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From the guest editor

Welcome to our summer 2012 edition where the focus is very much on international issues, with an undercurrent of how they might affect insolvencies in the UK.

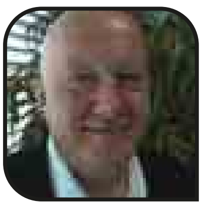
As detailed in Michael Thierhoff's excellent piece on insolvency law revisions in Europe's German engine room, and Willem Keukens' commentary on changes in Dutch law regarding financial assistance there is much afoot in foreign parts – further evidence is provided by Myriam Mailly and Emmanuelle Inacio in their timely overview of further changes in France, Italy and Ireland. Chris Laughton's pragmatic views on maximising use of local professional expertise makes a lot of sense, particularly when read in conjunction with the levels of complexity outlined by Jennifer Marshall in her article on the anti-deprivation principles applying in Lehman.

There is, of course, also an ongoing consultation on possible changes to EU Insolvency Regulations and incoming R3 president Lee Manning is right in saying we have not seen the end of focus pre-packs – on the day I am writing this we are invited to a round table meeting with the new minister, Norman Lamb, on that very matter.

I would also reinforce his comments on engaging with creditors. Having attended the recent creditor-side consultation meeting at The Insolvency Service, the level of anti-pre-pack vitriol expressed by representatives of trade bodies surprised me, as did the lack of understanding of some of those representatives of the commercial issues involved. I am pleased to see in the interview with him that Lee intends that R3 will continue to engage with these bodies at a high level.

With these international and domestic changes in mind the only prediction I will make with confidence is that managing UK insolvency cases will become more complex and costly.

Writing this in early May we are now apparently in a double-dip recession although compared with the ITN News at Ten in the 1980s when each Friday edition ended with a summary of thousands of job losses, and the early 1990s when responsible IPs sometimes declined to take appointments due to lack of immediate resource to deal with trading cases, it does not yet feel catastrophic. My inner cynic does, however, doubt Whitehall's ability to measure even the M1 (motorway, I mean) to a tolerance of 0.2 per cent – never mind the shifting cloud of GDP. Expect a slow recovery and fill those jerry cans with sun lotion for the blazing summer ahead.



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The value of insolvency

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Tough love

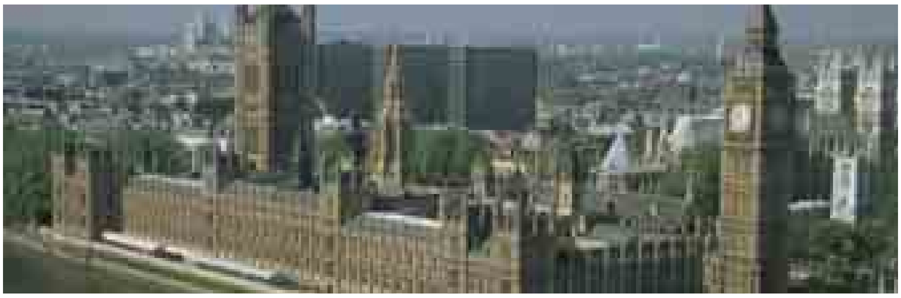
Stuart Frith asks, 'Is it time to tell it as it is if we want to rescue the rescue culture?'

While I feel in the first flush of youth, I was reflecting, the other day, that the number of us who can remember the section numbers for creditors' meetings under the Companies Act 1948[1] and for a private examination under the Bankruptcy Act 1914[2] is ever dwindling. There are even some of us who can remember the days before public relations became such an important part of practice; when we were there to do a job and, if we did it well, that was the best type of advertising. That is not intended to reveal a Luddite attitude on my part. It is not that long ago that I attended a meeting of insolvency practitioners in Yorkshire who were addressed by an executive employed, at not insignificant expense by the organisation concerned, to promote the image of IPs with the general public. 'Do you know', he said, 'there are people out there who think you can charge what you like?!' This caused some consternation among the gathering; not least because most of them thought that they could. There was evidently much work to be done.

> "The proliferation of the perceived ills of pre-packs has nothing to do with whether or not notice has to be given to the creditors when selling a business back to the directors. It is the lack of liquidity available to fund trading administrations that is to blame."

Progress, but for how long?

We have come a long way since 29 December 1986 on the issue of regulation. The days of the 'cowboy' liquidators riding into town and selling the assets back to the directors at a discount, leaving the creditors high and dry, are long gone. We know that pre-packs are, of course, *entirely* different, but it is an illustration of the difficulty that we still face that the general public thinks that they represent two sides of the same coin. The recent backtracking by the Secretary of State on ill-thought out proposals concerning disclosure involving pre-packs was due in no small part to the hard work that was done by R3 and others in persuading him to think again, but for how long? We have been recently confronted by proposals that have at their core the remarkable notion that it is inconvenient to have a judge determining when someone should be subject to the rigours of a bankruptcy order. There are clearly many more battles that lie ahead.



Loss of focus at ministerial level

We now live in an age of spin and counter spin; where policy seems to be driven by the readers of the *Daily Mail* rather than the professionals operating at the coal face. These proposals seem to me to betray a complete loss of focus at ministerial level on the priorities that are really necessary to promote the rescue culture. The reasons for the proliferation of the perceived ills of pre-packs has nothing to do with whether or not notice has to be given to the creditors when selling a business back to the directors. It is the lack of liquidity available to fund trading administrations that is to blame. Similarly, the courts are dealing with the serious issues concerning bankruptcy perfectly well, thank you very much, and the proposals that were sent round recently advocating that The Insolvency Service would come to the rescue and save us from ourselves were unwelcome to say the least.

It is significant that here we are 25 years on from the introduction of the Insolvency Act 1986 and we still do not know exactly what is or what is not a provable debt. The *Nortel* case in the Supreme Court will be heard by no less than seven Law Lords, but not until the late Spring of 2013. While not tempting fate, the decision may not take the debate much further in favourably determining this issue and may be delivered at an instance when there will be little time to resolve the problem by the introduction of remedial legislation before the next general election. Parliament will not act while the case is progressing and the effect of this uncertainty is clearly inhibiting the rescue of otherwise perfectly good businesses because of the super priority that certain classes of creditor presently enjoy.

The pursuit of the Holy Grail of public acclamation for IPs

The perception of IPs is better than it was, but have we got as far as we are likely to go in the quest to be loved and adored by the masses? Or should we recognise that this is the best we are going to achieve? Is it the case that our pursuit of the Holy Grail of public acclamation constrains us in our dealings with the media and others from delivering harsh messages, particularly to the government, concerning priorities directed towards the preservation of jobs and, through that, the recovery the economy needs and the public demands?

> "Does our pursuit of the Holy Grail of public acclamation constrain us… from delivering harsh messages – particularly to the government – concerning… the preservation of jobs and… the recovery the economy needs?"

Perhaps there may be a time for the IP militant tendency to make its feelings known on the issues we all passionately believe in and, if that involves upsetting a few on the way, so be it! Oh, and by the way, I am not afraid of the reintroduction of the 'I' word in our Association's title, if it comes to that; particularly if it makes what we do easier for others to understand.

[1] Section 293
[2] Section 25

STUART FRITH is head of the Corporate Recovery and Insolvency Group at Stephenson Harwood LLP.

President's column

Lee Manning outlines the challenges for his year as president of R3.

April marked the start of my R3 presidency and, after a year as vice-president, I know that my predecessor, Frances Coulson, will be a tough act to follow! Frances did a fantastic job of being the human face of the insolvency profession, ensuring that the voice of our members was heard by legislators, those who influence them and the public in general, when it mattered. There are a number of on-going campaigns and issues that still need time and dedication and I will be taking these on, just as Frances did for Steven Law before her.

It will be interesting to have another appointment-taking IP as president – for those of you who don't know, I have eight years' experience at Deloitte and prior to that I spent 14 years at Kroll. I guess my highest profile cases have been in retail, for example Land of Leather and, more recently, Oddbins, so we'll have a lot to say about a sector facing so many challenges. It is certainly a crucial element of my programme for this year's annual conference in Barcelona. These stories from the frontline get the attention of journalists and MPs alike as they bring our work to life. Indeed I was recently asked to comment on the challenges facing the retail sector for Jeff Randall's programme on Sky News, and I look forward to further media appearances as R3 president.

> "In January of this year the government announced it is reconsidering the three-day notice period and this was without a doubt a success for the profession."

The regulatory challenge

There has been a change in who we'll be dealing with in government as Edward Davey MP has moved on and we have a new insolvency minister, Norman Lamb MP, to engage with. This relationship will be key, as we know there is still work to be done on regulation of IPs. The consultation into regulation laid down a difficult challenge for us and included proposals for a separate fee review system and an independent complaints body. R3 was able to address these threats through strategic parliamentary work. At the moment, alternatives such as streamlining the regulators and having joint complaints' reviewers within several of the RPBs are being considered. I will continue to work with other interested bodies and regulators to try and influence the eventual outcome.

Technical issues to address

The pre-pack story also isn't over and we are likely to hear more on this, especially in the press. In January of this year the government announced it is reconsidering the three-day notice period and this was without a doubt a success for the profession. However, there is clearly still a lot work to be done to improve understanding and change negative perceptions of pre-packs; and from the IPs side, ensuring that we continue to address SIP disclosures on pre-packs in a transparent manner.

I would also like to look into ways to improve the Company Voluntary Arrangement (CVA) process. As you know, CVAs are a valuable business rescue tool: they ensure that most if not all of the workforce in a troubled business is retained; they are highly transparent as they can only go ahead with creditors' approval; and are a lower cost alternative to some other insolvency procedures. However, there is still scope for improvement, especially when it comes to engaging large creditors. Even though 75 per cent of creditors need to approve a CVA, this proportion is by value and so large creditors (eg HMRC) can often, in effect, control the decision. Knowing how these creditors intend to vote early on can be hard to ascertain, yet this knowledge would have an impact on which 'rescue tool' the IP decides to use, and we are looking at ways that this process might be improved. Engaging with the creditor community overall is another theme of my year.

Finally, football is a subject that is close to my heart and an area where I have significant professional experience. During my presidency, I would like to look at the Football Creditors' Rule and how this system impacts on the principles of parity in insolvency situations. This is a topic that many people feel very passionate about and maybe there could be an appetite for change if we see many more high profile football administrations and unworkable CVAs – as we invariably will. We will be canvassing the membership's views on this and the CVA process that flows from it.

Boosting benefits for members

R3's campaigns to clarify administration expenses and 'Holding Rescue to Ransom' also continue to rumble on, hopefully with some positive announcement from government soon. As if this isn't enough, like every president before me, I have a clear idea of what I wish to bring to the table to boost benefits and resources for our members and improve clarity and fairness for creditors.

> "The Football Creditors' Rule is a topic that many people feel very passionate about and maybe there could be an appetite for change if we see many more high profile football administrations and unworkable CVAs."

I have my work cut out to maintain the momentum that has been built up so far and I am looking forward to the challenge ahead. Much has been done already to improve the perception of IPs and understanding of the value of our work. It is vital that this good work continues, so wish me luck and by the time you read this I should have already rolled up my sleeves and got stuck in.

LEE MANNING is president of R3 and a partner in the Restructuring Services division at Deloitte LLP.

Living wills – the deadline approaches

Leaders of the G20 agreed in 2010 that they would work together to make cross-border bank failures easier to handle and, in 2011, the Financial Stability Board announced that big international banks were required to produce 'recovery and resolution plans'.

For the UK, this means that, by the end of 2012, 29 of our biggest banks must produce a 'living will' that spells out how they could be stabilised or shut down in the event of a crisis.

But while the UK and USA are making good progress, many European and Far Eastern banks are not, and it is cross-border issues that are critical to the success of the overall plan.

A survey by Ernst & Young of 19 of the 29 UK banks suggested that regional differences could be problematic. While Simon Gleeson, Clifford Chance, was quoted in the *Financial Times* as saying, 'What makes resolution planning so difficult for multinational banks is that it is impossible to predict how national resolution authorities will deal with each other.'

At the end of last year, the Association of German Banks was reported as saying that, 'Living wills are a theoretical concept that imposes an enormous administrative workload without any certainty that this concept will actually work in a crisis…and create a false sense of security.'

Double-dip for UK economy

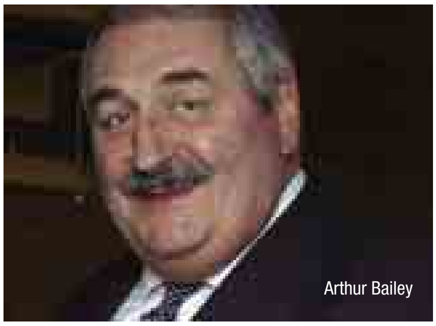
Britain's economy has slid back into technical recession as it contracted by 0.2 per cent during the first quarter of this year, with the construction industry seeing the largest fall. This follows the 0.3 per cent decline of the last three months of 2011.

However, according to the *Financial Times*, some economists have questioned the accuracy of the official data from the Office for National Statistics, noting that industry surveys from the services, manufacturing and construction sectors show stronger growth.

There is now speculation that the Bank of England, which had indicated a reduction in quantitative easing, may now rethink its strategy.

Chancellor George Osborne said the eurozone crisis had impeded Britain's recovery and that the economy was proving more difficult to repair than had been expected. But Brendan Barber, general secretary of the TUC insisted that austerity isn't working and suggested the UK follow the example of the USA, where there is now limited growth.

ICAEW vice-president elected



Arthur Bailey

Arthur Bailey has been elected as ICAEW's next vice-president and will formally take office on 13 June 2012.

A consultant with Begbies Traynor, Kingston Smith and a non-executive director, Bailey has served on ICAEW's council for 14 years, including three years as chairman, and is currently a member of its board.

Bailey will act as vice-president in support of Mark Spofforth who will be president for 2012/2013. The deputy president will be Martyn Jones.

Spain's banks downgraded

Eleven of Spain's largest banks were downgraded by Standard & Poor's at the end of April, following a previous downgrade of Spain's sovereign debt rating.

The government is attempting to set up a 'bad bank' scheme, similar to NAMA in Ireland, in a bid to avoid an international 'bailout' programme. But with the news that the jobless rate for Spain has risen to nearly one in four and half of young people between 18 and 24 are unemployed, any substantial growth in the economy looks remote.

Spotting elephants, turf-warfare and the anti-deprivation principle

In two recent Lehman Brothers decisions, the English courts have considered that the application of the anti-deprivation principle of English insolvency law depends on whether the relevant transaction was commercially sensible and in good faith. **Jennifer Marshall** explores how easy it is to pin down these concepts in practice and the cross-border issues that arise.

One thing can be said about the Lehman Brothers insolvencies: they are throwing up some interesting case law. In particular, in two significant judgments (the *Belmont* decision of the Supreme Court last July and the *Firth Rixson* decision of the Court of Appeal in April of this year), the English court has considered the 'anti-deprivation principle'. This is a judge-made rule of English insolvency law, the broad effect of which is to invalidate, as a matter of public policy, any agreement which provides that assets are to belong to a company until its insolvency, but are then to be taken away from the insolvent estate. The touchstone arising from these two decisions is whether the arrangement in question is a *bona fide* commercial transaction, entered into for reasons other than an intention to evade insolvency law. At first blush, this sounds straightforward and, indeed, in the two cases in question, the court had no difficulty in concluding that the transactions in question were commercially sensible ones, entered into in good faith. However, unlike with an elephant, it may not always be easy to spot whether a particular transaction falls on the right side of the line, particularly where one of the motivations in structuring a transaction may be the protection of the contracting party in the event of the counterparty's insolvency. Furthermore, as these concepts are matters of intention (rather than law), they may need to be dealt with by way of assumptions in any legal opinions, which could cause concerns for clients and rating agencies. Finally, it is clear that the English approach to this particular issue is very different from the approach of the US courts under the US Bankruptcy Code, which gives rise to some interesting cross-border questions. These were not expressly dealt with in the judgments but may need to be resolved at a future date.

> "The English approach to [the anti-deprivation principle] is very different from the approach of the US courts under the US Bankruptcy Code."

Belmont Park Investments PTY Limited v. BNY Corporate Trustee Services Limited and Lehman Brothers Special Financing Inc[1]

In July 2011, the Supreme Court concluded that the anti-deprivation rule did not apply to invalidate the contractual waterfall provisions in a Lehman Brothers' structured finance transaction that operated to make the priority of certain creditor payment rights conditional upon whether or not an event of default had occurred with respect to the relevant creditor. By way of background, Lehman Brothers International (Europe) (LBIE) established a multi-issuer secured obligation programme (referred to as the Dante programme) under which notes were issued to investors by various SPVs (the isuers). Lehman Brothers Special Financing

Inc (a US entity) (LBSF), entered into a swap agreement with each of the issuers. Security was granted over certain collateral (purchased with the investment proceeds from the notes) in favour of (among others) the note-holders and LBSF as swap counterparty. The security agreement provided for a priority waterfall in the event that the security over the collateral was enforced and monies received, including what has become known colloquially as a 'flip clause'. This clause (a version of which is commonly used in securitisation and other structured finance documentation) provided that LBSF was to be paid in priority to note-holders for the purposes of receiving a swap termination payment under the swap agreement unless an event of default under that agreement (including LBSF's bankruptcy) occurred in respect of LBSF, in which case the note-holders would be paid in priority to LBSF.

When the Lehman Brothers group collapsed, an Australian investment manager (Perpetual Trustee) issued proceedings in the English courts on behalf of various note-holders claiming that the trustee of the notes (BNY Corporate Trustee Services Limited) should enforce the security and should pay the note-holders in priority to LBSF. Separate proceedings were brought by a number of other note-holders (including Belmont Park Investments) raising the same issues and the two sets of proceedings were heard together. LBSF intervened arguing that the note-holders were not entitled to such priority on the basis of the 'anti-deprivation principle'. By the time the proceedings reached the Supreme Court, the Perpetual note-holders had reached a settlement with LBSF but the Belmont note-holders had not.

In what was described in the *Firth Rixson* case (see below) as the 'authoritative statement' on the anti-deprivation principle, the Supreme Court upheld the validity of the flip clause. In so doing, the court made the following points:

- It is necessary to look at the substance of the agreement rather than its form.
- The key question is whether the provision in question amounts to an illegitimate attempt to evade the relevant insolvency law or has some legitimate commercial basis.
- Party autonomy is important and the courts should give effect, so far as possible, to contractual terms that parties have agreed, particularly in the case of complex financial instruments.
- The anti-deprivation rule should be given a common sense application that prevents its application to *bona fide* commercial transactions that do not have as their predominant purpose (or one of their main purposes) the deprivation of a party's property on its liquidation.

