign, were included in the April 2013 Enterprise and Regulatory Reform Act.

While it has taken a little time to come to fruition the consultation is very welcome and will, it is to be hoped, lead to a fairer and more effective business rescue process. I said when I took over as R3 president that I wanted to champion reforms that made the insolvency process fairer and the 'Rescue to Ransom' ticks every box on that score.

Given all the legislative and regulatory challenges that have come the profession's way in the last year – whether fees, pre-packs, regulatory oversight, or partial licences – it's good to see some positive, innovative policy work being adopted by government for review. Credit must go to R3's Policy Group chair and former president Steven Law and the R3 Press, Policy, and Public Affairs team for driving the campaign to change the law. Hopefully, R3's work will have a really positive impact on business rescue once the consultation concludes and the changes are finally implemented.

Next in our sights is personal insolvency reform.

The personal insolvency regime in England and Wales is in many respects effective, but there are improvements that can be made to it to make sure it is capable of dealing with 21st century debt issues. While we've seen some major changes since the 1986 Act, the government has not reviewed the personal insolvency regime as a whole since then. On top of this, the reforms that have been made have not been kept under regular review to make sure they have carried on working as intended.

Earlier this year, R3 launched the 'Personal Insolvency Landscape', a set of proposals for holistically updating the personal insolvency regime. We've had excellent feedback on the proposals from MPs and key stakeholders, including debt charities and think tanks like StepChange and the Centre for Social Justice. Many of our proposals have been echoed by others. In July, R3, alongside StepChange, hosted a well-attended parliamentary roundtable to discuss personal insolvency reform, and it's fair to say that pressure for real change is building.

> "Looking again at the policy pipeline, we come to a set of proposals that are not R3's but where we have an important role to play in their development and implementation."

It is good news then that The Insolvency Service has recently launched a 'call for evidence' on DRO reform and raising the level of the creditor's bankruptcy petition threshold. But: there's a danger that this 'call for evidence' could be a missed opportunity.

A similar 'call for evidence' – note, not a formal 'consultation' or 'review' – took place in 2011 and resulted in only minimal changes being made to the personal insolvency regime. This was despite arguments from R3 and debt charities for much wider reform; many of these arguments are still being made now.

So why is the scope of the latest 'call for evidence' so narrow?

The case for amending the creditor's bankruptcy petition threshold – £750 – is compelling (it was last set in 1986 and is woefully out of date) but there are plenty of other aspects of bankruptcy that deserve attention too such as the automatic discharge period and its interaction with Bankruptcy Restriction Orders and Undertakings.

Likewise, it doesn't make sense to focus the other half of the 'call for evidence' only on DROs. Changes to DROs will affect bankruptcies and IVAs while existing shortcomings with IVAs and bankruptcies ought to be tackled. There is also the interaction with debt management plans to be considered. It is time the personal insolvency regime was looked at as a whole; the call for evidence will not do that but it would be pleasing if this were to be a precursor to a full review. But in case it is not, we – and others – will continue to make the case for more comprehensive review and reform.

Looking again at the policy pipeline, we come to a set of proposals that are not R3's but where we have an important role to play in their development and implementation: the Graham pre-pack reform proposals.

While it is not for R3 to set up and run the proposed 'pre-pack pool' – this is supposed to be independent of the profession – it is in our interests to see the reforms developed in as practical a way as possible. While the profession does have concerns about aspects of the package of reforms, the current proposals are more attractive than the 'reserve power' the government is planning on introducing should the Graham recommendations not be introduced satisfactorily. As drafted this power, set out in the new Small Business Bill (section 117), could lead to a ban of all connected party administration sales! In fairness it is difficult to imagine that such a comprehensive ban is intended but it is probably prudent to avoid the possibility.

Having already hosted a policy roundtable to discuss the Graham review, we will continue working with the regulators, The Insolvency Service, and creditor groups to see how Teresa Graham's recommendations can be put into practice.

Continuity of supply, personal insolvency, and pre-packs aside, there is still plenty on R3's policy 'shopping list' that we would like to see implemented, from an enhanced role for insolvency in tackling fraud, to a permanent exemption for insolvency litigation from the Jackson reforms. There is never a dull moment.

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

Gaining the high ground

The Teresa Graham Review, her report and recommendations offer a unique opportunity for our industry to take back the moral high ground on pre-packs.

Those within the industry who use this approach know its value, but those outside are often confused and sometimes downright suspicious. This isn't surprising, but sometimes I sense there is something of a 'it's unfair, we don't care' or a 'we can't ever change detractors' misconceptions, so why bother?' attitude.

As well as recognising the value of pre-packs, what Teresa has done is to redirect the spotlight onto the directors of the companies, rather than IPs. This is where it should always have been. After all it was the directors who oversaw the business in its progress towards insolvency, not the IP.

However, as the navigators of the process, IP are, quite rightly, in the firing line in two key areas: marketing and valuation. The debate on the 'what' in SIP 16 needs altering, more accurately 'upgrading', has already started, with Teresa offering some clear and sensible ideas for the Joint Insolvency Committee to consider. It is in everyone's interest that the changes are quickly agreed upon and implemented.

An open system

However, the industry has to appreciate that it operates in an open system, and that others are both entitled and likely to take a close interest in the way we take up the gauntlet and work constructively to find an approach that tackles the mistrust that surrounds the most contentious area of pre-packs, the connected party sale.

Teresa has advanced the idea of the directors, prior to the administration, voluntarily seeking an independent view on the validity of the proposed pre-pack as a means of maintaining as much economic value as is possible. There are undoubtedly matters of detail to be worked out re the establishment of the pool of credible experts to opine on submissions. Neither Teresa nor R3 are under any illusion over the practical difficulties. However, that is not a reason for not working constructively either to make her concept work or to find a better solution that delivers the desired outcomes of greater confidence in pre-packs, greater confidence in IPs and consequently a reduction in the so-called 'noise' that is characterised by complaints in MPs' and the minister's postbags.

Increase transparency, increase trust

I share Teresa and The Insolvency Service's view that doing nothing is not an option. But doing something without the will and energy to succeed will not be enough.

> "Others are both entitled and likely to take a close interest in the way we take up the gauntlet."

Be clear, although we can be justifiably proud of our World Bank ranking of seventh-best globally, there are still other areas where we can improve, not least in the way complaints are handled and, where justified, sanctions are handed down to those that don't meet the necessary standards of insolvency practice or ethics.

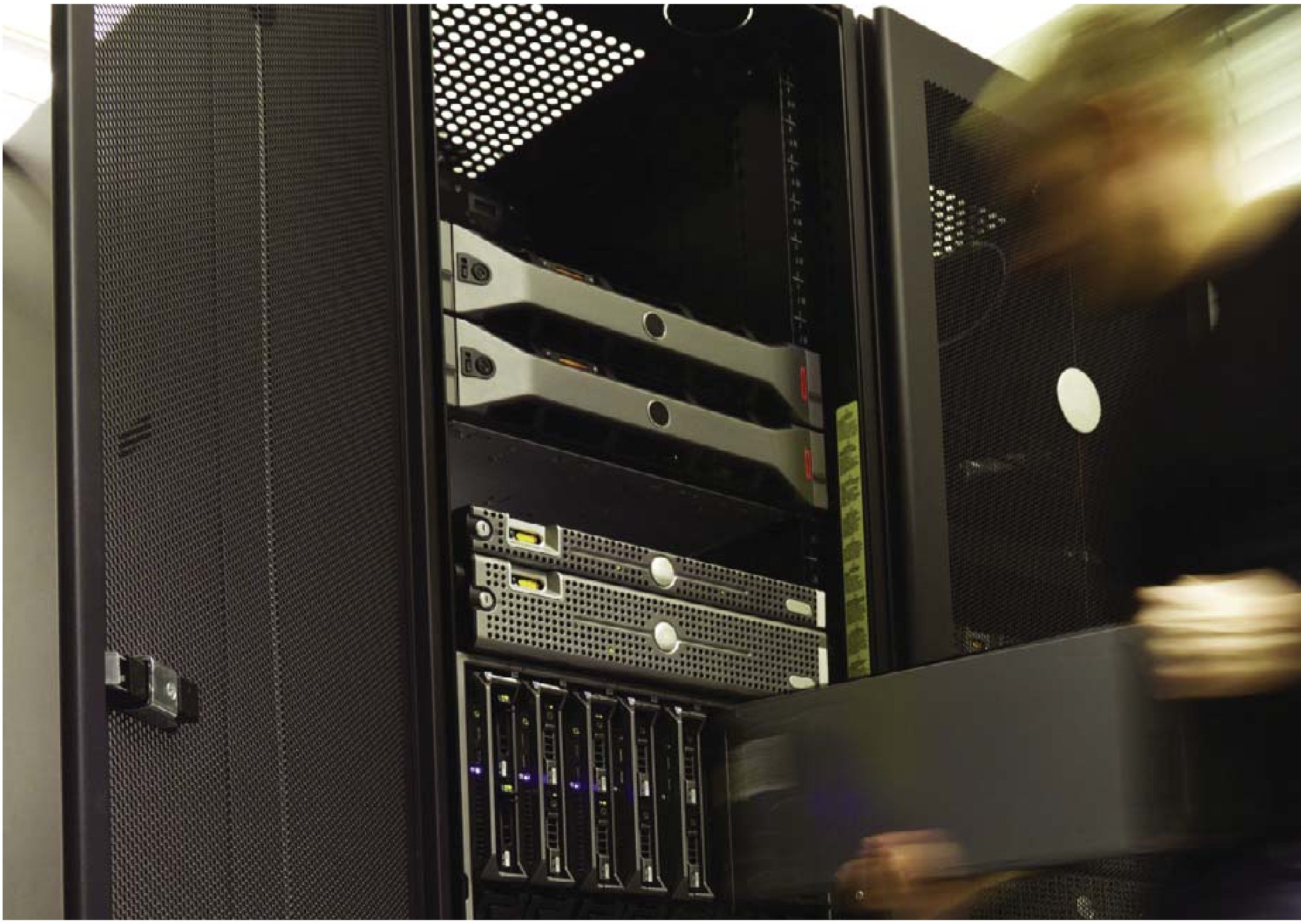
Certainly, the changes represented by the Complaints Gateway and the imminent uploading of published sanctions to the IS website involve a significant increase in transparency that should lead some increase in trust, but there remains a very small element within the industry who need either to improve their standards or, frankly, should leave it, either voluntarily or through regulatory action.

What we can do

Individual IPs may ask, 'what can I do, it's up to the regulators to amend the SIPs and as for the "pool of independent experts" that's for someone else to establish'. Well, I suggest there are two areas where the IP can provide impetus; firstly, by encouraging their RPB fully to support the initiative and to work quickly to upgrade the relevant SIPs; and secondly to examine how he or she operates when dealing with creditors and other affected parties where a pre-pack is involved. On one level this comes down simply to 'telling the story' simply and clearly in reports rather than following a SIP-related tick list. Of course IPs will be concerned to remain compliant in the eyes of their own compliance team and their regulatory monitors, but can you all confidently say that your reports fully answer creditors' legitimate questions on why a pre-pack is appropriate; how the assets were valued; and, where appropriate, how the business was effectively marketed; and where it was not appropriate to market it, why not? The answers to those kinds of questions will build up a picture in the mind of the creditor community which either leads them to view the IP as a professional doing a difficult job and doing it well, or they will see you as another example of the IP in cahoots with the 'dodgy director' and vulnerable to criticism from journalists, ill-informed pundits and politicians.

R3 works continuously to promote and protect the industry. Helping to turn Teresa Graham's recommendations into reality will assist us do this. We will achieve a better, truer image the more we engender trust. ◻

GRAHAM RUMNEY is the chief executive officer at R3.



Technical update

Continuity of supply in formal insolvencies.

Continuing the trade of a business in administration is only possible where key supplies are maintained and funding allows. If the cost of supply increases in the event of insolvency, or supply is withdrawn altogether, it becomes more difficult, or even impossible, to rescue or retain value in a business. As a result of this, struggling companies that might otherwise have gone down this route may be forced to cease trade and go into liquidation.

R3 has long argued that suppliers of essential services should be prevented from taking advantage of formal insolvencies by adopting obstructive tactics in order to extract ransom payments, or impose unreasonable contract terms, as a condition for further supply. Apart from impeding possible rescue, such payments may result in those creditors effectively receiving preferential treatment at the expense of others. R3 has also argued that the exercise, on grounds of insolvency alone, of contractual termination provisions (so-called '*ipso facto* clauses') should be precluded, subject to appropriate safeguards for suppliers. These were the main planks of R3's 'Holding Recue to Ransom' campaign, a campaign that has now had some success as explained below.

Critical services

Of particular importance are utilities and IT services and infrastructure. At the moment ss233 and 372 of the Insolvency Act 1986 deal with suppliers of gas, electricity, water and telecoms services, and ensure that they are not put in a preferential position by being able to demand payment of outstanding charges as a condition of continuing supply. However, the 1986 legislation was enacted at a time when utilities were provided by primary national suppliers and difficulties have been encountered in cases where utilities are provided by an intermediary, such as a landlord or management company, as an on-seller. These appear not to be covered by the existing legislation. Moreover, ss233 and 372 do not cover the provision of IT services, which today are critical for the functioning of most businesses in a way they were not nearly 30 years ago.

> "These appear not to be covered by the existing legislation."

This last point was recognised by the inclusion in the Investment Bank Special Administration Regulations 2011 of provisions to ensure the continuity of supply of IT equipment, including software, data and infrastructure, and prohibiting the exercise of *ipso facto* termination clauses in such contracts after the commencement of the special administration.

Powers

As a result of R3's campaign, the Enterprise and Regulatory Reform Act 2013 introduced enabling powers to allow the secretary of state to amend ss233 and 372 to extend their provisions to supplies by a specified description of person, and

supplies for the purpose of enabling or facilitating anything to be done by electronic means. It also contains powers for the secretary of state to provide that insolvency-related terms of a contract will cease to have effect when a company enters administration, or when a company or individual enters into a voluntary arrangement.

The Insolvency Service has now (July 2014) issued a consultation document on the exercise of these powers, incorporating a draft statutory instrument, the Insolvency

> "The government recognises that preventing reliance on termination clauses will interfere with the right to freedom of contract."

(Protection of Essential Supplies) Order 2014. In summary, the effect of the proposed changes would be to apply the existing provisions to on-sellers of utility supplies, add IT suppliers to the list of suppliers covered by the existing provisions, and ensure the continuity of utility and IT supplies by preventing reliance on insolvency termination clauses.

The government recognises that preventing reliance on termination clauses will interfere with the right to freedom of contract, and that such interference is only justified when absolutely necessary. For this reason the power will be restricted to the main rescue procedures, administration and voluntary arrangements, and is subject to a number of safeguards.

Broad definition

The draft statutory instrument extends the scope of ss233 and 372 to include 'a supply of gas, electricity, water or communications services by a person who carries on a business which includes giving such supplies' (this is intended to deal with the on-seller point), and 'a supply of goods or services… by a person who carries on a business, which includes giving such supplies, where the supply is for the purpose of enabling or facilitating anything to be done by electronic means'. The latter are widely defined and include computer hardware and software, point of sale terminals, any service enabling the making of payments, information, advice and technical assistance in connection with the use of information technology, data storage and processing and website hosting.

Essential goods and services

The draft SI also inserts new ss233A and 372A to deal with *ipso facto* clauses. These provide that an insolvency-related term of a contract for essential goods or services will cease to have effect if, in the case of a company it goes into administration or enters into a voluntary arrangement, or in the case of an individual, if the individual enters into a voluntary arrangement. These provisions only apply to contracts for the supply of goods or services specified in ss233 or 372, ie for utilities and IT services, and are subject to a number of safeguards.

An insolvency-related contractual term is a provision under which the supply or the contract would terminate, the supplier would be entitled to terminate, or other consequences would occur, because of the administration or voluntary arrangement, or because of some prior event.

Termination of contract

When an insolvency-related contractual term ceases to have effect, the supplier may terminate the contract if the insolvency office-holder gives consent, if the court grants permission, or if any charges accruing due under the contract after the

> "It could be argued that these changes do not go far enough."

beginning of the insolvency proceedings are unpaid for 28 days. The court may only grant permission if it is satisfied that the continuation of the contract would cause the supplier undue hardship.

Less welcome is the proposed provision that the supplier may also terminate the supply if he gives notice to the office-holder within 14 days of the beginning of the insolvency process that the supply will be terminated unless the office-holder personally guarantees the payment of the ongoing charges, and the office-holder does not give that guarantee within 14 days of receiving the notice. While in line with the existing legislation for utilities the whole concept of seeking personal undertakings is inconsistent with position that a solvent company's directors face.

Extending the scope

Apart from the personal undertakings these changes are likely to be welcome. It could be argued that they do not go far enough. They apply only to the supply of utilities and IT services, whereas the objective of R3's campaign was to bring all suppliers of essential services within the scope of the utilities regime. The government has evidently chosen not to do so, and there is therefore still the risk of rescue being held to ransom.

The consultation is open until October 8, and is available on the gov.uk website. ◻

Technical Bulletin

Technical Bulletin 107 was issued in June. Its contents included:

- Business rates – provable debt or expense?
- Revised Statements of Insolvency Practice for voluntary arrangements and protected trust deeds
- VAT – deregistration of insolvent businesses
- Distance selling – new regulations which may affect insolvency practitioners
- Companies House – undischarged bankrupts check
- Insolvency of counterparty to a derivative contract – reporting requirements
- Insolvency tests considered by the Court of Appeal
- Challenge to administrators' conduct – assignment of mis-selling claim
- Stay of actions in provisional liquidation effective in Luxembourg
- Dissolution of company in Portugal did not affect winding up proceedings in England.

MIKE PINK is the chairman of the General Technical Committee and an associate partner at KPMG.

JOHN FRANCIS is the technical director at R3.

Is pre-pack the backdoor to UK insolvency regimes?

Patrick Cook considers how IPs – and creditors – are affected by the outcome of three thorny cases.

The COMI rules prevent a foreign based company from accessing the UK insolvency regimes, unless it has a sufficient connection with the UK. However, in Christophorus 3 Limited the High Court approved the 'flipping up' of a specially created UK newco in a German group to enter administration.

The background

The High Court described this case as 'an elaborate scheme for the restructuring and refinancing' of a German group.

The group was headed by a Luxembourg and German holding structure beneath which two German intermediate holding companies were the main borrowers. Beneath the borrowers was the German trading group, which provided security. An intercreditor agreement regulated the priority of indebtedness owed by the two intermediate holding companies under three facilities: a revolving credit facility and senior and junior loan notes. The loan notes were unlikely to be repaid.

The creditors wanted to avoid an insolvent liquidation. The intercreditor agreement included two standard but important terms:

1. Any new subsidiaries were required to join the intercreditor agreement and to provide security;
2. The security agent could release an 'obligor' upon a share sale provided it was implemented under a court process.

