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RECOVERY

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Interview with Giles Frampton
The new R3 president on doing the right thing, protecting his profession and what would happen if there *were* no IPs

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

From the editor

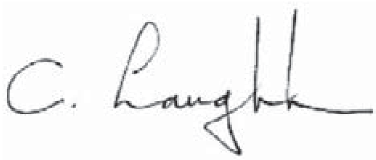
Almost seven years ago, the financial crisis began with BNP Paribas noting a 'complete evaporation of liquidity' in relation to two of its funds. Since then banking has changed dramatically, as has financial regulation, and one consequence is that banks' financially distressed customers are treated very differently, with fewer entering formal insolvency. The markets are betting that the ultra-low interest rate environment we have enjoyed for over five years will start to change from early 2015 and the zombie company phenomenon may yet lead to an insolvency up-tick, but it will not be soon – interest rates are likely to move relatively slowly – and it will be modest – time heals and some zombies are coming back to life without intervention. The restructuring and insolvency market is not what it used to be.

Against this backdrop, we have been treated to a raft of government consultations and legislative proposals, as our new president, Giles Frampton, discusses in his column on p6 and in our interview on pp46–48. They range from the Jackson reforms' impact on insolvency litigation costs (you are urged on p4 to ask your local MP to support a permanent insolvency exemption) to the European Account Preservation Order, brought in by European Regulation as this issue went to press (we will be looking at the impact on UK IPs, despite the UK government not having opted-in to the Regulation, in the autumn).

You may be aware of the government publishing the outcome of its Transparency and Trust consultation, which could improve the director disqualification regime (another subject to which *RECOVERY* will return), but you cannot have missed the government proposals on IP regulation (discussed by Andrew Tate on p7). Whether you're in favour of a single regulator, segregation between regulation and the provision of services to IPs, or a unified regulatory process, it is clear that more needs to be done to remove 'bad' IPs from the profession and to speed up the disciplinary process.

R3 was able to provide clear evidence to the government that its partial licence proposals in the Deregulation Bill were based on the false premise that small practices would benefit, as Victoria Jonson explains on p38. We need similarly to respond to the IPs' fees consultation, which (as Giles says on p47) has taken a simplistic and extreme approach. When R3 asks its members to provide feedback, please respond. You will help us all.

Finally, if there is one technical article you read in this issue (out of the many on offer), let it be Tony Bugg's *Legal update* on pp10–12, which explores the transformation of insolvency law brought about by judicial decisions from *Atlantic Computers* to *Games Station*.



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

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WINTER **The leisure industry**

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R3's work on the 'Jackson' reforms: campaign launched

R3's campaign for a permanent exemption for insolvency litigation from the 2012 Legal Aid Act (LASPO – the 'Jackson' reforms) was launched with publication of an independent research report on the impact of the reforms in April 2014.

Insolvency litigation was granted a temporary carve-out (from April 2013 to April 2015) from the LASPO. Government tasked the profession, working with HMRC, to develop alternative solutions on the basis that the carve-out would come to an end in April 2015.

R3, with the support of ACCA, ICAEW, ICAS, IPA, JLT Specialty, Moon Beever and Moore Stephens commissioned Professor Peter Walton from the University of Wolverhampton to identify how much money is currently enforced and returned through the current regime, and whether there were any alternative solutions that would be as effective.

This research found that:

- Insolvency litigation currently enforces claims of approximately £300m per annum.
- £50m–70m relates to money owed to HMRC – the rest is to businesses.
- Approximately £160m is returned to creditors a year.
- Most of the money would be lost under the reforms.
- The majority of claims realise £50,000 or less – these claims are unlikely to be pursued under the new regime.
- There are no alternatives that will secure creditors the same amount of returns and ensure that directors who commit bad practice are brought to justice.

R3 understands why changes to civil litigation funding were made in 2012 – to protect public money and protect the public interest. The research demonstrates that insolvency litigation already does this – it returns money to creditors (including HMRC) and brings directors who have committed bad practice to justice.

The government is remaining steadfast that the carve-out for insolvency will come to an end in April 2015. Therefore, using the findings of the research, which show the clear economic benefit of insolvency litigation, R3 is speaking with ministers and civil servants across HMRC, the Ministry of Justice and Department for Business to seek a permanent exemption. We are also working closely with stakeholders in the business, accountancy and law communities, and undertaking press work. The launch of the campaign and report was covered on the front page of the *Times*' Business section at the end of April and in the trade press.

If you are an R3 member and would like to write to your local MP to ask for their support in seeking a permanent exemption, or write to the minister responsible for civil litigation at the Ministry of Justice, please find draft letters and details to find your local MP at: www.R3.org.uk.

Buyout secures jobs

The future of more than 100 jobs has been saved following the pre-pack sale of aerospace and defence parts manufacturer Micro-Metalsmiths. The family-owned company, which was celebrating 50 years in business, was sold as a going concern after entering administration in early May. The two-part deal included the sale of the North Yorkshire company, some of its assets and the share capital of a sister company MM Microwave Ltd. The buyout by Sylatech Ltd has been enough to ensure the job security of 111 staff in total.

Hunter Kelly of EY's restructuring team, who together with Charles King was acting as joint administrator, said that Micro-Metalsmiths had effectively run out of cash as a result of challenging trading conditions and a large pension scheme deficit.

'We were able to secure a going-concern sale to Sylatech, which has safeguarded the future of all 111 employees across Micro-Metalsmiths and MM Microwave. A going-concern sale represents a better outcome for Micro-Metalsmiths' creditors than the alternative, which would have been immediate closure,' he explained.

UK wind turbine firm saved

Leading small wind turbine manufacturer Evance has been acquired by Ecotricity after going into administration at the beginning of May. The Loughborough-based firm, which produces a turbine popular with schools, farms and homes, will now work with Ecotricity's developers to offer both horizontal and vertical axis windmills within 12 months.

A change in government policy on subsidies was blamed for the slump in sales of the small wind turbine business, which had been flourishing under the Feed-in Tariff scheme.

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R3's parliamentary work on football finance

The Football Creditors Rule is a controversial and emotive topic of discussion on the football pitch and in the corridors of Westminster. Football creditors getting paid in full whilst unsecured creditors, including local businesses and supporters, receiving very little (as little as 0.77p in the pound – Plymouth Argyle 2011) has become publically unacceptable and led to significant debate about football finance and governance.

As part of that debate, R3 has kicked off a campaign to redress the balance of the Football Creditors Rule for unsecured creditors. Whilst R3 recognises that the Football Creditors Rule is here to stay, we have developed a number of proposals to level the playing field and better protect unsecured creditors. Led by R3's former president, Lee Manning, recommendations include:

- A minimum dividend for unsecured creditors to ensure they receive some of what they are owed over a defined, reasonable period of time.
- Introduce a one point reduction for clubs that have missed payments to HMRC for two consecutive months.

R3's proposals have been welcomed by MPs from all major political parties in Westminster, and the Government has said it is committed to reviewing proposals on football finance.

For more information on this campaign and to review R3's recommendations for reform, please visit the R3 website or feel free to contact a member of the R3 communications team.

President's column

New president **Giles Frampton** on the issues he'll be focusing on this year.

The next 12 months is likely to be an important year for the insolvency profession as we deal with the outcomes of the numerous consultations and reviews that affect us. Some change is desirable, but it is of the utmost importance that any change improves the profession and does not undermine it.

There are issues, such as pre-packs and fees, where we will have to respond to what the government is proposing, but there are also areas, for example personal insolvency and fraud, where we would like to see our own ideas adopted.

I should like to record my thanks to Liz Bingham for all her hard work in the past year. It is very much appreciated. As president, continuing Liz Bingham's good work, I am determined that our profession's voice should continue to be heard on the issues that matter to us. It will be a busy year!

By way of background, I am a chartered accountant and partner in Richard J Smith & Co, a specialist insolvency and forensic accounting practice dealing with both companies and individuals based in Devon and Cornwall. I became involved with R3 in 2005, firstly as a member of the General Technical Committee and then as its chairman, a role I relinquished last year. I have also been the accounting member of the Insolvency Rules Committee, chairman of the ICAEW's Insolvency Licensing Committee and the examiner for the JIEB's personal insolvency paper.

Over the next year, there are three things I will be focusing on as president: the value of the profession; the fairness of the profession; and the regulation of the profession.

Our profession is a valuable one. In 2012, we helped save over 6,000 businesses and roughly 750,000 jobs (based on research by ComRes). The Office of Fair Trading believes we return roughly £4bn a year to creditors from realisations of £5bn and the World Bank says the UK has the world's seventh best insolvency regime, typically returning 88.6 pence on the pound to creditors.

It is evident that we play a vital role in the economy, restoring businesses and individuals to financial health where we can, clearing up the mess where we cannot, and returning money to creditors, giving them confidence to lend and trade.

Unfortunately the profession's value can be overlooked or obscured: reference is sometimes made to negative 'perceptions' about aspects of the profession, typically involving fees or pre-packs, and there is a

danger that these perceptions, rather than objective evidence, might form the basis for policy making.

Given the sensitive and difficult nature of insolvency, it is understandable that parts of our work will attract extra scrutiny. We need to ensure that the value the profession delivers is recognised – and protected too. Where we bring value, we need to say so; and where we see proposals that threaten our ability to deliver value for creditors, debtors, and the public as a whole, we need to push back.

At the same time, there are parts of the UK's insolvency regime that would benefit from change. While we want our profession to be treated fairly, we need to make sure that creditors' and debtors' experience of the process is fair too.

> "We play a vital role in the economy."

There are several changes that could be made to both the corporate and personal insolvency landscapes. The directors' disqualification regime remains a priority area, and we were pleased to see the government propose a series of reforms. We look forward to the introduction of an updated electronic reporting process, and we look forward to working with the government on their 'Trust & Transparency' proposals.

On the personal side is a standard one-year bankruptcy term fair on the creditors who have lent to those recklessly accumulating debt? Delaying discharge where a Bankruptcy Restriction Order has been made to the date when the BRO ends might give those creditors a better chance of some redress.

Then there is the issue of the amount of debt at which a bankruptcy order can be made. 'The bankruptcy level' of £750 was set in the 1986 Act. It is equivalent to almost £2,000 in today's money. Raising it would remove single, small liability cases from the bankruptcy regime and a recurring bone of contention.

Improvements could also be made to the way the profession is governed and regulated both in the way that we are scrutinised and policed by our regulators and the statute that dictates how insolvency works.

Insofar as statute is concerned the government has issued revised draft new rules incorporating 'common parts' for such procedures as meetings and reporting. In principle this is to be welcomed. Unfortunately the review and revision does not encompass the Act, the draft rules are in some places no more than an aggregation of the existing rules and, despite pleas from all the users, forms have been replaced by necessarily prolix descriptions. We hope that government can be persuaded of the advantages of implementing a more satisfactory revision.

The government is also taking steps to update the oversight of the profession and, although we have some concerns about one or two of the specific proposals, we agree that it is helpful to look in more detail at this issue.

The government is keen to explore the option of a single regulator for insolvency practitioners and is proposing to make provision for this eventuality. R3 believes it may be better served by looking at a unified regulatory process. This would ensure consistency and coherence of regulation and enforcement while maintaining a link between individual IPs and their professional bodies; it might even reduce the disruption and cost of moving from a multi-regulator system.

No doubt many of these issues will still be 'live' in 12 months' time when I pass on the baton to Phillip Sykes but during my term of office I am keen to make some substantive progress in support of the profession.

Value, fairness, effective regulation; a profession that is seen to be delivering value in a fair and accountable way is one that will have the confidence of the public and UK businesses. ◻

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

Regulation, regulators and the role of R3

Andrew Tate considers the regulatory reform package.

Given the fact that the existence of eight insolvency regulators can seem a little idiosyncratic to those within the profession, it's understandable that those outside it view the number of regulators with a degree of bemusement, or even concern.

In discussions with a reporter from *Newsnight* recently, the way our profession is governed was a running theme. And, of course, The Insolvency Service's proposals for 'reforming' insolvency fees were accompanied by just as bulky a set of proposals on regulation.

> Problems with consistency, speed, and effectiveness will also invite scrutiny from government and other observers.

The insolvency regulators' roles are incredibly varied and tricky to fulfil. There's a balance to strike between being a 'tough' regulator and not stifling the ingenuity and creativity of IPs working in difficult circumstances.

Having recently been on the receiving end of a monitoring visit, my own impression is that, on the ground, the regulators do an impressive job. The monitors we've dealt with have been quick to get to the heart of regulatory issues in the complex files we've handed over; they're quick to understand the nuances of particular cases; they are adept at avoiding becoming bogged down in trivialities and are able to pick out key issues.

That said, things aren't perfect: there's plenty in what The Insolvency Service has proposed on improving regulation with which IPs could agree.

R3's recent member survey on the issue suggests the profession has a number of key concerns with how regulation works beyond the monitoring visits. While there are no areas where IPs think the regulators are 'failing', there are one or two areas where the balance of opinion is a little too close for comfort.

Looking at the positives first, IPs seem satisfied by the transparency of regulation (nearly two-thirds of R3 members believe the system 'performs well' when it comes to keeping track of disciplinary proceedings) and its effectiveness as a deterrent to bad behaviour (another two-thirds say the system 'performs well' here).

However, things appear to be close to falling short on removing the 'bad' IPs from the profession (55 per cent 'well', 36 per cent 'poorly'), the speed of the disciplinary processes (48 per cent: 32 per cent), the consistency of the regulators' processes (48 per cent: 27 per cent), and the consistency of the regulators' sanctions (43 per cent: 30 per cent).

While we would all wish regulators to be measured and considered in their approach, these shortcomings can rankle. IPs' transgressions should be treated equally regardless of their regulator; poor IPs reflect badly on the profession and they should be prevented from practising if their errors are serious enough.

Problems with consistency, speed, and effectiveness will also invite scrutiny from government and other observers.

Then there are areas where regulators' hands are tied: the issue of insolvency fees springs to mind.