One argument that had found favour with the court at first instance and one of the judges at the Court of Appeal was the 'flawed asset' one. The note-holders had argued that LBSF's right to be paid in priority to them was conditional upon no event of default having occurred and therefore could be described as a 'flawed asset' in the sense that the interest was flawed from the outset by the necessity of

> "The Supreme Court considered that categorising the asset as a 'flawed asset' (or the right to payment as a conditional one) should not be considered to be determinative in itself of the question of whether the contractual provisions will be held to be effective."

the relevant conditions precedent being met. However, the Supreme Court considered that categorising the asset as a 'flawed asset' (or the right to payment as a conditional one) should not be considered to be determinative in itself of the question of whether the contractual provisions will be held to be effective. In particular, if the flawed asset or conditional interest is drafted so that it determines or changes on liquidation or administration, the anti-deprivation principle is capable of applying and the provision will only be effective on one of the other grounds dealt with in the judgment (such as the good faith test discussed above).

Lomas v. *JFB Firth Rixson*[2]

In April 2012, the Court of Appeal handed down its judgment in four appeals,[3] all of which concerned the consequences of an event of default under the ISDA Master Agreement (the Master Agreement), principally the 1992 version. Given that this agreement serves as the contractual foundation for more than 90 per cent of over-the-counter derivatives transactions globally, and that there are trillions of USD of derivative transactions outstanding at any time, there has been much excitement about the decision in the industry. The court considered, in particular, section 2(a)(iii) of the Master Agreement, which provides, among other things, that the obligation of each party to make each payment or delivery specified in each confirmation to be made by it is subject to the condition precedent that no event of default or potential event of default with respect to the other party has occurred and is continuing. In the case of both LBIE and LBSF, a number of counterparties who were 'out-of-the-money' at the time of the collapse had relied on section 2(a)(iii) so as to avoid making payments that would otherwise have been due to the insolvent estates, while also not designating an Early Termination Date under section 6(a), to avoid crystallising an early termination amount payment obligation to the defaulting Lehman entity.

The Court of Appeal's judgment is lengthy and deals with a number of issues regarding the construction of the Master Agreement. This article focuses on the second appeal, *LBSF* v. *Carlton*, in which LBSF sought to challenge the operation of section 2(a)(iii) on two specific grounds, namely that (a) it contravenes the anti-deprivation principle of English insolvency law or (b) it contravenes the *pari passu* rule of distribution between creditors in an English liquidation. The court followed the decision in *Belmont* to the effect that the areas of operation of these two rules are distinct. The anti-deprivation rule is concerned with contractual arrangements that have the effect of depriving the insolvent estate of property that would otherwise have formed part of it. The *pari passu* rule governs the distribution of assets within the estate following a liquidation. It therefore invalidates arrangements under which a creditor receives more than his or her proper share of the available assets or where (as in the leading House of Lords case of *British Eagle*[4]) debts due to the company on liquidation are to be dealt with otherwise than in accordance with the statutory scheme. It seems clear that LBSF only sought to invoke the *pari passu* principle because, if this principle is infringed, it is not necessary to show that the transactions in question were in bad faith or were not commercial (see below).

Anti-deprivation principle

The Court of Appeal referred extensively to the recent Supreme Court decision in *Belmont* (see above). Applying the 'good faith and commercially sensible' test, the court thought it was difficult to see how section 2(a)(iii) could be said to offend against the principle on the facts of this particular case. It considered that the purpose of section 2(a)(iii) is to protect the non-defaulting party from the additional credit risk involved in performing its own obligations while the defaulting party remains unable to pay its own. The indefinite suspension of the payment obligation of the non-defaulting party (like any attempt to balance competing interests) might be criticised as imperfect but it could not be said to be uncommercial.

The court also considered the *quid pro quo* test adopted by Mr Justice Briggs at first instance. Briggs J had suggested that one way of distinguishing clauses that fell on the wrong side of the line from those that did not infringe the anti-deprivation principle might be as follows. Where a contractual right represents the *quid pro quo* for something already done, sold or » delivered before the onset of insolvency (or in other words has already been 'earned'), then the court should be slow to permit the insertion, even from the beginning, of a flaw in that contractual right. However, where the contractual right consists of the *quid pro quo* for services yet to be rendered or something still to be supplied by the insolvent company in an ongoing contract (in other words, where the right has not yet been 'earned'), the court will readily permit the insertion of such a flaw. Briggs J considered that the interest rate swaps in *Firth Rixson* fell into the latter category.[5] The court considered that the anti-deprivation principle has to be considered on a case-specific basis in which the *quid pro quo* test will be relevant as one means (but, by implication, not the only means) of distinguishing between a commercial re-arrangement of rights to reflect the economic consequences of insolvency and an attempt to pre-empt the distribution of assets in liquidation.

The *pari passu* principle

As referred to above, the anti-deprivation principle will not be applied where the transaction in question is entered into in good faith and is commercially sensible. However, these limitations do not apply in relation to the *pari passu* principle. Hence if section 2(a)(iii) were considered to breach the *pari passu* principle, it would be invalid whatever the motivation behind the section. However, the court held that section 2(a)(iii) did not breach this rule. This was for two reasons:

(a) The *pari passu* principle is only engaged in respect of assets of the insolvent estate as at the commencement of the liquidation. In this case, there was no debt payable to LBSF when its liquidation commenced because the obligation to pay was subject to the condition precedent that there be no continuing event of default. There was therefore no property that was capable of being distributed. This is very much a 'flawed asset' analysis and so it appears that this is enough to prevent the *pari passu* principle coming into play, even though it is not enough (of itself) to prevent the anti-deprivation principle from applying.

(b) Carlton was not a creditor of LBSF in respect of the payment that would have fallen due, but for section 2(a)(iii). In most cases, the *pari passu* rule will be relied upon by the liquidator to defeat a creditor's reliance on a contractual arrangement that was intended to give him or her preference in relation to the distribution of the estate.

Cross-border aspects

It is interesting to note that LBSF is not subject to any insolvency proceedings in England but rather is subject to Chapter 11 proceedings under the US Bankruptcy Code. This begs the question of why the English court was considering, in both *Belmont* and *LBSF* v. *Carlton*, English insolvency law concepts (such as the anti-deprivation principle and *pari passu* principle) rather than the *ipso facto* provisions that apply under the US Bankruptcy Code. It seems likely that a different result would be reached applying the US provisions. Hence in January 2010, in a case brought by LBSF against the Perpetual note-holders,[6] the US Bankruptcy Court held that the flip clause was an unenforceable *ipso facto* clause that violates sections 365(e)(1) and 541(c)(1)(B) of US Bankruptcy Code and any action to enforce such clause as a result of LBSF's bankruptcy filing would violate the automatic stay under section 362(a) of the US Bankruptcy Code.[7] Furthermore, in September 2009, the same judge (Judge Peck) rejected the position of Metavante Corporation that it was entitled to rely on section 2(a)(iii) of the Master Agreement to withhold its own performance on an ISDA that was in-the-money for LBSF. The court also indicated that Metavante only had a limited period in which to exercise its safe-harboured right to terminate the Master Agreement, after which it would be subject to the automatic stay that arises in a US bankruptcy (a case of 'use it or lose it').

> "The application of the anti-deprivation principle is fact specific but both of these judgments suggest that it is unlikely to be applied in arms' length transactions where there are commercial justifications for including the provision in question."

The choice of law aspects are not dealt with in either of the UK judgments referred to in this article; instead, in each case, the court was simply asked to consider the English law concepts without being told why they were relevant. There can be no suggestion that English insolvency law would apply in relation to LBSF, simply because the contracts in question were governed by English law. Instead, the English court may have been asked to consider English law principles on an anticipatory basis, for the reasons set out below.

LBSF has already sought recognition, in England, of the US Chapter 11 proceedings as 'main insolvency proceedings' under the Cross-Border Insolvency Regulations 2006. That does not mean, however, that all decisions handed down in those US bankruptcy proceedings are to be automatically recognised, and given effect to, in England. Instead, LBSF will have to make individual applications for assistance or relief from the English court in relation to particular decisions (such as, for example, any decision of Judge Peck that may be obtained in relation to the Belmont note-holders). In deciding how to exercise its discretion regarding whether or not to grant that relief, the English court is likely to take into account whether there are any analogous provisions of English insolvency law that would have applied had LBSF been in an equivalent insolvency process in England. In the author's view, this is the only relevance that English insolvency law has in respect of LBSF.

Conclusion

The application of the anti-deprivation principle is fact specific but both of these judgments suggest that it is unlikely to be applied in arms' length transactions where there are commercial justifications for including the provision in question. Hence the focus is very much on the commercial rationale of the parties. If the *quid pro quo* test applies (and it can be said that the contractual right has not yet been 'earned' by the time of the liquidation), this will be helpful but it is not the only factor to be taken into account. It is hoped that a transaction that falls on the wrong side of the line will be like an elephant: we will know it when we see it but the tests are somewhat nebulous and the author suspects that this is not the last word we will hear on the subject. Furthermore, the real battle in respect of LBSF – ie the question of which law actually applies – has not even begun. ◻

1 [2011] UKSC 38
2 [2012] EWCA Civ 419
3 The four judgments subject to appeal were: *Lomas* v. *JFB Firth Rixson, Inc* [2010] EWHC 3372 (Ch); *Lehman Brothers Special Financing Inc* v. *Carlton Communications* [2011] EWHC 718 (Ch); *Pioneer Freight Futures Co Ltd (in Liquidation*) v. *Cosco Bulk Carrier Co Ltd* [2011] EWHC 1692 (Comm); *Britannia Bulk plc (in Liquidation)* v. *Bulk Trading SA* [2011] EWHC 692 (Comm)
4 [1975] 1 WLR 758
5 This test was endorsed by two of the judges in *Belmont*
6 The Belmont note-holders were not party to this decision but it is expected that, if LBSF were to bring proceedings against the Belmont note-holders in the US, a similar decision would be reached
7 Leave to appeal with respect to the US Bankruptcy Court's decision was granted by the US District Court but the case settled before the appeal could be heard.

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Recent case summaries

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

Personal insolvency

***(1) Daniel Ford and (2) Liubov Ford v. John Alfred George Alexander (Trustee of the Estate of the Appellants)* [2012] EWHC 266 (Ch)**

Facts: The appellants were adjudicated bankrupt on 12 October 2007. As the appellants' trustee in bankruptcy, the respondent was the beneficial owner of a property owned and occupied by the appellants. The respondent issued an application for possession and sale of the property (the application) pursuant to section 335A of the Insolvency Act 1986 (the Act). Where an application is made more than one year after a trustee has been appointed, section 335A(3) provided that unless the circumstances of the case are *exceptional*, the court shall assume that the interests of the creditors outweigh all other considerations.

The appellants claimed an order for sale would be disproportionate for various reasons including the fact that they would be homeless and would not satisfy the definition of 'priority'.

The judge at first instance considered article 8 of the ECHR: namely, that everyone has a right to respect for their private and family life. The appellants' assertion that section 335A must be modified to apply a proportionality test was also reviewed [*Manchester City Council* v. *Pinnock* [2010] UKSC 45].

After consideration of various authorities dealing with balancing exercise between section 335A and article 8, the judge concluded that no *exceptional* circumstances had been established. The judge also held that even if the correct test was 'proportionality', it would not be disproportionate to order a sale of the property. The application was successful.

Held: Permission to appeal was refused as the grounds of appeal were based on a misunderstanding of the judgment. The judge nevertheless considered the arguments surrounding article 8 in significant detail.

Although the cases reviewed at first instance demonstrated that section 335A was not incompatible with article 8, such cases predated the *Pinnock* decision. Nonetheless, the requirements in section 335A(2) and the change of emphasis in section 335A(3) did not infringe article 8(2). Rather, section 335A provided a necessary balance as between the rights of creditors and the respect for privacy and the home of the debtor. Section 335A also satisfied the test of being necessary in a democratic society and was thus

proportionate. This conclusion echoed the pre-*Pinnock* bankruptcy cases and the judge saw no basis for coming to a different conclusion.

Comment: The balance to be achieved between section 335A and article 8 is one of the most litigated areas in personal insolvency; however' human rights arguments are not usually very successful. This case reaffirms that the substantive tests and procedures within the Act will generally satisfy the requirements of the Human Rights Act.

Corporate insolvency

***Globespan Airways Limited (In Liquidation)* [2012] EWHC 359 (Ch)**

Facts: Globespan Airways Ltd (the company) was placed in administration by court order on 17 December 2009. The automatic end of the period of administration was therefore 16 December 2010. On 14 December 2010, a notice (the original notice) was hand delivered to the Registrar of Companies (the registrar) pursuant to paragraph 83 of schedule B1 of the Act, which provided that a company seamlessly moves from administration to creditors' voluntary liquidation upon registration of the said notice. Various consequences flow from such a process including: (i) continuity in control of the company's affairs by office-holders; and (ii) a different computation of the 'relevant time' for the purpose of transaction avoidance provisions. Such consequences would not follow if there were a gap between the two regimes.

However, the registrar rejected the original notice as the administrators' addresses had been wrongly inserted. Further notice was duly sent to the registrar and was registered on 4 February 2011 (the final notice), such that the register recorded that the administration ended and the liquidation began on 4 February 2011.

Held: The judge concluded that as the final notice was sent *after* the expiry of the administrators' period of office, it was invalid [*Re E Squared Ltd* [2006] EWHC 532 (Ch)]. Regarding the original notice, the judge held it had been properly delivered despite the error.

The primary purpose of paragraph 83 is to provide a simple and cost effective way to move from administration to liquidation. The seamless nature of the move was demonstrated by the language not only of paragraph 83 but also the provisions dealing with the consequences of such action. A purposive rather than merely literalist interpretation of paragraph 83 must therefore be adopted.

The judge held that the effective date of registration under paragraph 83(4) should be the date of *receipt* of a paragraph 83 notice. Had the registrar accepted the original notice, the register would have recorded a seamless move from administration to liquidation on 14 December 2010.

Section 1096 of the Companies Act 2006 conferred a limited power on the court to order the removal of matters from the register in certain circumstances. The register wrongly showed the company as having seamlessly moved to liquidation on an incorrect date, which was at least capable of causing harm to the orderly winding up of the company's affairs. The judge ordered the removal of the incorrect entries and the registration of the original notice with effect from 14 December 2010.

Comment: The preferred interpretation of paragraph 83(4) would not assist if an office-holder posted the paragraph 83 notice on their last day in office such that it was not received by the registrar until *after* their appointment had ceased. In order to avoid an undesirable gap between administration and liquidation, office-holders should ensure the requisite notice is hand delivered *before* the end of the period of administration if necessary. ◻

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Technical update

Termination of tenancies: Law Commission proposals for reform.

The Law Commission is the statutory independent body set up to keep the law under review and recommend reform where necessary.

Law Commission report 303

Law Commission reports are always a good read, and can be a useful source of succinct and accurate information about complex areas of the law. One such is Law Commission report 303 published in October 2006 on termination of tenancies for tenant default. The Commission previously consulted on this in its paper 174 published in 2004. The 2006 paper sets out proposals for reform, and contains a draft Bill that would, if enacted, give effect to the Commission's recommendations. The Commission proposals would replace the existing law of forfeiture with a new statutory scheme for both commercial and residential tenancies.

It is important to note that the recommendations would only apply to England and Wales. The law in Scotland is different.

Under the current law of forfeiture a landlord can terminate a tenancy in response to a breach of the tenant's obligations by entering the premises and changing the locks or by commencing court action. Landlords often forfeit because of fears that they risk waiving the breach, and losing the right to act on it in the future, if they negotiate with the tenant or commit some other act of forbearance.

In its 2004 paper, the Law Commission set out its view that the law of forfeiture is outdated, complex, inconsistent and can lead to injustice, and that it is badly in need of reform. The Commission points out that the current law puts businesses at a disadvantage, and that the recent demise of a number of big high street names might have been prevented if there had been an effective alternative to forfeiture that supported a negotiated settlement of landlord and tenant disputes. It creates problems for landlords, who cannot negotiate in good faith for fear of waiving a breach, but may struggle to remove persistently bad tenants who belatedly remedy their breaches to obtain relief. And it puts holders of interests derived from the tenancy, such as sub-tenants, mortgagees and others, in a precarious position, because when a tenancy is forfeited their interests disappear, and they must take costly and complex steps to obtain relief.

> "The recent demise of a number of big high street names might have been prevented if there had been an effective alternative to forfeiture that supported a negotiated settlement of landlord and tenant disputes."

The Law Commission claims that the proposed reforms would help small businesses in financial difficulties to continue trading, and would remove the current perverse incentive for a landlord to disrupt the tenant's business by changing the locks at the first opportunity. The scheme is designed to work with the aims and structures of modern insolvency law and practice.

Under the new scheme, all interested parties would receive notice of the landlord's complaints before any further step was taken. They could negotiate directly with the landlord and tenant or – if court action could not be avoided – apply for one of a range of new orders specifically designed to protect their interests. The scheme would require exchange of information at an early stage, with the aim of a negotiated settlement of disputes. Court action would be the last resort and would have to take into account the conduct of the parties – in particular steps taken to resolve the dispute – when deciding what order to make and how to allocate costs. This builds on the Civil Procedure Rules and recent efforts to encourage settlement and reduce litigation.

Any tenant default would trigger the statutory scheme, unless agreed otherwise by the parties. There would be a summary termination procedure to permit landlords to regain possession quickly where premises had been abandoned or the tenant had no realistic defence.

Key features of the scheme

The scheme introduces a new concept of 'tenant default' to define the circumstances in which a landlord may seek to terminate the tenancy before the end of its term. In simple terms, tenant default would be a breach by the tenant of a covenant or condition of the tenancy. There would be no need for a forfeiture clause or right of re-entry to be included in a tenancy agreement, although the tenant should be given an explanatory statement explaining what can happen in the event of tenant default.

It would be open to the parties to agree that the breach of one or more covenants would not comprise tenant default and so exclude or limit the application of the scheme. It would no longer be possible for the landlord to 'waive' the breach (either intentionally or inadvertently).

> “The scheme would require exchange of information at an early stage, with the aim of a negotiated settlement of disputes. Court action would be the last resort.”