The issues

The group could not overcome the COMI rules given the location of the borrowers and security providers.

Christophorus 3 was created as a newco intermediate holding company *beneath* the German borrowers (alongside the rest of the group) which acceded to the intercreditor agreement. The newco provided a nominal form of security (a pledge over an intragroup debt) to become an obligor under the intercreditor agreement.

The newco's immediate parent (one of the intermediate German borrowers) sold newco to the ultimate parent Lux holding company. The newco then owned the main operating part of the group as a new intermediate holding company.

The senior loan notes were accelerated and the holder called in the newco's security. Newco applied for an administration order in the UK with a proposed pre-pack to sell the shares in the intermediate (borrower) holding companies to a new company owned mainly by the creditors in order to repay the revolving credit facility. The loan notes were to be surrendered for new debt.

What did the court decide?

As Christophorus 3 was incorporated in the UK COMI considerations did not apply.

The court determined that Christophorus 3 was an 'obligor' under the intercreditor agreement even after it was moved around the group's chain of ownership. This was based on the wording of the intercreditor agreement and the fact that it would not have made sense for an obligor to be released simply because of an intragroup transfer. It was important that Christophorus 3 was a subsidiary for six months before it was sold to the ultimate parent company so that it was not merely a 'fleeting or evanescent' group entity.

What does this mean for practitioners?

This decision does not change the COMI rules but suggests that an intercreditor agreement could be used to 'flip up' a UK newco to permit a UK pre-pack.

This is likely to be an attractive option if shifting COMI would have adverse tax or bureaucratic consequences. Alternatively, the creditors could agree to change the governing law of the facility to English law.

This new area retains many uncertainties such as the length of establishment of the newco before flipping up (which will require creditor forbearance) and the potential for challenging any new security given by an acceding newco as a preference or transaction at an undervalue. This decision should accordingly be treated with a degree of caution rather than being viewed as a panacea for changing COMI.

What happens to funds held in escrow when the paying entity goes into administration?

Escrow mechanisms are familiar territory for most practitioners. The case of *Bristol Alliance Nominee No. 1 Ltd and others* v. *Neil Andrew Bennett and others [2013] EWCA Civ 1626* explores what happens when funds are held in escrow at a time when the paying entity goes into administration.

A|Wear traded from premises in Bristol and Leicester. It suffered trading difficulties and negotiated the surrender of the leases, which would take effect by way of a deed of variation under which the parties' mutual obligations under the leases. On completion a surrender premium (equivalent to one year's rent) would be released to the landlords' solicitors to be held in escrow. In time the landlords served notices to complete the surrenders, and shortly afterwards A|Wear went into administration. The administrators refused to complete the surrenders or to consent to the issue of legal proceedings against the company, instead applying to court for directions.

> "The monies no longer formed part of the company's assets and were not available for distribution to its creditors."

The issues

The administrators wanted to know which of the company and its landlords were entitled to the funds held in escrow. If the landlords were not entitled to the monies, the question of whether they should be permitted to bring an action for specific performance of the surrenders was also raised. In the High Court, the judge decided that the landlords were not yet entitled to the monies, and that specific performance was not necessary since the landlords could recover the premises by way of forfeiture for non-payment of rent. In addition, an order for specific performance would deprive A|Wear (and its creditors) of the future right to those monies. Particular attention was paid to the fact that the monies were held by the landlords' solicitors as 'stakeholders' rather than as trustee, and that under the terms of the stakeholder arrangements the company was entitled to the return of the surrender premiums at the end of the lease term should the landlord not serve a notice to complete the surrenders before that time. The landlords appealed to the Court of Appeal.

What did the Court of Appeal decide?

The Court of Appeal decided that – although the escrow monies were held by the solicitors as stakeholders – the landlords had correctly issued notices to complete the surrenders. The payment condition in the escrow arrangements had therefore been fulfilled and the landlords were entitled to the escrow monies. That being the case, the monies no longer formed part of the company's assets and were not available for distribution to its creditors. The court would grant specific performance since A|Wear had not fulfilled the agreements' terms. Refusal of such an order would promote the interests of A|Wear's creditors over those of its landlords in circumstances where there was no good reason to do so.

What does this mean for practitioners?

Fundamentally this concerns the delivery of property, which is then held in limbo until some further condition is fulfilled. Until such time as the trigger condition occurs ownership of the property will normally remain with depositor. This can cause problems in insolvency as – until such time as the escrow condition is fulfilled and title passes – the asset in question will still form part of the depositor's estate and hence will be available for distribution to its creditors. The landlords in this case were lucky in that the escrow condition had been fulfilled and entitlement to the money had passed before A|Wear entered administration. It could easily have gone the other way. When structuring these arrangements therefore, practitioners would be well advised to couch the arrangement in terms of a trust, which (provided the trust is properly constituted) has the effect of removing the assets from the insolvent estate of the depositor, regardless of whether or not the escrow/vesting condition has been fulfilled.

Can an entity whose debt obligations are limited in recourse be said to be balance sheet or cash flow insolvent?

Can a debtor be found to be balance sheet or cash flow insolvent even though its obligations are limited (in terms of creditor recourse) to the available assets? This was the question facing the High Court in *Re ARM Asset Backed Securities SA [2013] EWCH 3351*.

The background

ARM was an issuer of Luxembourg law governed bonds, backed by investments in US life insurance policies (through a Delaware based trust). The trust remitted proceeds to the company to allow it to meet bond obligations as and when they matured. The bonds themselves contained 'limited recourse' provisions, meaning that bond holders could not receive more from the company than the assets it had in hand.

Day to day management of the company was carried out in London. A licence from the Luxembourg regulator was not initially sought. When its later application was refused, the company stopped taking on new business. Its directors, realising that the company could not service its bonds even though they were limited in recourse, sought a winding up order on the grounds that it was just and equitable to do so. They also sought the appointment of provisional liquidators.

The issues

The issues for the court were:

(i) whether the company's COMI was located in England;

(ii) whether the company could be said to be balance sheet or cash flow insolvent and;

(iii) whether it was appropriate to appoint provisional liquidators.

What did the court decide?

On the COMI issue, the court was satisfied that the fact the company's decision-making and administration was conducted from London (and that was apparent to third parties) was sufficient to rebut the presumption that the location of its registered office (Luxembourg) was the centre of main interests.

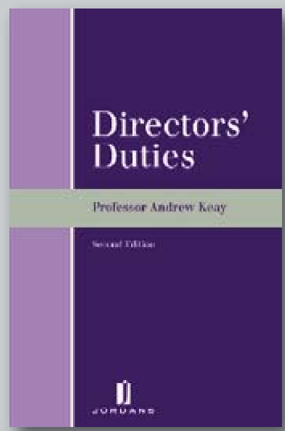
The court also decided that the company was balance sheet insolvent. Much reliance seemed to have been placed on the fact that bond holders would be entitled to submit proofs of debt for the full face value of their bonds, regardless of whether there would be assets available to meet them. It was clear that assets would be insufficient to meet the company's liabilities, and therefore the company was insolvent on both a balance sheet and a cash flow basis.

On the issue of the appointment of a provisional liquidator, the court decided that it was appropriate to do so, both on the basis that it was almost inevitable that a winding up order would be granted and – although assets would not be in immediate jeopardy – a liquidator would be better placed than the directors to propose a CVA or scheme of arrangement in order to realise the company's assets in an orderly manner.

What does this mean for practitioners?

It is unlikely that this will be the last we hear about this issue. The decision was made seemingly without reference to the Supreme Court decision in *Eurosail*, nor was the issue of whether a bond holder's proof for the full amount of their debt would actually be admitted to proof addressed. It is uncertain whether limited recourse provisions would entitle a full proof of debt to be admitted (particularly in light of *Eurosail*) and therefore whether balance sheet or cashflow insolvency are appropriate measures for an entity such as ARM (leaving aside issues of licensing by the Luxembourg authorities).

PATRICK COOK is a partner at Burges Salmon LLP.



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> "The chapter on derivative proceedings deserves special mention."

Directors' Duties

When the Companies Act 2006 first came into force with a new set of codified directors' duties, many litres of ink were spilt by commentators saying not very much of any real use about the possible implications of these reforms. A few years on, we have some case law on these new statutory duties and the second edition of *Directors' Duties* by Andrew Keay does an excellent job of summarising it.

Whilst the book is deliberately limited in scope to the new codified duties under the Companies Act, the dearth of case law so far on some of the key provisions means it is necessary for the author to consider the common law position as well as engaging in some well-informed theorising as to what the law is or should be.

The structure of the book is helpful if the reader already knows the relevant duty for the issue at hand. For example, if the issue is the duty to avoid conflicts of interest, then there is a chapter on the duty as well as its practical application and the commentary is thorough and excellent. However, for legal or practical issues where the relevant legal duties are perhaps not immediately obvious from the outset, it takes a bit of hunting around to find the relevant parts of the book. In a future edition of this book, it would be useful to see some sections or sub-sections devoted to common issues arising for directors. For example, a section on the principles that apply when directors consider the payment of dividends or a return of capital; what duties come into play and what are the potential pitfalls?

Insolvency practitioners will be interested by the very good analysis of the duty of directors to consider the interests of creditors, what this means in practice and how it gives rises to the possibility of claims by an insolvency company by its liquidator. The chapter on derivative proceedings also deserves special mention for its user friendly explanation of the not uncomplicated law and practice.

All in all, a very useful store cupboard textbook, which will no doubt continue to be popular and oft cited as the case law develops further under the Companies Act 2006.

BREE TAYLOR is a partner at Memery Crystal LLP

Legal Q&A

David Johnson answers your insolvency queries.

I am the administrator of a limited company registered in Scotland, appointed by the Court of Session in Edinburgh. A disgruntled creditor, based in London, has applied to the Companies Court in London for permission (pursuant to paragraph 43(6)(b) of Schedule B1 to the Insolvency Act 1986 (Sch. B1 and the Act)) to bring litigation against the company. Can I insist that the application is heard in Scotland?

While the answer is well established, many litigants are still caught out by this particular jurisdictional issue. The Companies Court should dismiss the application. It should be heard in the Court of Session.

The reasoning is as follows. Paragraph 43(6)(b) of Sch. B1 provides that *'no legal process… may be instituted against the company… except – …(b) with the permission of the court'*. The phrase *'the court'* is defined in Section 251 of the Act as *'a court having jurisdiction to wind up the company'*. According to Sections 117 and 120 of the Act, the court having jurisdiction to wind up a company registered in Scotland is the Court of Session (or the sheriff court in certain circumstances), and not the Companies Court in London.

> "As the secured creditor has been paid off in full, his vote must be calculated at zero."

This will not prevent the applicant subsequently making (in substance) the same application to the Court of Session, at which point the court will need to consider the balancing exercise along the lines set out in *Re Atlantic Computer Systems plc* [1992] Ch. 505. If the creditor is seeking to bring a pure monetary claim against the company, it is unlikely that that the court would grant permission – the usual procedure for proofs of debt should be followed (see *Re Nortel Networks* [2010] EWHC 826(Ch)).

As the administrator of a limited company, I recently issued my proposals containing a statement pursuant to paragraph 52(1)(b) of Schedule B1 of the Insolvency Act 1986 (Sch. B1 and the Act), and as such I did not call an initial meeting of creditors. A creditor (whose debt amounts to over ten per cent of the total debts of the company) requested an initial meeting of creditors (pursuant to paragraph 52(2) of Sch. B1). Shortly before the meeting, the debt due to the only secured creditor of the company was paid in full. The secured creditor still demands the right to vote at the meeting and has referred me to Rule 2.40(2) of the Insolvency Rules 1986, which permits a secured creditor to vote '*in respect of the full value of his debt without any deduction of the value of his security*'. What should I do?

The secured creditor cannot vote at the meeting.

Rule 2.38(4) of the Insolvency Rules 1986 deals with the calculation of votes for a meeting of creditors. The vote is calculated according to the amount of the creditor's claim as at the date of administration, less any payments made to him after that date in respect of his claim. As the secured creditor has been paid off in full, his vote must be calculated at zero. Rule 2.40(2) merely provides, in respect of a meeting requisitioned under paragraph 52(2) of Sch. B1, that the value of the secured creditor's security is not deducted from his vote. However, if the value of his debt is already zero, the Rule has no practical application in the circumstances.

I have recently been appointed as the administrator of a limited company, which operates a national chain of gaming arcades. The company's operations, and records, are in disarray. A creditor is claiming retention of title (ROT) over electronic fruit machines supplied for use in the arcades, for which it has not been paid. I have sent out the usual ROT questionnaire, asking for evidence to support the claim, and asked the ROT creditor to attend the premises to identify the machines it alleges are subject to ROT. The questionnaire has been returned only partly completed and the creditor has taken no steps to identify or locate the machines over which it claims ROT. However, the ROT creditor claims that I am duty bound to compile an inventory of goods at all premises and identify which are subject to ROT. The creditor is threatening to pursue a claim against me personally for wrongful detention of the machines and conversion. What are my obligations in this regard?

Thankfully, recent guidance has been provided by the High Court. In *Blue Monkey Gaming Limited* v. *Hudson & Others* [2014], HHJ McCahill QC held that the administrators were not under a duty to compile an inventory of the assets held at

> "It is the duty of the person claiming ownership to identify his own goods."

each of the premises, nor *'on their own to set about identifying machines owned by individual third parties'*. It is the duty of the person claiming ownership of goods to identify his own goods, not for the administrators to do so. To hold otherwise would be unrealistic and unworkable.

You should refer the relevant creditor to this recent authority and give him a further opportunity to complete the ROT questionnaire in full, provide evidence of ownership and attend the premises to identify his claimed goods. You should then adjudicate the claim on the basis of the evidence supplied.

DAVID JOHNSON is a barrister and senior associate at Taylor Wessing.

Recent case summaries

Latest insolvency update from **Daniel Lewis**.

***Hosking* v. *Slaughter and May* [2014] EWHC 1390 (Ch)**

The essential issue in this case was whether it was open to a subsequent liquidator to seek an assessment of the fees of solicitors instructed by a previous administrator, where the fees had been agreed by the previous administrator. It might apply equally in any case where any previous officer holder has reached agreement as to the fees of solicitors instructed by him and a subsequent office-holder has sought to challenge that decision.

Facts: The facts were straightforward. A motivated informal committee of creditors had pressed the administrators to investigate the claims available to them, to which end they had instructed the respondent firm of solicitors and to which end legal fees of £2.5 million had been incurred, agreed and paid. On this advice, the administrators decided that there were no claims that could be pursued and the administration was brought to an end and a compulsory winding up order made.

> Insolvency practitioners were trusted to judge for themselves...

The liquidators that were as a result appointed sought to challenge the fees paid to the solicitors and made an application for their assessment under: (a) the Solicitors Act 1974, (b) rule 7.34 or (c) the court's inherent jurisdiction. The first ground was not pursued. Mr Registrar Jones at first instance held that the power to order assessment was not available where the fees had been agreed by the administrators and that, although the court retained an inherent jurisdiction to order the assessment of fees where the power to agree fees had been accorded to the responsible insolvency practitioner the court should not usurp that function. On appeal His Honour Judge David Cooke upheld that conclusion, with one minor refinement.

Rule 7.34 (as in force at the relevant time) provided that the costs, charges or expenses of any person are payable in relation to a company insolvency shall be subject to detailed assessment unless agreed between the 'responsible insolvency practitioner'. The same principle, albeit in different form, is now found in rule 7.34A.

As the judge noted, the breadth of the words 'costs, charges or expenses of any person' are broad and liable to include a broad range of persons who might provide services to an insolvency practitioner (for instance, an agent instructed by an administrator to advise and assist in the sale of a company asset).

Held: Both the Registrar and the judge on appeal took account of the fact that the legislation has changed so that the previous position, which required **all** fees to be subject to assessment, no longer applied. The Act and the Rules no longer required taxation in every case: insolvency practitioners were trusted to judge for themselves whether such an assessment was in the interest of creditors. The Registrar's interpretation on this point was upheld. There would be no point in the power to agree appropriate fees if such an agreement did not have a binding effect. The relevant insolvency practitioner with the power to agree costs was the office-holder that was in office at the time.

The Registrar had held that the court retained the power to require the assessment of costs under rule 7.34(4) in relation to any legal proceedings. The respondent solicitors challenged the Registrar's conclusion that the use of that power was available in this case, since it applies to 'proceedings before the court' and at the conclusion of previous proceedings no costs order had been made. The judge held that the power was only available to the court seized of the proceedings, as otherwise the power would confer a general power to order retrospective assessment.

The Registrar had accepted (correctly in the judge's assessment) that the court retained an inherent jurisdiction to direct an assessment of an office-holder's expenses. The Registrar had been correct in the exercise of his discretion in choosing not to exercise this power in this case. Notwithstanding criticisms of the manner in which the solicitors had been instructed, these factors did not outweigh the fact that the Insolvency Rules provided for a responsible insolvency practitioner to agree fees.

Practice points:

The decision of a previous office-holder to agree expenses will bind a subsequent appointee except that…

The court retains an inherent jurisdiction to require detailed assessment. It would need to be a clear case to displace the principle that an office-holder can agree fees.

The power under rule 7.34(4) to order the detailed assessment of the costs of legal proceedings cannot be exercised retrospectively: the power is to be exercised by the court hearing the proceedings at the time that they are heard.

***Patel* v. *Mirza* [2014] EWCA Civ 1047**

While there is no honour among thieves, the judgment of the Court of Appeal in *Patel* v. *Mirza* represents an interesting expansion in the circumstances in which the court will come to the aid of a party to an illegal transaction.

Facts: Mr Patel brought a claim against Mr Mirza for the recovery of £600,000, which he had paid as part of a spread-betting arrangement. Mr Mirza claimed to have contacts within RBS who would be able to supply advance information about a statement that the Chancellor of the Exchequer was expected to give about the government's investment in the bank. In fact the expected statement was never made, and Mr Patel sought repayment from Mr Mirza. Mr Mirza claimed to have paid the money to a third party who was now bankrupt and denied any obligation to repay Mr Patel. At trial at first instance, Mr Mirza raised (somewhat belatedly) the argument that the money had been paid under an illegal contract and was therefore irrecoverable.

> Mr Mirza claimed to have paid the money to a third party who was now bankrupt and denied any obligation to repay Mr Patel.

Held: The Court of Appeal accepted that Mr Patel was relying upon an illegal agreement in order to bring his claim. It was well established that if Mr Patel had withdrawn from the scheme *before* it became clear that the agreement would not be performed, he would have been entitled to repayment. The Court of Appeal went further: there was no distinction to be made between cases where the withdrawal from the illegal arrangement took place voluntarily before it was performed and where withdrawal took place because the illegal arrangement *could not* be performed. Mr Patel was therefore entitled to his money back, despite his preparedness to engage in an illegal arrangement.