The nature of insolvency means IPs' fees will probably always be a sensitive subject. Consequently, even though an IP may be able to justify the fees charged in a case, it's important that creditors have the opportunity to understand or even challenge that justification. Recourse for unsecured creditors or debtors concerned about fee levels is perceived to be limited in

> However, things appear to be close to falling short on removing the 'bad' IPs…

some situations: it's only really the courts (the costs of accessing, which can be prohibitive) where a serious challenge can be made. It would make sense for regulators to be given the power to look into fees too.

Indeed, this is one of the proposals included in The Insolvency Service's regulatory reform package.

The service's proposals are worth a closer look. There are some solid suggestions – bringing fee challenges within regulators' remits being one. There are others where, while I can see what The »

Insolvency Service is trying to achieve, new problems might be created were they to be introduced.

Many of The Insolvency Service's specific proposals concern the secretary of state being handed new powers to intervene in the regulatory process. Although I have noted the problems with speed and consistency that the current system has, I don't believe that government intervention would necessarily be the answer for various reasons.

- Remedial action by the secretary of state – whether directing a regulator to take action, or taking direct action against an IP – wouldn't address the regulatory lapses that required intervention in the first place.
- Introducing what would effectively be a 'shadow' system of regulation would undermine the point of delegating regulation to the RPBs in the first place, and would risk creating even more inconsistency.
- The existing RPBs have decades of regulatory experience, while an oversight regulator (not necessarily The Insolvency Service) would not.

The other concern is the language in the proposals – there are references to 'value for money' and 'public interest' judgements for the RPBs to make, neither of which are defined – and the plan to allow the secretary of state to create a 'single regulator' at a later date is unclear.

On first glance, the single regulator may seem a panacea to our regulators' consistency and speed issues but it is not one that that would be without its own problems. Creating a new regulator from scratch risks a regulatory gap as the new body gets up to speed while the existing RPBs step back. The new regulator model would need to embrace the myriad of good initiatives the current regulators undertake.

> "As a profession, we would benefit from enhanced transparency and accountability."

There are alternatives, R3 has suggested The Insolvency Service considers introducing a unified regulatory process (that would be shared by existing regulators), for example.

Personally, I think the role of the Joint Insolvency Committee could be boosted too. JIC provides a forum for the RPBs to discuss their approach to regulation, but it does suffer from a lack of dedicated resource and is consequently, and unfairly, viewed by some as a 'paper tiger'.

My own experience working with JIC (which has very restricted resources) and with R3 (which has a skilled team to promote and develop many different aspects of the profession), highlights how much more JIC would be able to achieve with a limited but dedicated budget and staff.

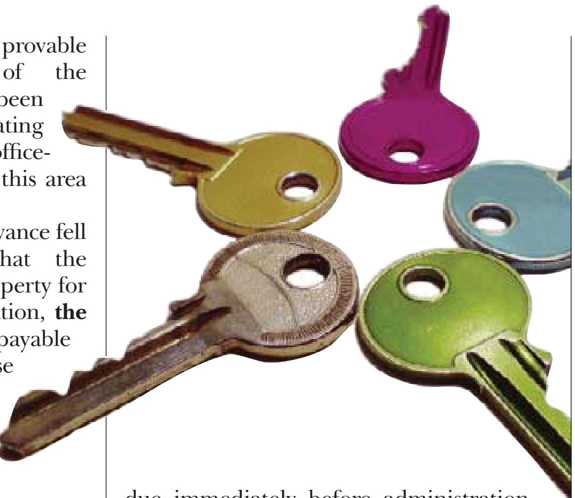
As a profession, we would benefit from enhanced transparency and accountability – a perceived absence of which can sometimes seem to distract ministers and civil servants from looking at other issues for which there is no readily apparent 'quick fix', such as unsecured creditor engagement.

The regulation of the insolvency profession is not broken; but it can be improved. ◻

ANDREW TATE is a partner at Reeves & Co and is chairman of the R3 Smaller Practices Group (SPG) Committee.

Recent case summaries

A corporate insolvency update from **Daniel Lewis**.



The treatment of rent as a provable debt or expense of the administration has long been a vexed area creating considerable uncertainty for office-holders. Until recently the law in this area was anomalous in that:

(a) If a quarter's rent payable in advance fell due **during the period** that the administrator was using the property for the purposes of the administration, **the whole** of that quarter's rent was payable as an administration expense even if the administrator gave up occupation during the quarter (*Goldacre (Offices) Ltd* v. *Nortel Networks UK Ltd* [2011] Ch. 455);

(b) If a quarter's rent payable in advance fell due **before** administration, **none** of that rent was payable as an expense of the administration even where the administrator retained possession for the purposes of the administration. The rent was instead a provable debt in the administration (*Leisure (Norwich) II Ltd* v. *Luminar Lava Ignite Ltd* [2013] 3 W.L.R. 1132).

> "Rent of £3m remained unpaid in respect of those stores."

The practical effect of this was that it was often in the company's interests to enter administration immediately after the quarter's rent had fallen due. The company could then continue to trade (either in administration or following a sale of the business, through a successor company) without payment of the rent that had fallen due immediately before administration. While such a result might be for the benefit of creditors as a whole (by relegating the landlord's claim for rent to a pari passu entitlement), that result was achieved at the expense of a single creditor (the landlord). The fairest result in the two instances referred to above would be that the rent be treated as an expense of the administration on a pro-rata 'pay for what you use' basis, thereby avoiding saddling the administration with expenses from which the creditors derived no benefit but equally avoiding the situation where the continued trading from the company premises is at the expense of a single creditor.

The issue in *Re Game Station Ltd* [2014] EWCA Civ 180 was whether this was a result open to the Court of Appeal on the basis of the case-law.

Facts: The claims arose from the administration the Game group of companies. One of the group companies was tenant of hundreds of leasehold retail properties from which the group traded. Rent was payable quarterly in advance and fell due the day before the group entered administration. While some stores were shut down immediately, others continued to trade through the administration and following a sale to the purchasers of the business. Rent of £3m remained unpaid in respect of those stores.

At first instance the judge followed the decisions in *Nortel* and *Luminar* but granted the landlords permission to appeal.

The legal principles: Where rent falls due immediately before administration, the rent is provable as a debt in the administration (rule 2.87). Rule 2.67, on the other hand, provides that expenses of the administration will include 'expenses properly incurred by the administrator in performing his functions in the administration of the company'. This rule is subject to the salvage principle, which allows for a debt that would otherwise be provable to be treated as an expense of the administration.

> "The decision will need to be taken at an early stage at to whether to continue trading from company premises."

The authoritative statement of the principle was given in *Re Lundy Granite Co* (1870-71) LR 6 Ch App 462: *'if the company choose to keep the estates for their own purposes, they ought to pay the full value to the landlord'.*

Held: In his judgment Lewison LJ provided an authoritative review of the authorities on the salvage principle and the apportionment of rent. He held that the principle was not constrained by the fact that rent payable in advance could not ordinarily be apportioned, since there was no termination of the lease or change of tenant. The salvage principle required that the company pay 'full value' for the use of the property. To limit requirement to provide 'full value' to cases where the rent fell due after administration would be an arbitrary result. Instead, whether or not a quarter's rent in advance was payable before or after administration, the rent should be treated as accruing day-to-day as an expense of the administration. ◻

Practice points

- The administrator must pay for what he uses. This cuts both ways: the administrator is not required to pay for the whole quarter of post-administration rent if he subsequently goes out of possession during that quarter.
- The disadvantage for administrators is that they are now denied the 'breathing space' available where rent in advance has fallen due immediately before administration.
- The effect of this is that the decision will need to be taken at an early stage at to whether to continue trading from company premises. This might be a strategic decision that can be taken in advance in the case of some appointments, but might be far more difficult where there has been little or no involvement of the office-holder before administration.
- It remains unclear whether the administrator is required to pay only for those parts of the premises which he is using on the same basis as he is required to pay for the period of his occupation. The better view appears to be that the rent that is payable is that due under the lease (albeit that it may be apportioned for the period of occupation) and that there is little room for arguing that the extent of occupation can be taken into account.
- It is also uncertain whether or not ancillary charges (in particular service charges) will be treated in the same way as rent. While service charges and insurance reserved as rent might be readily apportionable, in a case where charges fall due for major works for instance, it is not readily apparent how the total charge would be to the benefit of the administration or how this charge might be apportioned.

DANIEL LEWIS is a barrister at 3 Hare Court.

Technical update

Mike Pink and **John Francis** examine the EU recommendations for national restructuring regimes.

With attention focused on revisions to the European Regulation on Insolvency Proceedings, we should not lose sight of the Commission's other plans for European insolvency law. These perhaps have not attracted as much attention as they might. This may be because the EU legislative process is somewhat opaque, and tends to operate largely out of sight until breaking, often unexpectedly, into the open.

> "EU legislative process is somewhat opaque, and tends to operate largely out of sight."

For some time now Brussels has been on a mission to encourage EU member states to modify their insolvency laws with the aim of promoting business rescue and helping to boost enterprise. The Commission sees this as an important element in the struggle to resolve the economic crisis. In the summer 2008 edition of *RECOVERY* Richard Heis wrote about the Commission's communication issued in October 2007 entitled *Overcoming the Stigma of Business Failure – for a Second Chance Policy*. The purpose of this document was to encourage member states to adopt measures to address the negative consequences of business failure and its negative image with the aim of promoting innovation and job creation. It was noted that the UK was in the forefront of adopting measures met with the Commission's approval.

In November 2011 the European Parliament adopted a resolution on insolvency proceedings, which recommended harmonising various aspects of insolvency law across the EU. This was followed in July 2013 by a Commission consultation on a new European approach to business failure and insolvency. The aim of this consultation was to help identify areas where differences between national insolvency laws might hamper the establishment of an efficient insolvency legal framework in the internal market, and the issues on which a new European approach should focus so as to develop a rescue and recovery culture across the member states. The R3 response to this consultation is available on the R3 website.

Study into regimes

Following the consultation, Insol Europe was commissioned to carry out a comparative study into rescue and pre-insolvency regimes in the various EU member states. Insol Europe's report was submitted to the Commission in October 2013, and included recommendations for minimum standards for proceedings in the pre-insolvency stage or early stages of insolvency/distress.

The most recent development has been a further communication from the Commission, issued in March this year, incorporating detailed recommendations, which member states are encouraged to adopt. According to the document (C(2014) 1500 final):

> 'The objective of this recommendation is to encourage member states to put in place a framework that enables the efficient restructuring of viable enterprises in financial difficulty and give honest entrepreneurs a second chance, thereby promoting entrepreneurship, investment and employment and contributing to reducing the obstacles to the smooth functioning of the internal market.'

> "The commission points out that each year around 200,000 businesses across the EU face insolvency."

In its press release the Commission points out that each year around 200,000 businesses across the EU face insolvency and 1.7 million people face losing their jobs as a result. For this reason, viable enterprises should be given the opportunity to restructure and stay in business.

The key recommendations set out in the document are:

General features

- Debtors should have access to a preventive restructuring framework at an early stage as soon as there is a likelihood of insolvency. The debtor should remain in day-to-day control of its affairs, and should be able to request a temporary stay of individual enforcement actions. A plan approved by a prescribed majority should be binding on all, subject to confirmation by the court in certain circumstances.
- Any new financing necessary for the implementation of a plan should be protected from challenge as an antecedent transaction.
- The restructuring procedure should be brief and flexible, and the role of the court should be limited to necessary protection of the rights of creditors and others.
- The formal opening of court proceedings should not be necessary, and a mediator or supervisor should only be appointed by the court, in the case of a mediator, to assist the debtor in negotiating the plan, or in the case of a supervisor, to exercise oversight and protect the interests of creditors and others.

> “Creditors in different member states should enjoy equivalent rights.”

The stay

- The stay should include a stay against enforcement actions by secured and preferential creditors, but should not interfere with the performance of ongoing contracts.
- A stay should be granted in all circumstances where a plan has a reasonable prospect of being implemented and the majority of potentially affected creditors are in support.
- Any obligation to file for insolvency otherwise provided for in domestic law should be suspended during the stay.
- The duration of the stay should generally not exceed four months. Member states may provide that where there is evidence of progress in the negotiations the total duration should not exceed 12 months.
- The stay should be lifted when no longer necessary.

Restructuring plans

- Member states should lay down clear and specific provisions on the content of restructuring plans.
- Plans should clearly identify the affected creditors, the effect of the plan, the position taken by affected creditors, the conditions for new financing, and the potential of the plan to ensure future viability of the debtor.

Adoption by creditors and confirmation by the court

- Affected creditors should be able to adopt plans, and creditors with different interests should be treated as separate classes.
- Creditors in different member states should enjoy equivalent rights.
- Plans should be capable of adoption by certain creditors or classes of creditors only, provided other creditors are not affected.
- Plans affecting the interests of dissenting creditors, or making provision for new financing, should be confirmed by the court, and the conditions under which a plan can by confirmed by a court should be clearly specified in national law.
- Courts should be able to reject plans that clearly have no prospect of success.

The document also contains recommendations to limit the negative effect of bankruptcy on entrepreneurs and allow them a second chance. The document recommends that entrepreneurs should be fully discharged from their bankruptcy debts after three years, subject to appropriate more stringent conditions for cases of misconduct or dishonesty. Clearly this recommendation only makes sense in relation to individual debtors.

Member states are invited to implement the recommendations by the anniversary of the date of the document, which seems a very short time. The Commission will assess how the recommendations have been implemented by member states within 18 months of the date of the document, again surely an unfeasibly tight timescale. At the time of writing the UK government's intended response to the recommendations is not known.

> “Member states are invited to implement the recommendations by the anniversary of the date of the document, which seems a very short time.”

The R3 website technical section

Could I take this opportunity to remind members of the resources available in the technical section of the R3 website. This includes all the R3 Technical Bulletins, technical alerts, ad hoc guidance papers and notices, helpsheets, most of the statutory insolvency forms in editable PDF format, links to relevant legislation, bibliography, and Statements of Insolvency Practice. I hope members find this useful. Comments and suggestions are always welcome.