A landlord wishing to proceed would be required to warn the tenant of the impending action by giving a written notice. The tenant default notice would have to set out the details of the breach, any remedial action required and the date by which it should be completed. The notice would also have to be served on those who hold qualifying interests deriving out of the tenancy (principally mortgagees and sub-tenants).

The primary purpose of the tenant default notice would be to ensure that the tenant complied with the obligations under the tenancy. It could also provide a period for negotiation by the parties. If the service of a tenant default notice failed in its primary purpose, the landlord could make a termination claim. The claim would be served on the tenant and on all qualifying interest holders who had previously been served with a tenant default notice.

Once the court was satisfied that the tenant default had occurred, it could make such order as it considered appropriate and proportionate in all the circumstances. In arriving at this decision the court would have to take into account a number of considerations, such as the conduct of the landlord and the tenant, whether any action could be or had been taken to remedy the default and whether the deadline by which it was to be remedied was reasonable.

Various orders would be available to the court. A termination order would end the tenancy and any interests deriving out of it. A remedial order would set out what the tenant must do to remedy the default and the date by which it must be remedied. An order for sale would require the tenancy to be sold and the proceeds distributed. There are two orders that could only be sought by qualifying interest holders. These are a transfer order, which would require the tenancy to be transferred to the applicant or a third party, and a new tenancy order, which would grant the applicant a new tenancy of all or part of the demised premises.

The scheme provides an alternative summary procedure under which the landlord could bring a tenancy to an end without applying to the court. It is intended for use in cases where the tenant would have no realistic prospect of resisting a termination order or where premises had been abandoned.

Insolvency and the new scheme

It seems that during the consultation exercise some confusion arose about tenant insolvency under the new scheme. The Law Commission proposed that tenant insolvency should not, in itself, comprise tenant default. However, parties would remain free, as they are now, to make specific provision as to the tenant's financial standing, and a breach of such a covenant would constitute default and trigger the scheme. Where a tenant is subject to formal insolvency proceedings, however, the protections from forfeiture that are currently afforded to tenants under insolvency law would apply with equal force to termination actions under the new scheme. In fact, in two important respects they would improve the tenant's position.

1) First, the new scheme would address the anomaly that a landlord may effect forfeiture by physical re-entry without seeking the leave of the court even if the tenant is bankrupt (*Razzaq* v. *Pala* [1997] 1 WLR 1336).

2) Secondly, the draft Bill inserts a new provision in section 260 of the Insolvency Act 1986 to the effect that where an IVA has been approved, no termination notice may be served on the debtor except with the leave of the court. However, there is no equivalent provision for CVAs.

> “The Law Commission has recently been taking informal soundings to see if the proposals [in the report] still enjoy substantial support.”

The new scheme leaves an area of uncertainty in situations where a tenant is insolvent but not otherwise in breach of its covenants, but has not yet entered a formal insolvency process. If a landlord were to apply for a termination order in such circumstances, the court would be required to take any relevant matters into account, which would, no doubt, include any proposed insolvency process and, as a consequence, the interests of creditors as a whole. For example negotiations towards a CVA or IVA would probably be a relevant matter and might be expected to result in a stay or an adjournment. Nevertheless the outcome is uncertain and the process is likely to involve some cost. It might be appropriate therefore to impose a prohibition on any lease covenant that makes insolvency alone a 'terminating event'. Such a prohibition would not prejudice a landlord's rights and would avoid unnecessary uncertainty and expense.

Although no action was taken in response to the report at the time it was published, the Law Commission has recently been taking informal soundings to see if the proposals still enjoy substantial support. If the Government were to accept the Law Commission's recommendations, it is likely that there would be a period of re-consultation before a Bill was introduced. This would provide a further opportunity to comment on the scheme.

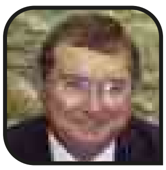
Further information is available on the Law Commission website at: **http://lawcommission.justice.gov.uk/areas/termination-of-tenancies-for-tenant-default.htm**. □

TUPE and collective redundancies – R3 submissions to government

Members may be aware that in November last year the Department for Business Innovation and Skills issued calls for evidence on the effectiveness of the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) and the collective redundancy consultation rules.

The General Technical Committee responded to both calls for evidence, setting out the reasons why these legislative provisions cause difficulties in insolvencies, and suggesting ways in which they might be ameliorated.

Both submissions are available on the Consultation Responses page of the members' section of the R3 website.



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Legal voice

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

Legal Q&A

Nathan Gopichandran answers your insolvency queries.

I have been approached by the directors of a company wanting to make an urgent administration appointment. There is no qualifying floating charge-holder but do they have to give notice to anyone first?

Paragraph 26(2) of schedule B1 to the Insolvency Act 1986 and rule 2.20(2) of the Insolvency Rules 1986 prescribe who (in addition to any qualifying floating charge-holder (QFCH)) is required to be given notice of intention to appoint an administrator, which includes the company itself where it is not the company making the appointment.

In *Minmar (929) Limited* [2011] EWHC 1158 (Ch) the directors' failure to notify the company was held to invalidate the appointment. The chancellor also suggested that the notice period must be 'reasonable'. Several cases have since attempted to clarify what is 'reasonable', the most recent being *National Westminster Bank plc* v. *Msaada Group* [2011] EWHC 3423 (Ch) and *Re Virtualpurple Professional Services Limited* [2011] EWHC 3487 (Ch). Unfortunately, these judgments were given on the same day without reference to each other and came to different conclusions. Warren J in *Msaada* held that 'reasonable' means five business days and that, even if there is no QFCH, notice must still be given. Norris J in *Virtualpurple* took a different approach, holding that where there is no QFCH no notice is required and that, even if notice were required, failure to give notice would not necessarily invalidate the appointment.

“One option, where the directors are appointing, is to require the company to acknowledge receipt of the notice and consent to short notice.”

This judicial conflict is clearly unhelpful, particularly where an urgent appointment is required. One option, where the directors are appointing, is to require the company to acknowledge receipt of the notice and consent to short notice. This could also be recorded in the board minute or record of the directors' decision to appoint. Another option is for the company itself to appoint, thereby obviating the need to give any notice to itself. However, you should bear in mind Henderson J's obiter remarks in *Re Frontsouth (Witham) Limited* [2011] EWHC 1668 (Ch) that '*shareholders should not be able to procure the appointment of administrators by the company, or make an application to court for that purpose, at a time when as a matter of internal corporate governance the decision in question is one to be taken exclusively by the directors*', which casts some uncertainty over the validity of a company appointment unless accompanied by an appropriate board resolution.

However, neither of these options help where there are other persons required to be notified under rule 2.20(2) such as a sheriff, bailiff or distraining landlord. Presumably, the literal approach adopted in *Msaada* would require these persons to be given five business days, effectively elevating their status to that of a QFCH. Given they do not have a right of veto, this period of notice would appear to be unreasonable and counter-productive.

I am the trustee of a bankrupt who has a good negligence claim against his former solicitors but I don't have any funds to pursue it; can I assign the claim back to the bankrupt on the basis that I receive a percentage of any proceeds?

You have power, with sanction, to assign the claim on deferred terms (s314 and paragraph 9 of part I of schedule 5 of the Insolvency Act 1986).

However, you should be aware of the potential liability for adverse costs if the bankrupt loses, as the court has a discretion in certain circumstances to make a third party costs order against you (s51 Senior Courts Act 1981).

If you assign the claim outright for cash and do not benefit from the outcome, you will not be liable for adverse costs. However, I assume the bankrupt can't pay you an acceptable amount up front but is willing to share the spoils.

“If you assign the claim outright for cash and do not benefit from the outcome, you will not be liable for adverse costs.”

While this is an attractive solution, the Court of Appeal in *Hunt* v. *Harb* [2011] EWCA Civ 1239 reaffirmed that by retaining an interest in the outcome of the case, the trustee is at risk of adverse costs. Although in most cases this will not be perceived as a significant risk, to minimise it further, you could:

- Obtain an indemnity from the bankrupt, although this is likely to be of limited value;
- Require the bankrupt to obtain ATE insurance against adverse costs;
- Apply to court for sanction and seek a direction that you will not be liable for adverse costs;
- Consider reflecting the contingent element of the consideration as a percentage of excess proceeds over a certain amount.

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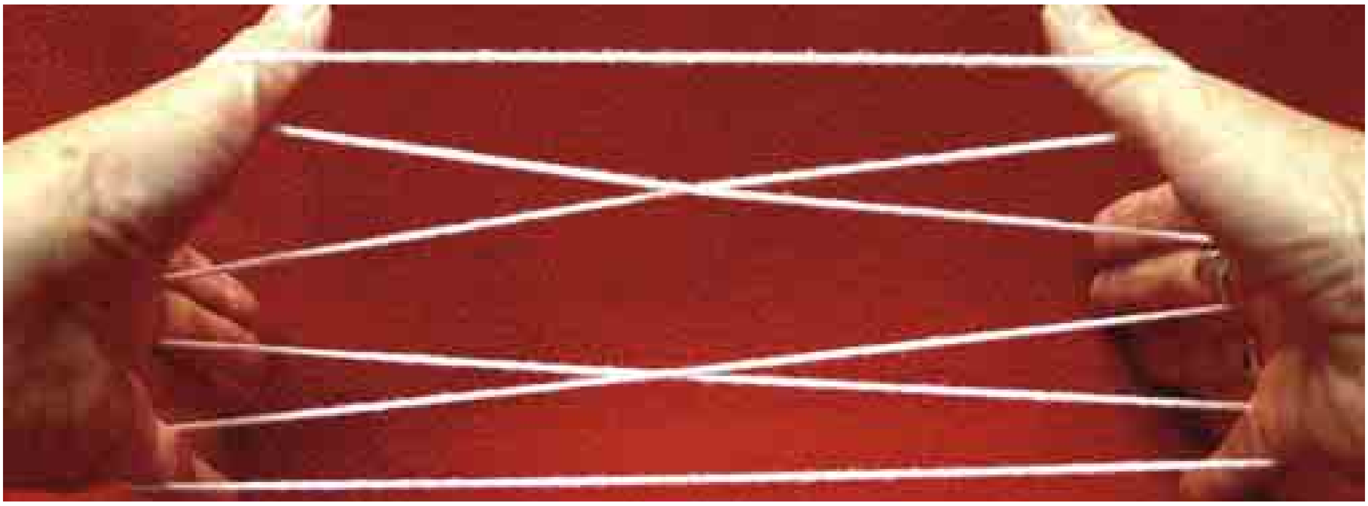

An IP's guide to cross-border insolvency

Chris Laughton offers advice in picking your way through the cats' cradle of laws in different jurisdictions.

Don't try to act outside the UK – get local assistance!

As a rule of thumb the observation above is pretty useful, but what should an IP really do when faced with cross-border insolvency questions?

It can be tempting to take article 18(1) of the EC Regulation on Insolvency Proceedings too literally when it says that an insolvency practitioner in main proceedings (which most cases are) *'may exercise all the powers conferred on him by the law of the State of the opening of proceedings* (ie the UK) *in another Member State'*. So do we just do what we do in the normal way using UK law across Europe?

> I know of an English IP who no longer holidays in France after sacking a French workforce without notice.

Well, no, at least not if you want to stay out of European jails. The sting in the tail is article 18(3), which provides that *'in exercising his powers, the liquidator should comply with the law of the Member State within the territory of which he intends to take action'*. I know of an English IP who no longer holidays in France after sacking a French workforce without notice. My own experience of dealing with French employees of an English insolvent company was one of the following French employment law procedures, which involved my not being represented when conducting formal meetings with each of the employees, in French, while they were represented. When in Rome, as they say...

Recognition and assistance

What about recognition under the UNCITRAL Model Law? Chapter 15 of the US Bankruptcy Code is the usual example cited. Of course Chapter 15 can work well, but I know more than one US attorney who would say Chapter 11 is easier and more powerful. Also, you have to remember that the US is a federation of states with local laws. I was seeking to realise cash in a Florida bank account in the name of a bankrupt and Chapter 15 proved to be the least appealing of several options, including using state law and applying for Chapter 11. In fact, the US process was so challenging for a number of reasons that we eventually avoided it by getting the bankrupt to execute the necessary documentation.

I have used section 426 of the Insolvency Act 1986 for acting in the different jurisdictions within the UK, but I have not sought to request the assistance of the courts in the 'relevant countries or territories' using their counterparts of this section. That is largely because you need local advice to seek that assistance and the local advice usually produces other solutions, in my experience. One exception was the Insolvency Act 1986 (Guernsey) Order 1989, which enabled the courts of the two jurisdictions to apply aspects of English insolvency law to a Guernsey company's affairs.

The Centre of Main Interests

An insolvent entity's Centre of Main Interests is a subject that consumes a good deal of ink, not all of it constructively. The flexibility of the concept as currently enacted generates contrary argument from both the legal purists, who want clarity of definition, and parties who feel disadvantaged when it is invoked. Hopefully, insolvency practitioners cut through all this and use COMI, along with all the other tools at their disposal, to achieve pragmatic and practical solutions. Let's just keep battling against ideas such as basing COMI on the circumstances that prevailed exactly one year before the opening of insolvency proceedings, which has been proposed (presumably by someone recently working in a parallel, theoretical universe).

The real point about COMI is that it's a question of facts and evidence. A German subsidiary, wholly controlled, managed and administered from London was not susceptible to German insolvency proceedings, despite its sole employee being German and located in Germany. The case threw up some interesting challenges about moving from an out of court administration to a creditors' voluntary liquidation when the latter requires court recognition, but in the circumstances there was no alternative.

> The real point about COMI is that it's a question of facts, and evidence.

Secondary proceedings

Secondary proceedings are something you might wish to avoid if you were satisfied that the foreign establishment (within a single entity – we are not talking about subsidiaries here) is better handled as part of your main proceedings. However, some local creditors may then have a bargaining counter to use against you. What you need to do is ensure that no creditor is worse off

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by not having local secondary proceedings. This may involve finding a way to get the local equivalent of the Redundancy Payments Service to recognise your appointment as triggering their obligation to pay the claims of local employees, which can be easier said than done, whatever the strict legal position might be.

Alternatively, if your main UK estate is light on assets and you are disinclined to invest your own time and money in the complexities of dealing with a foreign establishment that might at any time disappear into foreign proceedings, you may choose to have a secondary liquidator appointed in another jurisdiction. Critically, in many jurisdictions you will not have the opportunity to choose your own, or even influence the choice of, liquidator, so this is not a step to be taken without expert local advice.

There are bilingual or dual-qualified lawyers in the UK able to help you with assets in the particular jurisdiction of their speciality (some have written in previous issues of *RECOVERY*), but this doesn't apply to all jurisdictions. I haven't made it work in Latvia or Bulgaria for example. In both those countries the solution was to go to a local (bilingual) lawyer, who in one case was also an IP.

Seeking in-country professional help

Two key points when seeking in-country professional advice or assistance are: as far as possible to use someone you know and trust; and to remember that their underlying laws, culture and expectations may be very different.

> “When using an in-country professional… a good approach is to ask how to achieve your broad objective… or what is the best alternative they can suggest.”

Many foreign advisors will produce what looks like a learned thesis if asked for written advice. Occassionally their approach can be highly theoretical, focusing on black letter law and (sometimes) precedent. Usually a good approach is to ask how to achieve your broad objective (sell that going concern, or realise these assets and get the proceeds into your hands in the UK, for example) or what is the best alternative they can suggest.

It really is not a trivial point that language can be the least of the barriers you might encounter. But don't let that put you off. Whether realising US real estate or Italian debts, my experience is that knowing and using a good local professional is always at or near the top of the list of appropriate solutions. INSOL International (of which you are automatically a member if you are a member of R3) and INSOL Europe (which, as its Immediate Past President, I urge you to join if you are not already a member) are the ideal contact mechanisms for getting to know fellow professionals in other jurisdictions. Of course, this works both ways and your new friends may also need your help in the UK. But if such networking is not for you, there are IPs in the UK who have the connections to solve your foreign problems. ◻

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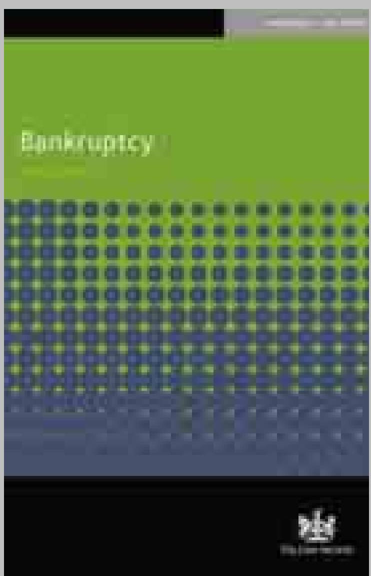
Book review



Bankruptcy

- **Edition** First
- **Author** Vernon Dennis
- **Publisher** Law Society
- **ISBN** 978 1 85328 883 8
- **PRICE** £39.95

The third and final instalment of Vernon Dennis's Insolvency Law Series, *Bankruptcy*, is a very useful reference guide for those new to dealing directly or indirectly in personal insolvency. It is a step-by-step guide of the procedural process of bankruptcy. Dennis has a skill for explaining a complex and sometimes less than exciting subject in a clear and engaging manner. This would enable even those without a background in insolvency to gain a fundamental understanding of the legal and procedural processes, and the subsequent consequences of a bankruptcy petition.

Dennis introduces the topic of bankruptcy with a brief history of its ancient origins and how bankruptcy has evolved into today's current understanding; and spends an appropriate amount of time on 'alternatives to bankruptcy' including a discussion on the idea of individual voluntary agreements, encouraging the reader to consider other options.

The book moves through a logically laid out explanation of the procedure of bankruptcy, from the pre-conditions that need to be fulfilled before a petition is started and how the petition should be submitted and administrated in court, advising on likely outcomes if one path is taken over another. The author codifies a large amount of legislation and case law in an effective, digestible manner – guiding IPs where to look in a minefield of information.

The book considers the rights and obligations of all the interested parties including the debtor, creditor and the trustee, as well as the effects that a bankruptcy petition may have on said party. In some circumstances, as Dennis points out, the creditor may be in a better financial situation by not taking out a bankruptcy petition on his debtor.

Akin to the *LPC Practice Guides* Dennis takes the time to lead the reader through the relevant statutory provision and case law and gives guidance on how to fill in the numerous forms needed to file a bankruptcy petition.