DANIEL LEWIS is a barrister at 3 Hare Court.

Schemes of Arrangement: The comeback king?

The relative attractions of alternative restructuring tools.

'Slow, cumbersome and costly for everyone involved'. Although we could be talking about England's World Cup performance, we are in fact referring to how Schemes of Arrangement are often perceived. As a restructuring tool, Schemes tend to be regarded as the less attractive, older brother of Company Voluntary Arrangements (CVAs) due to the level of court involvement, the lengthy timetable and the thorny issue of dividing creditors into classes. That said, Schemes have had a comeback in recent years and can be, where the circumstances dictate, a very attractive tool to restructure debt obligations. This stems from their flexibility, availability to foreign companies and their most striking feature, the ability to bind secured creditors and disenfranchise those with no economic interest, features which are not shared in many cases by CVAs.

In this article, we consider when a Scheme may be a more appropriate restructuring tool than a CVA and touch on the differing role of an insolvency practitioner in each. The comparison table opposite highlights the key differences between CVAs and Schemes, some of which we will discuss in greater detail.

How to Scheme

A Scheme is a compromise or arrangement between a company and its members or creditors or any class of them.[1] Unlike CVAs, Schemes are not formal insolvency procedures and have always been governed by the Companies Acts (now contained in ss.895-899 of the Companies Act 2006) and never by the Insolvency Act 1986. They are available in solvent and insolvent situations and have been historically popular as a means of a company takeover and for insurance company insolvencies. Schemes are flexible and can essentially be anything a company and its creditors/members agree between themselves. There must, however, be an element of 'give and take'[2] in order to qualify as a scheme of arrangement for statutory purposes. Schemes are usually proposed by the company (or its administrator/liquidator) but can in theory be proposed by a shareholder or creditor.

> "There must be an element of 'give and take'..."

Planning stage

One should not underestimate the amount of work involved before getting to court, including drafting all necessary documentation and engaging with impacted stakeholders, who sometimes sign a lock-up agreement committing to vote in favour (often for a fee). For the reasons discussed below, at the initial stage, serious thought will go into class constitution.

Convening hearing

The hot topic for the court at this stage is creditor classes. Classes should be determined based on whose legal rights vis à vis the company are not so dissimilar that they would be able to consult together and engage in sensible dialogue with a view to their common interests.[3] Generally, one would expect a company with tiers of secured debt to have different classes of creditors in accordance with their respective rights under intercreditor arrangements, ie separate classes for the senior and junior secured creditors on the one hand and unsecured creditors on the other.

Meetings

The voting threshold is a majority in number holding 75 per cent in value of each class of those present and voting. A key distinction and attraction of Schemes compared to CVAs is that if a creditor's rights are not affected by the proposal on the ground that they do not have any economic interest in the company's assets, they are not entitled to vote.[4] If therefore, the value of the business breaks in the senior debt level, the junior creditors are effectively 'out of the money' and need not be invited to vote on the Scheme. The valuation of the business is therefore fundamental as it dictates who is in the driving seat. Currently, a going concern valuation is considered best practice.[5]

Sanction hearing

The court can refuse to approve the Scheme if stakeholders have not been treated fairly or the classes were not fairly represented. The review by the court is not just a box-ticking exercise. It will also consider any creditor objections who may challenge on unfairness grounds. The test for fairness is whether the Scheme is one a reasonable, honest man, having regard to his own interests might properly approve.[6]

The court is concerned that the Scheme appears fair and equitable, as opposed to considering its commercial strengths. The court may also consider how the classes would have fared in a comparative liquidation (if that is the likely alternative).

Once the Order is made and delivered for registration at the Companies Registry, the Scheme becomes fully effective and binds everyone,[7] including secured creditors and anyone that opposed it. This is a key advantage for companies with various levels of secured debt and a crucial distinction to CVAs, which cannot affect secured creditors without their consent. A Scheme is deemed final at this stage, whereas CVAs are challengeable for 28 days after notice of the result of the creditor's meeting is filed at court.

When to Scheme

Nowadays, CVAs are seen as better suited to smaller companies or companies that only seek to compromise unsecured creditors. Schemes, on the other hand, are becoming a popular alternative when tackling more complex corporate restructurings with various debt levels. This is because Schemes have three key benefits over CVAs: their ability to bind secured creditors and to disenfranchise junior creditors and their availability to foreign companies. That said, in the context of a company in need of a financial restructuring, a Scheme is not usually 'Plan A' and is often instead used as a back-up threat to focus stakeholders' minds in order to encourage a consensual restructuring.

> "Schemes are becoming a popular alternative when tackling more complex corporate restructurings with various debt levels."

Bind-ability and disenfranchisement

In recent times, two key types of debt restructuring Scheme have evolved, which cannot be achieved via a CVA:

1. Pre-pack/transfer Schemes

This is a method used by senior 'in the money' creditors to enforce their security and effectively bypass junior creditors, who are so far 'out of the money' that they do not get a vote. It involves a schemed company ('OldCo') transferring its assets to a NewCo owned by the senior creditors. NewCo pays for the price of the assets by 'credit bidding' the claims of the senior creditors equal to the value of the assets such that their claims are reduced by this value. Some or all of the remaining senior liabilities may be assumed and secured by NewCo. OldCo will often be in administration or in the context of real estate assets, a receiver will have been appointed. This ensures an independent assessment of the value of the assets, therefore limiting the risk of challenge. For this process to work, there ought to be an intercreditor agreement in place, which allows the administrator/receiver to sell the assets to NewCo free from the existing security. As a result, the disenfranchised junior creditors' liabilities remain unaffected against OldCo, which effectively becomes a valueless shell. In *Re Bluebrook*,[8] junior creditors tried to object to such a Scheme on unfairness grounds but their arguments were rejected as they had no economic interest in the company.

2. Cramdown Schemes

Such Schemes have developed as a way of circumventing unanimous or high majority lender consent provisions in loan agreements where consensual discussions have broken down. Schemes

	SCHEME	CVA
Timing and cost	Court involvement and creditor class issues generally result in a 2–3 month timetable and therefore higher costs.	No court sanction required and no classes – generally quicker and cheaper to implement.
Classes of creditors	Yes – classes based on sufficiently similar rights against the company.	No – one creditor pool votes on the CVA proposal.
Who is bound?	All members and creditors including secured creditors and those who oppose.	Unsecured creditors only. Only affects secured or preferential creditors who opt in.
Who votes?	Only creditors/members impacted by proposal, ie no economic interest = no vote.	All unsecured creditors. Secured creditors can vote in respect of any unsecured element of their debt.
Available to foreign companies?	No COMI test – company must be capable of being wound up in the UK and have a sufficiently close connection to this jurisdiction.	COMI test applies.
Moratorium?	No unless coupled with administration. Court has recently granted a stay of creditor legal action but extent of the jurisdiction to do so is uncertain.[9]	Generally no unless the company is also in administration. There is a 28 day moratorium available for smaller companies (though rarely used).
Proposal content	Can affect part or all of a company's creditors or members – as a result, tends to cater for more complex restructurings.	Compromise with all unsecured creditors only.
Voting threshold	Majority in number representing 75 per cent in value of each class present and voting.	Creditors comprising: (a) 75 per cent in value of those present and voting; and (b) 50 per cent in value of unconnected creditors.
IP involvement	No IP required (unless company in administration or liquidation).	IP required to act as Nominee and subsequently as Supervisor.
Effectiveness and scope for challenge	Effective once court order sanctioning the Scheme is delivered for registration at Companies House. Can be challenged on unfairness grounds at sanction hearing stage – also susceptible to challenge due to class issues at the convening hearing.	Effective from date of creditors' meeting. Challengeable on grounds of material irregularity or unfair prejudice for 28 day period after notice of meeting result filed at court.

Scheme process

- **First court hearing (the convening hearing)**
  The company seeks the court's permission to call a meeting of the relevant creditors/ shareholders;
- **Meetings**
  The relevant classes of stakeholders meet to vote on the proposal; and
- **Second court hearing (the sanction hearing)**
  – the court decides whether to approve the Scheme.

Likely timetable:

1. First court hearing – likely to take 2–3 weeks to get a hearing date.
2. Meetings usually held 14 or 21 days after the hearing (depending on articles of association).
3. Second court hearing – again likely to take 2–3 weeks to get a hearing date.

Total: likely 2–3 month process excluding the planning stage and depending on court availability.

have recently been used to implement debt for equity swaps and amendments and extensions to facilities, which would not have otherwise been possible. As a further example of how innovative Schemes have become, a recent case involved a 'pension deficit for equity swap' whereby a Pension Trustee released various entities from their obligations in exchange for a cash payment and majority shareholding in the company.[10]

Foreign companies

Unlike CVAs, Schemes are not 'main insolvency proceedings' under the EC Insolvency Regulation,[11] which means a foreign company does not have to show that their centre of main interests (COMI) is in England. This is highly convenient when dealing with large multi-jurisdictional corporate groups, which may have their COMIs in many different countries. Instead, a company has to show it is capable of being wound up here (which in theory is open to all foreign entities as 'unregistered companies' [12]) on the grounds that it has a sufficiently close connection to this jurisdiction.[13] This hurdle is fairly low given that recent case law has established finance documents with English governing law clauses will satisfy this requirement (even if a governing law clause is changed to English law from a foreign law by a majority lender vote undertaken in accordance with the terms of the loan agreement solely for the purpose of enabling the company to make use of a Scheme).[14] In addition, the presence of creditors or assets located here will suffice to give the English court jurisdiction. As a result, there has been a recent influx of Schemes for companies from Delaware to Kuwait.[15] That said, if a Scheme is unlikely to be recognised in the company's home jurisdiction or is being used instead of a local equivalent process, the court may reject it.

It is thought England's open arm attitude to foreign corporate refugees seeking to restructure here via Schemes will continue and that it is unlikely Schemes will be brought within the ambit of proposed amendments to the EC Insolvency Regulation to include certain insolvency rescue procedures where a COMI test would apply.

The insolvency practitioner's role – *Scheme* v. *CVA*

Schemes do not impact on the management of a company and unlike nominees and supervisors in CVAs, there is no requirement to involve an insolvency practitioner at any stage. However, where a Scheme is coupled with an insolvency process, the administrator/liquidator will play an instrumental role in preparing and implementing the Scheme proposal and engaging with stakeholders. In addition, if a Scheme is used as a means of distributing a company's assets to creditors, an insolvency practitioner's role in a Scheme will be largely similar to that in a CVA and he will be responsible for determining the value of creditors' claims (including the assessment of contingent claims) and the distribution of dividends.

> "Schemes are experiencing a rebirth and are being used in increasingly inventive ways and have become a popular restructuring tool."

One issue that the court had to consider recently in the *Miss Sixty* case[16] was whether an insolvency practitioner, appointed as administrator by a creditor, could legitimately propose a pre-packaged CVA supported by that same creditor, who alone held sufficient value to vote it through. Whilst the facts related to CVAs, the same issue could equally apply to Schemes. The court held that the insolvency practitioner was able to exercise his discretion to propose the CVA, subject to limits as to how such discretion was exercised. In that case, the court held that an administrator must act professionally and independently, in good faith and not merely on the instruction of the majority creditor, particularly when a CVA is structured such that it is bound to be passed by the majority of creditors whose position is not affected or is improved but there is a smaller class whose rights will be materially affected. The court commented that the administrators in that case 'seemed to have lost a proper sense of objectivity'.

Conclusion

With their venerable roots, Schemes are experiencing a rebirth and are being used in increasingly inventive ways and have become a popular restructuring tool when a unanimous decision among stakeholders is impossible. Their key strengths over CVAs, namely their ability to compromise secured creditors, ability to disenfranchise out of the money creditors and availability to foreign debtors bolster their position as a solid alternative. That said, the heartaches associated with creditor classes and the time and cost implications of court involvement should always be borne in mind as potential drawbacks. Despite this, Schemes are bearing the hallmarks of the Comeback King ready to reclaim his restructuring crown. ◻

1 S895 Companies Act 2006
2 *Re Savoy Hotel Ltd [1981] Ch 351*
3 *Re Hawk Insurance Co Ltd [2001] EWCA Civ 241*
4 *Re Tea Corp [1904] 1 Ch 12, IMO Carwash*
5 *Re Bluebrook Ltd, Re Spirecove Ltd, Re IMO (UK) Ltd [2009] EWHC 2114*
6 *Re Dorman Long & Co Ltd (1934) 1 Ch 635*
7 S899(4) Companies Act 2006
8 *Re Bluebrook Ltd [2010] BCC 209*
9 *Bluecrest Mercantile NU* v *Vietnam Shipbuilding Industry Group [2013] EWHC 1146 (Comm)*
10 *Re Uniq Plc [2011] EWHC 749 (Ch)*
11 *EC Regulation on Insolvency Proceedings (1346/2000/EC)*
12 S.221 Insolvency Act 1986
13 *Re Drax Holdings Ltd [2003] EWHC 2743 (Ch)*
14 *Re Rodenstock GmbH [2011] EWHC 1104, Re Apcoa Parking Holdings GmbH and others [2014] EWHC 1867 (Ch), Re Drax Holdings Ltd (above)*
15 *Re Icopal As and others [2013] EWHC 3469 (Ch), Global Investment House KSC [2012] EWHC 3792 (Ch)*
16 *Mourant & Co Trustees Ltd* v. *Sixty UK Ltd (in administration) [2010] EWHC 1980 (Ch)*

MICHAEL RUTSTEIN is a partner at Jones Day.

ALEX LOFTHOUSE is an associate at Jones Day.

Editor recovery@r3.org.uk | Recruitment recovery@r3.org.uk/recruitment

10 things you need to know about CVAs

After completing CVAs for the Bella Italia and Café Rouge brands, **Clare Kennedy** and **Elaine Nolan** offer a must-do list.

Using a CVA to restructure a property portfolio might seem like a simple solution – the company is freed from non-performing sites, enabling the rest of the business to go forward. But is it that straightforward? In this article we take a look at ten key factors you need to consider when planning a CVA.

1. Determine whether a CVA really is the best option

A CVA may not be the only or the best solution and, in any event, a solvent solution should always be considered first, especially where there are leases close to termination that could be allowed to expire naturally at minimal cost. Alternative insolvent options should also be considered (especially where creditor voting is likely to be tight). A full diagnostic review will assess the option that best suits the circumstances.

> “A CVA should be part of a wider solution and be used in parallel to other tools.”

2. Don’t use a CVA in isolation

A CVA usually only addresses one part of a stressed or distressed business and, unless the other issues are also addressed, the business may yet fail. A CVA should be part of a wider solution and be used in parallel to other tools such as a financial restructuring, operational realignment and non-core disposal processes.

3. Ensure the company can withstand the long-term cost and consequences of a CVA

The cost of a CVA is not restricted to immediate professional fees; costs may also include the effect of a working capital squeeze as suppliers tighten their terms, which can sometimes be forgotten. These, combined with often huge demands on management time, can make a CVA a costly process.

4. Treat guarantee claims fairly

In complex group structures, multiple entities often provide lease guarantees. All claims, whether provided by those companies subject to a CVA or not, should be treated equally. While it may be tempting to strip guarantees at a nil value, recent case law has found this to be inequitable and has resulted in successful challenge. Establishing the value of the companies providing guarantees is a vital piece of the jigsaw.

5. Create a credible offer for landlords

A CVA should offer better returns to the creditors than they would receive in a winding up. As well as the financial benefits, demonstrating the benefits of a ‘soft landing’ is essential to a successful offer. A staged return of the property over an agreed period of time; the prospect of a long-term tenancy with a replacement tenant; the provision of the services of a property agent at the company’s cost, and the benefit of any key operating contracts and assets are all key factors in securing landlord support.

6. Communicate the benefits openly to creditors

The 14 day period between the launch of the proposals and the creditors meeting(s) provides the company with the opportunity to communicate with its creditors, setting out the benefits of the proposals. Management of the company are best placed for this role, as they are able to leverage their existing relationships. They will also be able to secure and gauge likely support.

Developing a coherent communication strategy is key, together with ensuring a well-trained team is used to convey the message to key stakeholders.

7. Assess the likelihood of the CVA being accepted

The likelihood of creditors accepting the CVA is best estimated using voting models. Underlying voting assumptions can then be stress-tested and recent voting patterns overlaid against the models to quantify likely results. As the intentions of individual creditors become clear the voting models can be updated to reflect the latest data. Further actions can then be planned on the basis of the voting outcome.

8. Anticipate and prepare for creditor action

A fair proposal is a statutory requirement; that is, terms must not favour one category of creditor over another. Early engagement with institutions such as the British Property Federation will help the nominee to ensure that the proposals are well thought through and in the best interests of the creditors.

By providing a clear explanation of the selection criteria for each CVA category, creditors and other stakeholders can see that a fair process has been used. However, even if the proposals are fair, some creditors may use the threat of a challenge to improve their personal positions.

Under some leases, landlords are able to initiate pre-emptive action to recover their sites through forfeiture on launch of the CVAs. In addition, until the creditors’ meeting, there is no moratorium in place unless the company is already in administration. A good understanding of the potential risk of this action and a mitigation strategy, which would include having lawyers and security on standby, is key.

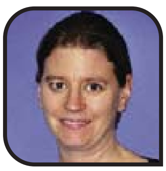
> “Even if the proposals are fair, some creditors may use the threat of a challenge to improve their personal positions.”

9. Time the CVAs carefully

The timing of a CVA can have significant cash flow implications and, where possible, should be tied to the rent quarter date so that the company benefits from the terms of the new agreement at the start of the next rent quarter.