Technical Bulletin

Technical Bulletin 106 was issued in March. Its contents included:

- Consumer credit regulation – important changes with effect from 1 April 2014
- Consumer credit regulation – FCA participation rights with effect from 1 April 2014
- Deposits and fees – increases with effect from 6 April 2014
- Employment rights – increases in statutory limits
- Industrial and provident societies – administrations, CVAs and Companies Act schemes
- TUPE – changes introduced with effect from 31 January 2014
- Urgent applications in bankruptcy and the Companies Court
- Tax relief available for fixtures in property acquisitions
- Court of Appeal rules on treatment of rent as an expense
- Administration – applications to court in the absence of creditor approval of administrator's proposals
- TUPE – Court of Appeal clarifies application of ETO provisions
- Sales by administrators in breach of contract
- Scottish liquidators could not abandon onerous property
- Contribution notices issued by the Pensions Regulator
- English scheme approved for Netherlands company
- IVA – creditors bound by decision of second creditors' meeting following successful challenge to the first
- Trustee's costs on annulment of bankruptcy
- European Insolvency Regulation – clawback provisions where defendant is in a non-member state
- European Insolvency Regulation – obligations honoured for the benefit of the debtor
- Chapter 15 recognition refused by US court

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The changing face of English insolvency law: it's a generation game

The law is not static. Even principles once well-understood by one generation, are subsequently reinterpreted by the next to adapt to the changing needs of commerce and society.

Over the past quarter of a century, English insolvency law has undergone something of a transformation guided by changes in policy (from liquidation to rescue) and in audience (from national to international). It remains also an area where judge-made law is of paramount importance.

Changing priorities

One area of insolvency law that has exemplified constant evolution concerns creditor priority. During the course of any insolvency, those owed money by the debtor can broadly expect one of three outcomes: to be paid in full, to receive part payment or to receive nothing at all. Yet this deceptively simple proposition is not so easily implemented as it is stated.

A look at some of the developments in the past 30 years shows how radical some of the changes faced by creditors and insolvency practitioners have been:

- the Insolvency Act 1986 introduced a new administration procedure aimed at the rescue of companies following the 1982 Cork Report. It is worth recalling that the justification for administration was as an alternative to liquidation for those companies where there was no floating charge such that the business could not be rescued by the appointment of an administrative receiver, perhaps the last time that the floating charge was viewed positively by the legislature;
- in *Re Atlantic Computer Systems plc (No.1)* [1992] Ch 565, the Court of Appeal considered that the court had a discretion to direct payment of amounts as insolvency expenses. While in respect of the *Lundy Granite* principle for liabilities arising under pre-liquidation contracts such discretion had hardened into a set practice, a flexible approach was necessary in administration given its fundamentally different aims;
- in *Re Toshoku Finance UK plc* [2002] 1 WLR 671, the House of Lords discredited the *Re Atlantic* idea that the court had any discretion in determining liquidation expenses whether under rule 4.218 or under the *Lundy Granite* principle. This was widely interpreted as also meaning there was no such discretion as to administration expenses, although the point was not entirely certain;
- the Enterprise Act 2002 streamlined the administration process, all but banned floating charge administrative receivership appointments after the experience of the recession in the 1990s and provided for a new rule 2.67 on administration expenses, which mirrored, for the most part, rule 4.218 on expenses in a liquidation;
- in *Re Leyland Daf Ltd* [2004] 2 AC 298, the House of Lords prevented the deduction of liquidation expenses from floating charge assets. In doing so, it overruled the Court of Appeal decision in *Re Barleycorn Enterprise Ltd* [1970] Ch 465. However, statute soon stepped in to reinstate the previous position, which is now reflected in s176ZA;
- in *Re Spectrum Plus Ltd* [2005] UKHL 41, the House of Lords recharacterised what had previously been thought since the late 1970s (*Re Siebe Gorman* [1979] 2 Lloyd's Rep 142) to be a fixed charge over book debts as, instead, merely a floating charge;
- in *Re T&N Ltd* [2005] EWHC 2870 (Ch), the High Court found that potential tort claimants were unable to submit proofs of debt. The law on that particular point was then changed by legislation in 2006;
- in *Re Nortel; Re Lehman* [2013] UKSC 52, the Supreme Court overturned earlier Court of Appeal authority on what constituted a 'contingent liability' for the purpose of the provable debt provisions in the Insolvency Act and Rules, significantly on the grounds that those decisions did not reflect the ambition that *'all possible liabilities within reason should be provable'*, an ambition reflected in the Cork Report in 1982 and dating even further back into the 19th century. It also clarified the scope of administration expenses and the concept of non-provable claims, dispelling the myth of the 'Black Hole'; and
- in *Re Games Station* [2014] EWCA Civ 180, the Court of Appeal held that administrators must pay rent as an administration expense for each day they occupy premises. This overturned the judgment in *Goldacre (Offices) Ltd* v. *Nortel Networks UK Ltd (in administration)* [2010] 2 BCLC 248 and restored a degree of pragmatism – but not the laws – which had existed during the *Re Atlantic* era.

Over a generation then, the courts have spun a complex web of principles impacting on creditor recoveries and insolvency law.

But, a question not often asked is – what influences change in the law?

On occasion, legal authority simply falls more and more out of favour and there is a period of uncertainty as to what the guiding legal principles are. A good example of this latter category of change concerns provable debts and expenses, in particular the judicial reinterpretation of the *Re Atlantic* approach to expenses, primarily as a consequence of the changes to administrations brought about by the Enterprise Act 2002.

The Atlantic principle

It is first necessary to understand the *Lundy Granite* principle. In *Lundy Granite Company, ex party Heaven* (1871) LR 6 Ch. App 462, the court held that a liability under a contract entered into before commencement of the liquidation could be treated as if it were an expense if the liquidator retained the benefit of the contract for the purposes of the winding-up. Doing so was a matter of *'common sense and ordinary justice'* according to Sir W James LJ in that case. What started life as the application of *'Equity's understanding of 'fairness''* (as Mann QC said in *Re UK Housing Alliance (North West) Ltd (in administration)* [2013] EWHC 2553 (Ch)), eventually solidified into principle leaving *'little if any room for the intervention of Equity'*. The underlying rationale for the development of the principle was that there was little difference between a landlord being able to levy distress for rent falling due after the winding-up and directing the liquidator to pay the rent in full.

The *'hard and fast principles'* in liquidation had *'no place'* in administrations, according to Nicholls LJ in *Re Atlantic*, where instead a *'flexible approach'* was necessary:

'there is no room in administrations for the application of a rigid principle that, if land or goods in the company's possession under an existing lease or hire purchase agreement are used for the purposes of an administration, the continuing rent or hire charges will rank automatically as expenses of the administration and as such be payable by the administrator ahead (so it would seem) of the pre-administration creditors… Such rigid principles would be inconsistent with the flexibility Parliament must have intended should apply by giving the court a wide discretion.'

As a result, the treatment of, in particular, rent as an expense in administrations was a matter for the court's discretion. This led to the common practice of administrators paying landlords rent for the period during which premises were used – essentially, on a pay-as-you-go approach.

The gradual decline of *Re Atlantic*

The decision of the House of Lords in *Re Toshoku* rejected the idea of any *Re Atlantic* discretion existing in a liquidation:

'The second point is the proposition that whether debts should count as expenses of the liquidation is a matter for the discretion of the court. In my opinion there is no such discretion. Rule 4.218 determines what counts as expenses… The court will of course interpret rule 4.218 to include debts which, under the Lundy Granite Co principle, are deemed to be expenses of the liquidation… But the application of that principle does not involve an exercise of discretion any more than the application of any other legal principle to the particular facts of the case.'

In effect, the House of Lords were clear that although there may be a discretion as to the remedy a creditor may be allowed to exercise (eg bring proceedings, levy distress or execution), there was no role for the court to exercise a discretion to determine whether a claim is a liquidation expense. Rule 4.218 was an exhaustive code of the liquidation expenses and the *Lundy Granite* principle simply enlarged the categories within it, by treating certain pre-liquidation liabilities as if they were expenses. It was a matter of statutory construction, not discretion, informed by that principle.

The catalyst for the decline in the *Re Atlantic* principle in administrations was the introduction of rule 2.67 of the Insolvency Rules 1986 by the Enterprise Act 2002. This set out a list of categories of administration expenses based on the list of liquidation expenses in rule 4.218 and so opened the backdoor for the *Toshoku* decision on liquidation expenses to apply in administration. The flexible approach of *Re Atlantic* began to be doubted.

Game over for *Re Atlantic*

However, *Re Toshoku* did not deal expressly with *Re Atlantic's* view as to how the *Lundy Granite* principle applied in administrations. For a while, some considered therefore that discretion remained alive and well in determining what ranked as an administration expense, at least in respect of pre-administration liabilities. However, the more the point was considered, the less palatable this view became particularly as rule 2.67 mirrored the expense categories set out in rule 4.218 for liquidations. Accordingly, Richards J held in *Exeter City Council* v. *Bairstow* [2007] 4 All ER 437 that Parliament must have intended that classification as an administration expense had the same consequence as classification as a liquidation expense and that, in accordance with *Re Toshoku*, the court had no discretion in the matter – at least in respect of post-administration liabilities.

> "The catalyst for the decline in the *Re Atlantic* principle in administrations was the introduction of rule 2.67 of the Insolvency Rules 1986 by the Enterprise Act 2002."

The High Court in *Re Goldacre* then took the view that the *Re Atlantic* approach could not stand in light of *Re Toshoku*. The rejection of the flexible approach in *Re Atlantic* led to the upset of the previously accepted practice of paying rent as an expense in so far as premises were being used. From this developed the practice of administration appointments being made the day after rent fell due in advance on a quarter day. *Goldacre* held that administrators using premises on a quarter day had to pay rent as an expense for the entire quarter, even if they vacated during that quarter since common law does not allow rent payable in advance to be apportioned and there was no *Re Atlantic* discretion available to soften this blow. *Re Luminar* [2012] EWHC 951 (Ch) confirmed that rent payable in advance and falling due before appointment was merely a provable debt, even where the company occupied for the purpose of the administration through the rest of that quarter. Similarly, the court had no discretion to order payment of the rent as an expense. The timing of administrators' appointments therefore often determined whether or not landlords would be paid for a period of occupation.

Of course, the Court of Appeal in *Re Games Station* [2014] EWCA Civ 180 most recently overruled the *Goldacre* and *Luminar* decisions and held that administrators must pay rent as an expense but only day by day for the period during which possession of property is retained for the benefit of the administration. However, the point about the impact of *Re Toshoku* on *Re Atlantic* stands. Indeed, it was common ground that status as an expense was *'not a question of an exercise of the court's discretion'*. Rule 2.67 is a complete enumeration of the administration expenses and is, like rule 4.218, simply enlarged by the *Lundy Granite* principle. In particular, Lewison LJ in *Re Games Station* said that: *'I accept that whether the salvage principle applies is not a matter of discretion. As Lord Hoffmann explained in Toshoku it is a principle that informs the interpretation of the rules which contain the complete list of what could rank as expenses of the relevant insolvency process.'*

In exercising the discretion not to treat as expenses payments due to the owners of equipment sublet by the company in administration, Nicholls LJ in *Re Atlantic* proceeded by dealing with the case as one where the question was whether the moratorium should be lifted to allow the owners to repossess. In light of how the law has moved on since then (as illustrated by *Re Games Station*), it would appear the result would be different today and the case would be treated along the 'pay as you go' approach.

The Court of Appeal's decision in *Re Games Station* removes the apparent arbitrariness and marks a return to the pre-*Goldacre* practice. It supports flexibility and commercial pragmatism once again – arguably as did *Re Atlantic* – but it does not revive the discretionary, case-by-case approach Nicholls LJ advocated. The rejection of the idea that the courts should have a role other than statutory construction in relation to what counts as an expense or provable debt is evident in the Supreme Court's decision in *Re Nortel; Re Lehman* [2013] UKSC 52. Neuberger LJ thought that if the court could direct an administrator to give a liability a higher ranking than it otherwise would be given under the Insolvency Act and the Rules, such a result *'would be extraordinary… because it would involve a judge effectively overruling the lawful provisions of a statute or* » *statutory instrument'*. Similarly, the court had no power to direct an administrator not to treat an amount as an expense if that was what it was.

The Supreme Court reassesses *Re Toshoku*

The Supreme Court decision in *Re Nortel; Re Lehman* further illustrates the way in which authority may be subsequently reassessed and interpreted differently, and the value of the law being reviewed by the Supreme Court in some cases.

While *Re Toshoku* was clear in its rejection of any *Re Atlantic* discretion in expenses, it gave rise to confusion as to what exactly its ratio was as to when amounts were expenses. This was particularly relevant in the case of statutory liabilities arising during the course of an insolvency and their treatment. The Supreme Court in *Re Nortel; Re Lehman* clarified how *Re Toshoku* should be interpreted and rejected the interpretation offered by the lower courts (including the Court of Appeal) that an amount arising during an insolvency would likely be a 'necessary disbursement' if it were not a provable claim. In particular, while not an *'absolute rule'*, Lord Neuberger (who gave the main judgment) considered that a liability would only be a 'necessary disbursement' constituting an administration expense *'if it arises out of something done in the administration (normally by the administrator or on the administrator's behalf), or if it is imposed by a statute whose terms render it clear that the liability to make the disbursement falls on an administrator as part of the administration – either because of the nature of the liability or because of the terms of the statute.'* In relation to statutory liabilities and the construction of *Re Toshoku*, the Supreme Court confirmed that a statutory liability can only be an administration (or liquidation) expense, if either the relevant statute requires this or the nature of the liability is such that it must reasonably have been intended by the legislature that it should rank ahead of provable debts.

At the same time as tightening the scope of what may count as an expense, the Supreme Court also adopted a wide approach to the interpretation of the term 'provable debt' under the Insolvency Rules, overruling earlier long standing decisions, which suggested that certain debts (particularly if contingent) should not be provable. As stated already above, Lord Neuberger considered that *'all possible liabilities within reason should be provable'*.

The Supreme Court was also comfortable with the idea that there may be some amounts which were neither provable debts nor expenses and so would only be recoverable, in effect, where there was a surplus enabling all creditors to be paid in full (including post insolvency statutory interest). For an example of such claims, see the decision of Richards J in *Re LBIE (in administration)* [2014] EWHC 704 (Ch) in relation to certain currency conversion claims, which he held ranked as non-provable liabilities, payable only after the payment in full of all provable debts and statutory interest on those debts.