Without going into great depth, Dennis offers those with a more academic interest in the subject 'food for thought' by questioning certain elements of the law and highlighting problematic areas; but does this in such a way as not to confuse those new to the subject.

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The 'Investment Bank' Special Administration Regime

Adam Plainer and **Mike Pink** explain some of the main features of the new regime and illustrate the benefits and limitations of it in the context of MFG UK.

The collapse of Lehman Brothers and the ensuing financial crisis highlighted that the general administration process in England and Wales did not adequately cater for the complexities of a failing UK investment bank. Accordingly, new rules and regulations (in the form of the Investment Bank Special Administration Regulations 2011 (the Regulations), which were supplemented by the Investment Bank Special Administration (England and Wales) Rules 2011 (the Rules)) were introduced by parliament in order to assist in improving recoveries in a timely fashion from any future investment bank failure.

When the UK broker-dealer arm of the MF Global group, MF Global UK Limited (MFG UK), entered into special administration on 31 October 2011 following the Chapter 11 bankruptcy of its US parent company, MF Global Holdings Limited, it did so under the new Special Administration Regime (the SAR). This was the first 'special administration' under the new regime.

The special administration of MFG UK is still on-going and is providing a testing ground for the SAR. Accordingly, the purpose of this article is to explain some of the key features of the new regime in the context of MFG UK and some of the practical concerns MFG UK's special administrators have faced in making early distributions under the new SAR.

Who is special under the SAR and what makes the SAR 'special'?

'Special Administration' and its variants

The new rules and regulations apply to UK investment banks, which, for the purpose of the SAR, include institutions that hold client assets and are authorised to carry on certain regulated activities by the FSA. Important to note, however, is that the SAR also applies where the relevant institution is not a deposit taking bank, so the special resolution regime under the Banking Act 2009 does not apply.

Instead, the SAR provides for what is called 'special administration' and two further variations on the special administration process: special administration (bank administration) and special administration (bank insolvency). This article will not endeavour to discuss the intricacies of either of these two variations as MFG UK was not a deposit taking institution and it entered into administration under the umbrella procedure 'special administration'.

Objectives

Fundamental to the SAR are its three objectives, which administrators have a duty to follow, and that replace the administration objectives administrators have grown familiar with under paragraph 3 of Schedule B1 of the Insolvency Act 1986. These are:

1) to ensure the return of client assets as soon as is reasonably practicable;
2) to ensure timely engagement with market infrastructure bodies, the Bank of England, the Treasury and the FSA, in the UK and abroad; and
3) to rescue the investment bank as a going concern or to wind it up in the best interests of the creditors.

These objectives can be addressed in any order and prioritised as the special administrators see fit, although the special administrators must set out that order of priority and how they intend to address each objective in their proposal to creditors. The special administrator is not required to return all client assets before addressing unsecured creditors.

Note, however, that the FSA has the power to direct the special administrator to prioritise certain objectives over the others if that is necessary to maintain public confidence in the stability of UK financial markets. MFG UK has not been subject to any such direction by the FSA.

> "In *Lehman* the court held that it had no jurisdiction to sanction a scheme of arrangement that sought to effect a compromise or arrangement over assets held on trust. The SAR has provided a mechanism to address some of these problems."

Return of client assets

One of the main difficulties in dealing with an insolvent investment bank, which became apparent in *Lehman Brothers*, is identifying what securities and cash are held on trust for clients with sufficient certainty for them to be safely distributed and how to deal with shortfalls – eg where clients' trust claims to securities exceed the amount of the securities held on those clients' behalf in either a client or house omnibus account at the investment bank. In particular, in *Lehman* the court held that it had no jurisdiction to sanction a scheme of arrangement that sought to effect a compromise or arrangement over assets held on trust. The SAR has provided a mechanism to address some of these problems by providing certain processes for assisting special administrators with the objective of returning client assets as soon as is reasonably practicable.

However, although client monies are a subset of the definition of client assets under the Banking Act 2009, the Regulations expressly state that the return of client assets regime provided for under the Rules, does not to apply to client money. Thus, the return of client money continues to be governed by the FSA's CASS rules.

Accordingly, the SAR distinguishes between three different categories of claimants: (i) those with client money claims; (ii) those with client asset claims and (iii) those with unsecured claims against the general estate.

Other 'special' provisions: supply contracts

It is worth noting that the SAR prevents suppliers in respect of a limited listing of service areas (dealing with or relating to IT hardware and software used by the investment bank in connection with trading of securities and derivatives etc) from exercising contractual termination rights in respect of arrears under the contracts of supply in the period prior to the special administration, where the entity in special administration was the counter-party (rather than, say, its service company). This has proved a useful tool in securing much of the necessary IT hard- and software to assist in the orderly special administration of MFG UK.

Some practical challenges of making early distributions

Return of client money

Despite the fact that at the time of contemplation the Supreme Court had not yet handed down judgment in the *Lehman* client monies case and that CASS Rules do not provide a mechanism for the interim distribution of client money, in pursuance of objective 1, the special administrators of MFG UK considered, with the approval and support of the FSA (who is afforded a greater role under the SAR), that they should make an interim distribution from the client money pool to those who have valid claims against that pool.

In preparing for this interim distribution the special administrators of MFG UK faced considerable challenges to model the appropriate assumptions concerning the size of the client money pool and appropriate reserves to be made in respect of all possible claims against the client money pool. Nevertheless, the existence of objective 1 ultimately allowed the special administrators to do this in stark contrast to the situation in respect of Lehman Brothers International (Europe) Limited, whose administrators, at the time of writing, have been unable to make a distribution of client money.

The impact of the *Lehman Brothers* Supreme Court decision

Although the special administrators of MFG UK were able to make a distribution of client money in pursuance of objective 1, because the return of client money is still governed by the FSA's CASS rules, as noted above, the special administrators needed to make (and continue to revise their) assumptions in respect of (i) the size of the client money pool and (ii) the appropriate reserves in respect of all potential claims against that pool.

"The special administrators must now consider whether they will apply to court for further guidance in respect of certain issues that remain unresolved, or have arisen following the judgment, before making any further distributions of client money in accordance with the SAR's objectives and before establishing whether there is a shortfall in respect of those monies."

Accordingly, the recent Supreme Court decision in the *Lehman* client monies case has become increasingly relevant to the special administration of MFG UK as it affects both the size of MFG UK's client money pool and the potential claims into that pool. Further, following the judgment, the special administrators must now consider whether they will apply to court for further guidance in respect of certain issues that remain unresolved, or have arisen following the judgment, before making any further distributions of client money in accordance with the SAR's objectives and before establishing whether there is a shortfall in respect of those monies.

Shortfall claims on the general estate

A consideration in respect of distributions in relation to the unsecured estate is the shortfall regime contemplated by both the SAR and the CASS regimes. Both the CASS regime in respect of client money and the SAR in respect of client assets provide that where there is a shortfall in the amount of money or assets available for distribution, as relevant, the clients in respect of each of the client asset and client money pools will bear those shortfalls *pro rata* and the resulting claim in respect of those shortfalls will be a claim against the unsecured estate for the balance. Accordingly, until those shortfall claims are ascertained, or appropriately reserved for, making interim distributions in respect of the unsecured estate will continue to present the special administrators with its own unique challenges, which the special administrators will likely look to resolve by making reserves.

Objective 2: engagement with market infrastructure bodies, etc

Under objective 2 the special administrators are required to liaise with market infrastructure bodies to facilitate the operation of default rules and arrangements to facilitate the settlement of trades. However, the special administration of MFG UK has shown that, although there is an obligation on the special administrators to liaise with these parties in order to minimise disruption of business and financial markets, the SAR does not assist in mitigating the loss of control of the special administration itself caused by the relevant exchanges invoking their default rules to effect the close-out process on their exchange. In the case of MFG UK, this has caused considerable delay to the special administrators in reconciling their client's positions because of the dependence on information from third parties. The special administrators' powers continue to be subordinated to the rules of recognised exchanges and clearing houses as set out in part 8 of the Companies Act 1989.

In summary

Despite its imperfections, the SAR has proved that it is capable of providing a mechanism by which the special administrators can make timely distributions to certain categories of claimants. Nevertheless, the FSA has indicated that it will commence a formal consultation period with the industry in respect of the SAR, so it is likely there may be further legislation to deal with any outstanding issues surrounding client money. ◻

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The Stanford saga: cross-border insolvency and restraint proceedings collide

The problems of maximising asset values subject to claims in competing jurisdictions.

Introduction

The collapse of a corporate entity owing to the discovery of a fraud it has perpetrated may trigger a number of competing claims over its assets. Liquidators may be appointed to satisfy creditors. Prosecutors may impose criminal restraint orders to freeze assets pending confiscation. Victims of fraud may seek freezing orders to preserve property pending their own actions for recovery.

Untangling this web of conflicting interests is taxing enough if all the entity's assets and those who would lay claim to them are situated in one jurisdiction. Identifying who has ultimate priority over those assets across several distinct jurisdictions is even more complex. Not only may there be competing claims from receivers, liquidators and other creditors for repatriation to a number of separate jurisdictions, but with the increasing use of requests for mutual legal assistance by foreign prosecutorial agencies there will often be a criminal dimension too. There is also the question of how frozen and/or restrained funds should be used pending the determination of criminal charges or civil complaints against relevant parties, or until the most appropriate forum for the dissolution of a business has been discovered.

No recent case has thrown these complex and often competing issues into sharper relief than the attempts by law enforcement in the United States and liquidators in Antigua to realise the assets of Stanford International Bank (SIB). These attempts have led to thought provoking decisions in this jurisdiction, which this article considers.

> "Not only may there be competing claims from receivers, liquidators and other creditors for repatriation to… separate jurisdictions, but with… requests for mutual legal assistance by foreign prosecutorial agencies there will often be a criminal dimension too."

Background

In February 2009 the Securities and Exchange Commission (SEC) filed a complaint against Sir Allen Stanford, SIB and other parties alleging securities fraud. This followed the revelation that SIB was a vehicle for a $4.4 billion Ponzi scheme. At the same time, the SEC obtained a receivership order over all SIB's assets. With SIB registered in Antigua, the Antiguan Court then appointed receivers over SIB's assets who found themselves in direct competition with the SEC's receiver.

It did not take long for the saga to find its way into the English and Welsh courts for, as was quickly discovered, SIB held some $100 million to $110 million in assets in this jurisdiction. At first the SEC obtained civil freezing orders over SIB's UK property.

In April 2009 there followed an application by the Serious Fraud Office (SFO) to the Central Criminal Court (CCC) for a restraint order made pursuant to article 8 of the Proceeds of Crime Act (External Requests and Orders) Order 2005 (ERO). The ERO provides for the imposition of restraint orders, akin to those under the Proceeds of Crime Act 2002 (POCA), to be directed to assets suspected to be proceeds of crime in this jurisdiction at the request of a foreign prosecutor. The SFO was acting as agent for the SEC and Department of Justice (DoJ), pursuant to a request for mutual legal assistance.

Following an order of the Antiguan Court that SIB be liquidated and its assets vested in the Antiguan liquidators an application was made to the High Court for recognition of the Antiguan liquidation of SIB as a 'foreign main proceeding', pursuant to article 17(2)(a) of the UNCITRAL Model Law on Cross-Border

Insolvency (the Model Law), along with an order vesting SIB's UK assets to those liquidators. Being so recognised would, of course, give the Antiguan liquidators priority over SIB's assets held in the UK. Their application was granted by Lewison J ([2009] EWHC 1441 (Ch)).

The liquidators then applied to the CCC for a variation of the restraint order so as to give effect to the High Court's decision. By this time they had been served

> The Court of Appeal quashed the original restraint order for material non-disclosure but continued… to impose a new order… retaining the SFO's administrative priority.

with the material on which the SFO's application for the restraint order had been based. As when making the restraint order the CCC had not been made aware of either the civil injunctions or Antiguan liquidation proceedings the liquidators extended their application to include quashing the order on the basis that it had been granted following material non-disclosure. That application was refused.

The SEC appealed the High Court's rejection of their application for registration, and the registration of the Antiguan liquidators. The liquidators appealed the decision of the CCC not to discharge the restraint order. These appeals were heard together, and led to the first important judgment in the Stanford saga.

In Re Stanford International Bank [2010] EWCA Civ 137

The Court of Appeal dealt firstly with the question of which proceedings were to be recognised as the foreign main proceedings under the Model Law. It upheld Lewison J's decision and recognised the Antiguan liquidators.

The court first held that the Antiguan liquidation was a foreign proceeding for the purposes of the Model Law whereas the SEC receivership was not. On analysis the receivership was not 'collective'; rather than being designed to identify and distribute SIB's assets to its creditors its function was to preserve those assets from dissipation.

Secondly, SIB's Centre of Main Interests (COMI) was to be presumed to be Antigua as that was where its office was registered. Only when the COMI of the insolvent entity is based in the same jurisdiction as the applicant for registration as a 'foreign main proceeding' can those proceedings be said to be a 'main proceeding'. In SIB's case that presumption had not been rebutted; the COMI was in Antigua and the Antiguan liquidation the 'foreign main proceeding'.

The Court of Appeal quashed the original restraint order for material non-disclosure but continued, however, to impose a new order. This order, notwithstanding the fact that it was imposed later in time, retained the SFO's administrative priority (this would be quite different under POCA with priority given to a liquidator so long as he had been appointed before any restraint order is made).

The court also set down some helpful guidance for how parallel restraint and insolvency proceedings should be managed; essential reading for practitioners (see paragraph 204).

The result of the decision was that the liquidators were confirmed as the lawful custodians of SIB's assets. They were, however, trumped by the SFO/DoJ's restraint order. While both appealed to the Supreme Court this continuing tension was to produce the next interesting decision in this story.

In Re Stanford International Bank (Central Criminal Court)

In July 2011 the Antiguan liquidators applied to the CCC under Article 8(2) of the ERO to vary the restraint order. The application sought permission to draw down (as a loan) some $20 million of SIB's assets held in England and Wales as SIB's 'living expenses'.

The liquidators needed funds. There were the on-going costs incurred in maintaining SIB's assets, necessary to avoid a fire sale and preserve their value. They wanted to develop properties held by Sir Allen and SIB to enhance their value for later sale. Other outgoings included the costs of legal claims contemplated against various third parties including seeking recognition as the 'main foreign proceedings' in the US, instituting so-called 'claw back claims' against the net winners from the SIB scheme and maintaining freezing orders obtained against Sir Allen's girlfriend who appeared to be unloading Stanford's property at undervalue. Funds could be sourced from third party funders to meet these costs, but at punishing interest rates.

The SFO (as agent for the DoJ) 'fundamentally disagreed' with the release of any assets; the correct approach was for all SIB's property in the UK to be preserved pending an application under the ERO by the SEC receiver for repatriation to the US.

The judge, Gloster J, noted that she was required to balance competing interests. On the one hand there was the need to preserve assets situated in this country from diminution, the 'legislative steer' of a restraint order either under the ERO (or POCA). On the other, there was the need for creditors to be properly protected. Balancing those interests required a 'flexible and pragmatic approach'.

Gloster J concluded that the variation should be allowed. The Court of Appeal when (re)imposing the restraint order had specifically made provision for SIB's 'living expenses' which, although inappropriately worded, suggested that they envisaged costs incurred by the liquidation being met at least in part from restrained funds. In any event the liquidators were not seeking to permanently remove the relevant funds from restraint; they were prepared to enter undertakings that the money would be repaid following the sale of SIB's assets in Antigua and elsewhere. The cost of sourcing alternative funding was, in the circumstances, far too high.

To Gloster J, the liquidator's proposals seemed both realistic and proportionate and the judge was not prepared to run roughshod over the views of experienced professionals without good reason. It was also at least 'reasonably arguable' the Antiguan creditors could establish a proprietary claim against the restrained funds, which would exempt them from the ambit of the restraint order in any event.

Comment

In this (still on-going) case the concomitant restraint proceedings have self-evidently proved a cumbersome, costly and unnecessary sideshow to the real issue. The question has never been whether those assets are preserved for the benefit of SIB's creditors or the victims of Stanford's fraud. In practice the two groups are to all extents interchangeable. The question is which proceedings are more appropriate. This is what the Model Law is supposed to answer, yet the answer it has given has been short-circuited by the restraint proceedings. Restraint orders made under the ERO are undoubtedly a useful prosecutorial tool for preventing the dissipation of assets by defendants facing investigation or prosecution by overseas agencies, but courts in this jurisdiction faced with similar issues should be alive to their capacity to muddy what may already be less than clear waters.

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Sovereigns and banks: a clear and present danger to each other?

Thomas F Huertas explores the relationship between sovereign debt and the banking system.

Recent troubles in the eurozone demonstrate that banks pose a risk to sovereigns, and sovereigns pose a risk to banks. Although steps are underway to defuse each of these risks and to disentangle them from one another, there can be no guarantee that the steps will succeed. The situation remains fraught and is likely to remain so for some time.

During the crisis, sovereigns bailed out banks in the United States of America and various European countries. They injected equity into banks, extended credit and/or guaranteed banks' liabilities – all because sovereigns considered that banks were too big or too important to fail. Total support for banks exceeded €10 trillion. This strained the public finances. The ratio of public debt to GDP rose and the rating of the sovereign either sank or came under threat.

Protecting the sovereigns from banks

Governments have recognised that the policy of 'too big to fail' is too costly to continue. Under the aegis of the G-20, the Basel Committee has reformed regulation so that banks will be less likely to require resolution. Capital requirements will increase, and liquidity will be strengthened. Also under the aegis of the G-20, the Financial Stability Board has established principles for resolving banks that do fail so that they can be resolved without taxpayer support and without causing havoc in either financial markets or the economy at large. Work is now underway to turn these principles into a practical tool kit that the authorities can use, if a bank needs to be resolved.

" If adopted and implemented, these proposals will ensure that private investors rather than taxpayers bear the cost of bank failure. "

Broadly speaking, the tools likely to land in the final kit will enable the authorities to engineer something akin to a pre-pack recapitalisation of the failing bank. Investor capital (preferred stock, subordinated debt and possibly some portion of senior debt) will bear loss, while the bank continues to service customer obligations, such as deposits. If adopted and implemented, these proposals will ensure that private investors rather than taxpayers bear the cost of bank failure. That will reduce the risk that banks pose to sovereigns.