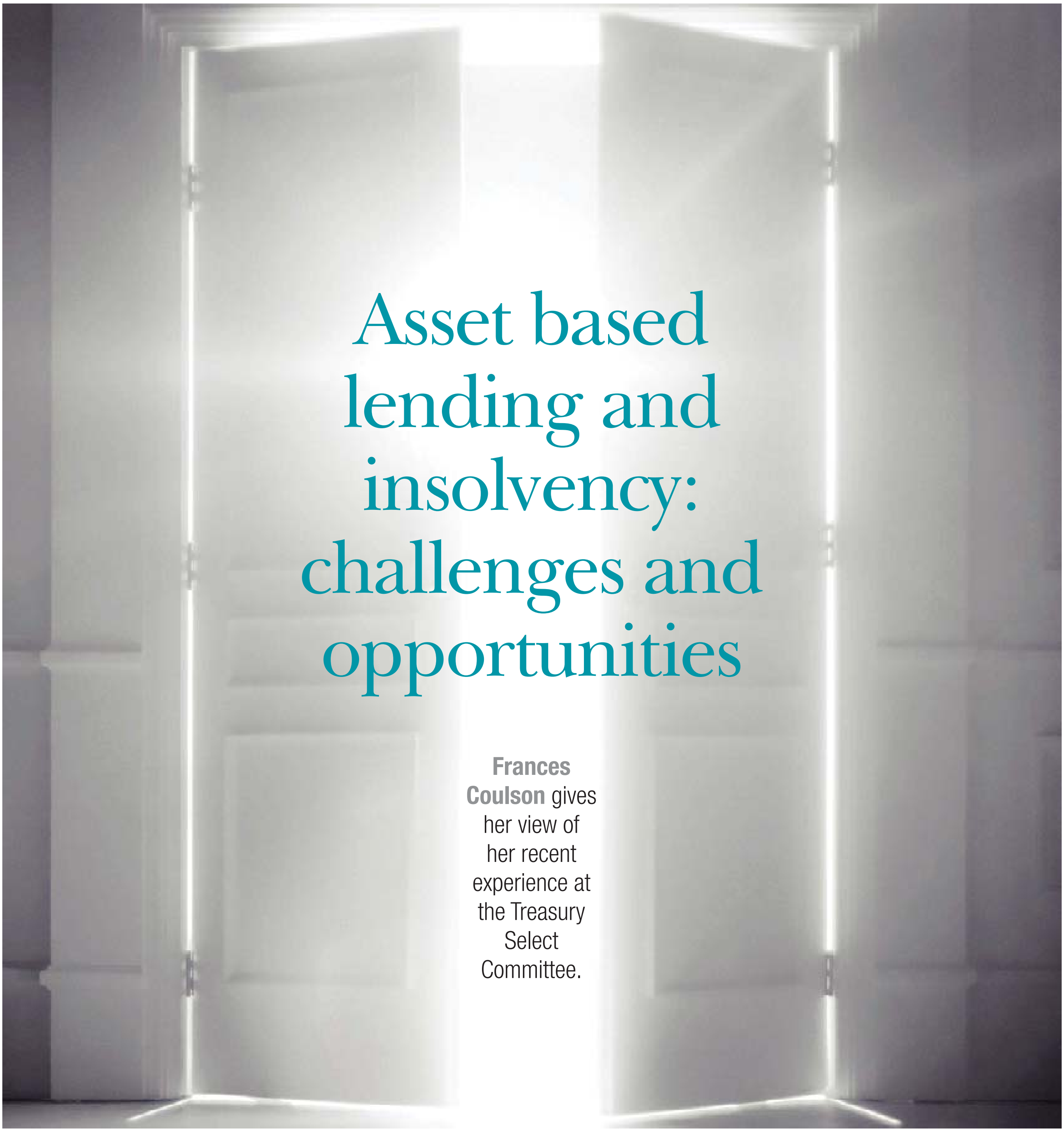
10. Encourage voting

It is unlikely that all creditors will attend the meeting, but they should all be encouraged to vote. Providing dedicated phone hotlines and email addresses means creditors have an efficient, easy way of lodging their proxies if they cannot attend. ◻



CLARE KENNEDY is a director at Zolfo Cooper LLP.

ELAINE NOLAN is a partner at Kirkland & Ellis LLP.



Asset based lending and insolvency: challenges and opportunities

Frances Coulson gives her view of her recent experience at the Treasury Select Committee.

The Treasury Select Committee is conducting its investigation into lending to small and medium sized enterprises (SMEs) at present and has heard evidence from banks and others on a wide range of topics surrounding the non-availability of finance, the behaviours of lenders over the last few years and, of necessity in this regard, insolvency. On 10 June it looked specifically at asset based lending (ABL) and members raised various issues that have been the subject of concern over the last few years in particular. See archive of the evidence given at **www.parliamentlive.tv/Main/Player. aspx?meetingId=15491**.

> “A poor image turns potential business away.”

Martin Morrin, chair of the Asset Based Finance Association (ABFA) and managing director at RBS Invoice Finance gave a sensible opening statement as to why ABL is important to SMEs and of course, it is. SMEs often have limited fixed assets, find a lack of availability of overdraft facilities, particularly at short notice, and the factoring/ID facility enables them to unlock cash flow, and can impose a certain discipline in terms of credit control and due diligence. However, our lawmakers have concerns surrounding the industry that should not be ignored or paid lip service to.

Complaints and challenges

Steve Baker MP suggested that the use of ABL might suggest that the borrower was in trouble. Brooks Newmark MP stated that the industry was ‘rife with abuse’ and certainly MPs appear to receive a large number of complaints surrounding the

> “I think administrations should always exit into liquidation or CVA.”

issue. Mr Newmark referred to 'poor practice' in the industry with brokers 'targeting failing businesses and profiting from collapse', to which Mr Morrin responded that no member of ABFA should target failing businesses or benefit from misfortune. However, this is an area of challenge for the ABL industry and insolvency practitioners. Not all lenders (and no brokers) are members of ABFA anyway. Cleaning up the offenders is important to the good lender majority. Perception is, if not everything, very important. A poor image turns potential business away and a failure to recognise and tackle abuse will result in increased burdens in regulation for lenders and IPs alike.

Rethinking the area

Of course there are areas where the ABL industry does need to clean up its act. The scenario where main bank lending is called in or reduced, the customer moved to a separate company for invoice discount finance, then onwards to another lender who buys out the debt shortly before insolvency, is a scenario many of us are familiar with and one that causes losses to

> "Quite a lot of movement is needed in terms of change or it will be another case where self-regulation hasn't worked."
>
> **ANDREW TYRIE MP,**
> **Treasury Select Committee chairman**

unsecured creditors in the attendant large termination fee and collection fees. As Mr Morrin said, the industry cannot price fix in terms of termination fees, but perhaps some rethink is needed in the area. This is often not risky lending; the debtors are good and the recovery of debt to cover lending pretty certain. Naturally companies with poorer credit ratings can generally expect to pay more for finance and that is a commercial market issue. Directors may be complicit in the insolvency scenario detailed above, getting their business back for a small sum in a pre-pack from a lazy or complicit administrator appointed by the latest lender; or they may be horrified by the track the company has been forced down. What they haven't done usually is taken advice early or often enough or placed the company into administration themselves early enough in the best interests of the creditors. A triumph of hope and a desire to keep their own income going over a proper view of creditors' interests.

Use plain English

SMEs entering into these agreements, especially at the smaller end, do need, in the absence of any bargaining power, plain English. They also need short guides to the downsides if a termination event occurs and if not independent advice, then at least some prescribed information about the cost of the lending and termination and what range of termination events might trigger an appointment, as well as details about their duties to creditors. Where the lender is clearly well secured in this way there is something to be said for forcing at least a 14 days' notice of termination, (rather than 'forthwith') remediable by repayment of the principal debt and with a moratorium on a lender appointment meanwhile. Of course one aspect to consider would be the impact on bank lending if they too would have to give 14 days' notice of termination before enforcement and how this might impact on or interact with the notice of intention to appoint an administrator.

Keep costs down

Looking at the insolvency itself, if unavoidable then I believe there should be changes to make the situation fairer for unsecured creditors. I would welcome discussion but perhaps if a charge is registered within 12 months of insolvency then only the principal sum is secured and the termination fee/charges are either unsecured or only a capped element of them should be secured. In a pre-pack the same oldco directors in newco may be actually collecting the debts and while oversight of that process or other safeguards may be sensible for the lender, the costs of collection should not be high.

Rewards and fairness

Of course there needs to be ease of lending, with appropriate rewards for riskier lending, and of course administrators need to be able to operate swiftly and unhampered in selling the business, pre-packaged or otherwise, but I believe that after the company's struggle for survival fails, and rescue of the business has been achieved by sale, and last minute frenetic activity has concluded, then a review of what has occurred should be undertaken with a firm eye on fairness and *pari passu*. I think administrations should always exit into liquidation or CVA, not dissolution unless a court orders otherwise. The liquidator should be the Official Receiver or an IP other than the administrator and, as advocated by R3 in the case of sales to connected parties, a small pot should be retained from the sale of the business to fund the liquidator. In CVAs the creditors have the vote at least so there is a second look there too. Furthermore (as suggested by Steve Hunt of Griffins) para 83 Schedule B1 could be amended so that a liquidator can be appointed to investigate the company and consider any claims available so that any opportunity to give a return to creditors is maximised, even where a dividend to unsecured creditors (so easily wiped out by fees) cannot be certified on exiting administration.

Codes of practice

There is no doubt that progress has been made by ABFA in introducing its code of practice, professional skills council and the availability of the ombudsman, but: a) licensing/membership of lenders is optional so not everyone has to abide by the code; b) the code itself is brief and perhaps needs developing in terms of best practice, such as brief bullet points of the likely costs in the event of default, definition of the situations that trigger default, and what happens in the event the lender appoints an administrator and the rights and responsibilities of the directors; c) compensation is too low.

The Treasury Select Committee chairman Andrew Tyrie MP said that 'quite a lot of movement [was] needed' in terms of change, or, he said, it would be 'another case where self-regulation hasn't worked'. He considered that 'a lot more has to be done'. Martin Morrin agreed that change was needed.

Review and investigate

To summarise I believe improvements have been made but that all lenders should be regulated/licensed so that standards can be set and maintained and a badge of good lending can be relied upon. I believe that smaller SMEs need particular protection akin to consumer finance; that changes to the insolvency regime to facilitate a cold case review of

> "All lenders should be regulated/licensed so that standards can be set and maintained and a badge of good lending can be relied upon."

the administration and any potential claims available would ensure that there is a second look and encourage investigation of director behaviour so that claims can be maximised. I think there are opportunities for asset based finance to increase and help SMEs grow, and for lenders and IPs to avoid criticism and regulatory shackles being tightened by making sure their own self-regulation is effective and applies to all, with heavier penalties for those who fall below the standards.

FRANCES COULSON is head of insolvency and litigation at Moon Beever Solicitors and chair of that R3 Fraud Group.

Protecting the IP from unfair prejudice claims in a CVA

IPs must be mindful of a landlord's potential to claim unfair prejudice, say **Ben Jones** and **Barry Gross**.

There are only two grounds on which a creditor may challenge a CVA under section 6(1)(a) of the Insolvency Act 1986 (IA 1986). The first ground is 'unfair prejudice', that the CVA unfairly prejudices the interests of a creditor, member or contributory of the company. The second ground is that there has been some material irregularity at, or in relation to, either of the meetings (for instance, creditors were told that the creditors' meeting would be at 9.00 am on Tuesday in London and it was held at 10.00 am on Thursday in Manchester). This article focuses on the unfair prejudice ground for challenge, and how the recent spate of innovation in CVAs has advanced the analysis when it comes to compromising the interests of landlords.

The cooling off period

An application under section 6 IA 1986 must be made within 28 days of the creditors' decision to approve the CVA being notified to the court, or, if the creditor was not given notice of the creditors' meeting, within 28 days of the day on which he became aware that the meeting had taken place. Great care is taken in practice to ensure that all creditors who will be affected by a CVA are given due notice and receive copies of the proposal, so that the company and its stakeholders can be certain that the risk of challenge is extinguished once the 28 day period has passed (and a short buffer may be built into the timetable to cater for a creditor making an application at the eleventh hour that is not immediately notified to the company). Much can turn on the timing of expiry of the 'cooling off period', as often any wider restructuring will have as its trigger this period passing without any creditor intervening. It is important therefore that the stakeholders who are party to the restructuring have a contingency plan; it can be relatively inexpensive for a dissenting creditor to make an application under this section, the effects of which can be amplified if the future of the company is dependent on the completion of the restructuring, and there is insufficient liquidity available to fund the business and legal expenses throughout a fight in court. The CVA proposal will therefore usually have the fingerprints of a contingency plan throughout it, and the nominee or another IP will be prepared to take an administration appointment to deliver that plan if a challenge with any merit is made.

> "It is important that the stakeholders who are party to the restructuring have a contingency plan."

At the hearing of an application under section 6, the court may revoke or suspend any decision approving the CVA, or give directions for the summoning of further meetings to consider any revised proposal that the person who made the original proposal may make.

Horizontal and vertical tests

The requirement of 'unfair prejudice' is a two-fold test. Firstly, the creditor must show that he has been prejudiced by the CVA, especially by comparison with other creditors, and secondly, that the prejudice is unfair.

In reviewing whether there has been prejudice, the court will compare the relevant creditor's position under the CVA with:

- the treatment of other creditors under the CVA (the 'horizontal comparison'), ie is the relevant creditor worse off when compared to other creditors?
- the position that the creditor would be in

absent the CVA (the 'vertical comparison'), ie what is the likely alternative scenario to the CVA – typically an insolvent liquidation or administration – and would the creditor be better off in that scenario? This issue tends to be most acute on the most profitable leases from the perspective of the company (eg the store on Oxford St) because in an administration the landlord might expect its lease to be assigned to a better covenant with no adverse economic changes. In contrast even the most light touch of that lease under the CVA, such as putting it onto monthly rental payment terms, might fall foul of the vertical test.

For the purpose of the horizontal test, a differential treatment of creditors under the CVA is not automatically unfair; it may be, if it can be demonstrated, that it is necessary to treat creditors differently to ensure the continuation of the company's business (which underlies the voluntary arrangement by paying essential suppliers in full to guarantee continuation of service).[1] This is an absolutely essential justification for landlord CVAs, without which they would fail. This is because, typically, the 'compromise' under the CVA is borne principally by landlords, who are asked to accept reductions in rent for the short to medium term, whereas other unsecured creditors, such as suppliers and employees, from whom the continuation of provision of service is essential to the continuation of the company's business, are kept whole. The rub for landlords is that under a CVA all creditors can vote on

> "The rub for landlords is that under a CVA all creditors can vote on the proposals..."

the proposals, as a single class, including connected creditors, even if the CVA does not affect them. In practice, most nominees will insist on obtaining the support of at least 75 per cent of the landlords to the proposals, even if technically that is not required, as a matter of best practice.

Effecting variations

Some CVA proposals have also sought to effect ongoing variations to the terms of some of the categories of lease, for example by altering the amount of the rent payable pursuant to a rent review, or by changing the basis on which rent is paid from a contractual rent to a turnover rent, to align more closely the tenant's business with the landlord. These terms sometimes seek to effect permanent changes to the terms of the relevant leases, which will continue in effect after the CVA itself has been completed.

Would the court view such variations as fair and reasonable if the landlord challenged the CVA?

Neuberger LJ, in *Thomas* v. *Ken Thomas Ltd* said that it would seem wrong that a tenant should be able to trade under a CVA for the benefit of its past creditors, at the present and future expense of its landlord. If the tenant continues to occupy the property in order to trade under the CVA, and hopefully trade out of the CVA, it should expect to pay the full rent under the lease. He went on to say that he considered that a CVA should so provide and, if it did not, in the absence of special circumstances, the landlord might well be entitled to object to the proposals as unreasonable.[2]

So why don't they? The answer is that in *Thomas* v. *Ken Thomas* the landlord had lost both his right to receive the full rent, *and* his right to forfeit the lease for non-payment of that full rent. The reasoning goes that if a CVA provides for future rent to be varied, and the landlord retains his right to take back the premises, then on this potential ground at least, the CVA is not unfair. While CVAs will remove the landlord's right to forfeit as a result of the CVA (not doing this would remove the benefit of the CVA), they tend to counter-act this with a contractual right for the landlord to call for a surrender or assignment of the lease. Indeed, several retail CVAs have proceeded on this basis (for example the Bowlplex, Travelodge and Fitness First CVAs), although the concept has not to date been the subject of court proceedings. CVAs typically also contain provision for a 'pot' of cash, generated from profits realised in the CVA, to be set aside for landlords of compromised leases, to compensate them for the cost to them of the compromise.

Can a CVA bind landlords to future changes to the underlying leases?

A legal lease cannot be varied other than by deed,[3] and a CVA is not a deed. However, a CVA can impose a contractual moratorium on the enforcement by the landlord of their rights against the company in CVA. If it is approved correctly, the CVA binds all creditors, including those who dissented. These two concepts appear contradictory, and the question has not yet been considered by the courts. It would seem logical that, following the conclusion of a CVA, the rights of creditors are no longer subject to the conditions contained within the CVA, and revert to the pre-CVA position. It is certainly arguable that there is a risk that a court may find that the terms of a voluntary arrangement cannot effect a valid amendment to a lease. Alternatively, a court may take a commercial, pragmatic view, and conclude that a CVA proposal containing purported amendments to a lease, which was effected to save a business, was supported by the majority of creditors, and was approved correctly, should be upheld. Given the inherent risk, it may be that the CVA should simply contain a framework for negotiation of permanent changes to leases within agreed parameters set out in the CVA, such negotiations to be commenced within 12–18 months of the end of the CVA. This means that the company and its directors will have to undertake a programme of engagement with individual landlords but it may be necessary if an extension of the CVA is to be avoided.

Can a CVA unilaterally effect a surrender of a lease?

A surrender of a lease is a consensual act, requiring the agreement of both landlord and tenant. It can occur by operation of law, or by express agreement between landlord and tenant in a deed of surrender.

The work-around that was tested in the Bowlplex CVA and has been used in other subsequent CVAs is as follows. Landlords whose leases are categorised as not forming part of the business going forward, but who have a 'soft landing' of the agreement of the company to pay, say, six months' reduced

> "Alternatively, a court may take a commercial, pragmatic view..."

rent until the leases have to be terminated, have the right to deliver to the tenant a notice to vacate. However, if the landlord has not forfeited the lease, or it has not been surrendered by deed or by law, or assigned to an assignee of the landlord's choosing before the expiry of the six-month period, then the relevant lease is deemed to be terminated at that date. The tenant agrees to move out of occupation, hand back the keys, and deliver a deed of surrender to the landlord, along with a completed deed of assignment of all the tenant's fixtures, fittings and chattels at the premises. Effectively, the terms of the CVA purported to amend the underlying lease to insert new rental obligations, and create an agreement for surrender.

Why would landlords accept these terms? The thinking is that for six months » the business rates are paid by the company and the properties are occupied. There are no soaped-up windows and the landlord has a fair run at attracting another tenant. At the end of the term, the premises would be left with all tenant fixtures and fittings intact, which would be beneficial in terms of finding a new operator for the business.

> “.Why would landlords accept these terms?”

Why not merely commute the rent? One of the biggest liabilities associated with being an occupier is business rates. These are payable by the person entitled to possession of the relevant property. Actual occupation does not matter. In order to avoid this liability the tenant needs to put itself in a position of no longer being entitled to possession. It is doubtful that a CVA can effect a valid surrender of a lease, since this would require some form of acceptance by the landlord. However, by unilaterally giving up all its rights and passing the power to the landlord to complete the deed of surrender at any time, the tenant would argue he or she is no longer ‘entitled to possession’.

Whether these terms would stand up to challenge through the courts remains to be seen both in terms of unfair prejudice to a landlord and to remove the tenant from being considered ‘entitled to possession’ for rates liability.