Periods of transition

While *Re Atlantic* was good law, rent was generally paid as an expense on a pay-as-you-go basis. However, during the period of transition from *Re Atlantic* to *Re Goldacre* to *Re Games Station*, an 'all-or-nothing' approach developed, which was unhelpful and harmful to landlords and the rescue culture. Certainty has only recently begun to be provided to questions that, really, were rather fundamental yet largely ignored by Parliament.

“The global financial crisis of 2007 and the subsequent collapse of Lehman the following year are perhaps the clearest examples of where developments in law have distinct, readily identifiable and forceful causes.”

Yet some transitions are less gradual. Sometimes, legal authority is abandoned abruptly (albeit not always entirely unexpectedly) and with it years of commercial comfort are swept away. For example, consider the comments of Morritt VC in *Re Spectrum Plus* (subsequently upheld by the House of Lords having been overturned by the Court of Appeal):

'…Siebe Gorman has stood for 25 years with little criticism. It is suggested that most banks' standard forms are drafted on the assumption that Siebe Gorman was correctly decided and that thousands of liquidations have been conducted on the same assumption… It is with the greatest hesitation and reluctance that I differ from the conclusion of Slade J in Siebe Gorman. Nevertheless I am convinced that it is wrong.'

Other times, changes in the law are due to a 'changing of the guard' – perhaps as leading individuals in the judiciary retire and are replaced by the next generation. Alternatively, there may be a subtle change in applicable legislation.

Certainly in recent years, there has been a reluctance to use the common law to stray into areas best left to Parliament. For example, in *Rubin* v *Eurofinance SA; New Cap Reinsurance Corporation (in liquidation)* [2012] UKSC 46, the Supreme Court held that the principle of modified universalism (whose emergence had been identified by Lord Hoffmann in his seminal judgment in *Cambridge Gas Transportation Corporation* v. *Official Committee of Unsecured Creditors of Navigator Holdings plc* [2006] UKPC 26) did not permit any derogation from the ordinary common law rules on recognition of foreign judgments. The law relating to international insolvency law and reciprocity of judgments was not for *'judicial innovation'* but should be left to Parliament and international consensus. Similarly, in *Belmont Park Investments PTY Ltd* v. *BNY Corporate Trustee Services Ltd* [2011] UKSC 38, the Supreme Court considered that the introduction of any general rule, such as that found in the US Bankruptcy Code, preventing contracts from being terminated solely by reason of a party's insolvency, would require legislative change in the UK – an *'ipso facto'* restriction such as this could not be imposed using the common law anti-deprivation rule.

The global financial crisis of 2007 and the subsequent collapse of Lehman the following year are perhaps the clearest examples of where developments in law have distinct, readily identifiable and forceful causes. For example:

- the global banking crisis led to international efforts to establish a more resilient, stable and competitive banking sector through both structural reform (such as ring-fencing proposals) and non-structural reform (such as bank resolution);
- the collapse of Lehman triggered a new special administration regime for investment banks; and
- *Lehman* has given rise to a staggering array of complex legal cases – often decided at high speed – in areas of financial law such as client monies and client assets, interpretation of ISDA contracts, issues of security under the legislation governing financial collateral, the ranking of claims (as highlighted above) and the resurgence of claims brought on the basis of 19th century principles (such as the anti-deprivation principle) or constructive trusts.

The meltdown following *Lehman* has arguably seen that pace of change accelerate at a rate faster than usual and has ushered in a new era. Of course, the law as developed will not stand still and will continue to adapt. The agents of change are many – politics, shifting views as to the role of the judiciary, changes in commercial practice, financial crises – but it is for each generation to accommodate that change as best it can.

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Legal Q&A

Andrew Laycock answers your insolvency queries.

I am the trustee in bankruptcy of a bankrupt who is approaching discharge. Prior to bankruptcy his wife obtained an order in matrimonial proceedings for the payment of a substantial lump sum against him in addition to maintenance payments. The wife petitioned for his bankruptcy based upon non-payment of amounts due. He has asked me if the matrimonial liability remains after bankruptcy and if he will have to attempt to pay the amount outstanding to his wife.

The position is relatively well established. Arrears due under an income payments order or agreement in matrimonial proceedings are provable in the estate *re Hargreaves [2010] BPIR 1111*. Lump sum and costs orders are provable debts under rule 12.3 of the Insolvency Rules 1986. Discharge does not release the bankrupt from any bankruptcy debt that arises under any order made in family proceedings or under a maintenance calculation made under the Child Support Act 1991 (s281(5) Insolvency Act 1986).

> "The jurisdiction so conferred is discretionary."

The section does, however, confer a discretion on the court to release the bankrupt from the matrimonial order and your bankrupt could apply to the court to obtain such an order. The guidelines were set out in *McRoberts* v. *McRoberts [2012] EWHC 2966 (Ch)*. In that case an application made by the bankrupt for relief from a debt arising from ancillary relief proceedings was rejected. The court confirmed that the default position was that the liability would survive discharge. In this case the wife had lodged a proof of debt of £244,000 being the amount due to her under an ancillary relief order. The court undoubtedly had jurisdiction to provide for release to such extent and on such conditions as it may direct. The jurisdiction so conferred is discretionary. The following were considered to be the guidelines to be followed by the court:

(a) the prejudice to the respondent/obligee in releasing the obligation if otherwise there would or might be some prospect of any part of the obligation being met and

(b) the potential prejudice to the applicant's realistic chance of building a viable financial future for himself and those dependent upon him if the obligation remains in place.

If your bankrupt can prove financial hardship such an application may have the chance of success.

As administrator of a company I have made my proposals to the creditors. It is a relatively small administration and the creditors have failed to provide either approval or rejection of the proposals. As a result, I have no approval for my fees or my adopted strategy. What steps should I take?

The starting point in circumstances where rejection of the administrator's proposals has arisen is an application to court for directions. Although para 55 Sched B1 Insolvency Act 1986 does not expressly require the administrator to seek directions from the court, it implies that there will be a hearing and therefore that an application will be made *(Lavin & Others* v. *Swindell (aka Re BTR (UK) Limited) [2012] EWHC 2398 (Ch))*.

However, in your case this is not the position as the problem has arisen due to the apathy of creditors and not a conscious vote rejecting the proposals. In the circumstances you will be required to make a determination as to the way forward. It has been clarified that the courts would not wish to intervene in the commercial decision-making of office-holders. Unnecessary expense will be incurred in asking the court to give directions that will serve no effective purpose. The course of action to be taken by you will depend on the particular circumstances of the case and require you to exercise your judgement. This was the determination of the court in *Parmeko Holdings Ltd (in administration) [2013] EWHC B32 (Ch)* where similar facts existed and the court concluded that all it was being asked to do was to confirm the extensive powers that already existed in favour of the administrators. In that case the court was being asked to place the company into liquidation but this was not realistic bearing in mind that no creditor had proposed it.

The court recommended that administrators in these circumstances should indicate in their report to the court if anything could be achieved by an application to court under para 55 (2) and, if not, that they would not make such an application. The purpose of the court's

> "The problem has arisen due to the apathy of creditors..."

powers under that provision is to give directions to the administrator only where there is 'some real question as to the course that he should follow'.

However, useful guidance was given in respect of the office-holders' fees and the court did consider that it was proper to seek the court's approval in the circumstances for the basis upon which the administrators could recover their fees and an application in respect of the same could be made by you without criticism.

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When charities come to grief

An overview of the options available for different charitable structures.

The formal insolvency of a charity can be all the more difficult because of the impact of its loss on the beneficiaries it serves. Prevention remains better than cure, and when in financial difficulty, trustees and their advisers should consider the possible causes of insolvency, the nature of the legal entity constituting the charity, and any peculiarities of insolvency law relevant to that entity.

What causes charity insolvency?

Donations are a charity's lifeblood. As well as representing day-to-day cashflow, they can also be 'capitalised' over time to generate investment income. A poor economic climate can have a double impact on a charity's income reducing both donations and returns received from funds held as investments.

> "Prevention remains better than cure."

Many larger charities receive a significant proportion of their income from contracts for the provision of services. The cancellation or default of a material contract can tip the balance into insolvency. Funding from the government, grant-makers or other established donors can be cut unexpectedly, and while the most robust charities receive income from a range of sources, this is not always easy to achieve.

Not all funding comes without restrictions. Legal conditions may apply to the use of specific funds that make them unavailable to settle some or all of the liabilities of the charity: grant funding may be subject to specific conditions, and endowments and special purpose trusts may be established precisely to ensure that funds are not available for the general expenses of the charity or to satisfy its creditors in the event of insolvency.

Increasingly charities may borrow to fund their capital needs but this is always accompanied by repayment and servicing obligations. Often there is a mismatch between long-term liabilities and short-term income or assets, and if a charity intends to refinance a term loan, a reduction in income or a change in bank lending criteria can mean that banks are no longer willing to refinance the whole debt.

It is not only borrowing that can give rise to unmanageable liabilities. In recent years, substantial pensions liabilities, often arising from defined benefit schemes, have started to pose a significant threat to charity solvency. A number of recent cases have served to demonstrate that extraordinary liabilities such as these need to be monitored and managed as actively as the more predictable liabilities for rent, wages and other contractual commitments.

Optimal financial management and any rescue or insolvency of a charity will need to consider all of the above; however, one aspect of charity insolvency that is not always understood by advisers is the range of different legal forms that a charity can take, and the procedures that can and cannot be used in the event of formal insolvency. We identify below the main charitable structures that practitioners may come across, and provide an overview of the options available in each case.

Company limited by guarantee

A substantial proportion of charities operating in England and Wales today are companies limited by guarantee. Guarantee companies have members and directors and are very similar to the more familiar companies limited by shares; however unlike share companies the liability of the members is limited to the amount of their guarantee (usually between £1 and £10). A charitable company's profits are not distributed to its members and may only be applied for its charitable purposes.

The company's directors will also be the charity's trustees, and will have duties and obligations under both company law and charity law. Charitable companies are also subject to both charity law and company law, and are subject to both regulation by the Charity Commission and bound by the usual Companies House requirements.

> "A poor economic climate can have a double impact on a charity's income."

The Insolvency Act 1986 (IA 1986) treats guarantee companies like companies limited by shares, other than in relation to the members' liability (noted above), and the normal range of insolvency procedures under that Act is available. All assets owned by a charitable company are available to meet its debts in a formal insolvency, including any funds that are donated and held for the charity's general purposes. The situation is more complex where a charitable company holds assets to which it is not beneficially entitled – the most common example being property held as a special purpose trust or as endowment funds. If correctly constituted, such trusts may ring-fence assets from creditors in insolvency. We discuss this in more detail below.

In certain circumstances trustees of charitable companies may be required to contribute personally to the assets of an insolvent charitable company. As they will be treated as directors, they will have the same duties and liabilities as a director of an insolvent non-charitable entity. Antecedent transactions provisions under the IA 1986, and wrongful trading, also apply to charitable companies.

> "Charities have been structured as trusts for centuries."

Trusts

Charities have been structured as trusts for centuries. Trusts are commonly governed by a trust deed, although trusts can also be created in a will or other documents. A trust has no legal personality distinct from its trustees and cannot hold land or sign documents in its own name; its business is therefore conducted by and in the name of the individual trustees.

With many modern trusts the trust document will set out the procedure according to which the trust may be wound up but many older trust deeds lack such provisions. A charitable trust will not itself be subject to insolvency procedures under the IA 1986.[1]

If the assets of a charitable trust are insufficient to meet its liabilities, those liabilities become the responsibility of the trustees; it should however be noted that trustees who have acted in accordance with the terms of the trust are usually entitled to be indemnified out of its assets, although this will be of little comfort in insolvency.

Many charities have subsidiary entities including non-charitable trading companies and subsidiary charities of which they are a trustee. In the case of subsidiary charities, the insolvency of the parent/trustee charity raises the question: are the assets of the subsidiary trust available to the creditors of the parent/trustee charity?

> "The members and committee of an association may be personally liable for the association's debts."

In general, provided the parent/trustee charity had the necessary powers to declare the trust and exercised them effectively, the answer to this will usually be 'no'; however, the recent case of the Wedgwood Museum Trust[2] (in which the trustees failed to declare valid trusts) demonstrates the potential pitfalls of attempting to insulate assets from operational risk in this way. It should also be noted that separate permanent endowment funds may sometimes be available to meet liabilities where the parent charity is itself structured as a trust, though professional advice should always be sought.

Charitable incorporated organisations (CIOs)

The CIO was introduced last year as a bespoke charitable vehicle possessing the advantages of limited liability without requiring registration at Companies House. A CIO has a separate legal personality and has charity trustees and members, both of whose liability is limited. The governing document of a CIO is its constitution, which may be drafted using the 'foundation' model, under which trustees and members are the same, or the 'association' model, under which trustees and members form different groups.

CIOs are regulated solely by the Charity Commission, and are governed by a bespoke statutory regime, which includes the Charitable Incorporated Organisations (Insolvency and Dissolution) Regulations 2012. These regulations apply the provisions of the IA 1986 to CIOs such that, with certain modifications, the IA 1986 applies to CIOs as if they were companies. These regulations also set out a dissolution procedure for CIOs, which may also be wound up voluntarily in accordance with their constitution.

One notable disadvantage to the CIO regime at present (both for lenders and trustees seeking credit) is the absence of a »

public register of charges recording security given to a creditor over a CIO's assets.

Unincorporated associations

Membership-based charities that do not have significant liabilities or activities may be structured as unincorporated associations (sometimes called clubs or societies) and are usually governed by rules or a constitution. Like trusts, unincorporated associations have no separate legal identity, and it is usually the members of an executive committee who enter into agreements on its behalf. As with a trust, the members and committee of an association may be personally liable for the association's debts.

> "Royal Charter bodies can no longer be put into administration or become subject to a CVA."

There is provision in the IA 1986 *(Part V)* for an association or company not registered under the Companies Act 2006 to be wound up in the same way as a registered company; however, as the courts will only treat an unincorporated association as an unregistered company for these purposes if it is formed for profit or gain,[3] this will rarely apply to charitable entities. Otherwise, no other procedures under the IA 1986 are available.