Risk to banks

Sovereigns also pose a risk to banks. Sovereigns can reschedule or restructure their debt or even default on their obligations. Although the sovereign has the power to levy taxes, there are economic limits on the amount of tax that a government can extract from an economy without harming growth and there are political limits on the share of government spending that voters will allow governments to devote to debt service. Consequently, government bonds are not free from credit risk. Nor are they free from interest rate risk. As a result, government bonds can and do vary in yield and price.

This poses a risk to banks, for banks are heavy investors in government bonds. Indeed, in most countries, banks are disproportionately invested in the bonds of the sovereign in which they are headquartered. Banks are therefore exposed to significant loss, if the sovereign has to reschedule or restructure, or if the Central Bank raises interest rates.

If banks hold their sovereign bond portfolio in their trading book, they have to mark such bonds to market and hold capital against the possibility that the price of the bond may decline. But if banks hold such bonds in the banking book, they are generally not required to hold capital against their sovereign bond positions and such positions are exempt from the limit that banks would otherwise face on large exposures to a single borrower. Consequently, if a sovereign has to restructure its debt, its banks are likely to require recapitalisation as well.

Protecting the banks from the sovereigns

Sovereign risk therefore poses a threat to financial stability. That makes efforts to reform government finances all the more important. But it also poses questions as to whether steps should be taken to break the link between the sovereign and the banks. Liquidity regulation already takes a step in this direction. For the purpose of calculating the liquidity buffer, government bonds are valued at market prices less a haircut to allow for possible price declines. Similar considerations were used in the recent stress test conducted by the European Banking Authority. At some point, therefore, it seems likely that the treatment of government bonds will come onto the agenda of systemic risk boards. When it does, one should expect such boards to consider recommending that all government bonds be marked to market and subject to capital requirements. This will help insulate banks from sovereigns. ◻

" If a sovereign has to restructure its debt, its banks are likely to require recapitalisation as well. "

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Gaining ground: Germany's revised insolvency law

Revisions to the German insolvency law permit more flexibility. **Michael Thierhoff** explains why lawyers in England and Wales may need to raise their spinnakers to stay ahead.

Rivalry between England and Germany has often been the source of creativity and progress. When the Emperor promoted what is known as the Kieler Woche it was prompted by envy and fascination for Grandma Victoria's Cowes Week.[1] The lack of family ties over the years has moved rivalry to football and more recently to legislation.

With a clear eye on England, the German legislator is in the process of revamping the Insolvency Code. Step one became effective on 1 March 2012 and covers businesses, and will be discussed in this article. Step two will address consumers and, among other things, abbreviate the discharge period. Finally, step three will deal with group insolvencies.

Deficiencies recognised by the legislator and to be addressed in step one were:

- choice of IP
- debt-for-equity swap
- abuse of minority rights
- marginal use of DIP (debtor-in-possession).

Choice of IP

For major cases, the law now requires a preliminary creditors' committee to be established and heard on personal requirements and the choice of the individual, before an IP is appointed. The committee should reflect the creditors' community and be comprised of representatives of secured creditors, major creditors, small creditors and the employees. Upon filing, the debtor is obliged to provide the information necessary to the court (list of creditors etc). The court has to adhere to the criteria defined by the committee for the choice of IP and, if the committee unanimously votes for one individual, has only marginal room not to follow such a choice.

Time will tell how this works in practice. Given that potential remuneration for members of a creditors' committee is more of a deterrent than an incentive because people are busy, have limited time and the debtor is still trading, the judge may opt to declare the matter urgent and appoint an IP of his or her choice – and wait for the round of applause from the committee appointed later. While even this committee has the right to revise the court's choice, this in practice is unlikely to happen. Time lapse and the cost involved make this extremely unattractive.

So, in order to make use of this option the party filing is well advised to bring along a creditors' committee and present criteria for (and/or a choice of) IP to the court upon filing.

Debt-for-equity swap

In the event the creditors vote for a Chapter 11-type restructuring (*Insolvenzplanverfahren*), this may now also impact on shareholder rights in any shape or form admissible under corporate law. Therefore, it is now possible to convert debt into equity as part of the court agreed restructuring. If such restructuring is impacting on shareholder rights, the shareholders are also permitted to vote, forming their own group(s). As before, acceptance of a restructuring does not require the consent of all groups; if the majority of groups have voted in favour – both in terms of numbers and amount – the court approves the restructuring, unless it is deemed unfair. This means that shareholders may be outvoted. However, creditors whose claims are to be converted to equity have to consent individually.

Minority rights

Excessive minority rights had made *Insolvenzplan* proceedings a gamble, as dissenting creditors were able to blackmail the debtor and others by instigating litigation or threatening to do so. The new rules now offer an array of ways to mitigate this risk, and go as far as allowing the court to make way for the plan to proceed if the IP can claim that the disadvantages claimed by the dissenting party are clearly of a minor nature and are outweighed by the advantages of going ahead with an effective restructuring.

DIP

The ways to open DIP proceedings have been widened with a number of potential road blocks removed. For example, a unanimous vote for DIP by the preliminary creditors' committee reduces the discretion of the court to decline a DIP request to zero. In addition, the preliminary proceedings (usually two to three months, due to the German system of payroll funding) now also call for the appointment of a trustee (*Sachwalter*) in the case of a DIP, rather than a preliminary administrator.

Protective shield (*Schutzschirmverfahren*)

Moreover, we now have a process where, with proof of not being illiquid at the time of filing, a DIP application and an envisaged restructuring grant the right to propose the trustee to the court – and the court will grant up to three months to prepare the *Insolvenzplan*. On application, a stay is granted. While the practical details of this process may need some time to allow smooth sailing, the concept does offer a host of new options.

Well, I was never convinced that German Insolvency Law was as bad as sometimes portrayed by spectators from across borders. We were also allowed to use some of the white keys on our piano and had some competitive options in stall. But, with the new rules now in place, you are all invited to take another look. In all fairness, you will have to admit that the object in the rear view mirror has come much closer.

[1] Both sailing events now claim to be the largest in the world.

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Revision of the Dutch financial assistance prohibition

Willem Keukens outlines changes to Dutch law that will affect the dynamics between lenders, a purchaser and a target.

Anyone who has ever been involved in a refinancing or restructuring of a company (or group of companies) where one or more Dutch entities were involved, has probably come across the infamous Dutch financial assistance prohibition. The Financial Assistance Rules in the Netherlands have the reputation of being among the most strict in Europe and are generally regarded as too burdensome.

Changes to the law pending

As part of a thorough revision of Dutch company law – in particular relating to Dutch BVs (private companies with limited liability) – there is a change in law pending to come into effect that would ultimately abolish the current financial assistance prohibition for Dutch BVs. It is the intention of the Dutch legislator that this change in law is effected as of 1 July 2012 or, should this goal not be reached, ultimately 1 January 2013.

The current Dutch financial assistance prohibition for BVs is rather technical, but boils down to the following: (i) a BV (or any of its subsidiaries) may not provide security, price guarantees or otherwise warrant the performance of a transaction for the benefit of a third party that acquires shares in the capital of that BV and (ii) a BV may only grant loans with a view to the acquisition of shares in its capital by a third party to the extent of that BV's freely distributable reserves.

> "The abolition of the financial assistance prohibition is greatly welcomed in the acquisition finance practice and may also make life much easier for some of the parties involved in restructurings."

A transaction that violates the financial prohibition solution is generally considered to be null and void.

There are solutions available, which, for the most part, mitigate the risk of particular financial assistance transactions being null or void. For example, it is not uncommon that, after the acquisition of a

company, that company legally merges with the purchaser. As a consequence of that legal merger the security rights granted by the target to secure the acquisition loan are no longer 'tainted'. The Dutch Supreme Court also offered a helping hand as it has ruled that an arrangement by which the target company borrows money, grants security rights to the lender to secure these loans and subsequently extends the loan acquired to the purchaser with a view to the acquisition of shares in the capital of the target, in principle, does not violate the Dutch financial assistance prohibition.

Unanswered questions

However, these solutions are not always sufficient and they can be inadequate to deal with the financial assistance prohibition, so there are still many questions that remain to be answered. A question that is still unresolved is, for instance, whether the financial assistance prohibition applies to all subsidiaries of a target or just to the Dutch subsidiaries.

In the light of this and because the financial assistance prohibition is not regarded as necessary to accomplish protection of creditors and shareholders, the Dutch legislator has chosen to completely abolish the financial assistance prohibition. When the proposed changes in law come into effect, the current financial assistance rules will no longer exist – with immediate effect. Existing loans, security rights and guarantees that are currently 'tainted' by the financial assistance prohibition would no longer be limited. This would apply to all existing financial assistance transactions, provided that interested parties did not contest the validity thereof before the effective date of the amendment to the law.

Instead of a prohibition of financial assistance-related transactions, the board of directors of a Dutch BV will be responsible to assess whether providing financial assistance is in line with the corporate objectives of the company and in the best interests of the company and its stakeholders. This includes assessing the impact of the company providing financial assistance on its financial position. A director will have to weigh all pros and cons at both company and group level.

If, for instance, a company that has provided financial assistance goes bankrupt, a director of a BV may be held liable but only if it can be said that a director acting reasonably would not have made this decision and that the director can be blamed for serious instances of mismanagement. Whether or not this is the case will ultimately depend on all the circumstances at hand: did the director inform him- or herself of the consequences of providing financial assistance? Were all pros and cons weighed? It seems advisable to suggest that the least a director should do is properly to document every step in the decision-making process when providing financial assistance in order to mitigate liability risks as much as possible.

A welcome change

The abolition of the financial assistance prohibition is greatly welcomed in the acquisition finance practice and may also make life much easier for some of the parties involved in restructurings. These hard and fast rules are, however, replaced with the rather 'soft' rule of directors' liability. This inevitably leads to some degree of uncertainty as to when and to what extent a director will be liable. It is expected that, as a consequence, directors will exercise some restraint when deciding whether or not to provide financial assistance and it will be interesting to see how this will affect the dynamics between lenders, a purchaser and a target. ◻

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Major changes in some European member states' insolvency legislation

An outline of the latest major changes made or expected in several European countries.

European member states' insolvency legislation has seen several major changes during the past few years. For example, the coming into force on 1 July 2010 of the new provisions of the Austrian Insolvency Code have adapted the existing proceedings with a new debtor-friendly terminology, while the Law 38/2011 passed by the Spanish parliament (applicable from 1 January 2012) seeks to increase and improve the use of restructuring mechanisms for the benefit of debtors under the Spanish insolvency regime. Some of the major changes in Italy, Germany, France and Ireland are summarised below.

Italy

The Act 3/2012 (issued from the Legislative Decree 212/2011) was recently enacted and the new provisions came into effect on 29 February 2012.

The main goal of the Act is to provide a new legal tool allowing a private individual who is ineligible for standard insolvency procedures (ie where a debtor can no longer meet his or her credit commitments) to negotiate their debts with their main creditors. The procedure would allow them to discharge their debts and would involve all of their creditors, and effectively introduces consumer bankruptcy to the Italian regime.

> "The [French] legislature has now reintroduced this provision in law no. 2012-387 of 22 March 2012 after Simplification of the Law. Accordingly, the SFA procedure is finally applicable to financial holding companies."

Germany

On 1 March 2012, the Reform Act on insolvency law entered into force.

With a view to facilitating the restructuring of companies within insolvency proceedings, the reform allows creditors to select the insolvency administrator at an earlier stage than before, ie from the opening of preliminary insolvency

proceedings. This offers greater opportunity for creditor participation and the strengthening of creditors' powers.

France

The French legislature issued a new law no. 2012-346 on 12 March 2012 on protective measures applicable to safeguard reorganisation and liquidation procedures. Before the passing of this law, the president of the court could only order protective measures such as seizure or sale of a debtor's assets if a liquidation was extended to cover other assets intermingled with those of the debtor or if the debtor was culpable. This new law now allows the president of the court to order protective measures against a debtor's assets based on the extension of a safeguard, reorganisation or liquidation procedure due to confusion of assets. The purpose of the new law is to limit the diversion of the debtor's assets in all insolvency procedures.

The new procedure called 'accelerated safeguard procedure' (*sauvegarde financière accélérée* – SFA) came into force on 1 March 2011 but has already been subject to modification by the lawmaker. (SFA was initially introduced by law no. 2010-1249 on Banking and Financial Regulation of 22 October 2010.) The decree no. 2011-236 of 3 March 2011 was enacted to specify the new procedure of the SFA. However, a problem had been identified in the SFA even before it had entered into force. The lawmakers had wanted to create a new tool reducing conflicts of interests between banks and financial holding companies in the context of secondary LBOs. However, SFA was limited to companies that have more than 150 employees or a turnover of more than €20 million. Financial holding companies were therefore excluded from the scope of SFA as they seldom reach these thresholds. The decree was supposed to broaden the scope of SFA, but, given its importance, the provision was incorporated into the law on Simplification and Improvement of Law of 13 April 2011. However, this provision was declared, *inter alia*, unconstitutional for procedural reasons on 12 May 2011. So the legislature has now reintroduced this provision in law no. 2012-387 of 22 March 2012 on Simplification of the Law. Accordingly, the SFA procedure is finally applicable to financial holding companies.

Ireland – final draft to follow

The Irish government has published its Personal Insolvency Bill in draft form. The Bill is to provide for three new non-judicial debt settlement systems for individuals as well as new regulations permitting a creditors' meeting to be held other than in the form of a physical meeting (ie voting by telephone or electronically by email or online). The Bill has also proposed amendments regarding the discharge of bankrupt individuals who might otherwise seek to move their Centre of Main Interests (COMI) to a more favourable bankruptcy regime in another European member state (such as the United Kingdom).

The final version of the draft is yet to be issued. ◻

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A brief overview of the new practice direction on insolvency proceedings

David Fletcher and **Michael Arnott** outline the main points of interest in the new directive for IPs.

A new Practice Direction on Insolvency Proceedings (the PD) came in to force on 23 February 2012 through the unusual legislative mechanism of the Lord Chancellor's assent. The timing of his assent was not pre-determined, so its effectiveness caused a flurry of interest.

It replaces all existing Practice Directions, Practice Statements and Practice Notes on Insolvency, which is a welcome consolidation.

Any practitioner who is starting insolvency proceedings or making an application in existing proceedings (especially a remuneration application) needs to be aware of its contents.

Remuneration

The Insolvency Rules 1986 (the Rules) relating to remuneration were amended in 2010. One effect of this amendment was to introduce a new basis of remuneration. In addition to the existing bases – remuneration as a percentage of realisations and remuneration on a time/costs basis – the 2010 amendments introduced the basis of remuneration as a set amount.

The PD reflects that change. A combination of different bases is envisaged, where appropriate, and the overall remuneration package can (and should) be tailored to the circumstances of the case.

"There are eight guiding principles set out in the PD that should be considered *during the preparation and presentation* of remuneration applications."

The PD applies to any remuneration application made under the Insolvency Act 1986 or the Rules (paragraph 20.1).

Guiding principles

There are eight guiding principles set out in the PD that should be considered *during the preparation and presentation* of remuneration applications. They are:

- The onus is on the office-holder to justify his or her fees.
- The benefit of any doubt remaining after such justification should not be for the office-holder's benefit.

- The professional integrity of the office-holder should be recognised.
- The remuneration should reflect the value of the services rendered.
- The remuneration should be fair and reasonable.
- Both the remuneration and the information provided about it should be proportionate to:
  - the amount of remuneration to be fixed;
  - the nature, complexity and extent of the work; and
  - the value and nature of the assets and liabilities in the estate.
- Professional guidance as to remuneration may be considered.
- The court will take into account the timing of the remuneration application and the reasons for any delays!

Paragraph 20.4 sets out in detail the information that is required to be provided in support of a remuneration application and includes any other documentation that '*…[is] likely to be of assistance to the court in considering the application*'. This is a wide definition and it is clear that there will be considerable art in preparing and presenting a successful remuneration application.

The understandable sensitivity that the profession, the government and the public have to the question of office-holders' remuneration makes this part of the PD rather significant. An application that contains all the necessary ingredients for success could still fail if presented poorly or inappropriately, so time spent on considering presentation will be time well spent.

Administration extensions

The previous view of the courts was that an application to extend the period of administration should be issued no less than six weeks prior to expiry. The PD reduces that time period to one month.

If the applicant is late then the application must be supported by evidence explaining the delay. There are possible costs' sanctions for making a late application without satisfactory reasons for doing so.

As a matter of best practice, and given the consequences of failing to obtain an order in time, it still makes sense to make your application six weeks in advance.

Court documents

The headings of court documents in insolvency have changed. Practitioners should review their precedent documentation as soon as practicable to ensure compliance.

Urgent applications

We understand that the RCJ will be operating an urgent list on Wednesday afternoons, but a certificate of urgency will be required with possible adverse costs orders if urgency is not established.

This has been a concise overview of the PD covering the most salient issues arising from it for IPs. There are a number of other effects relating to winding up petitions, statutory demands in personal insolvency, service of court documents and appeals that will be relevant to varying degree, depending on an IP's practice. □

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Focus on Scotland

Securities granted by Scottish entities and securities over Scottish property

In considering the affairs of an insolvent company or individual, the insolvency practitioner (IP) will require to assess the rights in security granted by the insolvent party (the borrower) in favour of third parties. This article looks at the securities that are used under Scottish law or granted by Scottish companies and looks at the main differences with their counterparts under English and Welsh law (English law).

Types of security in Scotland

The types of security that we usually come across in Scotland are the standard security, floating charge, pledge and assignation in security.

Standard security

The standard security is used in Scotland to charge freehold property and also leasehold property granted for a period of more than 20 years. It is the only way to charge freehold and leasehold property in Scotland. The security right is only created once the standard security is registered in the Land Register of Scotland or Register of Sasines, as appropriate.

In England, the nearest equivalent to the standard security is the legal mortgage and is used to charge freehold property and leasehold. In addition, there is also a concept under English law of an equitable mortgage, which is a security that falls short of a legal mortgage, for example, a legal mortgage that has not been properly registered where that is required or otherwise falls short of the formal requirements for a legal mortgage. Another example would be a debenture granted by an English company or LLP, which includes a fixed charge over English freehold property.

If a standard security is granted by a Scottish or English company or LLP, then it requires to be registered at Companies House within 21 days of the date of its registration at the Land Register or Sasines Register. If the standard security is not registered within this time limit, the charge is void against any liquidator, administrator or creditor.