Conclusions

When preparing a CVA proposal that will compromise the claims of a company’s landlords, the directors and advising IP must be mindful of the potential for a landlord, or group of landlords, to bring a claim of unfair prejudice, and take advice as to how likely the proposed terms would be to result in such a claim, and how likely that claim would be to succeed. Statement of Insolvency Practice 3.2, in force from 1 July 2014, makes it clear that an IP advising in relation to a CVA should be satisfied that a fair balance is struck between the interests of the company and the creditors, and he or she should take into account the likely attitude of any key creditors and the general body of creditors, in particular as to the fairness and balance of the proposals. It will always be beneficial to enter into negotiations with affected landlords at an early stage, and to try to find benefits for the landlords in the proposed terms – such as mitigation of their potential liability to empty rates. □

> “Whether these terms would stand up to challenge through the courts remains to be seen.”

[1] See *Prudential Assurance and Others* v. *PRG Powerhouse and Others* [2007] EWHC 1002 Ch at paragraphs 88 – 90

[2] See *Thomas* v. *Ken Thomas Ltd* [2007] 1 EGLR 31 at paragraph 34

[3] See s52 Law of Property Act 1925

BEN JONES is a partner, restructuring & insolvency, at Berwin Leighton Paisner LLP.

BARRY GROSS is a partner, real estate structured solutions, at Berwin Leighton Paisner LLP.

We live in strange times

With the number of UK businesses using invoice financing stubbornly static **Ian Woodley** considers the benefit in times of difficulty.

One feature of the recession was the banks deciding that overdraft funding was no longer what they wanted to do. As had happened in previous times, just when SMEs needed more cash the banks were looking to manage down their risk, especially when it was underpinned by reducing property values.

This should have presented the invoice finance industry with an open goal, as flipping an overdraft into an invoice finance facility is a relatively straightforward thing. So why hasn't it happened – at least, not on the scale that the asset based lenders (ABLs) were expecting?

The benefits

The beauty of invoice finance is that it allows a company to generate cash against the quality of its customers rather than the focus being on its own credit worthiness. Small businesses, especially those wounded by the recession, are ideally placed to raise cash as they start to climb back up the curve.

Still, the number of UK businesses using invoice financing is stubbornly static and many lenders this year are struggling to meet their targets and objectives despite the favourable conditions.

The perception of invoice finance is not always positive. There is a generation of accountants who still refer to it as 'the lend of last resort' – which is both unhelpful and inaccurate. Ironically the banks, which through their subsidiaries dominate the market, don't help matters either as invoice finance is generally only offered once overdraft lending has been stretched to breaking point.

> This should have presented the invoice finance industry with an open goal.

From the customer's perspective there are stock concerns too. It's expensive when compared to overdraft, possibly, but not having enough liquidity is also costly – or in some cases, terminal. Invoice finance also needs a degree of discipline in respect of internal processes, which many SMEs are either unwilling to deliver or incapable of delivering.

It would seem therefore that the ABL industry finds itself between a rock and a hard place but as ever in financial services once a road block is faced, someone will find a way around or over it.

The concept of spot or selective invoice finance is not new. Maybe it has taken the creation of a perfect storm for it to flourish and indeed it's the product that currently, as a firm, we are asked for most.

In essence, the facility is created around a single invoice or a collection of invoices with one customer that can be ring-fenced within the ledger. The debenture holder, usually the bank, would need to waive its claim to this specific debt so conversation number one is to establish whether they are happy doing this. Typically the bank's focus is on property assets and personal guarantees so it is relaxed giving up part of the ledger. It is also faced with the challenge that it has probably already said no to additional cash so won't want to frustrate the customer in their attempt to legitimately raise the money elsewhere. In addition to the bank's support one also needs a good debtor and an understanding of the contractual relationship around the supply of goods or services.

The money is raised for the period until the invoice is paid so is short-term by nature. There is nothing to stop an ongoing relationship forming where the customer dips in and out of the facility on a need basis, so the flexibility is huge.

Its use is best explained by a case we looked at recently.

A business had found a potential purchaser but the deal wouldn't pass due diligence unless a number of creditors were satisfied. The overdraft facility was already full and the bank was unwilling to push it further. The business needed £70k to solve a two-month problem. Its customer base was strong and included a relationship with a multinational blue chip concern whose current invoices were sufficient to cover what was needed. The directors were sure they didn't want a traditional invoice finance facility so its selective cousin was the best option. As the bank had introduced the case they were immediately onside in respect of the waiver so from initial phone call to money in the bank took only three days.

This is no exception; there is a massive growth in the interest in this product.

It will be interesting moving forward to see how the mainstream invoice finance numbers are eroded by short-term selective deals. At present none of the major lenders offer the selective options, it's the domain of the small independents. This is probably because they would rather have a begrudging new customer for a full facility than a happier low-profit short-term one. They may have no option but to change.

> Not having enough liquidity is costly – in some cases, terminal.

This will also change the dynamics between the insolvency profession and the ABLs, as without a debenture, how attractive are ABLs as a business source? So much for reciprocal business…

IAN WOODLEY is the owner of Now Financial.

Provisional liquidations: kill or cure?

Daniel Lewis and **Nyla Yousuf** look at provisional liquidation as an alternative rescue procedure.

As an insolvency procedure, provisional liquidation is usually an emergency measure, directed to recovery in the sense of preservation of assets rather than as a means of business rescue or asset realisation. The appointment of a provisional liquidator as the 'caretaker of assets' can (and usually does) bring an end to the business of the company (a fact that the applicant for appointment must draw to the court's attention and explain why it is not considered appropriate to seek an injunction or to give the company notice of the application (*Re City Vintners*, unreported 10 December 2001, Etherton J)).

There are, however, an increasing number of instances in which the court has used the appointment of a provisional liquidator as an alternative to administration. Although this approach is not perhaps as novel as it first appears, recent cases emanating from the Birmingham District Registry in particular, show that provisional liquidation may be used for the purpose of achieving a more favourable realisation of a company's business or assets than might be achieved in either administration or liquidation.

Developments in the use of provisional liquidation

It is not ordinarily within the powers and duties of a provisional liquidator to realise assets. In *Ashborder BV* v. *Green Gas Power Limited* [2005] EWHC 1013 (Ch) an injunction was granted preventing the provisional liquidators from selling the company's rights in litigation to the same creditors who appointed them. Etherton J considered it:

'…*neither a straightforward nor obvious proposition… that the duty of the provisional liquidators is to realise the assets of the companies for the best value they can achieve at the time. Provisional liquidators are, as the name indicates, appointed provisionally, pending the hearing of the winding up petition. Their appointment… is usually to preserve assets pending the hearing of the winding up petition. They are not liquidators following a winding up order, seeking to realise the assets of the company for the best value they can reasonably obtain.*'

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The courts have, however, been prepared to entertain the use of provisional liquidation more flexibly. In *MHMH Ltd* v. *Carwood Baker Holdings Ltd* [2005] BCC 536 the appointment of a provisional liquidator was sought by a group of FSA-regulated companies providing financial advice to the public and subject to substantial claims for mis-selling. The companies had (before the appointment) entered into an agreement for the sale of the business that was subject to a term providing that if the companies were subject to 'a relevant insolvency event' the buyer would be released from further payment of the consideration. Unusually, a 'relevant insolvency event' was not defined as including the appointment of a provisional liquidator. Moreover, the appointment would enable members of the public to initiate claims under the FSA compensation scheme.

It was contended by the buyer that the use of provisional liquidation was an abuse of process and that it was not open to them to sell the assets. Evans-Lombe J did not agree. He made the appointment, holding that the categories of case in which a provisional liquidator might be appropriate under section 135 of the Insolvency Act 1986 (the Act) was not closed and that the authorities demonstrated 'the flexibility of the remedy'. Enabling the sale of the business protected an asset (the rights to payment under the sale agreement).

A similar flexible approach was adopted in the following cases where administration was either inappropriate or unavailable:

In *Re Daewoo Motor Company Limited* (No. 366 of 2001) (unreported, 18 January 2001) a provisional liquidator was appointed to achieve an orderly disposal of assets under the protective mantle of an automatic stay of proceedings.

In *Re Bank of Credit and Commerce International SA* [1992] BCC 83 a provisional liquidator was appointed to administer the UK affairs of BCCI for a period of over two years so that investigations could be undertaken to see whether it was possible to arrive at a worldwide Scheme of Arrangement.

In *Smith* v. *UIC Insurance Co. Ltd* [2001] BCC 11 provisional liquidators were appointed because administrators could not be appointed in respect of an insurance company.

More recently, in *Re Arm Asset Backed Securities SA* [2014] BCC 252 provisional liquidators were appointed, not because the assets of the company were in jeopardy, but because they were in a better position than the company's directors to progress proposals for a CVA or other arrangement and for an orderly realisation of the company's assets.

The Birmingham cases

Recent cases in the Birmingham District Registry demonstrate a greater preparedness to appoint provisional liquidators not only because administration is inappropriate or unavailable, but where provisional liquidation is regarded as *preferable*. Provisional liquidators are subject to direct court oversight, which may be directed to achieving both a speedy realisation of assets and greater scrutiny of fees.

In *Data Power Systems Ltd* v. *Safehosts (London) Ltd* [2013] BCC 721 His Honour Judge Simon Barker QC was faced with (in effect) two opposing applications for an administration order by rival factions within the company (a shareholder and creditor on one side, a director and creditor on the other). The only issue on which there was agreement was that the company was insolvent. The parties were engaged in a 'turf war' as to the debts owed by the company and as to who should be appointed administrator.

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The evidence before the court was unsatisfactory in a number of respects. The judge concluded that it had not been demonstrated that the purposes of administration (set out in paragraph 3(1) of Schedule B1) would be met. The company had never traded and (aside from an expressed hope) there was no evidence that it could be established as a going concern. There was insufficient evidence to enable the court to conclude that administration would achieve a better result from creditors than being wound up; on the contrary, the evidence suggested that the costs of administration would absorb whatever assets became available to administrators, leaving nothing for unsecured creditors. As there were no secured creditors, the third objective of administration was also not engaged. The court declined to make an administration order holding that, while the threshold for the grant of an administration order is not a high one:

'The circumstances of this case serve as a reminder that insolvency alone is not sufficient to engage the jurisdiction for an administration order to be made, and further that the requirement of para. 11(b) of Sch. B1 is not a mere formality capable of being satisfied by assertions unsupported by cogent evidence sufficient to enable the court to be satisfied that, if an administration order is made, the purpose of administration is reasonably likely to be achieved.'

There was, however, significant plant and machinery that might be realised for the benefit of creditors, but for that to be meaningful the realisation would have to be achieved sooner rather than later. Accordingly, the judge treated the administration application as a winding up petition and appointed a provisional liquidator as a 'neutral person to come in, take over the company, and be charged with realising its assets with a view to raising as much as realistically possible for distribution to creditors as a whole'. That appointment was made with a view to increasing speed and limiting costs. Indeed, the judge kept a watchful eye over the fees of the provisional liquidator, which had to be approved by the court at the outset. The practical considerations of such an appointment for a provisional liquidator are considered further below; one other case is worthy of mention.

In *Re Brown Bear Foods Limited* [2014] EWHC 1132 (Ch) (also before His Honour Judge Simon Barker QC) the court declined to make an administration order and appointed a provisional liquidator. This was despite the fact that (unlike Safehosts) the preconditions for making an administration order *had* been made out. It appeared that the applicant company had made a number of payments to connected parties or for non-business purposes after presentation of a winding up petition. The court was concerned that an administration order would neutralise the effect of section 127 of the Act (so that the dispositions would cease to be void). Although the court could have made an immediate winding up order, this might have had the effect of preventing a more favourable realisation for creditors (since two potential purchasers of trade and assets had already been identified). Instead, a provisional liquidator was appointed with powers to get in and realise the assets of the company, to investigate the circumstances of the questionable dispositions and to apply for a validation order if appropriate.

Practical considerations

1. ***Powers and functions***

Sections 135(4) and (5) of the Act provide that the provisional liquidator shall carry out the functions conferred on him and that his powers may be limited by the order appointing him. Orders defining the scope of the provisional liquidator's powers should be drafted as comprehensively and permissively as possible, albeit consistent with the stated functions, to avoid creditor challenge. Where provisional liquidation is used as an alternative to administration, it is tempting simply to include the administrator's broad powers in Schedule

"Where provisional liquidation is used as an alternative to administration, it is tempting simply to include the administrator's broad powers in Schedule 1."

1; however, that is unlikely to be approved where (at least in part) the provisional liquidator has been appointed with a view to limiting the duration and costs of the appointment. There are also powers for which specific provision should be obtained (in particular those exercisable only with sanction in a winding up by the court, for instance the power to continue to trade).

2. ***Section 127 of the Act***

Where the purpose of the provisional liquidation is the sale of assets, section 127 is potentially engaged (as a disposal post-petition). Providing that the power of sale is specifically provided for in the order, sanction will already have been provided.

3. ***Control and payment of remuneration***

Often the court will wish to retain control of costs and this may form part of the reason for the appointment. It is sensible to prepare a costs budget and seek an order fixing remuneration under rule 4.30(1) and (2) of the Insolvency Rules 1986. A crucial point is that without an order the expenses will not be paid out immediately but instead will rank as an expense in the liquidation. Upon the winding up order being made the Official Receiver will be appointed liquidator under section 136 of the Act (there is no equivalent provision to section 140 of the Act, which allows the court to appoint as liquidator of the company the person whose appointment as administrator has ceased to have effect). Before the provisional liquidation concludes, therefore, approval for the totality of the remuneration and costs should be obtained together with an order for payment out. ◻

DANIEL LEWIS is a barrister at 3 Hare Court.

NYLA YOUSUF is an associate at Farrer & Co.

The doctor will see you now

Ian Gray examines the development of turnaround.

I started my involvement in turnarounds and restructuring in 1990. Since then the way in which the profession operates has changed substantially. When I began, the turnaround profession was small and in its infancy and there was limited awareness of the role. There were, however, some famous 'company doctors'. These included

> Talk about being thrown in at the deep end...

David (now Lord) James and Sir John Harvey-Jones who starred in the BBC television series *'Troubleshooter'*, where he advised ailing businesses. Many of the people who worked with David James are leaders in the profession today.

My early days in turnaround were with Postern Executive Group, which was probably the first turnaround boutique in the UK. Their set up allowed the deployment of teams into failing businesses. We often described what we did as being 'hands on management consultants'. At that time the company doctors tended to replace the management team. The chief executive and finance director would be the first to go. Indeed early in my career I was brought into Tottenham Hotspur, to replace the chief executive. Talk about being thrown in at the deep end. It had every aspect of a turnaround: a dysfunctional board; a bank that was probably in worse financial condition than the club; failing subsidiaries; Department of Trade and Industry and Stock Exchange enquiries; and press attention due to the characters involved. Luckily we won the FA Cup.

Back on their feet

Arguably, the peak period for employment was in 2006–2007 when around 80 turnaround professionals were hired by the NHS. By this time, the term company doctor was becoming obsolete and appointees were titled 'NHS turnaround directors'. This terminology also prevented us being confused with medics, so was probably in the best interests of the patients! In fact one time when I was in Dublin I woke up suffering from back spasms and unable to move. The hotel sent out for a doctor. The Chinese medic who

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arrived didn't understand the sort of doctor I was, and treated me as one of his own; the drugs he administered were so strong that I was back on my feet in no time. If only turnarounds could be delivered as swiftly. In the NHS we were not »

line managers and thus did not have the same leverage and influence as being the chief executive of a business. Instead, we had to adopt a different style and use our skills to show managers how to do things differently.

A specific title

The role of chief restructuring officer (CRO) first developed in the US in the 1990s. The heavy requirements placed on US companies seeking protection through the court-regulated Chapter 11 process meant the role of corporate rescuer had to

> “Good CROs will deploy both strength and diplomacy.”

be closely defined. Therefore the CRO emerged as a board-level appointee anchored in the management structure of the company but with clear responsibilities. In the US CROs are sometimes compared to ‘turnaround’ consultants although the former differ from the latter as a CRO is an official of the company and has executive power. The appointment of CROs in the UK became more common as turnaround boutiques from the US established a presence here. Having a more specific title is important as it makes a definite statement to all stakeholders: if a turnaround expert is brought in as merely an outside consultant or adviser, he or she may not have enough power to do the job.

Duties and remits

The position of a turnaround manager and that of a CRO does not have a precise legal definition in the UK. The role is executive and not advisory and the scope and duties must be clearly defined in an engagement letter. To ensure you have the requisite authority you should report to the chairman or chief executive. The appointment may or may not come with a board position. If not, the executive must ensure that if his actions are deemed to be that of a shadow director, he is covered by the firm’s directors and officers (D&O) insurance policy. There is also the rise in the appointment of turnaround directors as non-executive directors to boards. This has the advantage that the appointment is covered by the company’s D&O policy.

The appointment of a CRO brings with it the individual’s contacts, presence and track record that should, in part, appease the organisation’s creditors. But a CRO’s actual duties may differ widely from

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firm to firm depending on the situation. (It is important that all parties are clear about the CRO’s function as the title is sometimes given erroneously.) The remit can cover these core areas:

- Stabilisation and management of cash and working capital
- Responsibility for the turnaround plan
- Restructuring the balance sheet to handle the debt issues

- Operational restructuring and performance improvement
- Stakeholder management.

Good CROs will deploy both strength and diplomacy; they must be skilled negotiators while still being part of the team. However, it remains a temporary role and the CRO must never look to replace the CEO. By taking responsibility for the additional workload and the swift implementation of restructuring decisions, the CRO allows the board to continue to run the company. Having an expert on hand can be a huge comfort for the management team, however uncertain they may be initially.

Collaborative working

Turnaround experts have assisted financially troubled companies in the reorganisation process for decades. Today, CROs work collaboratively with the whole management team. When a turnaround professional is employed as a CRO, there is an important perception that the person is in full control of the reorganisation process, has a high level of independence, and displays an overriding duty of care to the company. By working collectively the long-term results of restructuring are much more likely to be positive long after the CRO has departed.

“The CRO’s experience and knowledge of restructuring can mean the difference between bank support or default, recovery or failure.”

Banks often facilitate the appointment of a CRO to assist with the varying issues of running a stressed business. However, the incumbent team is frequently in denial and will baulk at letting an ‘outsider’ near the organisation until other options have evaporated. Nevertheless early intervention is essential to increase the options available to stakeholders. The CRO’s experience and knowledge of restructuring can mean the difference between bank support or default, recovery or failure. A successful outcome will mean the survival of the business and save jobs.

Bank pressure

The banks’ influence over appointments is, however, changing. The UK banks today have little by way of distressed assets having spent the last few years tidying up their loan books. The banks have pressures on their cost of capital and that may be driving a different approach to

businesses with problems. We have seen banks divest their underperforming loans by way of portfolio sales. At least one bank takes an approach that unless the organisation can be turned around within about 18 months the client should take their business elsewhere, which can only be achieved by rebanking or a sale. A highly respected turnaround professional estimates it takes as long to ‘fix’ the business as it took to get into the situation. Selling the debt is similar to the strategy adopted by US banks. We may soon be seeing more of this approach in the UK.