Royal Charter bodies

Charities established by Royal Charter tend to be substantial organisations that are pre-eminent in their area of operation.

Royal Charter bodies are corporate entities that possess all the powers of a natural person. As they are incorporated by charter rather than under the Companies Acts they are likely to be classified as 'unregistered companies' under s220 of the IA 1986, and consequently may be wound up. Royal Charter bodies can no longer be put into administration or become subject to a CVA, and voluntary liquidation is also unavailable. This is rather limiting, but in 2011 the Work Foundation (a Royal Charter charity) went through a pre-pack provisional liquidation, which is increasingly being used in both charitable and non-charitable contexts to provide a more flexible solution.

Industrial and provident societies (IPSs)

Most IPSs are mutuals (ie organisations that exist for the benefit of their members). However, a small number are established for community purposes and may have charitable status. These IPSs are known as community benefit societies (CBSs). CBSs are incorporated charities constituted by a set of rules, and registered with the Financial Conduct Authority. While they are subject to charity law, they are not currently regulated by the Charity Commission.

Until recently, IPSs had no comprehensive statutory framework to deal with insolvency, though under the Industrial and Provident Societies Act 1965 an IPS could be wound up under the IA 1986. However, the recent introduction of the Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014 now means that the majority of IPSs can go into administration, and propose a CVA or scheme of arrangement.

The Charity Commission's powers

Insolvency practitioners should also note that in certain circumstances insolvency may prompt the Charity Commission to conduct an investigation or inquiry into a charity's affairs. The commission has wide powers to act to protect the interests of present and future beneficiaries of the charity, including powers to appoint an interim manager to take over the charity's management (see for example the recent case of the Dove Trust).[4] Where the Charity Commission concludes that charity trustees

> "Insolvency may prompt the Charity Commission to conduct an investigation or inquiry."

have been negligent in their conduct of the charity's affairs, they may also order the trustees to make a contribution from their own assets to compensate the charity for loss suffered as a result of their breach of trust.

Upcoming developments

The Law Commission is currently considering insolvency issues as part of its broader charity law review,[5] in particular the complex legal issues surrounding the availability of permanently endowed funds to meet properly incurred liabilities in insolvency situations, and the availability of property subject to special trusts to a charity's creditors. □

1. *Gilbert Deya Ministries* v. *Kashmir Broadcasting Corp Ltd* [2010] EWHC 3015 (Ch)
2. *Young & Anor* v. *HM Attorney General & Ors* [2011] EWHC 3782 (Ch)
3. *Re St James's Club* (1852) 2 De GM & G 383
4. http://www.charitycommission.gov.uk/news/charitygiving-website-suspended/
5. http://lawcommission.justice.gov.uk/areas/charity-law.htm

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Fighting talk

Compliance On Call constantly challenges accepted thinking to help improve the insolvency profession.

When Bill Burch and Gareth Limb first developed the concept of Compliance On Call in a hotel bar ten years ago, the idea seemed simple enough; there had to be a way to tell IPs what they were doing wrong and how to fix it, without wearing regulatory hob-nailed boots and threatening sanctions for getting it wrong. That led to the idea of doing regulatory-style visits outside the Recognised Professional Bodies (RPBs) and after a brief market-test during which Bill set up alone, Compliance On Call Ltd was duly incorporated in early 2006 when Gareth joined. With the addition of Mike and an enthusiastic commitment to do everything that they can to help clients and the profession in general, Compliance On Call carries an enviable reputation, but we have never been afraid to be controversial and challenge accepted thinking.

This article looks at some of our past crusades, considering areas that worked and others that were less successful and then moves on to consider some new windmills for us to tilt at over the coming months.

The IVA protocol

We still have a copy of an article we wrote in October 2006 about problems that the IVA market was facing at that time, primarily around evidencing clear advice to debtors and allowing the simpler, TIX-free world that we lived in then to process creditor votes more effectively. Over the subsequent months that led to discussions with the British Bankers Association and The Insolvency Service, and subsequently to the development of the IVA Protocol. The current Protocol is not exactly (!) what we envisaged and the IVA market place is forever changed since the arrival of TIX, but we still think that on balance, we helped the profession and punched above our weight.

Single regulator

We've never really believed that a single regulator could happen, or that there would be any significant benefit if it did. Without repeating the whole argument, we think that the current regulators would never agree to any one of them becoming the sole regulator and even if a new single regulator was appointed, the existing regulators would want to monitor the conduct and performance of their members, so that the single regulator would, in many areas, be an extra burden for IPs and not a replacement for the existing regulator. The new regulator would need funding and the existing regulators would continue as membership bodies, so IPs would just face increased costs, which would in turn impact on returns to creditors. We are not convinced that any potential reduction in regulatory visits would bring significant savings and we think that although there might be a marginal improvement in the perceived consistency in disciplinary decisions, the whole system would be weaker and more prone to bias and influence if it lost the competition between regulators that current keeps each one on their toes. We would welcome some simplification, however, as it is sometimes quite a strain to keep an eye of the individual preferences and requirements of so many different regulators and their monitors.

> “IPs would just face increased costs, which would in turn impact on returns to creditors.”

Ethics

Another area where our ideas are not consistent with the thinking of many in the profession, especially those in positions of power and influence, is that instead of trying to enforce the ethical code prohibition on commissions, the whole issue should instead be brought into the open. We believe that would eliminate the unfair bias against smaller firms, which are less able to use their size or complex trading structures to get around the rules. We believe that it would create a market place for insolvency work providers that could then be regulated to protect debtors and improve solutions for creditors rather than them being hidden in the shadows.

Disqualification

Another extreme idea that we put on our blog stemmed from the almost constant criticism of the Insolvency Service from a variety of stakeholders, that they are not doing enough to pursue delinquent directors and reject too many misconduct reports without pursuing the allegations. Our suggested solution, which has not yet attracted any great enthusiasm, was that the legislation could be amended to allow IPs, with some form of appropriate sanction from creditors, to pursue disqualification proceedings and consequential action for misfeasance in the company's name, in cases where the Insolvency Service was not prepared to risk public resources, but creditors still wanted the action taken.

Remuneration

At the time of writing, we still had a few days to submit our response to the IP fees consultation. By the time you read this, the closing date will be a distant memory, but we had two ideas that are worth airing here. Although we have some huge reservations about the methodology and conclusions drawn for the two reports on IPs' fees, we think that the profession probably has to do something to improve confidence in fee approvals without the ridiculous proposal in the consultation that an entire profession should change its basis of fee approval and redesign its entire business model overnight. Instead, we think that IPs should be required to follow the system already used in some cases in Scotland, where fees are charged on a time cost basis, but are then reported periodically and cannot be drawn until a suitable objection raising period (14 days in Scotland) has expired. In any event, we think that any changes should only apply to cases where the fees drawn exceed a set level to cover the basic level of work required on every case. It would be the IP's equivalent of the Official Receiver's Administration Fee, albeit set at a higher level. After all, even The Insolvency Service takes approximately the first £10,000 in compulsory liquidations and bankruptcies, and that is a publicly funded body and so does not have to make a profit to keep his landlord happy and staff in employment!

Redundancy Payments Service and Insolvency Service

We think that the Redundancy Payments Service (RPS) should be moved away from being part of the Insolvency Service and become an Agency of HMRC. At present we consider that there is a conflict between The Insolvency Service's duty to design legislation and enforce a framework that balances the interests of all parties, while having a vested interest in the main preferential creditor. This became particularly obvious when the RPS said that it would not meet the statutory liabilities to employees of companies in liquidation where that liquidation followed a CVA, because the CVA was the first insolvency event. By supporting its own department The Insolvency Service undermined the CVA process and potentially reduced the chance of a successful rescue for many viable, but distressed businesses, which is clearly at odds with its remit for insolvency policy. We think it makes a lot more sense for the RPS to be aligned with the tax and national insurance creditors.

And finally….

We should just finish off by letting you know what we do. We help IPs. We do that not by saying 'yes' and helping you hide errors, but by shining a light on your deficiencies and helping you address them. We provide technical support when you are unsure how the legislation affects a particular case in specific circumstances and we work with your existing compliance structure to test how robust systems are and help address any weaknesses. We can help when you correspond with regulators around visits or complaints. We have some fully updated documents and document packs, but rather than sell you an entire pack when you may only need a document or even some wording for a paragraph, we work with our clients to change only the bits that need fixing. We try to do the minimum we can at each practice. By spreading our client base and only doing essential work, we stay independent enough to see any deficiencies and provide some honest, if occasionally challenging, advice. We want nearly everyone to have us in for a few days each year and we stay flexible to try to let that happen without upsetting your existing technical staff or disrupting your systems. We constantly question our own work and that of our clients because we believe that there is often a different interpretation of the insolvency legislation and each set of circumstances requires a fresh pair of eyes. By discussing each issue with our IP clients and their managers we constantly improve the range of issues we can deal with.

Please visit our website and blog to get a better idea of who we are and what we do and email us if you'd like to know more.

BILL BURCH, director, responsible for ideas and enthusiasm.

GARETH LIMB, director, responsible for control and organisation.

MIKE NOAKES, associate, responsible for speed and efficiency.

Managing credit unions in distress and insolvency

Kevin Murphy explains the high profile and politically sensitive intricacies of a movement with 1 million members and £1bn in total assets.

Credit unions in the UK celebrate their 50th birthday this year. And in recent months establishment figures ranging from the Archbishop of Canterbury to politicians of all shades have lined up to promote credit unions as an ethical alternative to payday lenders. But there is much more to credit unions than the provision of loans to those unable to obtain credit from mainstream financial institutions.

> "There is much more to credit unions than the provision of loans."

A credit union is a member-owned financial cooperative, controlled by its members for the purpose of promoting thrift through the accumulation of savings, providing credit at reasonable rates and providing other financial services and financial education to its members. A particular feature of credit unions is their willingness to reach out to poorer sections of the community and promote financial inclusion.

Members save by accumulating 'shares' in the credit union. These savings can then be loaned out to members (at a maximum interest rate of 3 per cent per month – significantly below the typical rate charged by payday lenders). Some credit unions offer current accounts, which enable members to pay in their salary or benefits and make payments or cash withdrawals via a debit card.

While credit unions are very much part of the 'not for profit' sector, they do actually need to generate a surplus from their lending activities. Traditionally, any surplus after paying running costs is paid back to members in the form of a dividend on shares, although credit unions have recently been empowered to offer interest on savings instead of a dividend.

> "There are approximately 600 credit unions in the UK regulated by the PRA."

Credit unions are governed by the Industrial and Provident Societies Act 1965 and the Credit Union Act 1979. Each credit union is run by a volunteer board of directors elected from and by the membership, although most will also employ paid staff who run the day-to-day operations.

Last year, 2013, saw significant regulatory changes for the financial services sector (including credit unions) with the establishment of the Prudential Conduct Authority (PRA) under the Bank of England to handle prudential regulation and the establishment of the Financial Conduct Authority (FCA) to oversee consumer protection.

Credit union deposits are covered by the Financial Services Compensation Scheme (FSCS), which protects the first £85,000 of savings for each member. In practice, credit union rules and PRA regulations mean that no one member is able to save anything like this figure.

> "It is imperative for the IP to appreciate that credit unions are high profile and politically sensitive."

There are approximately 600 credit unions in the UK regulated by the PRA. In 2013, the movement reached the historic milestones of 1 million members and £1bn in total assets.

Financial distress

The majority of credit unions are well managed, and are able to generate surpluses from their lending activities to fund their operations and produce a dividend for members.

However, these lending activities are not without risk, and on occasion a credit union will experience distress due to significant bad debts, possibly through inadequate credit control procedures either when making or when collecting the loans. Similarly, credit unions can run into trouble due to failure to control costs, especially where expansion had been funded by grants that have dried up in times of austerity.

The impact of bad debts or soaring costs will be a deterioration in the credit union's capital-assets ratio. And from 1 October 2014, the PRA is strengthening capital requirements, raising the minimum capital-assets requirement for the smallest credit unions to 3 per cent, and raising the minimum requirement for the largest credit unions to 8 per cent.

There are likely to be a number of credit unions that will struggle to meet the new requirements. Where a breach appears likely, the PRA will require the board of directors to take steps to rectify the position. One option is to try to raise additional capital or to seek new grant income. Alternatively, it is often possible to arrange a merger with a strong neighbouring credit union. On occasion, none of these options are practicable, leaving the board with no alternative but to seek a formal insolvency solution.

Insolvency of credit unions

During the last 18 months, around ten credit unions have been wound up – of which my firm acted as liquidator for four. Until very recently, the only insolvency option currently available for credit unions (being industrial and provident societies) was a winding up by the court. This led to significant practical problems.

However from 6 April 2014, dealing with the insolvency of credit unions will be much more straightforward following the implementation of *The Industrial and Provident Societies and Credit Unions (Arrangements, Reconstructions and Administration) Order 2014*. This extends to industrial and provident societies and credit unions the ability to use the company voluntary arrangement and administration procedures under Parts 1 and 2 of the Insolvency Act 1986.

When an insolvency practitioner is instructed to advise the board of directors of a credit union facing distress, it is essential that the board and IP work closely with the PRA, FCA and FSCS while the various options are explored.

Following appointment as administrator or liquidator of a credit union, it is imperative for the IP to appreciate that credit unions are high profile and politically sensitive – and that the insolvency can have real effects on some of the poorer sections of society. I have set out below some of the key issues.

SCV file

Since 2010, all deposit taking institutions have been required to ensure that they can produce a 'single customer view' (SCV) data file, showing the names, addresses and amount held by each depositor. This provides the FSCS with the information required to make a fast payout, with a payout target of seven days from default. The most important day one task for the IP is to work with the credit union's directors and staff to update the SCV and send the file to Experian – which processes the payments on behalf of the FSCS. Ideally the SCV will have been tested prior to the insolvency to ensure that any data problems are ironed out. Following payment, the FSCS will usually become the credit union's largest creditor.