Floating charge

The floating charge in Scotland can secure the whole of the assets of the borrower. A floating charge can only be granted by a Scottish company or LLP. The floating charge floats over the assets until it crystallises on to the assets. Before a floating charge crystallises, the borrower can deal with secured assets without the consent of the lender.

Under English law, a floating charge can be converted into a fixed charge without crystallising. Another common

difference is that a floating charge is commonly found in a debenture rather than as a separate document. A debenture is an English law document granted by English companies and LLPs that creates fixed charges over certain categories of assets and floating charges over the remainder of the assets. The fixed charge means that the consent of the lender is needed to dispose of the assets charged. A fixed charge attaches to the charged assets and it gives the lender control over them. Fixed charges under debentures are not used in Scotland.

Similarly, a floating charge granted by a Scottish company or LLP requires to be registered at Companies House within 21 days of its execution and if it is not registered within this time limit then the charge is void against any liquidator, administrator or creditor.

Pledge

A pledge in Scotland is used to take security over moveable assets. The pledge is created by the pledge document together with delivery of that asset to the lender as security. Another arrangement called a pledge in Scotland is a share pledge. However, for this security right to be established, the shares require to be transferred to the lender or the lender's nominee, and the share pledge document will provide for the circumstances in which the shares are to be transferred back. The borrower generally retains the right to the dividend and to vote. Pledges granted by a Scottish company or LLP must, in certain circumstances, be registered with 21 days of their creation.

Assignation in security

An assignation in security in Scotland is used to take security over contractual rights, for example, a borrower's right to receive rents under a lease. The right in security is only created when the assignation is intimated to the debtor in that contractual right, for example the tenant, directing them to pay the rent to the lender rather than the borrower. Assignations in rent granted by a Scottish company or LLP must be registered at Companies House within 21 days of their intimation to the tenant.

English debentures purporting to cover Scottish assets

English companies or LLPs often have assets in Scotland and a debenture may purport to grant fixed charges over certain categories of property in Scotland and floating charges over any remaining property in Scotland. However, a fixed charge, within the debenture, over Scottish freehold or leasehold property will not be recognised under Scottish law because the only way of creating such security in Scotland is by a standard security. A fixed charge, within the debenture, over moveable assets will only be recognised if control of the moveable items has passed to the lender (like a Scottish pledge). A fixed charge, within the debenture, over contractual rights will only be recognised if the rights have been assigned to the lender and this assignation has been intimated to the debtors in the contractual rights, within the debenture, (like a Scottish assignation in security).

Conclusion

Under Scottish law, there are strict procedure steps to be taken in order to create a security. Under English law there are also strict procedural steps to be taken but there is also the concept of equitable security, which reflects the intentions of the parties. It is important from an IP's point of view to recognise the differences in securities under Scottish and English law in order to assess whether the Scottish assets are subject to a security right or whether the assets can be realised for the general body of creditors.

The author would like to acknowledge the assistance of colleagues from McClure Naismith LLP in writing about the various areas of interest: Securities – Paul Kenneth, Banking, Edinburgh; Rangers – Wilson Aitken, Property, Glasgow; Terminology – Nils Reid, Corporate, London.

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The Rangers administration: round one

'But if such be the law of England, on what ground can it be argued not to be the law of Scotland?' Lord Cranworth in *Bartonshill Coal Company* v. *Reid.*

Fortunately the House of Lords moved on and recognised that a legal system derived from Roman law and institutional writers did not always reach the same conclusion as a system based on precedents and common law. The wider legal community, however, is not always so sophisticated. The recent note by Lord Hodge for the joint administrators of the Rangers Football Club plc demonstrates the point.

A darker shade of pale

The background to the note is that Sir David Murray agreed to sell his majority shareholding in Glasgow Rangers, holders of a world record 54 league titles, to a Mr Craig Whyte for £1. This was on the basis that Mr Whyte used his funding to pay off the club's debt to Lloyds TSB of £18 million and undertook to make £5 million per annum available for investment in the club for a period of at least five years.

It quickly became clear, however, that Mr Whyte had apparently 'duped' Sir David and many others. The additional investment was not made, tax and VAT were not paid, and by 14 February 2012 administrators were appointed to the club. When the administrators investigated the books they found that Mr Whyte had not used his own funds to pay off the debts. Mr Whyte had forward sold to Ticketus season tickets for the seasons 2011–2012 to 2014–2015 for over £25 million. It was not the entire season ticket capacity but they accounted for 'about 60 per cent of the cash flow of Rangers in those seasons'. The agreements with Ticketus envisaged that Rangers would lend £16 million to Mr Whyte's company Wavetower who would repay the debt to Lloyds TSB, and the bank's debt and securities would be assigned to Wavetower. The arrangement looks very much like financial assistance contrary to S.678 of the Companies Acts but the administrators, to date, have not taken that point but asked for directions as to whether they could be prevented from terminating the Ticketus contracts.

The Ticketus agreements

The Ticketus agreements sold certain season tickets to Ticketus and then appointed Rangers as the non-exclusive agent of Ticketus to sell them and pay the proceeds into a designated account with Bank of Scotland for the sole benefit of Ticketus. The agreements bore to be governed by English law and the courts in England were to have exclusive jurisdiction over it. An opinion on English law was produced to the court, this said the agreement conferred a bundle of transferable licences to Ticketus that were irrevocable and could be enforced by equitable relief. Full beneficial title to the future income flow vested in Ticketus protecting Ticketus against the insolvency of Rangers.

The administrators did not challenge the English law analysis but said it was irrelevant as the law of Scotland determines the proprietary effect of the agreement in the context of the administration of Rangers.

Lord Hodge agreed that *'while the contractual aspects of a contract to assign corporeal moveables are governed by the law applicable to the contractual obligation, the final question of proprietary rights must be determined by the lex situs'*. On that basis under Scots law the licences did not create a real right to the season tickets. Ticketus also alleged that the agreement created a trust over the proceeds. Under Scots law, however, where truster and trustee are the same person (ie here Rangers) there must be constructive delivery of the trust subjects to create an irrevocable trust. As the proceeds (ie the monies to be paid for the season tickets) did not exist there could be no delivery. Lord Hodge's final blow was *'In Scots insolvency law, a contracting party who has paid in advance for an asset does not thereby acquire an equitable right in the thing and is treated as an unsecured creditor… This may shock English lawyers who are used to equity stepping in to protect contractual expectations in some such circumstances. But no unfairness arises in an insolvency when unsecured creditors are treated equally in accordance with their rights.'*

Ticketus now on the right foot

For reasons that are not relevant to the present discussion the administrators did not get the direction they were seeking. Ticketus, however, saw the writing on the wall. They have agreed to join a consortium seeking to buy the club with their debt reduced from £25 million to £10 million payable at £1 million per year, but only when the club is in Europe.

The message is clear: making an agreement subject to English law will not protect property rights where the property is situated in Scotland. Specialist advice under Scots law is required.

'In Scots insolvency law, a contracting party who has paid in advance for an asset does not thereby acquire an equitable right in the thing and is treated as an unsecured creditor.'

Terminology

I recall hearing the story of an English linguistics lecturer who upon stating learnedly to his class that there was no language 'on God's green earth' where a double positive form (eg 'Yes, Great!') could be held to have a negative meaning was met with the withering riposte of one wily Glaswegian student, 'Aye, Right!'

Scots is indeed a very different language and the terminology used by insolvency practitioners in Scotland is also different. Insolvency terms and expressions used north and south of Hadrian's wall are, confusingly, often either different words with the same meanings, or, the same words with slightly different meanings. The following are just a few examples:

Scotland	England
Sequestration	**Bankruptcy**
Accountant in Bankruptcy the department responsible for administering the process of personal bankruptcy and recording corporate insolvencies in Scotland.	**The Insolvency Service** the service responsible for the administration of certain corporate insolvencies and the administration of bankruptcy and debt relief orders in England.
Receiver a person appointed by the holder of a floating charge to enforce the rights and remedies of the holder of the floating charge.	**Receiver** a person appointed by the holder of a fixed charge to enforce his security, rather than applying to the courts for compulsory liquidation of the security provider.
Debt Arrangement Scheme (DAS) introduced by the Scottish Government, DASs offer legal protection against enforcement action and/or the compulsory freezing of interest and charges.	**Debt management plans** have a similar purpose to DASs but do not offer legal protection against enforcement action and/or the compulsory freezing of interest and charges.
Decree the final decision of a Scottish court in an insolvency action.	**Judgment** the final decision of an English court in an insolvency action.
Diligence the procedure for enforcing decree against debtors in Scotland.	**Enforcement** the procedure for enforcing judgment against debtors in England.

However, before these differences leave you *'bousing at the nappy with Tam o' Shanter and Souter Johny'* take consolation, for there are actually far more similarities than differences between the two regimes.

Fraud and misconduct: proportionate routes to recovery

Dodgy directors beware! **Jon Brown** describes how electronic gumshoes are on the prowl…

It is important to make clear that instances of fraud and serious misconduct in distressed companies remain the exception, rather than the rule. The vast majority of companies and directors we encounter have sought to deal proactively with trading difficulties and work with their lenders and other creditors in an effort to return the company to better health.

However, on the occasions where an issue of concern is identified, the challenge for the practitioner is how to deal with it in a way that satisfies statutory duties, is beneficial to creditors and proportionate to the size of the issue.

Practitioners' concerns when hearing the words 'fraud' or 'investigation' often stem from bitter experience of a case where delays, obfuscation and escalating costs have sapped the energy of those involved in the process. The risk of depleting returns to creditors and the uncertainty of a successful conclusion contribute to a reticence to tread the same path again.

In part this fear stems from a misconception that an investigation is only successful if funds are recovered for creditors. Not so. A brief investigation that considers misconduct and the potential for associated recovery can be equally valuable if it informs a commercial decision that pursuit is not in the best interests of creditors.

Such an assessment also enables a practitioner to illustrate that they have considered all routes to recovery and does not preclude them from reporting conduct through to The Insolvency Service or other appropriate authorities. Equally, it does not prevent creditors from funding a further investigation as a matter of principle, regardless of commercial considerations.

The early stage assessment

The landscape for investigations has shifted considerably in recent years. Detection methods have advanced and the balance of power has shifted to the investigator. Investigations are now driven by technology – primarily the collection and analysis of electronic data – which can reduce the time required to make progress. These developments have made what I would refer to as 'early stage assessment' possible. Such an assessment will take a matter of days rather than weeks and happen immediately on appointment. It will encompass clearly defined strategies relating to the review of electronic material and establishing the financial position of the target of a potential claim.

The desired outcome of an early stage assessment is to identify whether there is evidence of fraud or misconduct and if there is a likely commercial benefit in pursuing further. This brings forward the decision on whether to proceed and enables the practitioner and creditors to take an informed view before incurring the costs of a fuller investigation.

Electronic review

The majority of a company's key accounting records these days are likely to be in electronic format, which can be a blessing and a curse. People can be indiscreet in email and instant messenger conversations and identifying who knew what and when is often picked up from reviews of electronic communications.

The downside of this is the huge weight of information – it is not uncommon for an investigation team to be faced with more than a million documents to review depending on the size of the insolvent company. Reducing this population to a more manageable number therefore requires considerable thought, investigative experience and advanced technology.

This can be accomplished by the use of an electronic review system, where documents are indexed, held and made available for review using filters such as key words, date ranges or document types. Tools now exist to identify and recover email and documents deleted by users and a review of these documents at the outset of an investigation is likely to fast track understanding of the potential issues.

> "A brief investigation that considers misconduct and the potential for associated recovery can be [as valuable as recovering funds for creditors] if it informs a commercial decision that pursuit is not in the best interests of creditors."

Initial analysis of the accounting systems to identify who has posted a particular journal, accounting entry or adjustment can identify suspicious transactions. Any queries or concerns identified here can be further explored in targeted email review of those involved in any suspicious activity.

Asset identification

Understanding the financial interests of the target of a potential claim is vital for the practitioner and creditors. If looking to make civil recoveries, a lengthy investigation into the conduct of an individual who has no assets makes little sense.

Recent pushes towards financial transparency have driven a significant increase in the amount of publically available financial information accessible online and make initial assessments more straightforward.

Initial investigations, including email review, can provide leads to be followed in relation to assets held by the targets for any potential claim. These indications can often

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be traced through to various asset registers, property registers and databases of corporate structures in the UK and overseas.

An early assessment of the potential 'prize' enables the practitioner and creditors to take an informed view on whether it is commercially beneficial to pursue an investigation.

Further investigation and recovery

The early stage assessment combines the two elements – electronic review and asset identification – that enable the decision to embark on further investigation to be an informed one. It cannot guarantee success but it does provide a cost-effective way for practitioners and creditors to pick their battles.

Thereafter, maintaining a proportionate approach in any subsequent investigation, continuing to use technology and engaging in commercial negotiations, will give them the best opportunity of containing costs and maximising prospects of recovery.

These issues are best illustrated with a couple of case examples:

Project chess
– focusing the electronic review

The administration of a company where fraud was suspected provided us with a real challenge. With numerous trading sites, large offices in multiple locations and hundreds of employees with system access, gathering the appropriate accounting records to assist in continued trading, minimise disruption, but allow an investigation to take place, became logistically problematic.

Given the strong possibility of civil and criminal proceedings, there was little option but to capture all electronic information, from all sites. It was imperative to ensure that the information captured was preserved in a forensically sound manner – with a 'chain of custody' that illustrates how it was collected and to ward off later allegations of evidence tampering.

> "A number of the management team had deleted large quantities of emails and electronic files… [and] using a forensic tool it was possible to retrieve the majority of deleted items and… build up a quick picture of what had happened and who had been involved."

We deployed a team to work through the night following appointment, drawing all information out of the company's servers and prioritising a similar exercise over the laptops and phones of management. Our work was undertaken discreetly – with no indications given to employees that the collection of data was anything other than the norm in insolvency proceedings.

This data collection yielded more than 2.5 million documents, an unmanageable population for an initial review. We therefore ran automated tests across all data to identify any efforts by individuals to delete or hide email or documents. This approach allowed us to identify users of interest and then focus on the key documents that they had been working on or had tried to hide.

It transpired that a number of the management team had deleted large quantities of emails and electronic files in the days leading up to administration. Using a forensic tool it was possible to retrieve the majority of deleted items and our review therefore concentrated on those documents. It will be of little surprise that it was the deleted material that enabled us to build up a quick picture of what had happened and who had been involved.

This early stage assessment gave creditors the confidence that there was a strong claim. Following a short review of the financial interests of those responsible, which identified significant assets in the UK and a number of other jurisdictions, parallel civil and criminal proceedings were launched and a fuller investigation commenced.

Project phonic – asset recovery

When an office-holder from Ernst & Young was appointed as administrator of an owner managed business, we began to examine the events leading to insolvency. The company's bankers had taken on the lending relationship less than a year prior to the administration and had seen a rapid and alarming plunge in cash flow.

A short, targeted review of the directors' email, together with conversations with disgruntled employees, identified that more than £1million had been drawn out of the company in the lead up to administration through a variety of schemes, including preferences, stock movements at undervalue and false invoicing.

These issues are not uncommon in owner managed 'lifestyle' businesses, where directors do not always distinguish between personal and company funds. Cash-flow difficulties here have a double impact and can push people to behave in ways they would normally consider improper.

We worked with lawyers to draft an affidavit illustrating that the directors' conduct constituted misfeasance and launched a claim for the full amount of the company's losses. We also took the step of obtaining a freezing order to protect assets in a number of jurisdictions, identified as part of our early stage assessment, and to force the directors to disclose any that we had yet to identify.

Following partial admissions from the directors, negotiations took place and a commercial settlement was agreed, saving further time and costs. The directors' conduct was reported to The Insolvency Service. ◻

Tactical considerations

There are a number of considerations for a practitioner and creditors when faced with issues of fraud or misconduct.

Creditors may have wider commercial concerns if they continue to trade with, or provide lending to, associated companies and pursuing an action that may have ramifications in the solvency of the associated companies may not make logical business sense.

Transparency and communication between the practitioner and creditors is therefore necessary to ensure that the action taken is acceptable to all stakeholders. This includes ensuring that claims are fair, appropriate and not launched vindictively.

Where a decision is made to initiate some form of claim for redress, working towards an agreed commercial settlement is often the best solution. Any court case or prolonged dispute is a costly exercise and the quicker a settlement can be reached the better.

The IP, in conjunction with legal advisors, will also need to consider the extent to which the claims are framed using Insolvency Act (or Companies Act) offences or the extent to which powers of compulsion under the Insolvency Act are used.

As an example, fraud can be difficult to prove to criminal standards due to the requirement to show intent. A civil claim for breach of fiduciary duty is more straightforward as this would just require showing that the director did not act in the best interests of the company or with due care.

On occasions, gaining a summary judgment on one element of a claim (for example a transaction at undervalue) may be fairly routine. Prioritising this action can give the practitioner and creditors confidence that there will at least be some returns. These may then be used as a fighting fund to take further actions in relation to larger heads of claim.

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Merger control rules apply to the transfer of businesses in administration or liquidation

Sheldon Mills offers guidance for IPs on merger control rules.

There is no legal exemption from the application of UK merger control for the acquisition of businesses out of administration or from insolvency procedures. Insolvency practitioners need to be aware of how the merger rules may affect their clients and potential purchasers.

The Enterprise Act 2002 (the Act) imposes an obligation on the Office of Fair Trading (OFT) to refer to the Competition Commission (CC) for an in-depth investigation those qualifying mergers that give rise to the realistic prospect of a substantial lessening of competition. In such cases, in the absence of remedies being given to the OFT, the CC then decides, on a balance of probabilities standard, whether the merger will lead to a substantial lessening of competition. Ultimately, the CC has the power to impose the structural and/or behavioural measures it considers sufficient, effective and proportional to remedy any expected competition harm.

What acquisitions are caught?

The merger provisions of the Act may apply to acquisitions of companies and businesses but can also catch acquisitions of assets where these enable revenue to be generated. Importantly, the fact that a business may not be trading at the time that the acquisition takes place does not necessarily prevent the merger control rules from applying: this will depend on the facts of the case.

To qualify for review, the merger must trigger one of the two jurisdictional thresholds:

- the target's UK turnover exceeded £70 million in its last fiscal year; or
- the acquirer and target together have a share of supply in the UK, or in a substantial part of the UK, of 25 per cent or more in relation to goods or services of any description.