There is a huge amount of liquidity in the UK seeking places to invest. There are many US funds that have set up shop here, looking to do deals. They have a low cost of capital (although the investor expectations will not be low) and they have been buying underperforming assets from the banks. If the business is not performing it will still need help. As the debt may have been purchased at a discount it could be some time before the new economic shareholder will seek out the turnaround professional.

So much has changed due to the influence of the internet and the disintermediation of funders. Crowdfunding is still in its infancy but is becoming an increasing source of capital for businesses. It takes its name from the fact that the project is funded by the public. There is some evidence, whether debt, invoice financing, or equity, that this source of funding is being used in underperforming businesses.

The turnaround profession has developed from a handful of individuals to several hundred across Europe, with professional bodies and accreditation. Yet apart from a few turnaround firms, most operators remain sole traders, although some have created teams or umbrella organisations.

Part of the maturity of the industry is therefore the advent of professional bodies and standards. In the UK the Institute for Turnaround (IFT) and in

“A successful outcome will mean the survival of the business and save jobs.”

Europe the European Association of Certified Turnaround Professionals (EACTP) accredit turnaround professionals. Not only is EACTP pan European, from 2015 admission will by examination. Regular educational events and annual conferences are run by IFT, R3 and the Turnaround Management Association, all of which promote high ethical standards and codes of practice.

Challenges and influences

There are many new challenges ahead for the CRO. The volume of work has declined and the influencers have changed from a handful of banks to many US funds and their advisers. With the influence of so many US funders will the UK move towards a more US style corporate rescue? Will restructuring be done under Chapter 11 and under the jurisdiction of courts in New York? The market is likely to be quiet for another 18 months until some of the new lending works its way through. The need to market to many more organisations could lead to consolidation, as has been the case with other professional organisations, such as lawyers and accountants. Thus, the future looks very different from the early days of a handful of ‘troubleshooters’.

IAN GRAY of Baronsmead Consulting

The creditors' claims: a conclusion

Simon Duncan reviews and concludes his series of articles on creditors' claims.

Creditors' claims – a summary

- A liquidator does not have standing to bring a claim against a delinquent director pursuant to ss216/217 Insolvency Act 1986 or s15 of the Company Directors Disqualification Act 1986;
- The right to bring such claims is conferred by statute on the creditors and that cause of action cannot be assigned;
- A right of contribution will not arise in a nil asset estate but even when it does arise it can cause unexpected difficulties;
- A liquidator cannot act as a representative of the creditors pursuant to CPR 19.6;
- A debt can be assigned to a third party in some circumstances and the assignee may bring a claim.

The creditors' claims ss216/217 Insolvency Act 1986 and s15 of the Company Directors Disqualification Act 1986.

Section 217 of the Insolvency Act 1986 (IA) and s15 of the Company Directors Disqualification Act 1986 (CDDA) are derived from the same source and aimed at the same mischief. That is to say these sections make delinquent directors co-debtors with the company for the company's debts. In doing this, these sections strengthen creditors' rights of redress. They allow creditors to act when the evidence suggests that a 'phoenix' company has resumed the failed company's business improperly, or when creditors have lost money in the liquidation of a company run by a disqualified director.

Although the Acts themselves are silent as to who may bring a claim pursuant to these sections, the case law makes it clear that it is the creditors that have the requisite standing (see the Phoenix Phenomenon Part 1 in *RECOVERY* spring 2013) and *Re Prestige Grindings Ltd* [2006] B.C.C. 421.)

> "These are derived from the same source and aimed at the same mischief."

Prestige Grindings Limited entered creditors' voluntary liquidation on 06 February 2004. Mrs Sharma was appointed as the liquidator. From incorporation to liquidation, the only persons to act as officers of the company were Mr Yardley and Mr Hill. Mr Yardley was appointed as a director on 1 June 2001 and resigned on 21 January 2003. He was disqualified from acting as a director for seven years on 11 February 2003. Mr Hill was appointed as a director and secretary of the company on 20 April 2000 and remained a director at the date of liquidation.

Mrs Sharma alleged that despite his disqualification Mr Yardley continued to be a *de facto* director of the company, and that Mr Hill permitted this. Creditor claims in the liquidation amounted to £191,795.

Mrs Sharma issued an application inter alia for relief pursuant to s15 of the CDDA. The court listed a hearing to determine, as a preliminary issue, whether Mrs Sharma as liquidator had a right to bring such a claim against Mr Yardley and Mr Hill.

His Honour Judge Norris QC made the following statement:

'In my judgment s15 creates two separate sets of rights. To put the matter shortly and simply, it first makes the disqualified director personally responsible for all the relevant debts; and it secondly provides that the disqualified director is jointly and severally liable with the company for those debts. The first confers on the *creditor* a separate statutory cause of action against the disqualified director to supplement his contractual right against the company; the second gives the company a right of contribution from someone who by statute has become its co-debtor. *The section does not confer on the company (co-debtor A) the right to sue the disqualified director (co-debtor B) for the amount of the debt that is owed to C.* That is what paragraph 2 of the originating application seeks when it asks the court to make an order that Mr Yardley pay to the company the value of the relevant debts.

But *such a right is unknown to the general law and I hold that it cannot be spelled out of the words of the section*. The personal responsibility created by the sis to the creditor and with the company. The section does confer on the company the right to recover from the disqualified director a contribution in circumstances where the general law so allows. It is that right that the liquidator has under s15 and can enforce,' (my emphasis).

Misinterpretation

Unfortunately, this last sentence is frequently misinterpreted and even the main practitioner text in this area fails to make the point clear. The general law will allow a right of contribution where joint and several debtors exist (as here, the disqualified director and the company) and one has paid out more than his share of the debt. In these circumstances he can recover the excess from the other in equal shares. In a nil asset estate, there will not have been any distribution on the part of the company sufficient to set up a right of contribution from the company against the disqualified director (the company's co-debtor).

> "In these circumstances he can recover the excess from the other in equal shares."

In *Prestige*, an application was made pursuant to CPR 19.6 to allow the liquidator to act as a representative of the creditors. This was seen as a possible way around the problem of having insufficient standing to bring a claim (see the Phoenix Phenomenon Part 2 in *RECOVERY* summer 2013.)

It was argued that both the liquidator and each creditor had a common interest in establishing that of the former directors, Y was disqualified and H knew this but permitted him to act as he did. It was argued that they also had a common interest in establishing the periods during which they so acted in order to identify the 'relevant debts.'

The same interest test

However, this shared purpose was insufficient to satisfy the 'same interest' test as required by CPR 19.6. Each creditor has a direct statutory right of action in respect of the whole debt against the disqualified director, whereas the liquidator has only a right to claim a contribution where the general law so allows. Accordingly the interest was not the same interest and the application failed.

Even if it were possible for the liquidator to act in this capacity, the right of contribution can have other unintended consequences. The liquidator's claim is for the company's estate, whereas the creditor's claim is for himself. The consequence for a liquidator of pursuing a contribution claim against the former director when the company's estate has no assets and has made no distribution is to create a contribution claim by the former director against the liquidation estate. This is because they are co-debtors for the debts owed. This contribution claim will run counter to the liquidator's claim, though the ladder of priorities will ensure that the ranking of any such claim against the company will be below that of the liquidation expenses.

The situation is considerably more difficult where a distribution has been made to unsecured creditors (see the Creditors' Claims (3) 'The Trilateral Scenario.')

Sound authority

In any event, as was pointed out in *Prestige Grindings*, 'the liquidator is not an agent for the creditors, let alone one particular group. A voluntary liquidator is more rightly described as the agent of the company, an agent who has cast upon her by statute and otherwise special duties which include the duty of applying the company's assets in paying creditors and distributing the surplus among the shareholders, see *Knowles* v. *Scott* [1891] 1 Ch 717 at p722' (cited with approval).

Although a cause of action conferred by statute on the creditors cannot be assigned, there is sound authority for the proposition that an unsecured creditor, who is perhaps reluctant to bring a claim pursuant to s217 IA or s15 CDDA, may assign his debt to a third party. That third party could then bring a claim as the assignee/creditor. (See *First Independent Factors & Finance Ltd* v. *Mountford* [2008] EWHC 835 (Ch.))

A liquidator would be conflicted from taking an assignment of this sort, unless the informed consent of 100 per cent of the unsecured creditors could be obtained. It is possible to envisage circumstances in which such consent might be obtained where there are only a very small number of active creditors, prepared to sanction such an arrangement. Otherwise, one would anticipate an assignment to a third party who could then bring the claim.

The end of involvement

The practical difficulty for a liquidator is that this may mark the end of his involvement. While the assignee may have bought the debt, he has not bought it from the liquidator. If the assignee can pursue the claim without the liquidator's assistance then there is nothing in this process for the liquidator of the liquidation estate.

An agreement that stipulates that the liquidator can share in the proceeds of the resultant litigation may produce a conflict of interests. This is because the liquidator is responsible for adjudicating on creditor claims. A joint appointee for this purpose would add to costs. There would also be the risk that the liquidator would be in receipt in his fiduciary capacity of a secret profit.

One solution to these difficulties would be to ensure that no proceeds of the litigation itself were paid over to the liquidator. Instead, the assignment could provide that the proceeds of the litigation be applied for the benefit of the general body of creditors. The difficulty might be reaching such an agreement with both the assignor and the assignee. To take one extreme, if there was nothing in the litigation for the third party assignee then to what extent could this be said to be a genuine assignment?

Conclusion

The safest course where the facts support a good claim against the former directors pursuant to s15(1) of the CDDA would be to encourage the creditors to issue proceedings on their claim. An alternative would be to instigate an assignment of a relevant debt to a third party on terms that would, if the litigation resulted in a recovery, produce a return to the creditors in the estate of the company concerned. This is not likely to appeal to every liquidator because it is novel, and depends on the willingness of the creditors, the third party assignee and the liquidator to agree workable terms.

> "The general law will allow a right of contribution where joint and several debtors exist."

The broader question to consider is why a regime introduced to offer unsecured creditors a route to redress should not be actionable by an office holder such as a liquidator. A liquidator is best placed to bring such a claim on behalf of the company in liquidation. If such a claim is brought successfully then this action may result in a dividend to creditors. If disqualified directors knew that such a claim could be brought by an office holder then this might discourage them from acting while disqualified. The risk of such an action being brought would therefore serve an additional purpose; that of public policy. It would discourage unlawful conduct on the part of disqualified directors. ◻

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SIMON DUNCAN is a solicitor at Moon Beever Solicitors.

Keeping liquidation clean

Emma Collins provides an overview of the legal and practical issues of environmental risk that an officeholder should consider both prior to, and during, an appointment.

Environmental risk is an important consideration when taking an appointment as an administrator or liquidator of a company, particularly where the company operates a regulated business.

Considerations prior to appointment

If the business operated by the company requires a licence/permit to trade, consideration needs to be given to the types of licences/permits held by the company and whether these are sufficient for the operation of the business. If the licences/permits are held by third parties (such as other group companies or the individual directors and/or shareholders) what visibility and/or control will an office-holder have upon appointment?

> “If an office-holder knowingly allows the breach to continue this would leave an office-holder potentially liable to prosecution.”

Any purchaser of the business will need to hold the relevant permits/licences so it will be important to ascertain whether the licences/permits held by the company are transferable to a third party and whether there is any monetary value to be realised in the transfer of the licences/permits.

It will be important to find out whether the licence-holder has breached any condition of the licence/permit prior to appointment and whether any such breach is continuing. If so this could result in:

i) Increased risk to the office-holder on appointment – if an office-holder knowingly allows the breach to continue this would leave an office-holder potentially liable to prosecution;

ii) A risk of a monetary penalty being levied against the company, which may rank as an expense of the administration or liquidation;

iii) A negative effect on the value of the business – particularly a continuing breach is likely to have a negative impact on the value a third party will pay for the business as the cost of remedying the breach could be prohibitive;

iv) A breach of certain licences/permits can be a criminal offence, which may require the office-holder to make anti-money laundering notifications and obtain clearance to continue to act.

Contaminated land

Part 2A of the Environmental Protection Act 1990 contains the regime for historically contaminated land. The primary remediation liability rests on those who cause or knowingly permit the contamination; if they can't be found, on the current owners or occupiers of the land. The legislation provides that an office-holder shall not be personally liable for remediation unless the contamination is as a result of any act done or omission made by him that it was unreasonable for a person acting in that capacity to do or make.

> “The primary remediation liability rests on those who cause or knowingly permit the contamination.”

While it is helpful that the role of an office-holder is recognised in an insolvency situation there is little (if any) precedent on what constitutes ‘unreasonable’. So, for example, consider a scenario where, prior to appointment, the company had stored some contaminant on its land that

happened to be leaking into the ground and upon appointment the office-holder failed to take action to stop the leakage and clean up the site as there were insufficient assets to cover the costs in doing so. In that situation, would it be deemed to be

> "Upon a pre-pack business sale an administrator would be advised to make contact with the Environment Agency."

reasonable for the office-holder not to remediate despite having no funds to do so? This highlights the importance of thorough environmental due diligence prior to appointment.

Waste management

Waste activities are regulated by the Environmental Permitting (England and Wales) Regulations 2010. The Environment Agency has issued guidelines covering the financial difficulties of waste management operators that (inter alia) suggest that in principle the agency is supportive of a transfer application in situations where the licence-holder is suffering from financial difficulties (to avoid the disclaimer of the licence and the resulting liability falling back on the agency).

If a transfer of a licence/permit is required as part of a business sale it is important that the office-holder makes early contact with the agency to engage with one or more individuals who will be dealing with the transfer. This enables the office-holder to secure a point of contact throughout, which makes for a swifter and more transparent process. It is also worth noting that upon a 'pre-pack' business sale an administrator would be advised to make such contact with the agency (as, potentially, one of the company's largest creditors) in compliance with the SIP 16 guidance.

It is also essential that the proposed purchaser engages with the agency at the earliest opportunity. The agency will be concerned as to whether the replacement operator will be able to operate the facility in accordance with the licence/permit. In addition, the agency will require the purchaser to employ a person with a certificate of technical competence.

The transfer process can take a number of months during which the purchaser is likely to trade the business with the licence/permit held by the insolvent company. It is therefore vital that the office-holder (1) ensures there are comprehensive contractual obligations and safeguards within the sale documentation obliging the purchaser to comply with all necessary environmental legislation/regulations and the conditions of the permit (and indemnifying the company and office-holder for any breaches) and (2) maintains a 'watching brief' over the purchaser's operations and progress of the transfer application.

On a practical level, it is important for the office-holder to be ready to take action to suspend the purchaser's operations and to be in a position where he/she is able to disclaim the licence/permit if the breaches are continuing and the risk of action by the agency against the company and/or the office-holder becomes too great.

Disclaimer

An important tool at a liquidator's disposal is the power to disclaim onerous property and contracts. In *Re Celtic Extraction Limited [2001] Ch. 475* the Court of Appeal held that waste management licences (now environmental permits) could be disclaimed as onerous property and that s178(3) Insolvency Act 1986 could only be excluded by express provision. Care should be taken to determine whether the licence/permit in question is capable of disclaimer or whether some more lengthy surrender process is required (for example mining operating licences are incapable of being disclaimed and require a consensual surrender process).

At the outset of an administration appointment the office-holder should ensure the proposals contain the ability to move the company to liquidation (either voluntary liquidation where there is likely to be a distribution to unsecured creditors, or otherwise, compulsory liquidation) upon the exit from appointment of the administrators to allow for a swift disclaimer process, should this prove necessary.

Circumstances may arise (as highlighted in *Re UK Coal Operations Limited [2013] EWHC 2581 (Ch)*) where the risks involved with acting as office-holder of a company that holds one or more onerous licences/permits are such that the company must swiftly be placed into liquidation in order to disclaim those

> "Mining operating licences are incapable of being disclaimed and require a consensual surrender process."

permits as onerous property. As part of the UK Coal restructuring in July 2013 it was necessary for the main operating company to be placed into administration and a sale of the business effected by the administrators. However, the risk of continuing to hold onerous property (land and permits) relating to the mine at Daw Mill (which suffered a catastrophic fire prior to appointment) were such that it was imperative that the company be placed into liquidation as soon as possible after completion of the business sale in administration. A court order was therefore obtained directing the administrators not to comply with paragraphs 49 and 51 of Schedule B1 to the Insolvency Act 1986, which enabled the company to be placed into liquidation just three days after the administrators were appointed. This enabled the liquidators to disclaim the onerous property and contracts and reduce the risk of increased creditor claims against the company and risk to the office-holders themselves.

Conclusion

There are increased environmental risks associated with taking an appointment as office-holder over a company subject to environmental regulation/permitting. However, our experience shows that, with comprehensive due diligence carried out prior to appointment and early and regular contact with the Environment Agency and other relevant regulators, those risks are capable of management and mitigation. ◻

EMMA COLLINS is a managing associate for Addleshaw Goddard LLP.

Forty years and counting

Debbie Sams and **Ellen Launchbury** examine the impact of health and safety on asset disposals.

It has been 40 years since the introduction of the Health and Safety at Work Act (HSWA), following the findings of the Robens Report published in 1972 and the insolvency profession is no less immune to the legislation than any other sector.

The Robens Report highlighted the desperate need for change and the 1974 Act brought about immense improvements in the workplace; 40 years ago fatalities to employees covered by the legislation in place then stood at 651, whereas, figures for employee fatalities in 2013/14 have fallen to 133.

The Act was built upon a set of recommendations that remain the framework for existing and new legislation today. These recommendations were designed to:

- Introduce a single Act covering all workers that would contain general duties designed to 'influence attitudes'.
- Cover all those affected by the employer's undertaking such as contractors, visitors and members of the public.
- Place an emphasis on health and safety management and development of safe systems of work.

The emerging Act created a flexible system where regulations describe goals and principles, supported by codes of practice and guidance. Forty years on this still applies and remains relevant when applied to new and emerging technologies and sectors. The insolvency practitioner (IP), in 'assuming' the position of employer, takes on the ongoing responsibilities and liabilities of the former organisation, inheriting any bad practices and declining investment whether trading the business on with a view to a business sale or its closure and sale of assets.

So whose duty is it to care?

In my experience, understanding whose duty it is to oversee and maintain a safe and healthy working environment varies across the industry. This is particularly prevalent for those activities to which an agent/auctioneer is appointed, namely the selling of assets (sale of secondhand equipment) and the clearing of sites following the sale, which fall under the principles of the Construction (Design and Management) Regulations 2007 (CDM). This can be more easily understood by reverting back to the general duties of the HSWA as a chain of responsibilities, in which 'all' parties engaged on an appointment have duties, responsibilities and accountability (sections refer to that part of the HSWA):

> "Forty years ago fatalities to employees covered by the legislation in place then stood at 651 whereas 2013/14 figures have fallen to 133."