Communication with members

A key concern of the FCA is to ensure that adequate steps are taken to inform credit union members of the insolvency event, and to provide relevant information, especially regarding the FSCS compensation scheme. This can be done through a combination of letters, emails, website notices and helplines – and even the occasional TV or radio interview. Where members have their salary or benefits paid into the credit union, they need to be encouraged to make alternative arrangements. It is usually helpful to brief the local Jobcentre Plus to ensure that they are able to assist with the setting up of alternative bank accounts and the transfer of benefits.

Hardship fund

The majority of members of the credit union use their accounts as savings accounts and are able to wait for a week until they receive their FSCS cheque. However, some members will suffer genuine hardship if they are not able to access their funds – for example where benefits or salaries have been into their credit union account. In these cases, consideration should be given as to whether to set up a hardship fund.

> "Similarly, credit unions can run into trouble due to failure to control costs, especially where expansion had been funded by grants that have dried up in times of austerity."

Collection of loans

The single biggest asset of most credit unions will be its loan book, which needs to be collected in accordance with existing repayment terms. Often the credit union staff will be retained to assist with collection.

Directors' disqualification

Interestingly, directors of credit unions have not until recently been subject to the provisions of the Companies Directors Disqualification Act 1986. However, this changed with effect from 6 April 2014 when *The Cooperative and Community Benefit Societies and Credit Unions (Investigations) Regulations 2014* came into force.

While the credit movement is going from strength to strength, there will continue to be a handful of credit union insolvencies each year. I hope this article has given practitioners a steer for when they get the call. ◻

KEVIN MURPHY is a partner at Chantrey Vellacott DFK.

Trusts in special administration

Jo Robinson and **Viki Hamby** examine the case of Mid Staffordshire: the first trust special administration of a foundation trust.

Mid Staffordshire is probably the most high profile trust in the UK due to previous failings in care, the associated press coverage and the Francis enquiry that ensued. Six years on, there is rarely an article on NHS failings and challenges that doesn't mention the trust and its history. While local people are passionate supporters – with 50,000 marching to save services – the trust special administrators (TSAs) were given the responsibility of developing plans for the future to deliver high quality and safe health services.

The trust special administration regime

On 16 April 2013, Alan Bloom and Alan Hudson of EY, alongside Professor Hugo Mascie-Taylor, were appointed joint TSAs for Mid Staffordshire NHS Foundation Trust (MSFT), which operates acute hospitals at Stafford and Cannock Chase. This was the first ever TSA appointment over a Foundation Trust (FT).

The TSAs were appointed by Monitor, the sector regulator for health services, under the National Health Service Act 2006 (as amended in 2012). This gave Monitor powers to intervene in FTs that it considers to be unsustainable, enabling Monitor to take decisive action. To support this legislation, Monitor published the *Statutory Guidance for Trust Special Administrators appointed to NHS Foundation Trust (5 April 2013)*. Both the statutory guidance and the legislation set out duties that the TSAs must must have regard to and adhere to.

> "50,000 people marched to save services."

The TSAs must work to a legal timeframe, including 45 days to produce draft recommendations and a 30-day consultation period, following which the TSAs must finalise their recommendations to Monitor for approval by the Secretary of State for Health (SoS). The TSAs have two roles: firstly, overseeing the running of the trust on a business as usual basis and secondly, developing and consulting upon a draft report about what should happen to the organisation and the services it provides, so that local people receive high quality health services and care.

Why is a special regime needed?

There are two types of trusts; NHS trusts and foundation trusts. FTs were created to devolve decision making from central government to local organisations, to allow FTs to be more responsive to the needs of their local communities. In order to become an FT, NHS trusts must demonstrate that they are well led so they can deliver good quality care for patients on a sustainable basis. When Monitor assesses trusts for foundation status there are three main elements to their work: testing whether a trust meets the required quality performance threshold (working closely with the Care Quality Commission to determine this), assessing how well run the trust is, and assessing the financial viability of the trust to ensure it can continue to deliver high quality care on a sustainable basis.

The government's original intention was that all NHS trusts should achieve FT status by 2008, which has been further revised over time. To date, there are still a significant number of NHS trusts that have not achieved FT status. The TSA legislation was first used for an NHS trust in 2012 where a TSA was appointed over South London Healthcare NHS Trust (SLHT). SLHT has subsequently been dissolved, with services now provided by neighbouring trusts.

What happened at Mid Staffs?

MSFT is one of the most high profile trusts in the UK, following a variety of investigations and reports on care failings.

Following a reported £20m deficit in 2011/12, Monitor appointed a contingency planning team (CPT) led by EY in September 2012. The CPT established that the two hospitals run by MSFT were finding it increasingly difficult to provide adequate professional experience for consultants to maintain high quality services in the long term. In addition, without continuing cash support the trust would also be unable to pay its debts as they fell due. Given the findings of the CPT and other relevant factors, Monitor made the decision to appoint TSAs to MSFT. Despite the trust's success in improving clinical performance, its small scale meant it was both clinically and financially unsustainable in its current form.

Timeline

- March 2008: Healthcare Commission investigates apparently high mortality rates
- March 2009: Healthcare Commission reports significant failings relating to quality of care, governance and leadership since 2005
- 2009 onwards: Considerable and sustained improvements to the quality and safety of services, however, comes at a cost; serious financial problems
- June 2010: SoS announces public inquiry (Francis inquiry) into the role of the commissioning, supervisory and regulatory bodies in the monitoring of MSFT
- September 2012: Contingency planning team (CPT) appointed
- February 2013: Francis report published
- March 2013: CPT report states that the trust is clinically and financially unsustainable (despite providing safe care today), as well as proposed options for the future
- April 2013: Alan Bloom, Alan Hudson and Professor Hugo Mascie-Taylor announced as TSAs.

What did the TSAs do?

Following the appointment of the TSAs, the trust board and council of governors were suspended from office under the legislation. Alan Bloom immediately took on the role of accountable officer for the trust and the TSAs took on the functions of the governors, chairman and directors of the trust.

> "Mid Staffs is one of the most high profile trusts in the UK."

The TSAs worked closely with the trust's senior management. Although their executive powers ceased, trust senior management were still empowered with the day-to-day responsibility for running the trust.

Initially, The TSAs had 45 days to publish their draft report; however, this, together with other stages during the TSA process, was extended due to the complexities of the negotiations with, and decisions required from, a variety of stakeholders. This included any funding support in the future.

On 31 July 2013, the TSAs published their draft report and commenced formal consultation. This included holding eight public meetings and sending out over 50,000 copies of the consultation document and response forms; this was to inform the TSAs' final recommendations by gathering stakeholder views.

The draft report included a recommendation that MSFT be dissolved and the services operated through a clinical network with larger hospitals. Additionally, there were 13 service recommendations designed to achieve clinical sustainability and a significant reduction in the financial deficit.

After careful consideration of the responses to the consultation, the TSAs completed their final report regarding the future of services to be provided by the trust, which was submitted to Monitor on 17 December 2013.

The final report amended the draft recommendations as follows:

- A midwife-led unit be established at Stafford Hospital, to be managed in a maternity network with other providers;
- The paediatric assessment unit at Stafford will be run in conjunction with the accident and emergency department, led and delivered by paediatric-trained emergency doctors and paediatric nurses. Children who require overnight stay will be treated/cared for at other local hospitals; and
- Clarification of the arrangements for critical care, to allow for patients to remain at Stafford as long as there is immediate availability of the necessary staff, this will be reviewed on a case-by-case basis.

Together with the TSAs' other recommendations, which include setting up a frail and elderly assessment unit, more rehabilitation beds closer to home at both Stafford and Cannock and an enhanced range of elective surgery at Cannock, this was a step towards achieving a set of sustainable services for the future provision of safe, high quality healthcare for the residents of Stafford, Cannock and the surrounding areas.

On 16 January 2014, Monitor confirmed approval of the TSAs' proposal to dissolve the trust and passed the TSAs' recommendations to the SoS. On 26 February 2014 the SoS approved the TSAs' recommendation, to dissolve the trust and that Stafford Hospital should be operated by University Hospital of North Staffordshire NHS Trust (UHNS) and Cannock Chase Hospital should be operated by The Royal Wolverhampton NHS Trust (RWT).

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The Trust Special Adminstration timeline

Day 1	Tuesday 16 April 2013 Appointment of the TSAs take effect
Within 75 working days*	Wednesday 31 July 2013 Publication of the TSAs' draft recommendations
Within 5 working days	Tuesday 6 August 2013 The formal consultation process on the TSAs' draft recommendations begins
40 working days*	Tuesday 1 October 2013 The formal consultation process on the TSAs' draft recommendations ends
Within 55 working days**	The finalised report on the TSAs' recommendations is sent to Monitor
Within 20 working days	The final report is reviewed by Monitor and submitted to the Secretary of State
Within 30 working days	The Secretary of State decides on what action is to be taken

*On 19 June 2013 Monitor granted an extension of 30 working days for the publication of the TSAs' draft recommendations and an extension of 10 working days to the consultation period

**On 21 October 2013 Monitor granted an extension of 40 working days for the submission of the TSAs' final recommendations to Monitor

What were the main successes of the TSA?

Many of the significant changes seen over the last year at MSFT would not have occurred without the TSA process, nor broader conversations about the roles and responsibilities of key stakeholders within the local health economy (LHE). This has contributed to the wider discussions about how this and other LHEs should be managed.

> "The TSAs spoke to more than 2,600 people at eight public consultation meetings across the county."

The mix of the TSA team was also critical. We supplemented the skills and experience of the EY team with senior leaders in the NHS, this included Professor Hugo Mascie-Taylor, an experienced clinician and medical leader who was appointed as a joint TSA and Diane Whittingham, a former CEO. Our wider team also included our legal advisers (Morgan Cole) and communications and consultation experts (Ravenhill Media and Ipsos Mori).

In addition, the TSAs established effective governance mechanisms to ensure continuing robust internal governance and further build partnership working across the LHE. The TSAs created the sustaining services board (the SSB), with membership including the chief executive and senior director membership from the trust and all adjacent provider organisations to ensure strategic system-wide oversight and management of risks, service issues and workforce challenges.

Special Insolvency Regimes

- Water and sewerage undertakers (special administrators) – *None appointed to date*
- Railway administration (special administrators)
- National Air Traffic Services (special administrations) – *None appointed to date*
- Public private partnership administration (special administrators)
- Energy – power networks and supply (special administrators) – *None appointed to date*
- Bank/building society insolvency procedure, bank/building society administration procedure
- Postal administration regime (special administrators) – *None appointed to date.*

The TSAs set up two clinical advisory groups and an independent health and equality impact assessment steering group (HEIA SG) to support development of the recommendations. The clinical advisory groups were panels of clinical experts, who evaluated the TSA model to ensure the TSAs' work was informed by the guidelines from their respective royal colleges and professions as well as providing their professional judgement and experience on what constitutes safe care.

> "This was a step towards achieving a set of sustainable services for the future provision of safe, high quality healthcare."

The HEIA SG was established to look at the impact of the TSAs' draft recommendations on specific groups of people: those with disabilities; children; older people; women who could be affected by the changes to maternity services; people living with socioeconomic deprivation; people living in rural areas; and people from specific communities (ethnic minorities and the LGBT community). The HEIA SG report was published as part of the TSAs' final report.

The TSAs successfully managed a large consultation process, which included significant public involvement and management of high profile key stakeholders. During the eight-week consultation, the TSAs:

- Spoke to more than 2,600 people at eight public consultation meetings across the county;
- Held over 20 staff meetings (open to all staff) and several meetings with staff from specific clinical areas of expertise;
- Held over 80 meetings with key stakeholder groups, including MPs, the Ministry of Defence, local authorities, local clinical commissioning groups (CCGs) and the National Childbirth Trust;

> "The Care Bill has nearly finished its parliamentary process."

- Sent out in excess of 50,000 copies of the consultation document and response forms. Issued a significant number of press releases and placed adverts in the local papers to keep the public informed of the consultation process; and
- Received more than 15,000 hits to the TSA website since its launch, of which more than a third were during the consultation period.

How is this different to a private sector administration?

There are rudimentary similarities between the TSA regime and private sector insolvency legislation. The powers of the TSA are, however, more limited and there is a key alternate agenda compared to obtaining the best return for creditors – the sustainable provision of high quality services and care for patients. The focus of the MSFT TSA has very much been 'business as usual' in respect of the provision of services, with additional governance mechanisms in place to support this aim (eg the SSB).

In order to develop recommendations and ensure key stakeholder buy-in, stakeholder management has been paramount to this process, even to a greater extent than in a private sector insolvency. Continuous engagement with Monitor, the TDA, NHS England, local providers and the CCGs has been key as the TSAs have limited powers to 'impose' a solution without buy-in.

What were the challenges?

As well as being logistically challenging in terms of the consultation process, the TSAs work has been against the backdrop of intense public, media, regulatory and political scrutiny; 50,000 people marched in support of Stafford Hospital, the TSAs received thousands of emails, letters and telephone calls, all of which had to be responded to, stories on the trust in the press daily and significant use of social media. All had to monitored and reactionary statements issued where appropriate.

One of the ongoing challenges in the case of MSFT was therefore ensuring the stability of the trust in light of proposed changes as it went through the CPT/TSA process. This trust was already having difficulties in recruiting and retaining staff, which has further been exacerbated through this process. This was the reasoning behind setting up the SSB, as discussed above, to ensure the focus remained on the ongoing ability to provide care to patients.

There was also a question regarding what problem the TSAs were being asked to solve – was it MSFT or was it a bigger problem within the health economy? Under the legislation, the TSA was unable to mandate recommendations beyond the boundaries of MSFT, ie extending to the local health economy. This is being addressed under proposed amendments to the Care Bill, discussed further below.

If our recommendations were not implemented it was anticipated that the annual deficit would increase from £20m today to £42.5m in three years' time. However, during the draft report phase it also became apparent that, given the remit of the TSAs above and the anticipated inflation in the cost of healthcare services, that financial balance would not be possible in the short term without change in the local health economy. Our recommendations go some way to significantly reduce the deficit and financial support will be provided to UHNS and RWT in the short term to enable time for change to occur.

Another key challenge was the initially tight timeframes mandated by the legislation – the TSA was granted three extensions over the course of the process. There are unlikely to be many situations where extension would not be required due to the extent of the solution required to be developed and the level of stakeholder engagement. Again, this is being addressed under proposed amendments to the Care Bill.