Will the OFT examine completed transactions?

One of the unusual features of the UK merger regime is that merging parties can complete their transactions without waiting for approval from the UK competition authorities, although caution is advisable in this respect. First, the OFT can investigate completed mergers up to four months after they have completed (or the facts of the merger have been made public) to decide whether to refer the transaction to the CC. In such cases, the OFT may require that both businesses remain separate while the merger assessment takes place. Second, the CC may ultimately determine that it is necessary to force the partial or total divestment of assets or businesses if this is required to resolve competition concerns. Merging parties should not underestimate the practical and financial consequences if either of the above actions is required.

How does the OFT investigate?

An OFT review may be initiated either by the merging parties or at the OFT's own initiative. The merging parties can voluntarily submit a notification to the OFT in order to seek merger clearance. Most cases are determined within 40 working days of the notification being filed. Alternatively, the OFT has a 'Mergers Intelligence' function, to scan for non-notified mergers that may prove anti-competitive and harm consumers in the UK.

During its review, the OFT will determine the effect of the merger, as compared with the situation that would have prevailed absent the merger. In the case of mergers arising out of administration or insolvency, the OFT will seek to examine whether there was any prospect of the business being restructured, as well as what might have happened to the business or its assets in the absence of the merger in question.

To accept a 'failing firm' argument (that the business would otherwise have exited the market with no prospect of another purchaser) the OFT will require compelling evidence: where there is doubt in this respect, the case may be referred to the CC for a detailed investigation. The OFT often seeks information and evidence from insolvency practitioners in understanding the events leading to the exit of the business from the market, and surrounding the marketing and sale of the business or its assets during the administration or insolvency procedures. This information is often of great significance and the OFT encourages insolvency practitioners to co-operate in supplying such information.

In summary

The fact that a business has been acquired while in administration or liquidation does not prevent UK merger control from applying. The OFT has the power to investigate completed mergers and will call in for investigation those mergers that it believes may raise competition concerns. For parties considering a merger that it believes may raise competition concerns the OFT offers 'informal advice' on a confidential basis. This can provide useful information about the risk profile of a potential transaction.

Further information and relevant contact details can be found at: **www.oft.gov.uk//OFTwork/mergers/** and **www.competition-commission.org.uk/**. ◻

SHELDON MILLS is the director of the Mergers Group at the Office of Fair Trading.

Twickenham Film Studios Limited: in administration

Gerald M Krasner provides an update on the situation. Has the curtain finally come down on film production at the site?

In over 40 years in the profession, it is not often that I have had the opportunity to combine my professional work with my hobby. As an avid film-goer and the owner of hundreds of DVDs, I was therefore intrigued when I received a call from a London firm of accountants, inviting me to come to a meeting to discuss the financial situation of Twickenham Film Studios Ltd.

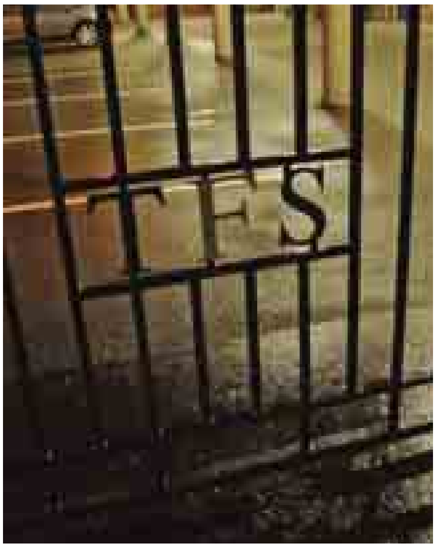
The initial situation

A meeting was set up for late January, attended by the UK director and the auditors. From the information obtained at the meeting, the following facts arose:

- The studios were 99 years old and their centenary would be celebrated in 2013.
- The company, which owned the studios, was incorporated in 1946.
- Unfortunately, the studios had lost in excess of £1 million over several years and the largest creditor was an associated company that had been funding these losses but was not prepared to continue to do so.
- Although the company was solvent on the asset test basis (the value of the studios was substantially higher than all of the liabilities) it failed the solvency test on the going concern basis in that it had virtually run out of money and was unable to continue trading other than in the very short term.
- There were two other directors, both professionals, in the US and the three directors represented the interest of a company registered in the Dutch Antilles.

A number of options were considered:

- Members Voluntary Liquidation (MVL) – but that was not deemed practicable, firstly as the director did not feel he could swear a declaration of solvency that all creditors would be paid in full within 12 months; and secondly, because it was necessary to trade during the MVL as the company's affairs were wound down. This was not something I was comfortable with in view of the personal liability angle.
- Company Voluntary Arrangement (CVA) but once again, this was not considered practicable because certain liabilities would be incurred post-approval of the CVA and there were insufficient funds to pay these liabilities in the normal course of events until such time as the studios were sold.
- Administration was therefore considered to be the most appropriate procedure in order to ring-fence the current situation and give the company time to dispose of its assets and deal with creditors.



Prior to my involvement in the consultation process, the directors, on behalf of the shareholder, had marketed the site to a number of potential parties and the shareholders had decided to enter into a deal with one of these parties, who did not intend to retain the site as a studio, but was going to develop the site for other purposes.

An outline deal had been agreed with this party prior to my involvement and it was made plain to me that the shareholders wanted this deal to go ahead within the agreed time scale. In the usual course of events, as administrator and an officer of the court, my primary duty was to the creditors (there were no secured creditors). However, this was a most unusual case in that if the studios were sold at the expected price, 80 per cent of the net proceeds would be for the benefit of the shareholders with the balance being used for payment of creditors and costs. Consequently, I had to take into account the views of the shareholder, both before and during the period of the administration.

> "The shareholders had decided to enter into a deal with one of these parties, who did not intend to retain the site as a studio."

Meeting with the staff

Following my appointment on 13 February 2012, I arranged to go to the studios two days later to meet all the staff (17 in total) in order to bring them up to date with the position. Prior to seeing the staff, I was given a short tour of the studios, which were full of posters and other memorabilia going back over the years. The studios had been involved in a number of very famous films including *Zulu*, *The Iron Lady* and *The Debt* and it was obvious that there was tremendous financial value as well as emotional value in this memorabilia, which somehow had to be disposed of. Although there was a lot of equipment at the studios, some of this went back many years and it appeared that not a lot of money had been spent on revamping the studios in recent times.

I then met with all of the staff to explain to them the financial position of the company and why it had gone into administration. I explained to them that under the deal that had been negotiated, the purchaser would not be continuing the current use of the studios and that the trading position was likely to be wound down over the next few months so that vacant possession could be obtained. From the schedules produced, it was apparent to me that the service contracts of the employees varied between 4 to 52 weeks so that some of them would be due substantial monies under these contracts. I informed them that I would not be adopting any of the contracts and that effectively everybody would be put on notice at the present time, but that ultimately all of their claims would be paid in full, firstly in part by the Government and the balance by the administrators, once the studios had been sold. At that stage, it looked as though exchange of contracts would take place in late March/early April, with completion for the end of September so that all creditors could be paid in full by the end of October 2012. A number of queries arose from the staff, which I dealt with and it was agreed that they would appoint two staff representatives to funnel all future enquiries to my office.

Save the studios?

That weekend, a full-page article about the imminent closure of the studios appeared in the Saturday *Telegraph* and, as a result, the following week I was inundated with many offers from potential purchasers interested in buying the site. Most were from property developers, but some were from people who wanted to maintain the studios. I explained that an outline deal had been agreed, but took their details so that if the deal did not go ahead, we would re-market the property and come back to them. It appeared that one party had started a petition to 'Save the Studios' and had obtained 3,000 signatures, including those of Steven Spielberg and Richard Attenborough. While sympathising with their objective, I did try to explain to them why the path that we were taking regarding the sale had to be adhered to.

At the time of writing this article, I have a database of 32 interested parties, if the proposed deal with the purchaser does not come to fruition.

On 2 April 2012, I circulated to all the creditors the administrators' proposals. Included within the proposals was a proposed CVA on the basis that this would come into force immediately after the creditors' meeting scheduled for 19 April 2012. The proposals explained that although the CVA would commence following the meeting, the administration would not come to an end until such time as completion of the sale had taken place. Consequently, the two would run in tandem. This would allow the joint supervisors to agree all claims of the creditors between now and September when completion is expected, so that once the monies were received by the administrators, these could be passed to the supervisors and creditors would be paid in full within a relatively short period of two to three weeks. Once completion had taken place a final progress report would be filed about the administration, which would then come to an end and it was envisaged that the CVA would also be finalised within one to two months of this time so that all matters relating to the creditors would have been dealt with before 31 December. It was then envisaged that following the end of the administration, the shareholders would pass the appropriate resolution to place the company into MVL, thus enabling a distribution to the shareholders to take place.

> "One party had started a petition to 'Save the Studios' and had obtained 3,000 signatures, including those of Steven Spielberg and Richard Attenborough."

The final scene

On 19 April 2012 a creditors meeting was held at the studios, at which the joint administrators' proposals and CVA were approved by the requisite majority. The proposed purchaser had still not exchanged contracts and following a meeting later that day with the Council, they effectively withdrew as it appeared that no change of use would be forthcoming unless the studios were first marketed for their current use.

The next few days were spent in discussions with two interested parties who wanted to retain the studios, culminating in a meeting on Tuesday 24 April at which the offer from the higher bidder was accepted and they have given me a non-returnable deposit of £100,000 to have a four-week exclusivity period to exchange contracts unconditionally. Did they exchange? Were all the jobs saved?

You will have to wait for the film to come out to get all the answers. □

GERALD M KRASNER is a partner in Begbies Traynor (Central) LLP, part of the Begbies Traynor Group.

Haulage industry update

Alan Clark outlines the new regulatory framework changes in the haulage industry and offers advice on how to avoid falling into the inspection pit.

Wherever you travel these days you will notice lorries. Road freight has become the preeminent mode of delivery following the expansion of warehousing required to service bricks-and-clicks retailers. Sixty per cent of UK freight is carried by third-party hauliers; as an idea of scale, the Road Haulage Association represents 8,000 companies with around 100,000 vehicles.

In addition, many firms run their own fleet for transporting their own goods and the regulatory framework outlined below applies equally to those companies, even if they are not carrying freight for hire.

All is not well in the haulage world. The economy and changes in regulation are making life treacherous. The Freight Transport Association's recent research found that fuel now represents 40 per cent of annual operating costs. And further increases in fuel duty are expected soon. The downturn in retail spending is drastically affecting load utilisation, and pricing is becoming even more competitive.

The regulatory framework

The regulatory framework is also changing. Hauliers operating goods vehicles over 3.5 tonnes must comply with the Road Transport Operator Regulations 2011, which were brought in to comply with EU legislation updating the Goods Vehicles (Licensing of Operators) Regulations 1995. Operator licences (O-Licences), are required for the number of vehicles under each operator's control. Hauliers must satisfy the regulator, the Traffic Commissioner (TC), that they are worthy of holding a licence. Guidance issued by the Senior Traffic Commissioner in December 2011 covers various key areas:

- good repute and fitness
- finance
- transport managers
- operating centres
- legal entities
- driver conduct
- impounding
- delegation
- case management
- principles of decision making
- written reasons/decisions
- appeals.

Included in these requirements are rules on such matters as vehicle maintenance, driver hours, running a suitable depot, financial resources and professional competence qualifications.

Good repute and fitness

This concerns any previous convictions in the UK or abroad, including defective vehicle offences; notification to TC; drivers hours breaches; speeding and motoring offences; overloading; and convictions relating to vehicle testing or plating.

> "Where an administrator is considering trading on, they will have to meet the ongoing monitoring and site management obligations."

Operators must inform TC within 28 days of changes related to legal form, financial standing, good repute and a transport manager's repute. This includes issues relating to insolvency procedures, fronting and phoenix arrangements.

Financial resources

Resources have to be available to maintain roadworthy vehicles. Operators with standard licences must have funds of £7,700 for the first vehicle and £4,200 for each successive vehicle in the fleet. This means cash needs to be available in the company at all times to fund maintenance. There is also the requirement to declare any financial difficulties, and the Senior Transport Commissioner has stated that in her view, where a company enters administration, the directors must have been aware of the company's predicament for some time and so should already have notified TC.

Transport managers

The designated transport manager must be of good repute and deemed to be professionally competent – either by holding a suitable certificate of qualification or entitlement by way of acquired rights.

Operating centres

This refers to the base or centre in which goods vehicles are normally kept. The depot must be suitable, which includes such matters as the availability of parking, times of operation, maintenance facilities, environmental matters and means of entry and exit from the site.

The operating centre must also be a stable establishment. This relates to record keeping and efficient and continuous operation of the depot. Vehicles must be roadworthy. If an operator doesn't do the maintenance him- or herself, there must be a written agreement with a garage. Driver hours must be monitored for working time directives regarding average weekly hours, maximum day and night hours, and break periods.

Corporate rescue?

One of the requirements of an O-Licence is that the operator must immediately inform TC if the financial standing requirements cannot be met. The Senior Traffic Commissioner has stated that operators are obliged to inform TC as soon as administration becomes a distinct possibility. Guidance is provided for administrators in relation to any management contract that they may enter into, how to proceed with any prospective or ongoing public inquiries, involvement of the previous directors with either the company in administration or any phoenix company, especially in relation to pre-packaged sales.

These requirements impact on the directors' ability to sell a troubled business as a going concern. Where some form of formal insolvency is needed, an operator needs to make an urgent application to the TC explaining how operations are to be conducted.

The good news is that Regulation 31 of the Goods Vehicles (Licensing of Operators) Regulations 1995 allows the TC to issue temporary directions. This application can be used where an administrator, with a suitably qualified transport manager, wishes to trade while trying to find a buyer. The Regulation 31 application will need to be in the name of the IP.

However, prospective administrators would be advised to heed rulings in various tribunal cases and to follow the guidance issued in December 2011 by the Special Traffic Commissioner.

Case studies

***Dukes Transport* (2001)**

Directors were based at the company's head office, which was remote from the operating depots. They relied upon transport managers located at the depots to fulfil their obligations. As a result, they hadn't carried out quality control/audit of driver records including compliance with driver time directives and the control and review of tachographs. Problems were uncovered with compliance, but the directors failed to discipline errant drivers severely. The TC ruled that operators were required to set up adequate systems, supervise and monitor those systems, and ensure they work.

***Brian Hill Waste Management Limited* (2009)**

This offers guidance on the approach to be taken to Regulation 31 where a haulage company enters administration. The administrator of Brian Hill Haulage & Plant Limited had contracted with the company to manage the business pending a going concern sale. However, TC was not informed of the loss of financial standing, nor the administrator's appointment. No application under Regulation 31 was made. When becoming aware of the administration, TC asked the administrator either to make a Regulation 31 application or surrender the vehicle discs.

The result was that the application by Brian Hill Waste Management Limited for an interim licence was refused; the administrator's agreement to transfer the licence ruled unlawful, and the licence held by the company revoked.

***Utopia Traction Limited* (2011)**

A transport manager had lost his good repute, and was replaced with the director's wife who eventually gained the necessary qualifications. Months later, the director was convicted of failing to produce tachograph record sheets, driver cards and other data. The TC was not informed of this conviction. A public inquiry was held where the TC ruled that the applicant had lost his good repute, had lost financial standing and was not professionally competent. The TC was concerned the applicant was 'fronting' for others. UTL appealed.

> "Guidance is provided for administrators in relation to any management contract that they may enter into, how to proceed with any prospective or ongoing public inquiries, involvement of the previous directors with either the company in administration or any phoenix company, especially in relation to pre-packaged sales."

At the appeal it was determined that UTL hired lorries from Felixstowe Logistic Services (FLS), who also provided fuel cards and undertook all vehicle maintenance. FLS, however, was owned by a disqualified operator. The part-time transport manager (the director's wife), checked tachographs, vehicle servicing and notified FLS when servicing was due. The booking of repairs was done in conjunction with FLS who also decided drivers' scheduling. UTL only did work for FLS and had no other contracts. Traffic managers, all employed by FLS, found work and forwarded details to UTL. Drivers were 'self-employed', and paid by the directors personally. The fund for maintenance was put into the company bank account by FLS, taken out later by the directors of UTL, and then put back in when the TC appeal was lodged. The appeal did not succeed.

Administrators take note

From these few cases it can be seen that, where an administrator is considering trading on, they will have to meet the ongoing monitoring and site management obligations. While in many industries it is common for an administrator to use external managers to help run the business in administration, in the haulage industry the TC will want the operator's licences to be overseen by the administrator personally, and then expect a plan to be in place to monitor the company's systems for both vehicle maintenance and control of drivers.

During 2012 further changes to transport law are being implemented. These will cover such areas as the operators' certificate of professional competence; nominated transport managers; and amendments to the specification and security of digital tachographs.

Given these constraints, many IPs may think about a pre-pack. Bear in mind that the TC will scrutinise the purchaser to make sure that fronting is not an issue. The new entity will need to show that all the requirements of an O-Licence can be met. From a practical standpoint, any new applicant without an existing licence will need to apply 12 weeks prior to completion of sale. This probably means that only an existing operator, running vehicles under its own licence, will be in a position to make an offer to acquire any remaining business swiftly. Even this will require an application to the TC to add the vehicles to the purchaser's operating licence. If the purchaser is not to trade from the insolvent company's premises, the premises from which the lorries are to operate will also need the approval of the TC.

With so many small hauliers in the sector, it is likely IPs will be asked to advise struggling haulage firms. Freight companies have to keep the wheels rolling to produce cash flow and so trading, even in the short term, is often needed to maintain asset values by enabling a trade sale. To keep the TC happy, bear in mind the following:

- Make a Regulation 31 application as soon as possible;
- Ensure that a suitably qualified transport manager is employed by the company;
- When trading pending a sale, ensure any management agreement does not create a position where the insolvent company is acting as a 'front' for another operator;
- Ensure that regular maintenance and driver record checks are being undertaken;
- Once trading has ceased, return the licence and vehicle disks to the TC and ask them to revoke the licence. □

Useful references

- Office of the Traffic Commissioner, Central Licensing Unit, Hillcrest House, 386 Harehills Lane, Leeds LS9 6NF (0300 123 9000)
- R3 *Technical Bulletin 86*
- **www.dft.gov.uk/publications/senior-traffic-commissioners-revised-guidance-directions**.

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At what price does the law come?