- Duties of employers (IP) to employees – the IP and their agent (s2).
- Duties of employers to others affected by their undertaking – members of the public, contractors and customers (s3).
- Duties of landlords or owners (s7).
- Duties of suppliers – site clearance contractors covered in more detail later (s6).
- Duties of employees – IPs (s7).
- Personal liability of directors (s37).

IPs and the agents they appoint are personally, as well as professionally, liable for any health and safety failings. Failure to comply with the regulations can have serious repercussions for firms and their employees. The IP must ensure that the agent is competent and trained, and in turn, the agent must ensure the contractors they employ are responsible and suitably qualified for their respective tasks. Ultimately, however, it is a legal duty of the administrator/liquidator at the top of the chain to verify the competence and resources of all organisations and internal teams instructed on a project, placing emphasis on minimising risk.

Exceptional circumstances carry their own risk too, for example, in the case of shared occupancy where employees acting on behalf of another organisation could cross the threshold and become the responsibility of the administrator of the distressed business. This is why it is critical that an in-depth understanding of health and safety is drawn upon.

Compliance with benefits

Asking the right questions and ensuring the competence of agents and contractors not only secures compliance, it offers valuable peace of mind. And while full compliance on the face of it appears to increase costs, the penalties, in the event of a serious incident, are unlimited. Effective management of health and safety, as well as being vital to employee 'well-being', has a general role to play in helping to achieve high performance teams, enhancing the reputation of the business and leading to financial benefits to the business. The clear business benefits to safely managing a sale include:

- Professionalism.
- Enhanced asset realisations.
- Minimised costs (efficient clearance activities, minimised dilapidation issues).
- Reduced risk of incidents/claims.

Dispelling the myth 'sold as seen'

Corporate responsibility has various definitions but broadly speaking it covers the ways in which organisations manage their core business to add social, environmental and economic value in order to produce a positive, sustainable impact on both society and the business itself. Within this framework we accept that there are many obstacles to achieving good standards and performance targets. Environmental factors, financial constraints and human factors are typical examples, but we have also had to examine some inherited myths and practices, the main one being 'sold as seen'.

Anyone supplying secondhand equipment for use at work must ensure, so far as reasonably practicable, that it is safe and without risks to health.

Auctioneers are deemed to be 'supplying' articles (including equipment) within the meaning of s53 of the HSWA and so have duties under s6. Under s6, the level of control over the goods to be

> "Anyone supplying secondhand equipment for use at work must ensure, so far as reasonably practicable, that it is safe and without risks to health."

auctioned is variable depending on the exact role to be undertaken. The seller also has duties and so the overall duty must be accepted by both parties as a shared responsibility. This can be further explained as follows:

Where the auctioneer acts purely as a broker and has no input into the product description, not having had sight or knowledge of the goods to be sold, then the seller would be more familiar with the goods than the auctioneer and would have a greater responsibility to meeting the duties than the auctioneer. This circumstance is mostly attributed to the non-insolvent/corporate client.

Where the auctioneers have examined, valued and catalogued the items, they are considered to have a greater responsibility than the owner/seller. This circumstance generally arises where administrators/liquidators instruct auctioneers to sell assets on their behalf.

The term 'sold as seen' or any similar phrase should not be used to avoid the legal responsibilities and if the machinery is clearly unsafe to a layperson then the auctioneer's liability will not be mitigated. Under these circumstances the auctioneer aims to ensure that, as far as health and safety aspects are concerned, equipment is supplied in the same condition with regard to its safety as when the product was originally placed on the market or first brought into use. In managing their own liabilities, auctioneers are likely to seek documentary evidence, such as a copy of the original equipment's instructions in English, locate records of inspection and/or conduct a thorough examination and apply a risk-based approach to each item.

An IP's efforts to locate and preserve these documents in the early stages of appointment reduces the risks of selling unsafe equipment and gives provenance to equipment, which enhances equipment's realisable value. Alternatively the auctioneer may mitigate risk by declaring the appropriateness for onward use as an unknown safe condition with specified make safe actions or concluding a sale via a dealer at a reduced price.

Mitigation of risk

There is a popular belief that there has to be an accident or injury for a prosecution to be made; however, health and safety focuses on prevention and encourages reasonably practicable prevention of exposure to risk for employees, visitors and members of the public affected by the activity.

Risk elimination is not always practical, but good planning, cooperation and coordination will allow everyone to focus on a successful sale. These principles underpin CDM, and practitioners should not be confused by the reference to 'construction'. The definition under the regulation offers a wide scope of activities, which includes those associated with the dismantling of plant and machinery. Many of the activities associated with the removal of equipment fall firmly within the construction industry, such as electrical works, working at height, exposure to asbestos and control of contractors.

Under the Management of Health and Safety at Work Regulations, employers are obligated to assess the risk of their intended activities under their appointment and IPs should seek to establish the risks associated with asset sales and their subsequent removal. The appointed agent/auctioneer has an important part to play in this area and at the point of instruction would arrange for a site survey that examines the range of site-specific hazards and explores a variety of ways to manage risks associated with the sale and clearance process. Such a survey should consider additional matters such as site set-up and security, traffic management, welfare provision, fire safety, hazardous substances, first aid and emergency arrangements.

Control of contractors

While it is rare that IPs appoint clearance contractors directly, they must ensure that the instructed auctioneer will only engage contractors who are competent and capable of completing the work asked of them. The control of contractors has a vital role in minimising risks throughout clearance activities, where there is a potential for many people and trades to be working on site simultaneously. All sales will require the use of contractors, whether a lift-out contractor is used, an electrician brought in to carry out disconnections or the simple collection of assets sold. However, by applying the basic principles of CDM, all sales can be effectively managed.

To break this down further, it should be common practice to assess the competence of contractors and request information on how the work they will carry out will be completed without risk to health and safety. There are many opportunities to provide information to contractors via site rules, signage, the site pack, reception board, induction and daily briefings. Obtaining Risk Assessments and Method Statements (RAMS) from contractors, and reviewing them to ensure they are suitable and sufficient, provides confidence that contractors have considered the environment and the tasks they are to undertake in terms of risk and safe working practices, further minimising risk of accident or injury occurring on site.

An eye to the future

In summary, IPs benefit from understanding the scope of their responsibilities in terms of a safe environment, provision of information and employment of competent agents and contractors, applying the principles of the CDM to help reduce the safety risks. This is more relevant now, than it has ever been as

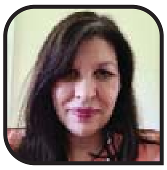
> "The term 'sold as seen' or any similar phrase should not be used to avoid the legal responsibilities."

health and safety continues to evolve and we live in a litigious world. Importantly following the Lofstedt and Lord Young's report, legislation is being revised and simplified.

Imminent changes to CDM will reverberate across all sectors. For the first time, even domestic projects will fall under CDM, together with proposed changes to 'notification' criteria, which define the point at which projects need to be notified to the HSE. Although reduction in bureaucracy is always welcome, there is a concern across the health and safety industry that these changes will not be easily understood by SMEs and that many of the changes, for example, removal of the Approved Code of Practice (ACoP), transference of roles and explicit competence requirements, will not strengthen CDM efficacy.

The consultation period has now ended and the results are eagerly awaited ahead of the April 2015 implementation. At this point, the impact of the changes is difficult to estimate. Watch this space!

DEBBIE SAMS is a divisional director at ES-Group Ltd.



ELLEN LAUNCHBURY is a director at Optimus Safety Ltd.

Insolvency practitioner fees in the UK – all alone in the world?

With the UK insolvency regime so highly regarded by the World Bank, will changes prove a costly mistake?

Introduction

The issue of insolvency practitioner (IP) fees has long been a controversial subject in the UK. The government has recently carried out a consultation (the consultation) looking at the regulatory regime governing IPs generally and IP fees in particular.[1] The consultation draws on the evidence from two independent reviews of IP fees. The first, reporting in 2010, by the Office of Fair Trading[2] considered, *inter alia*, fees charged in a sample of 500 administrations commenced in 2006. The second, conducted by Professor Elaine Kempson reported in 2013 (hereafter Kempson).[3] Both the OFT and Kempson identified that IPs charged differential fees depending upon whether a secured creditor had influenced the appointment of the IP (by the use of formal or informal panels). Where there was a secured creditor, it was common for the IP to provide a discount compared to cases where there was no secured creditor. This led the OFT (upon whose findings Professor Kempson relied) and Kempson to conclude that unsecured creditors were being overcharged by IPs.

> “This led the OFT and Kempson to conclude that unsecured creditors were being overcharged by IPs.”

Although Kempson did not make such a recommendation, the government has latched onto the apparent unfairness of this differential charging policy, by consulting on a new system for setting fees. The consultation proposes that in future, in general, where there is no secured creditor (or where secured creditors are paid in full), an IP's fees will be set on one of two bases:

1) a percentage of total realisations and/or distributions or
2) fixed fees. The current, almost universally adopted, time cost basis will no longer be available to IPs in the UK in such circumstances.[4]

> “The government has latched onto the apparent unfairness of this differential charging policy.”

Comparison with other jurisdictions

There are a number of potential dangers in adopting the change suggested by the consultation. One significant problem is that such a system would be out of line with those used overseas. If, as will be suggested, fixed fees are not widely used

The World Bank's top 20 world economies in terms of insolvency resolution**

Economy name	Rank	Time (years)	Cost (% of estate)	Recovery rate (cents on the dollar)	Main method of calculating IP fees
Japan	1	0.6	4	92.8	
Norway	2	0.9	1	91.3	
Finland	3	0.9	4	90.2	
Singapore	4	0.8	3	89.4	time cost
Netherlands	5	1.1	4	89.2	time cost
Belgium	6	0.9	4	89	
United Kingdom	7	1	6	88.6	
Ireland	8	0.4	9	87.6	time cost
Canada	9	0.8	7	87.3	
Denmark	10	1	4	87	
Iceland	11	1	4	84.5	
New Zealand	12	1.3	4	83.3	time cost
Germany	13	1.2	8	82.9	% of realisations
Austria	14	1.1	10	82.4	
Korea, Rep.	15	1.5	4	82.3	
Taiwan, China	16	1.9	4	81.8	
United States	17	1.5	7	81.5	
Australia	18	1	8	81.3	time cost
Hong Kong SAR, China	19	1.1	9	81.2	time cost
Sweden	20	2	9	75.5	
Spain	22	1.5	11	72.3	% of realisations
Italy	33	1.8	22	62.7	% of realisations
France	46	1.9	9	48.3	Less than €75,000: fixed fee Greater than €75,000: time cost
South Africa	82	2	18	35.5	% of realisations

abroad, it might be that the government's commitment to the introduction of such a new system might impact on the reputation the insolvency regime in the UK currently enjoys worldwide.

> "A new system might impact on the reputation the insolvency regime in the UK currently enjoys worldwide."

The World Bank's *Doing Business* project provides objective measures of business regulations and their enforcement across 189 economies. As part of this study, *Doing Business* assesses the time, cost and outcome of insolvency proceedings involving domestic entities. The ranking on the ease of resolving insolvency is based on the recovery rate for creditors. The cost of the proceedings is recorded as a percentage of the estate's value. The UK economy is ranked seventh.

The table** replicates the main datapoints recorded in relation to the World Bank's top 20 world economies in terms of insolvency resolution (and additionally shows the respective rankings of Spain, Italy, France and South Africa). We have added an additional final column to eleven of those jurisdictions to show the predominant method of calculating IP fees in those jurisdictions.

A flavour of these jurisdictions may be provided by looking in outline at three specific jurisdictions.

In Singapore, as in the UK, the time cost basis is virtually universally adopted. In 2005, the Singaporean Law Reform Committee[5] did not consider fixed fee arrangements as 'appropriate for determining the remuneration of insolvency practitioners'[6] and commented that the 'practice of charging fees by way of percentage is irrelevant in modern day insolvency practice and should be repealed in the Act.'[7] No such repeal has been effected but it is clear that Singapore holds very closely to the time cost basis.

> "It would appear that Italians believe their system compares unfavourably with remuneration across Europe."

In Italy, the remuneration of a trustee in corporate bankruptcy proceedings is primarily calculated as a percentage of assets realised, with the percentage varying depending upon the value of the assets »

realised. It would appear that Italians believe their system compares unfavourably with remuneration across Europe.[8]

In France, liquidators' fees are charged on a fixed fee basis unless total fees exceed €75,000, in which case the liquidator submits a claim to the court. A fixed fee is received for the reorganisation or safeguard proceedings with further proportional fees received for acts including registering and checking creditor claims, continuation of business operations, sale of various assets and payment of creditor claims. A claim in excess of €75,000 is made on the basis of time spent on the case with appropriate supporting evidence. A French judge has commented extra-judicially: 'A realistic remuneration system should, however, be based on the amount of time invested by the liquidator, not on fees for individual 'micro-tasks'; but the French government has issues with accepting a remuneration system based on the liquidator's expenditure of time.'[9] It seems the element of fixed fee remuneration is not universally popular in France. It is interesting to note that the French insolvency system is ranked number 46 by the World Bank.

> "The French government has issues with accepting a remuneration system based on the liquidator's expenditure of time."

Conclusion

Although we have only considered a sample of overseas jurisdictions, the pattern suggests a number of general points. All jurisdictions considered have, to some extent, adopted a system where IPs are predominantly or only paid either on a time cost basis or as a percentage of realisations or as a mixture of the two methods. The only exception that has been identified is lower value liquidations in France where the set fees total less than €75,000. Those jurisdictions reviewed in the top ten of the World Bank listings use predominantly the time cost basis.

Remuneration across the globe is always open to the taxation or scrutiny of the court on the application of, among others, the debtor's creditors. In some jurisdictions, certain procedures require the court to assess the fairness of the fees in all cases. Some jurisdictions have statutory limits for how much can be charged per hour/day (eg Hong Kong, the Netherlands, Ireland, and New Zealand) for some procedures, although these limits are not always adhered to in practice. Other than low value cases in France, we have not come across any evidence of a jurisdiction where there is either a requirement for fixed fees or where the use of fixed fees is commonly encountered in practice. We have come across no jurisdiction which draws a distinction between cases where a secured creditor is involved and those where it is not. The consultation's lack of uniformity in its proposed approach to IP fees would be contrary to overseas practices and the recommendations of the Cork Committee.[10]

Those jurisdictions that rely significantly on percentage realisations in setting IP fees show that in order to ensure some fairness in how high a percentage can be charged, some differential seems necessary depending upon the value or class of assets being realised. This type of system is not viewed particularly positively in, for example South Africa, and the potential problems in designing an effective and user friendly system appear significant. It is interesting to note that those countries reviewed here where percentage fees are widely adopted appear lower down the World Bank rankings than the UK.

> "It is interesting to note that those countries reviewed here where percentage fees are widely adopted appear lower down the World Bank rankings than the UK."

It would seem at best a brave decision by the government to alter a fundamental part of the UK insolvency regime when the current system is so highly regarded by the World Bank. It may prove to be a costly mistake to ignore the lessons from abroad. ◻

1 *Strengthening the regulatory regime and fee structure for insolvency practitioners* consultation by the Insolvency Service (2014).
2 Office of Fair Trading *The market for corporate insolvency practitioners: A market study* (June 2010) OFT1245 found at www.oft.gov.uk/shared_oft/reports/Insolvency/oft1245.
3 Review of Insolvency Practitioner Fees: Report to the Insolvency Service Elaine Kempson (July 2013) found at https://www.gov.uk/government/publications/insolvency-practitioner-fees-a-review.
4 It will still be available where there is a secured creditor who will not be paid in full.
5 *The Remuneration of Corporate Insolvency Practitioners and Certain Related Matters* (October 2005) found at: http://www.sal.org.sg/digitallibrary/Lists/Law Reform Reports/Attachments/ Remuneration of insolvency practitioners - final.pdf
6 *Ibid* at para 48.
7 *Ibid* at para 54 c.
8 See the comments of Luciano Panzani, President of the First Instance Court of Torino in H Vallender *The Remuneration of the Insolvency Representative in Europe* INSOL Europe Judicial Wing (Sept 2012) at p 70.
9 *Ibid* at p 39 (comments by Yves Merlat, Honorary Judge at the Commercial Court of Evry).
10 *Insolvency Law and Practice, Report of the Review Committee* 1982 Cmnd. 8558 at para.890.

* This article is an abridged version of an article with the same name that appears in full in (2014) 27 *Insolvency Intelligence* 86. We are most grateful to the editors of *Insolvency Intelligence* for their consent to this version appearing in *RECOVERY*.

** The table presented in this article is an abbreviated form of one available at: http://www.doingbusiness.org/data/exploretopics/resolving-insolvency.

CHRIS UMFREVILLE is a senior lecturer at Wolverhampton Law School, University of Wolverhampton.

PETER WALTON is professor of insolvency law at Wolverhampton Law School, University of Wolverhampton.

R3 contacts

President
Giles Frampton
giles.frampton@richardjsmith.com

Vice-president
Phillip Sykes
phillip.sykes@moorestephens.com

Deputy Vice-president
Andrew Tate
andrew.tate@reeves.co.uk

Administration

Chief Executive Officer
Graham Rumney
grumney@r3.org.uk

Assistant Office Manager
Tasneem Choudhury
tchoudhury@r3.org.uk

Smaller Practices Group; Personal Insolvency; Fraud Group; Regional Communications Committee

Director
Emma Hobson
ehobson@r3.org.uk

Finance

Finance Manager
Ryan Porter
rporter@r3.org.uk

Assistant Finance Manager
Alex Coles
acoles@r3.org.uk

Membership & Marketing

Head of Marketing & Member Services
Cynthia Matthews
cmatthews@r3.org.uk

Marketing Executive
Fareeha Afghan
fafghan@r3.org.uk

Database & IT Administrator
Samit Vadgama
svadgama@r3.org.uk

Membership & Marketing
membership@r3.org.uk
T: 020 7566 4238

Communications, Public Affairs and Policy

Director of Communications & Public Affairs
Victoria Jonson
vjonson@r3.org.uk

Communications Manager
Nick Cosgrove
ncosgrove@r3.org.uk

Public Affairs & Policy Manager
Alex Green-Wilkes
alex.green-wilkes@r3.org.uk

Georgina Dowling
georgina.dowling@R3.org.uk

Education, Courses & Conferences

Training Director
David White
dwhite@r3.org.uk

Head of Courses & Conferences
Angela Stannard
astannard@r3.org.uk

Courses and Conferences Organiser
Natalia Lada
natalia.lada@r3.org.uk

Courses and Conferences Marketing Executive
Kirsten Scully
kirsten.scully@r3.org.uk

Courses Administrator
Maggie Dean
mdean@r3.org.uk

Regional Events Co-ordinator
Sara Calvert
scalvert@r3.org.uk

Course Bookings
courses@r3.org.uk
T: 020 7566 4234 F: 020 7566 4225

Technical

Technical Director
John Francis
jfrancis@r3.org.uk

Technical Officer
Jonathan Ausena
jausena@r3.org.uk

Committee Chairs

Constitutional Adviser
Deborah Gregory, 020 7296 2000

Education, Courses & Conferences
David Chubb, 020 7583 5000

General Technical Committee
Mike Pink, 0207 311 1000

Membership & Member Services
Matt Dunham, 0161 953 6495

Policy Group
Steven Law, 01284 763311

Regional Communications Committee
Laurence Weeks, 01223 326600

Scottish Technical Committee
Eileen Blackburn, 0131 225 6366

Smaller Practices Group
Andrew Tate, 01634 899800

Regional Chairs

East Anglian
Frank Brumby, 01603 611370

London & South East
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Midlands
Richard Philpott, 0121 232 3000

North East
Allan Kelly, 0191 285 0321

North West
Richard Wolff, 0161 828 1990

Northern Ireland
Brian Murphy, 028 9043 9009

Scotland
Tim Cooper, 0131 222 9817

South
Andrew Watling, 023 8082 1868

South West & Wales
Ross Connock, 0117 923 4274

Yorkshire
William Ballmann, 0845 437 4660

Regional Representatives on the R3 Council

Eastern
Laurence Weeks, 07836 252136

London & South East
Alison Goldthorp, 020 7606 8855

Midlands
James Martin, 0121 265 2522

North East
Linda Farish, 0191 256 9500

North West
Richard Wolff, 0161 828 1990

Northern Ireland
Joan Houston, 02890 918200

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

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- Priority bookings for R3 courses and most of its conferences
- Technical bulletins and releases
- Access to the members' section of the R3 website
- An invitation to the R3 annual conference
- Continuing professional education at discounted rates

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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.