What happens next?

Provisions in the proposed Care Bill make amendments to the existing legislation relating to TSAs in light of some of the challenges faced by TSAs to date. The amendments consider circumstances where the TSAs make recommendations about service reconfigurations in neighbouring trusts, not just the trust over which they are appointed. For example, it explicitly extends the consultation process to include NHS trusts/FTs, or commissioners of NHS trusts/FTs that will be impacted as a result of TSA recommendations.

The amendments also extend the time available to the TSA to make recommendations (45 days to 65 days) and the time available for consultation (30 days to 40 days).

Further suggested amendments also extend the Care Quality Commission's (CQC) role in a TSA process, including requiring that Monitor appoints a TSA in light of failure by an FT to provide services that are of a sufficient quality.

> "The problems facing the NHS need to be considered at an LHE level."

The Care Bill has nearly finished its parliamentary process, with the amendments under consideration by the House of Lords. Depending on this, the bill will receive Royal Assent later in 2014.

Monitor, NHS England and the NHS Trust Development Authority have agreed to fund a series of 11 projects to help groups of commissioners and providers work together to develop integrated five-year plans that effectively address the particular local challenges they face. Staffordshire is one of the 11 LHEs chosen. These reviews are expected to conclude in summer 2014, further supporting the idea that the problems facing the NHS need to be considered at an LHE level, not just at a singular trust level.

What about the rest of the public sector?

There are a number of special insolvency regimes available in respect of public sector companies, or companies that have previously belonged to the public sector (now privatised), in addition to TSA legislation for NHS trusts and FTs.

It appears the trend of engaging private practice/sector professionals to assist with unsustainable public sectors may be set to continue.

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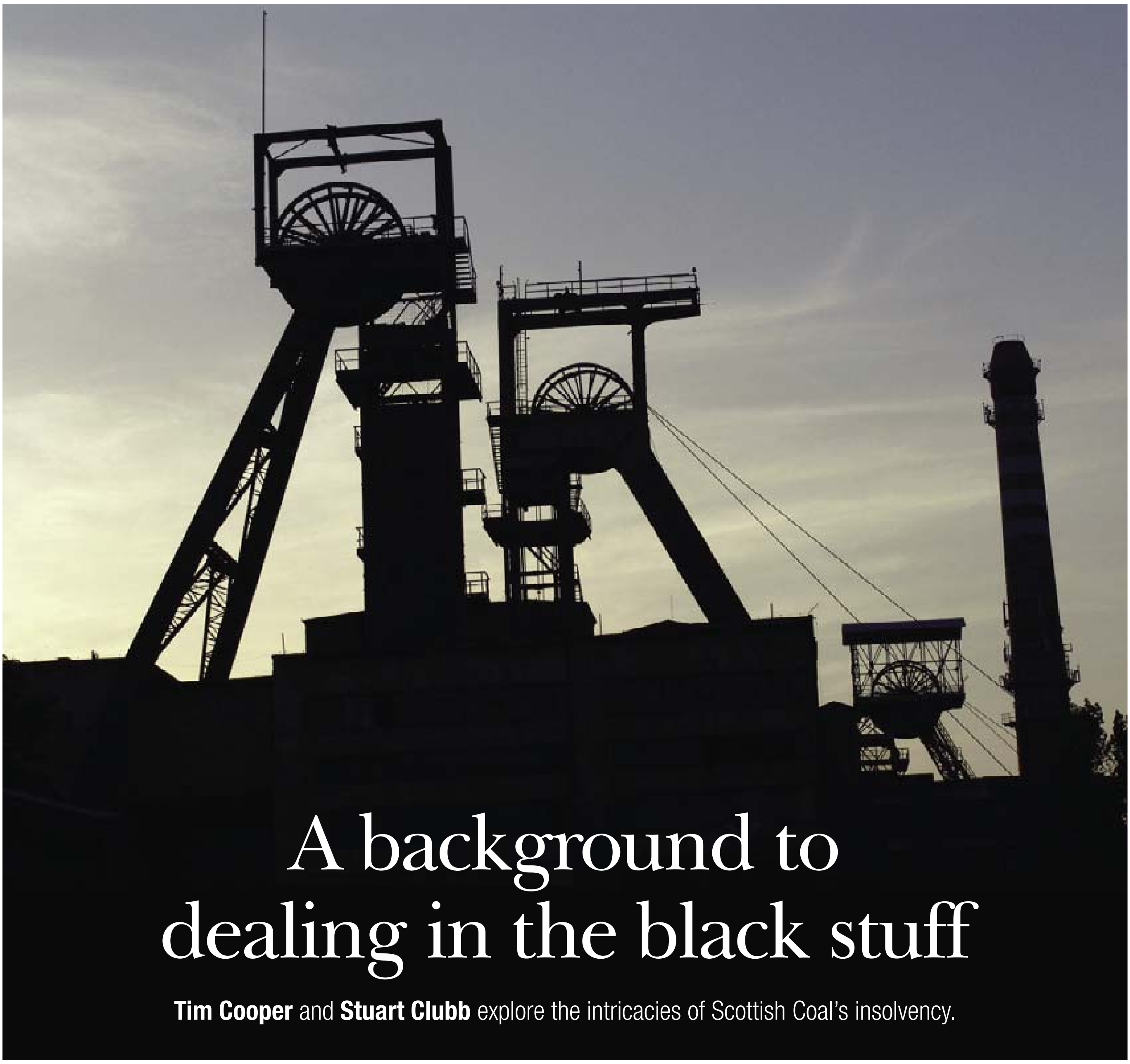

A background to dealing in the black stuff

Tim Cooper and **Stuart Clubb** explore the intricacies of Scottish Coal's insolvency.

The insolvency of Scottish Coal was always about one thing: how to bring the insolvency to an end, and while complying with the liquidators' duties, preserving creditors' interests, being fairly paid, and avoiding personal liability with limited funds.

In this sense, Scottish Coal is no different to any other liquidation. Rarely, however, does an insolvency involve almost every area of concern for insolvency practitioners, and cross so much uncharted territory on its route through to exit, as we have seen in Scottish Coal.

“Rarely, however, does an insolvency involve almost every area of concern for insolvency practitioners.”

The court decisions focus on the question of disclaimer/abandonment of land (heritable property) and statutory licences by liquidators of Scottish registered companies (Scottish liquidators). It is far from the whole story and this article aims to provide some background to how that question arose, and some of the issues arising for practitioners and legislative draftsmen generally from the decisions. The liquidation itself is continuing and its outcome remains to be seen.

Background

The activities of Scottish Coal fell into three areas:

- Coaling: the operation of open cast coal sites, including former 'coaled-out' sites requiring restoration, active sites, and future sites;
- Renewables: development of former sites towards planning permission to operate as wind farms; and
- Estates: management of developed sites for sale to pay debt or fund operations.

All of these activities were heavily regulated, presenting questions for a prospective liquidator about how such regulated responsibilities are managed in an insolvency. For example:

“All of these activities were heavily regulated, presenting questions for a prospective liquidator about how such regulated responsibilities are managed in an insolvency.”

(a) Coaling: coal minerals belong to the Coal Authority, not the land owner. The operator holds leases of the mineral rights and regulated licences to quarry

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and coal the sites[1] with responsibility for health and safety issues[2] on site.

(b) Environmental: the environmental impact is significant, involving invasive digging into the water table, disturbance of natural water courses and habitats, generating dust and mineral particles causing potential air and water pollution, governed by regulations on environmental contamination,[3] pollution prevention,[4] and water contamination.[5]

(c) Planning: Scottish Coal either held or had applications for necessary permissions for its use and development of its sites. Coaling, in particular, required the provision of Section 75 Agreements[6] to support planning conditions requiring the restoration of exhausted coal sites, backed by restoration bonds.

> “The liquidators were therefore faced with holding land with restoration liabilities outweighing any value.”

On liquidation, the estimated cost of restoration was around £75m. Former coal sites produce no income, only cost, and the active sites would generate insufficient cash to meet the costs for former sites and the active sites once exhausted. The court noted that the restoration bonds did not leave councils with enough cover to plug the gap.

The liquidators were therefore faced with holding land with restoration liabilities outweighing any value: in effect, a net liability. But importantly, doing nothing with the land would risk site flooding, water pollution, security and safety, and with all such risks comes the risk of personal liability. Managing and mitigating risk would require ongoing site care and maintenance expenditure – the ‘holding costs’.

So, Scottish Coal presented any liquidator with few realisable assets, while holding other ‘toxic’ assets incurring significant holding costs as expenses to avoid personal risk. In Scotland, there is no Official Receiver, so without a willing IP an orderly insolvent solution was not available. In an English company liquidation, the statutory disclaimer mechanism provides a solution in relation to onerous property[7] (including statutory licences)[8] where that mechanism is not expressly excluded elsewhere in statute. The *pari passu* principle is preserved, by relieving the estate of ongoing expense liabilities for unrealisable assets, so that realisations are distributed equally to creditors according to class.

Until Scottish Coal, there was no clear authority in Scots law for Scottish liquidators having a similar power to disclaim or ‘abandon’ land or licences. The liquidators of Scottish Coal could therefore not rely on this power as an exit route. In this context, Scottish Coal was really about how to manage all of the regulatory risks throughout the whole process of liquidation, within the total funds available, avoiding personal risk while being fairly remunerated. However, if such an ‘abandonment’ route could be used, and a necessity arose to do so, guidance from the court would be required to confirm whether or not such a power existed in Scots law.

The Outer House

In considering the first instance decision, it is worth reflecting on the purpose of liquidation.

Liquidation is the corporate equivalent of sequestration (bankruptcy): the division of assets of an insolvent estate equally among creditors according to their rank at a certain date. In Scotland, liquidation law and process is borrowed heavily from Scottish bankruptcy law. But, whereas liquidation kills the company, bankruptcy does not kill the individual. If the two regimes should achieve the same purpose, law borrowed from one will require a degree of translation for the other to work.

The school of thought in favour of Scottish liquidators having a power of abandonment of land derives principally from Section 169(2) of the Insolvency Act 1986 (Act):

‘In a winding up by the court in Scotland, the liquidator has… the same powers as a trustee on a bankrupt estate’.

If a Scottish trustee has a power to disclaim or abandon property, then logically it seems that Section 169(2) gives Scottish liquidators that same power, with a necessary ‘degree of translation’. When the Scottish Law Commission considered the question of onerous property in 1971 this appears to have been one of the reasons why it concluded that there was no requirement to introduce an express statutory right of disclaimer in Scotland.[9] It was not, however, a universally shared school of thought.

At first instance, Lord Hodge of the Outer House of the Court of Session had to address two questions:

1. Can a liquidator abandon/disclaim land in Scotland?
2. Can a liquidator abandon a statutory licence or permit?

The second question focused specifically on a water use licence to carry on controlled activities under the Water Environment (Controlled Activities) (Scotland) Regulations 2011 (CAR licences and CAR regulations respectively). It was not dependent on the answer to the first question, but gained practical significance because, if the liquidators weren’t able to abandon the CAR licences, then the holding costs would continue as unavoidable expenses even though the land in question had been disclaimed.

Lord Hodge found that a trustee did have a power to abandon heritable property, meaning that the trustee was freed from liability in relation to it, allowing him to realise and distribute the rest of the bankrupt’s estate. The distinctions between sequestration and liquidation were overcome by the Section 169(2) ‘translation’.

In addition to having a power to abandon ownership of the property (which would require to be regulated by the court), Lord Hodge said that a liquidator could also simply decline to deal with an asset, the consequence of which would be that the asset would not form part of the ‘liquidator’s patrimony’, but would remain in the company’s ‘mummified patrimony’. The holding costs would be enforceable against the ‘mummified patrimony’ only.

The second question, concerning statutory licences, was more problematic. The ability to abandon the CAR licences would depend upon the terms of those licences and the applicable statutory provisions.

> “Whereas liquidation kills the company, bankruptcy does not kill the individual.”

The CAR regulations in question make trustees, receivers, administrators and liquidators ‘responsible persons’. Responsible persons must comply with the obligations under the licences and with conditions for their surrender required by the Scottish Environment Protection Agency (SEPA). Could those obligations be avoided by abandonment/disclaimer? There was nothing express in the CAR regulations to that effect.

In answering that question, there were two possible interpretations of CAR.

1. The ‘broad interpretation’: a liquidator was precluded from abandoning the licence other than as provided for in the CAR regulations.
2. The ‘narrow interpretation’, the liquidators were only responsible for so long as they did not exercise their power to disclaim.

Lord Hodge considered that there were ‘powerful’ policy factors in favour of the broad interpretation, particularly public interest in the maintenance of a healthy environment and the remediation of pollution. However, the broad interpretation would remove the liquidator’s right to disclaim the CAR licences and impose costs of compliance as a new category of expense. Lord Hodge considered that this would be an amendment of corporate insolvency law, which was a reserved matter for the UK »

Parliament.[10] As the CAR regulations were an instrument of the Scottish Parliament, Lord Hodge reasoned that such an amendment would fall outside the legislative competence of the Scottish Parliament. So, this had to be reconciled by applying the narrow interpretation, and avoid the CAR regulations being outwith devolved competence.

> "Scottish property law does not allow a person unilaterally to abandon ownership of land."

The result was that, in July 2013, the Outer House found that Scottish liquidators had a power to disclaim heritable property and (subject to competent regulatory terms) statutory licences.