Elliot Mocton director of MRN Solicitors, reports on why, when dealing with the insolvency of a solicitors' firm, it is vital to understand the value of its assets.

While an administrator or funder can quickly ascertain the value of a widget, it takes an expert to value the worth of a solicitor's files and work in progress. Not only are you faced with the difficulty of valuing the papers, but you will also be faced with challenges from former clients, successor firms and the other party within the solicitor's litigated files who will all try to knock the value down. MRN Solicitors, the leading firm of solicitors that deals solely with legal costs, is well placed to assist you with dealing with these challenges.

Law firms in difficulty

It is acknowledged that there is an increasing trend of law firms, of all sizes and specialisms, going into administration. What is imperative, whenever dealing with a firm in crisis, is to understand fully the value of its assets.

The legal profession is unique in that, despite being very regulated and professional, the fees that it charges are subject to various statutory regimes. It is worthy of note that almost ten per cent of the Civil Procedure Rules, which regulate the way in which cases ought to be run, relate to costs.

Again, uniquely as a profession, solicitors use the services of specialised law costs draftsmen to ensure that their cost recovery is maximised, their disbursements are recovered and that all the rules and procedures are adhered to. MRN Solicitors is one of the very few such firms that is structured as a law firm to give you extra assurance when dealing with these issues.

> "Solicitors use the services of specialised law costs draftsmen to ensure that their cost recovery is maximised, their disbursements are recovered and that all the rules and procedures are adhered to."

Strong controls

It is often the mark of a successful firm that it has strong controls on this process to ensure that fees are effectively recovered.

Solicitors do not rely on their work in progress (WIP) printouts or ledgers to bill their clients as these reports are often inaccurate. Often, these reports use a low hourly rate (to limit the taxation on the WIP), under-record time and, for matters conducted with a conditional/contingent fee agreement, fail to account for any additional recoverable sums.

Accurate valuation

It is therefore incumbent on administrators and funders that a full audit of the value of the live files is undertaken. This must also be done on the preparation of a pre-pack.

MRN Solicitors is one of the largest firms in England that deals exclusively with legal costs. It has experience in valuing and recovering costs from all parties, be they live or former clients, losing parties to litigation, successor and intervening firms, as well as administrators of old firms.

Recent success

In a recent example, MRN has secured a recovery of over £1 million for administrators of a firm. In this case, the files were transferred with the benefit of a lien, to a successor firm with whom MRN worked. When the cases were eventually completed, MRN assisted in the recovery of the costs from the losing party to the litigation, apportioning the costs between the administrator and the successor firm and generally fighting off any challenges to the reasonableness of the costs claimed. In another example, an administrator was faced with almost 2,000 cases that he anticipated would have little value. By processing all these cases within a case management system, MRN was able to track the successor firms, previous clients and other parties and is actively involved with the recovery of these costs, which are now expected to be approximately £2 million.

Transferring costs

Most of the fees of MRN can be recovered from other parties rather than the administration and so it's a prudent step to take, which can only protect and improve the value of the assets that you are protecting. MRN can utilise the statutory regime in relation to legal costs to ensure that its fees are paid by the losing party to litigation and former clients of the firm

Elliot Mocton has over 12 years' experience of dealing solely with legal costs.

ELLIOT MOCTON is the director of MRN Solicitors.

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R3's Policy Group: the voice of the insolvency profession

Members views are collated, reviewed and policy formulated so that R3 can send clear messages to its audiences.

One of R3's principal roles is to be a voice for its members: in the press, with government and parliamentarians, and with a whole host of other related bodies – business organisations and the creditor community.

To do this, it is vital that R3 understands and promotes the issues that matter to members and the Policy Group is tasked with this role. It is the main discussion group, sounding board and agreement body for R3 policy. The Group was established in September 2009 and successfully chaired by Mark Andrews at SNR Denton until December 2011. The Group represents accountants and lawyers; members from large, small and medium-sized firms; and members from R3's specialist groups – the Small Practices Group (SPG), General Technical Committee (GTC) and the Personal Insolvency Discussion Group (PIDG). This ensures that R3 is speaking with 'one voice' as much as possible on issues that impact on the profession.

The work of the Policy Group

The work of the Policy Group has three principal strands.

1) Firstly, it is a good starting point for the discussion of newly raised issues – which may have been introduced by members, by other committees, external groups, by Policy Group members themselves or simply be driven by events. It allows R3 to hear initial views from all sections of the profession and acts as a barometer to assess the importance of issues to members, as well as how (and if) to proceed in addressing them. Issues at this stage are frequently added to the members' survey in order to gauge the opinions of the wider membership. And, indeed, R3's most crucial policies are only taken forward after consultation with members. Members' surveys are also vital in terms of gathering evidence, as are case studies, the information from which we use to make our case to decision makers.
2) Secondly, the Policy Group provides the opportunity to review R3's policy and public affairs activity and is updated on each occasion with progress made on ongoing issues since the last meeting. This allows R3 to respond to developments and amend our approach if need be.

3) Thirdly, the Policy Group has an important role in agreeing R3 policy, which may have stemmed from other R3 committees or from earlier Policy Group discussions. It debates and signs off on final drafts of policy papers, submissions to consultations as well as *ad hoc* policy lines, to allow R3's Communications team to respond to issues as they arise.

The message is getting through successfully

Over the last year R3 has had a good deal of success in addressing issues that matter to members. The most significant challenge was The Insolvency Service *Consultation on reforms to the regulation of insolvency practitioners*, published February

> "Through the Policy Group, members' views are put at the heart of our policy activities."

2011. The Policy Group formulated and submitted a response and representatives met with government officials and the then Insolvency Minister, Edward Davey MP, to explain the implications the proposed changes would have, especially on micro businesses. This resonated with the government, which has subsequently asked the profession and other interested bodies to make alternative proposals.

The Policy Group played a key role in averting the introduction of a European Account Preservation Order (EAPO) into the UK. R3 explained that the plans would give courts anywhere in the EU power to freeze funds in UK businesses' banks accounts without warning and this would severely hamper business rescue. In November 2011 the government announced it would be opting out of the EAPO due to 'implications for insolvency and impact on business rescue'.

There is, of course, still more to do and R3 and the Policy Group are continuing to work on matters that members have identified as big issues – both within personal insolvency (through the Personal Insolvency Discussion Group) and corporate insolvency. As an example, on the corporate side we continue to make the case for clarification of the administration expenses regime and challenge reforms contained within the Legal Aid, Sentencing and Punishment of Offenders Bill that would make pursuing dodgy directors frequently unviable.

Through the Policy Group, members' views are put at the heart of our policy activities. As always, we are keen to hear from members who are facing particular issues that we can look to address on your behalf. ◻

Members of the Policy Group

Steven Law (Chair), Baker Tilly Restructuring and Recovery LLP
Shay Bannon, BDO LLP
Alan Bloom, Ernst & Young LLP
Alison Byrne, Byrne Associates
Frances Coulson, Moon Beever
Giles Frampton, Richard J Smith & Co
Alison Goldthorp, Addleshaw Goddard LLP
Richard Heis, KPMG LLP
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STEVEN LAW, chair R3 Policy Group, is a partner at Baker Tilly Restructuring and Recovery LLP.

Keeping up to date in the ever changing statutory and best practice landscape

Carl Bowles recommends ways in which smaller practices can keep abreast of legislative and regulatory changes.

In recent years there has been an increasing burden on smaller practices to keep on top of statutory, regulatory, best practice and case law changes. Recent examples include the implementation of the Bribery Act 2010 and the *Paymex* decision on VAT in voluntary arrangements. Larger firms will have a compliance officer(s) to update systems and procedures and to keep office-holders and their staff aware of any changes. Many smaller firms do not have this advantage. In my experience, one of the biggest struggles for the smaller practice was the Insolvency Rules change in 2010, and the proposed Rules rewrite in 2013 will no doubt pose similar problems. These Rules' changes mean that three separate systems may need to be put in place, dependent upon the date of appointment and the transitional provisions; a big task for smaller firms.

Since 2005, the Recognised Professional Bodies (RPBs) have required their licence holders to conduct an annual or self-certification review. This mini audit provides evidence of compliance with legislation, Rules, SIPs and other statutory obligations. The review may be conducted internally, by, for instance, a JIEB qualified manager, or an external provider such as Compliance on Call, Nova Consultants or JOH Consultancy LLP, who can provide an independent and expert view that may be of significant benefit to smaller practices. There are also a number of providers of insolvency software packages, some of whom provide additional support with letter templates and limited technical updates.

How else can a smaller firm keep up to date?

Training courses

- R3 is the best known provider with a comprehensive course calendar, along with other providers such as Lime Legal, SESCA and Jordans.
- While worthwhile, courses can be costly to smaller practices in both cash terms and the opportunity cost (chargeable time) of the attendees. However, DVDs and webinars are being used increasingly by both R3 and the RPBs, which can mitigate the impact on the training budget.
- To assist with costs, smaller firms might consider sending one or a few of their staff to a training event, who can then present a summary to the rest of the office on what they picked up on the course.

> "One of the biggest struggles for the smaller practice [in keeping up to date] was the Insolvency Rules change in 2010, and the proposed Rules rewrite in 2013 will no doubt pose similar problems."

Seminars

- Many law firms provide seminars at low or zero cost and they may even come to your offices. Case law changes can immediately impact on strategy decisions, with *Goldacre* being a recent example. Joining one or more good insolvency solicitors' mailing lists can be an effective way to keep up to date with legal developments.
- Sweet and Maxwell and Lexis Library are two subscription insolvency databases that are both comprehensive and regularly updated. Lexology also provides case law summaries and it is free to subscribe.
- Many industry-specific organisations are also very happy to provide free seminars for staff, such as insurers, quantity surveyors and Health and Safety advisers.

RPBs

- A number of the RPBs provide checklists and guides for their members. The ICAEW, for example, has a useful Continuing Professional Development (CPD) Aide Mémoire, which shows the statutory changes and updates for the year in chronological order.
- Some of the RPBs also now have Twitter feed insolvency updates.

R3

- In addition to courses, R3 now has a very good online technical library on its website. This includes technical guides, bulletins and help sheets by appointment type, along with specific case-related updates and editable statutory forms. R3 Technical Bulletins are regularly sent out to all members to keep them updated on technical changes.
- The Smaller Practices Group (SPG) Forum in October this year, and the SPG Technical Review courses held in the spring are also great sources of relevant technical information on topics that regularly crop up for the SPG member.
- R3 now also has a Twitter feed with frequent topical updates and its regular E-bulletin also contains current information on important issues.

The Insolvency Service

- In addition to the regular 'Dear IP' updates, the Official Receiver Technical Manual is a very good online database available on The Service's website.
- A draft of the 2013 proposed Rules rewrite should be available this summer. Smaller firms may be well advised to keep abreast of the proposed changes to the Rules in readiness for any resulting changes to in-house systems and procedures.

Keeping up to date is a significant overhead for smaller firms and, unfortunately, this is unlikely to change for the foreseeable future. Many practices may now see the benefit of having a designated part-time compliance officer who can identify relevant changes and act on them. Another great idea is a Compliance User Group where smaller firms share resources with each other (there is currently one set up in London and the South East). The SPG Committee can put you in touch with other SPG members in your region who may also wish to adopt a similar programme, so please get in touch with Emma Hobson at R3 and let her know. ◻

CARL BOWLES is a partner at Carter Backer Winter LLP and a member of R3's SPG Committee.

COMING IN THE AUTUMN	13 September	4–5 October
	Lite Conference Chesford Grange, Warwick	SPG Forum Hilton Metropole (NEC), Birmingham

R3 events, courses and conferences

Month	Date	Event	Venue
June	12	Introductory Programme – Rescue 2	Prospero House, London
	12	Introductory Programme – Rescue 2	Irwin Mitchell Solicitors, Leeds
	13	Introductory Programme – Rescue 2	Deloitte LLP, Birmingham
	14	Partnership Insolvency	Holiday Inn Bloomsbury, London
	14	Charities and Insolvency	Holiday Inn Bloomsbury, London
	14	Midlands Regional Meeting	National Motorcycle Museum, Birmingham
	14	South West and Wales Black Tie Dinner	The Grand by Thistle, Bristol
	15	JIEB Graduation Ceremony	BMA House, London
	15	Yorkshire Regional Meeting	Crowne Plaza, Leeds
	15	Yorkshire Region Ladies Lunch	Queen's Hotel, Leeds
	18	North West Regional Meeting	JMW, Manchester
	19	Business & Options Reviews	CCT Barbican, London
	28	Debt Restructuring	Cedar Court, Huddersfield
	28	CVAs and Schemes	Cedar Court, Huddersfield
July	2	Eastern Regional Meeting	
	3	Introductory Programme – Rescue 3	Prospero House, London
	3	Introductory Programme – Rescue 3	Irwin Mitchell Solicitors, Leeds
	4	Introductory Programme – Rescue 3	Deloitte LLP, Birmingham
	12	Debt Restructuring	Holiday Inn Regents Park, London
	12	CVAs and Schemes	Holiday Inn Regents Park, London
	26	Midlands New Professionals Event	

Regional events: Midlands Regional Meeting; South West and Wales Black Tie Dinner; Yorkshire Regional Meeting; Yorkshire Region Ladies Lunch; North West Regional Meeting; Eastern Regional Meeting; Midlands New Professionals Event. All other entries: R3 events.

Regional events

R3 events

For further information on R3 courses and conferences, please visit the R3 website **www.r3.org.uk**, where you can download the full 2012 programme. Alternatively, call the Courses team on 020 7566 4234 to request a programme by post.

R3 membership categories

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

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

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

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

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

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

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

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R3 Council 2012–2013

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Laurence Weeks, Taylor Vinters
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Advertisers' index

IBC = inside back cover
IFC = inside front cover
OBC = outside back cover.

Interview with…

Lee Manning

Lee Manning, the new R3 president, answers questions about his programme for the coming year.

What are you looking forward to most about becoming president and do you have a personal priority for the year?

I'm passionate about working in the restructuring sector. I've been involved in insolvency since 1983 and had a more enjoyable career than I could possibly have expected – and now I want to give something back. Being R3 president gives me the opportunity to share the principles I feel strongly about and articulate them throughout the profession. But it's not about self-gratification, more about sharing. I believe the president's role is to be more of a chairman than a CEO. To gather people together, harness their ideas and shape them in a way that will benefit the whole community. By that, I don't just mean the insolvency profession, but all those for whom we work and those whose lives we influence by our actions. Working in insolvency you see the hardships people suffer – and it shapes you, makes you more rounded as a person. You only learn when things go wrong. Then you know you need to change how you do things – or try and change the rules that make it more difficult to do our job efficiently.

My main goal for the year is to work to make it clearer and easier for creditors to understand what we do – so that they feel we are working for them and giving them better value for money. To streamline the processes, the quirks in voting procedures and the way in which the insolvency world is governed so that we can undertake restructurings in a more certain environment.

Where do you think corporate insolvency numbers will be by the end of your presidency?

Corporate insolvencies rose slightly last year but they have calmed down a lot since the 2008–2009 slump. Over the coming year, with the economy still in the doldrums, problems in the eurozone still likely, high youth unemployment and a growth forecast of only 0.5 per cent, there is unlikely to be a major swing one way or the other.

What do you perceive as the biggest opportunity for the profession over the next twelve months?

The profession needs to recognise that it is there to serve a wider creditor community: lenders, shareholders, suppliers, employees, the general public – both the customers of businesses and the families of the employees; and we need to make sure that we do our best to deliver the highest standards within the law. If necessary, we should lobby to change the law and rules of

engagement to enable us to do the job in a more effective and cost efficient manner. By working together, through R3, we have the opportunity to influence change in policy and processes to deliver better economic returns for creditors generally – and with more transparency about how we do it.

Is the retail sector a barometer for what is happening elsewhere in the economy?

It may be for the consumer economy (leaving aside everyday groceries). There are two main facts that influence this: what affects the amount of money we spend and how we choose to spend it.

People now have less disposable income after paying the basics. In August 2011, Asda conducted a survey that showed that an average family had, on average, £65 less disposable income per month due to the rising cost of light, heat, fuel, basic foods and VAT. This figure has probably risen to £100 now – and this impacts particularly on the retail and leisure sectors.

Bricks and mortar retail faces challenges from electronic retailing but this is not a result of the economic climate. This technological impact on retailing was going to happen anyway.

The biggest challenge for retailers (apart from the internet) is continuing to attract customers to their stores by ensuring that their offering is more relevant and accessible to customers than their competitors. Where the offering or the way in which a product is offered is right – there will be buyers.

What do you see as the key messages that the industry should be conveying to politicians, the market and the public generally?

Being an IP is a difficult job and we need the politicians to help us rescue businesses more effectively by addressing some of our concerns: the codification of expenses in insolvencies (*Nortel* and Pensions, Protective Awards), alleviating rent problems (*Goldacre*), help us to give clarity to creditors at an earlier stage and greater certainty in our ability to plan for an insolvency rescue.

At the latest pre-packs consultation meeting with The Insolvency Service, creditors' representatives from several federations still saw pre-packs in a very negative light. How is R3 explaining the thought processes to them and working to improve the image of IPs?

R3 was successful in persuading The Insolvency Service that a three-day notice period was unhelpful and unnecessary. The essential ingredient of a pre-pack is speed – to protect value. R3 got across the message that a pre-pack, planned in advance, can provide the best possible outcome to a creditor for a business which, if left in an open-ended process, would cause them greater loss.

A pre-pack often involves selling a business back to its previous owners as they are usually the best people to take the business forward – or there is nobody available with the knowledge to do this. It is usually essential to have the previous owner involved in some capacity.

Sometimes the pre-pack results in no value to the unsecured creditors but this could have happened anyway. Other alternatives could be just as bad for the creditors.

Overall, we have a clear public affairs and policy strategy in place, which we will continue to work to, and this includes meetings with all these groups.

Are there any other stakeholder groups that you would like to engage more with that do not currently work closely with insolvency practitioners?

We already work with most of them but I'd like to sit down with the credit insurer community and forge stronger links. They can make or break an administration. This is part of the Holding Rescue to Ransom campaign. The creditor community need to be able to claw back some of their losses but holding a gun to our head isn't the way to do it.

They pull cover for suppliers to the company in administration, which can tip it into insolvency. They can be the catalyst for this. Dialogue is important between us. ◻

SARAH HOUGHTON is the publishing manager of *RECOVERY*.