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The ultimate in *self*-regulation

Michelle Butler explores the impact of new statutory objectives for RPBs.

We could soon be voyaging into uncharted territory with the introduction of statutory regulatory objectives for RPBs, as proposed by the draft Small Business, Enterprise and Employment Bill. What can you do, particularly if you work in a smaller practice, to avoid becoming one of the first casualties of an RPB intent on applying (and being seen to apply) these new objectives?

Case reviews

Shouldn't a good case review system be all that is needed to monitor compliance? I find some are too backward-looking: they check whether statutory deadlines have been met and whether reports met SIP standards. But is this *really* the purpose of case reviews?

Personally, I believe that case reviews should be more forward-looking. They should check whether all assets are being pursued appropriately (or whether the decision should be made to give up the chase); check whether distributions are being progressed; and perhaps review the time/fees position. I see case reviews as scheduled consultations between the case administrator and office-holder, a chance to step back and take a fresh look at strategies and objectives, and to pick up any loose threads where attention may have slipped.

> "These issues require a systems review, not a case review."

A case reviewer should have in mind what needs to be done on *this* case, whereas a review of statutory/SIP compliance is better done when the reviewer's focus is on how the wider practice operates, how problems arise, and how they can be avoided in future. These issues require a systems review, not a case review.

RPB reviews

Do the IPA's self certifications or the ICAEW's ICRs meet this need? Well, they are a start. The most revealing part of the IPA self certifications that I have seen is what remedial action has been proposed. Often, if this is lacking, then – surprise! – the same or similar issues pop up on the following year's reviews.

I see the IPA's recent announcement that it has dropped one year's self certifications as an opportunity for IPs to

design their own self-review systems. The ICAEW's ICRs similarly enable IPs to tailor-make reviews to meet their own needs. However, whether or not you are under a requirement to conduct RPB reviews, I strongly recommend running some kind of 'cold' review system – of a sample of cases, of systems/processes (such as bonding, cashiering, or anti-money laundering) or both. Many applications also produce automated diary reports, bond reviews, and funds summaries, which can be useful indicators of compliance and case progression trends, and simple spreadsheets can be designed to focus minds on case progression. Deep down, you know your practice's weaknesses, so be bold and keep those areas under close review.

'But you don't know what you don't know!'

I have had much sympathy for IPs who have self-reviewed their work diligently only to learn, at the next inspection visit, that they'd missed something. Compliance teams may keep their ears closer to the ground resulting in a tighter grip on the legislation's intricacies, but they too can suffer from groupthink, and no one knows everything (which, let's face it, has the unnerving tendency to alter from week to week!). This is true of internal compliance staff as well as external consultants, although the latter may have more opportunities to learn from others' mistakes (and successes).

It may be heresy to confess it, but personally I don't think you need to invest heavily in compliance staff or consultants to do a good job of self-regulation. Not every IP has the patience to be an impeccable reviewer, so delegate. Make the most of the knowledge base in your practice (recent JIE-sitters will be in pole position) and target those with an eye for detail, but be realistic: not every last little

> "Deep down, you know your practice's weaknesses."

error will be spotted, but that should not be disastrous (although you may want appointment and fee-approval processes scrutinised, as the tiniest flaws can prove very expensive). Of course, it helps if the reviewers have not done the work themselves – spotting flaws in our own work is well-nigh impossible – and I think a healthy inquisitive nature is indispensable: good reviewers continually ask themselves 'why did that happen?', 'could it happen again on another case?' and 'why do we do things that way?'

Finally, do not focus simply on technical compliance. The proposed regulatory objectives (s126 of the draft Bill) indicate what will be more important to the RPBs in future, so we could do worse than adopt these as the objectives of our own self-review processes:

- Providing high-quality services at a cost to the recipient that is fair and reasonable;
- Acting transparently and with integrity;
- Considering the interests of all creditors in any particular case;
- Maximising the value of returns to creditors and promptly making those returns; and
- Protecting and promoting the public interest (albeit an objective primarily for the RPBs).

If we take care of these big issues, maybe our RPB will show some mercy if we slip up on a minor technicality or two (well, we can always hope!). Importantly, we will be demonstrating to our regulator that we take *self*-regulation seriously. ◻

MICHELLE BUTLER works as a consultant, trading as Insolvency Oracle, and is a member of R3's SPG Committee.

SAVE THE DATE

18 March 2015
R3 Annual Dinner
Lancaster, London

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

R3 events, courses and conferences

Month	Date	Event	Venue
September	3	North East Regional Meeting	Newcastle
	4	Yorkshire Regional Meeting	Crowne Plaza, Leeds
	5	Scotland Ladies Lunch	Grand Central Hotel, Glasgow
	8	North West Regional Meeting	Manchester
	9	South West and Wales Regional Meeting	Bristol Golf Club, Bristol
	10	Yorkshire Region Golf Day	Scarcroft Golf Club, Leeds
	11	Midland Women's Group Afternoon Tea	Hotel du Vin, Birmingham
	18	Southern Regional Meeting	The Solent Hotel & Spa, Fareham
	18	Insolvency Conference	Crowne Plaza Chester
	22	JIEB Workshop 1 – General Insolvency	EY LLP, London
	23	JIEB Workshop 2 – Corporate Insolvency	EY LLP, London
	23	Introductory Series – Rescue 1 and Rescue 2	Irwin Mitchell Solicitors, Leeds
	23	Introductory Series – Rescue 1 and Rescue 2	Prospero House, London
	24	JIEB Workshop 3 – Personal Insolvency	EY LLP, London
	25	Personal Insolvency	Marriott Leeds City Centre, Leeds
October	2	East Midland Region Annual Dinner	Crowne Plaza, Nottingham
	7	Creditors' Meetings	Copthorne Tara Kensington, London
	7	Employee Issues and Redundancy	Copthorne Tara Kensington, London
	8	Thames Valley Meeting	Reading
	13	Yorkshire New Professionals Oktoberfest	Leeds
	16–17	SPG Forum	Hilton Metropole (NEC), Birmingham
	21	Insolvency Day	Squire Patton Boggs (UK) LLP, London
	23	Personal Insolvency	Copthorne Tara Kensington, London
November	4	Introductory Series – Liquidations 1 & Partnership Insolvency	Irwin Mitchell Solicitors, Leeds
	4	Introductory Series – Liquidations 1 & Partnership Insolvency	Prospero House, London
	4	South West Regional Meeting	Bristol Golf Club, Bristol
	6	Insolvency Litigation	Holiday Inn Bloomsbury, London
	7	London Region Ladies Lunch	Park Plaza, Westminster Bridge, London
	11	Insolvency Day	Squire Patton Boggs (UK) LLP, Manchester
	13	Southern Region Annual Dinner	St Mary's Stadium, Southampton
	18	Creditors' Meetings	Crowne Plaza, Birmingham
	18	Employee Issues and Redundancy	Crowne Plaza, Birmingham
	18	London and South East Regional Meeting	Haberdashers Hall, London
	25	Insolvency Litigation	Crowne Plaza, Manchester
	27	Yorkshire Women's Group Meeting	Leeds

Regional events

R3 events

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OBC= outside back cover

Interview with…

Anne Willcocks

Sandra Kessell talks to **Anne Willcocks**, external affairs director at The Insolvency Service.

Anne Willcocks

Anne Willcocks joined The Insolvency Service as head of policy directorate in 2009 and is now external affairs director. She has been involved in policy initiatives, such as debtor petition reform and has been working with R3 on the regulation of insolvency practitioners. She was appointed CBE in the 2014 New Year's Honours. The award was for her services to the development of market frameworks and leadership of major parliamentary bills.

What role do you see the Department of Business Innovation and Skills playing in getting business on-side when it comes to Teresa Graham's recommendations? How would this be funded?

The government has welcomed Teresa Graham's recommendations. Essentially a package of self-regulatory measures would tackle the concerns raised where pre-packs involve connected parties, and there would be a strengthening of SIPs. We won't be taking the recommendations forward ourselves, but we will play a role in ensuring that interested parties are brought together to get the pool up and running. The report didn't envisage that the new process would be onerous and we hope that it would be delivered in a proportionate way. Given the pressures on government spending, I don't see a prospect of government funding for this. The initial cost at least is likely to be borne by the connected parties themselves.

> "Teresa Graham's report found that a ban on all pre-packs was not the way forward."

Do you think that the regulations or the recommendations that are being put in place will reassure creditors? In an interview for RECOVERY last year Teresa Graham feared that unsecured creditors would just walk away if they felt the process had nothing in it for them.

Teresa consulted very widely as well as doing research, and has very much taken unsecured creditors' views on board. Her report found that a ban on all pre-packs was not the way forward – they can be in creditors' interest. The intention is to restore confidence in the process for all parties. Pre-packs have had a lot of air-time, given how relatively few there are. If we can reassure the wider public that this is a process with strong protections about valuation and fairness, then that can only help.

What would be the performance yardstick against which pre-packs' transparency will be judged?

Teresa Graham's report contained considerable data on how the market is working now and looking at that would be our starting point. There are some measurable aspects, such as returns delivered to creditors, how often the new pre-pack pool and viability of new procedures are used and what information is provided to creditors. Then we'd also want to gauge more qualitative aspects, such as whether creditors do actually have confidence in the valuations being used.

Will you be looking at how that is doing over the next five years?
We will be talking to people as it gets put in place. The reserve power to strengthen legislative controls on connected party pre-packs would expire after five years and we would certainly want to assess a position a year or so before this, which would allow time to discuss how the position has changed and whether the power should be exercised. That does imply that the new measures would be put in place quite promptly.

As oversight regulator we're involved with the Joint Insolvency Committee so we'll be looking to ensure it works quickly to get a new SIP 16 in place. We will do a more systematic review – probably around a year beforehand – to allow ministers to decide whether they need to exercise the reserve power before the Bill gets through Parliament.

> "Regulation can't be assessed through simple targets."

Regulation can't be assessed through simple targets so any decision by ministers will be based on an assessment of a range of factors. The Small Business, Enterprise and Employment Bill provides new objectives for regulation and IPs and they're subject to discussion in Parliament, but give the over-arching framework. It shouldn't matter which regulators an IP is authorised by, there should be confidence that they would be dealt with in the same way and that any misconduct would be effectively and promptly tackled. Ministers want to ensure that there's consistency as well as transparency and accountability.

The Complaints Gateway is a useful start in driving consistency and common proportionate sanctions, and a common appeal process would further help drive consistency. Appropriate publicity would support transparency. There has been considerable support for a single regulator but ministers also realise the value of self-regulation and the expertise it can draw on and the cost and disruption of change to take into account. Our approach is to strengthen the effectiveness of oversight regulation, to clarify the objectives of IP regulation and to build on the measures and strengthen the existing system. A single regulator is very much a reserve option for use only if these measures don't sufficiently deliver confidence. And as in the case of pre-packs, measuring confidence is not an exact science but we'll be looking to consult over that.

What performance targets are in use by the agency that relate to the service IPs receive from the Insolvency Services Accounts and case transfers by the Official Receiver, for example?
We have a range of operational targets to ensure that we're tracking the services we provide for IPs. We recently did a market test on Insolvency Services Account work to ensure that it provides value for money. The Small Businesses, Enterprise and Employment Bill also includes a measure suggested under the red tape challenge initiative to enable IPs to use an alternative banking service if they prefer.

We monitor the number of IP handovers and our audit and assurance teams look at such things as timeliness and quality on the handovers. And we now publish the IP rotas on our website and provide supporting details concerning allocation of cases to firms and we discuss regularly with R3 how these matters are working overall.

So, on The Insolvency Service's policy work, where next for policy?
We still have a considerable amount of work to do to follow through on the various initiatives, not least on the rewrite of the insolvency rules, which is not just picking up ideas from the red tape challenge, but is also trying to simplify and make the rules more consistent. This will also pick up changes needed to implement debtors' petition reform – a demanding project. I'm extremely grateful for all the input we've received from those in the industry. On personal insolvency, "we have just announced a consultation to review the debt relief order regime to see whether it has achieved what was intended and whether any changes are needed. The minister has also promised to review the creditor petition limits for bankruptcy. And on the international level, we need to ensure that the changes to EC Regulation meet UK needs. I don't think we'll be short of things to do!

How can the public and private insolvency sectors work in greater harmony?
We are increasingly moving to digital services and this should have benefits for those who work with IPs as well as for debt advisers. There's already a strong working relationship on director misconduct, where we rely on IPs identifying where we should focus our enforcement activities. This has helped us to achieve high levels of director disqualifications (over 1,200 last year, with ten per cent of those disqualified for more than ten years, and an average disqualification of over six years). Once 'D returns' come to us sooner and electronically, we'll want to maintain this strong relationship. There is a network of relationships between the Insolvency Service and IPs and we want to keep those links strong to ensure we act jointly in the best interests of creditors and also support debtors. There's been a sharp fall in debtor petition bankruptcy cases and in response we've reduced our staff numbers by nearly half over the last four years. We're rationalising where we have offices so changes may be coming at the local level. Official Receivers and IPs each have their own role to play in the bankruptcy system and it's important that we continue to work together in this changing environment to ensure the system works as effectively as possible.

Do you feel that the relationship has improved over recent years?
There's a high level of respect in the agency for IPs and we're trying to increase the links at all levels. We have a close and regular dialogue with R3, which is of great value. As responsibility for advising ministers on policy lies with the agency, there can be tensions when ministers decide on policies with which IPs have concerns. But we try to ensure full and open dialogue so that any views are fully taken into account. We're very frank in our discussions with both ministers and IPs and I think IPs value the opportunity to have their views plainly presented to the minister.

> "We've reduced our staff numbers by nearly half over the last four years."

What do you think the government should do to promote the positives and protect the UK ranking?
We're very proud of the UK's excellent World Bank rating – consistently in the top ten and now at seventh and above that of our major competitors. Both we, The Insolvency Service and ministers, use every opportunity we can to make sure people recognise how good our regime is at delivering high and speedy returns to creditors, which is what the World Bank rating measures. The UK is recognised as an excellent place to restructure and rescue businesses and we want it to remain that way. As market practice changes, we want to make sure our regime keeps pace. So we want to keep closely in touch with those using our regime to make sure it continues to meet their needs and deliver the best outcomes possible.

What do you think IPs' top three concerns are, or should be?
I assume that they want a regime that promotes rescue where possible and that allows them not only to *do* an excellent job for creditors but also to be *seen* to be doing so. There's a real opportunity for IPs to make sure that the recommendations from »

the Graham review are taken forwards and confidence in the work they do on pre-packs increased as a result. They'll also want to see any misconduct or lack of professionalism tackled effectively to ensure that stakeholders have confidence in their skills and professionalism. Taking firm action, quickly where appropriate, to deal with the very few IPs who don't follow the rules will help confidence. More transparency around the work that IPs do and the fees they charge should also help. If I had to point to one area where I'd like to see IPs pay more attention, it would be to ensure that consultation is effectively carried out where redundancies are proposed. Employment tribunals regularly criticised IP conduct in this respect. What can be done, and at what point, will depend on circumstances but IPs should be making every effort to consult.

What, if anything, have been the main challenges for The Insolvency Service working under the coalition government? And then also working to a fixed term Parliament?

Any government has to find ways of achieving agreement between different ministers and the coalition government has just been a different permutation of that. Coalition ministers have taken a strong interest in insolvency issues. As regards a fixed term Parliament, clearly there will be particular pressures to ensure that the legislation currently before Parliament, which includes a significant number of insolvency measures, completes parliamentary scrutiny before Parliament is dissolved. It's helpful because you don't have the speculation about when an election will be called but as you get closer to the deadline that puts pressure on the Parliamentary programme, which we'll feel as we're taking the Bill through.

> "I'm extremely grateful for all the input we've received from those in the industry."

So what recent change or proposal do you think has had or will have the most positive change on the UK's insolvency regime?

On the personal insolvency side, I think that the introduction of debt relief orders enabled especially vulnerable people in debt greater access to debt relief. Looking forward, the introduction of debtor petition reform – under which debtors' own petitions for bankruptcy will come to an adjudicator within The Insolvency Service – will be an important change. On the business rescue culture, the Supreme Court judgment on *Nortel* was important in clarifying an issue where there was wide concern about possible effects on rescue. And the new measures in the Small Business, Enterprise and Employment Bill strengthening the director misconduct regime will promote confidence that misconduct will be effectively tackled and should help to protect our market from wrongdoing overseas.

How much difference does social media make to the way you can get information out to the public and instantly see people's views of insolvency practice?

Social media does enable you to communicate in different ways with different audiences, but it's not the right means for all communication. It's early days for us but we're trying to use different mechanisms. Using our director disqualification work for example, one of its purposes is to give confidence in the marketplace that director misconduct will be tackled. That's not just a message we want to get to people we come across because they're going through insolvency but also to others in the marketplace. We have to use a range of channels and media and I am sure that social media has a place in among it. As we move to digital we are working with people to develop our services. Modern communication methods work for some of the vulnerable people we deal with. We want to make is as easy as possible for them to access our services.