The Inner House

Why did the Inner House overturn Lord Hodge's decision? In summary:

1. A trustee doesn't acquire ownership of property – property only 'vests' in a trustee. A trustee has the option to acquire ownership, but it is not automatic. What is 'abandoned' is the right to acquire ownership of the land, not the land itself.[11]
2. Scottish property law does not allow a person unilaterally to abandon ownership of land.
3. As regards the 'mummified patrimony', property can't become separated in any legal sense from the company's general assets: *'There is no separate "patrimony" of a company, mummified, mothballed or otherwise in a winding up… The whole assets of a company remain its property, which the liquidator is under a statutory duty to take into his custody'.*[12]
4. The narrow interpretation of the CAR regulations would go against the ordinary meaning of the language used, noting: *'…the CARs do not say that a liquidator is a "responsible person" only for so long as he does not exercise a power to disclaim… It would be a curious construction of an explicit provision that a liquidator is a responsible person and, therefore, responsible for ensuring compliance with the statutory licence, only for as long as he chooses'.*[13]
5. The purpose of the CAR regulations was to implement the European Directive policy objectives,[14] which require priority to be given to the 'polluter pays' principle over the *pari passu* principle. That purpose was within devolved competence, and the effect on liquidators of companies possessing a CAR licence was *'no more than a loose or consequential connection'.*[15] It was 'far from clear' that the *pari passu* principle was violated by the inclusion of environmental liabilities within the category of liquidation expenses. It did not create a new category of expense, but clarified where such costs would rank for payment as an expense. The broad interpretation did not therefore infringe reserved powers.
6. The CAR regulations did have an effect on the practicalities of insolvency, but more than that was required in order to place them beyond the devolved competence of the Scottish Parliament.

There will be no appeal of that decision to the Supreme Court.

Conclusion

For the liquidators of Scottish Coal, one possible exit route is closed, and the reality of how the case started for the liquidators simply continues.

> "The law of unintended consequences can produce well intended but perverse results."

Unless there is another case that takes these issues further, or there is legislative change, Scottish liquidators can only conclude that they cannot disclaim onerous land or statutory licences.

If this point of Scots law is taken further, either by case law or legislation, whoever falls to consider the issues will need to contend with the considerable complexities that the issue of disclaimer conjures up, as shown from these court decisions. Just some of these issues could be:

1. Is there a necessity for Scottish liquidators to have the same powers as an English liquidator? Creditors and IPs might instinctively say 'yes', and environmental protection groups might say 'no'. But that is simplistic, since the law of unintended consequences can produce well intended but perverse results: if an absence of such powers dissuades responsible practitioners from taking office, what happens if there is no one else to take responsibility (bearing in mind there is no Official Receiver in Scotland). Are the risks to the public and the environment in such a case greater or worse?
2. How can the environmental principle of 'the polluter pays' be reconciled with the *pari passu* principle? What weight should be given to one over the other? What does this mean for practitioners operating throughout the UK if courts in one jurisdiction take a different approach to the courts in another?[16]
3. For the legislature, how does the draftsman overcome the tensions between reserved corporate insolvency matters and devolved personal insolvency law, given that amendments to the latter incidentally translate to the former?
4. If European policy objectives, which are not concerned with insolvency regulation, are to be given prominence over fundamental domestic insolvency principles, how far must an insolvency practitioner go to discharge European regulatory cost as an expense, regardless of benefit to the insolvency?

> "Is there a necessity for Scottish liquidators to have the same powers as an English liquidator? Creditors and IPs might instinctively say 'yes'."

It will require either a case of similar significance to take the matter to the Supreme Court, or legislative review, to take these issues further. The Scottish Law Commission, in 1971, considered that there wasn't a demand in Scotland for an express statutory power of disclaimer. It remains to be seen whether the view is any different in 2014, as a result of this decision.

1 eg Coal Industry Act 1994, Mines and Quarries Act 1954, and Quarries Regulations 1999/2004
2 eg Health & Safety at Work Act 1974
3 eg Environmental Protection Act 1990
4 Pollution Prevention and Control (Scotland) Regulations 2012, Control of Pollution Act 1974
5 Water Environment (Controlled Activities) (Scotland) Regulations 2011
6 Town and Country Planning (Scotland) Act 1997, the Scottish equivalent of Section 106 Town and County Planning Act 1990
7 Section 178 of the Act.
8 *Celtic Extraction Ltd & Bluestone Chemicals Ltd* v. *Environment Agency [2001] CH. 425*
9 Scottish Law Commission, Memorandum No.16, 'Insolvency, Bankruptcy and Liquidation in Scotland', 27 November 1971
10 Scotland Act 1998, section 29 and Schedule 4
11 [2013] CSIH 108, paragraphs 111 to 118
12 [2013] CSIH 108, paragraph 123
13 [2013] CSIH 108, paragraph 138
14 Water Framework Directive (2000/60/EC)
15 [2013] CSIH 108, paragraph 156
16 eg Inner House in *Scottish Coal*, cf, Court of Appeal in *Re Celtic Extraction*

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The creditors' claims – Part 3

Simon Duncan examines the phoenix phenomenon further after provoking debates following last year's publication of Parts 1 & 2.

Section 15(1) of the Company Directors Disqualification Act 1986 (the CDDA) imposes personal liability for the relevant debts of the company on a disqualified director where he has been involved in the management of the company. However, section 15(1) is silent as to who may bring such a claim. The case law holds that such a right vests by statute in a creditor, not a liquidator, see *Re Prestige Grinding Limited* [2006] B.C.C. 421 (and *The phoenix phenomenon* in *RECOVERY* spring 2013).

Prestige is also authority for the proposition that the liquidator has a right to claim a contribution from the disqualified director where the general law allows. However, if the section 15(1) claim could be pursued by a liquidator it is said this would set up a right of contribution from the disqualified director against the company in liquidation that would defeat the liquidator's claim. This is because section 15(1) gives the company a right to a contribution from someone who by statute has become its co-debtor.

> "Is it fair to say that the contribution claim from D defeats part of A's claim?"

To illustrate, consider company A (in liquidation). A owes unsecured creditors £100. If a successful claim for £100 could be made by the liquidator against the disqualified director (D) pursuant to section 15(1) CDDA, £100 is paid to A. However, D has a right to claim a contribution against A because A is his co-debtor. D can only claim £50 from A because joint and several debtors have a right of contribution among themselves such that if one has paid more than his fair share he can recover the excess from the others in equal shares. The net result being that each co-debtor is liable to pay £50 to the creditors.

What's fair?

However, is it fair to say that the contribution claim from D defeats part of A's claim?

In practical terms D's claim would rank as an unsecured creditor claim in A's liquidation. This means that from the liquidator's perspective there would be no immediate prospect of returning funds to D. The liquidator's remuneration and expenses would also outrank any distribution in accordance with the statutory ladder of priorities. It follows that the existence of a right of contribution on the part of D would not, of itself, be sufficient to persuade a liquidator not to bring a claim pursuant to section 15(1) if such a claim was conferred on him. It would seem that the issue of priorities was not considered in the *Prestige* case.

If the liquidator has made a payment to a secured creditor is this sufficient to support a contribution claim against the disqualified director?

Section 15(1) does confer on A the right to recover from D a contribution in circumstances where the general law so allows. It is this right that the liquidator can enforce under section 15.

The general law (cited above) would give rise to a contribution claim against D where A has already paid monies out to the creditors. This is because A has then paid more than its fair share and D as the co-debtor can be obliged to contribute.

To continue with my analogy, A owes the creditors £100. A has cash assets of £50 and a distribution of £50 is made. A can claim a contribution from D and does claim £25. Would the right to a contribution still arise in circumstances where A's payment went to secured rather than unsecured creditors? In my view the answer must be no. If A has simply paid secured creditors we are outside of the statutory mechanism for recompensing unsecured creditors in circumstances where a director has acted while disqualified. We are not concerned here with the rights of secured creditors. In any event, a payment to secured creditors is arguably not a 'distribution' it is a re-payment of funds advanced, the beneficial interest to which always belonged to the secured creditor at least to the extent of their security interest.

> "*Prestige* is also authority for the proposition that the liquidator has a right to claim a contribution from the disqualified director where the general law allows."

In *Prestige* an application pursuant to CPR 19.6 that the liquidator act as a representative of the creditors failed because the liquidator's interests and the creditors' interests could not be said to be the same interests. If we assume that the liquidator could act in this capacity, in circumstances where the liquidator (for the company) has made a payment out to unsecured creditors, and claims a contribution from the disqualified directors, how vulnerable is such a claim where the liquidator (for the creditors) is pursuing a direct claim against the delinquent directors at the same time? Does set off have a role to play in this scenario?

The trilateral scenario

Consider that A owes unsecured creditors £200. A payment of £100 is made by the liquidator to those creditors from the cash assets of A (claim 1).

A, acting as a representative of the unsecured creditors, claims £200 from D. D pays £200 to A, who holds this sum on trust for the creditors (claim 2).

Claim 1 gives rise to a contribution claim from A (for the company's estate) against D for £50 (claim 3).

Claim 2 gives rise to a claim for a contribution from D against A (the company in liquidation) for £100 because both A and D are co-debtors for the sums owed to the unsecured creditors, (claim 4).

In so far as claims 3 and 4 are being advanced at the same time, arguably insolvency set off applies and claim 3 is vitiated and claim 4 is reduced to a claim for just £50 against A.

I have shown that the liquidator will not be overly concerned with claim 4 surviving against the company's estate because of the effect of the ladder of priorities. However, he is most unlikely to welcome the effect of set off on claim 3. This claim was created by the payment made pursuant to claim 1 and it was a claim for the company in liquidation. It has been effectively defeated by a claim against the company in liquidation that arose as a result of a payment made to the liquidator as a representative of the creditors (claim 2). In other words a claim for the company has been forfeited as a result of the claim brought by the liquidator as a representative of the creditors. This must have been what Norris J meant in *Prestige* when he used the word 'defeated' in this context though the effect of insolvency set off is not explained in the judgment. (Note that other practical and legal difficulties have been ignored for the purposes of this analysis, see *The phoenix phenomenon Part 2* in *RECOVERY* summer 2013.)

> "It is the oldest rule of all in equity that a man should not place himself in a position where his duty and his interest conflict…"

If a creditor assigned his debt to a third party, that third party could bring a claim as a creditor/assignee pursuant to section 15(1). Could the assignment be worded so as to claw back the proceeds of the litigation into the company in liquidation? The liquidator will want to ensure that he is able to draw his remuneration from the proceeds into the company's estate but would the assignor and the assignee wish to agree such terms?

There is sound authority for the proposition that an unsecured creditor may assign a relevant debt to a third party and that third party assignee creditor can then bring a claim that is conferred on him as a creditor, see *First Independent Factors & Finance Ltd* v. *Mountford* [2008] EWHC 835 (Ch).

Of itself this would confer no benefit on the liquidator, although it may be that such an assignment is unlikely to take effect without his involvement.

The liquidator of A could identify a good claim that a creditor could bring. He may be able to identify a creditor prepared to assign his relevant debt to a third party prepared to issue the claim.

The liquidator may be prepared to act as the assignee but this could lead to a conflict of interests where the liquidator is required to adjudicate upon the admission or otherwise of debts in the liquidation at the same time as he is pursuing a claim based on a proportion of those debts.

> "One solution to these difficulties would be to ensure that no proceeds of the litigation itself were paid over to the liquidator."

Debtor's duties

A good case to look at in this context is *Re Corbenstoke Ltd* (No 2) (1989) 5 B.C.C. 767. Harman J acceded to an application to remove a liquidator, one of the reasons being that as a debtor to the company his duties and personal interests were in conflict. He said:

'…It is the oldest rule of all in equity that a man should not place himself in a position where his duty and his interest conflict, without the fullest disclosure of the conflict and the approval of his continuing to hold that position despite the conflict.'

If there is a conflict in the context of a debtor/liquidator then this is very likely to be true as between a creditor/liquidator. It is unrealistic to suggest that the informed consent of 100 per cent of the creditors is likely to be available in the majority of insolvent liquidations. Accordingly, the liquidator cannot expect to be the assignee in this scenario.

A further conflict would also arise where the creditors' debts and claims had been assigned because, as a creditor, the liquidator could also vote in the liquidation at creditors' meetings on resolutions that favoured himself. This might be avoided if an assignment was premised on the waiver of any voting rights in respect of the assigned debt.

An assignment could be made to a third party, for example, a co-operative IP known to the liquidator. The difficulty that this causes is a practical one rather than a legal one. Essentially, how would the liquidator facilitating such an assignment get paid?

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

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

A claw back provision would not be objectionable per se. Indeed, there is authority on this point, see *Ramsey* v. *Hartley & Others* and *Jaffer* [1977] 1 WLR 686 CA. Here, a 35 per cent return of the litigation proceeds to a trustee on behalf of the creditors was approved.

> "The safest course where the facts support a good claim would be to encourage the creditors to issue proceedings."

Conclusion

The safest course where the facts support a good claim would be to encourage the creditors to issue proceedings on *their* claim. An alternative would be to instigate an assignment of a debt to a third party on terms that would, if the litigation resulted in a recovery, produce a return to the creditors in the estate of the company concerned. This is not likely to appeal to every liquidator because it is novel and depends on the willingness of the creditors, the third party assignee and the liquidator to agree workable terms. That said, if the factual basis to the claim is strong enough then it might be worth a try. □

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Directors' duties and misfeasance

Alice Pratt takes a look at the primary offences for which directors may fall foul during the period leading up to insolvency and assesses the remedies available.

While the financial recovery is in full swing for many, the other side of the coin is an economic landscape with over 100,000 zombie companies that are doing little more than servicing bank interest payments; and also the real risk for others of over trading as the recovery gains momentum. Inevitably, a number of those companies at the direction or, more often than not, lack of direction from their directors, will have been trading while insolvent for a period of time prior to entering an insolvency process.

> Any person who is knowingly a party to carrying on the business in that manner can be found liable for fraudulent trading.

A number of claims that are available in respect of breaches of directors' duties are only available to liquidators. Administrators are, however, able to bring claims that are available to companies generally against a director by way of the remedies found in the Companies Act 2006 rather than under the specific provision of the Insolvency Act 1986 (the Act). Although we have referred to 'directors' throughout, it should be remembered that the definition of director in the Act includes shadow directors and any other person who acts as a director, by whatever name called.

The main claims that can be brought are as follows:

Fraudulent trading

In the course of winding up a company, if it is found that a director carried on the business of the company with the intent to defraud creditors of the company or creditors of any other person then the director, or any person who is knowingly a party to carrying on the business in that manner, can be found liable for fraudulent trading pursuant to section 213 of the Act.

If a person is found guilty of fraudulent trading, a liquidator can apply to the court for a declaration that the individual makes a payment to the company for an amount equivalent to the loss that the company suffered as a result of the director's actions.

Any liquidator must carefully consider the extent of an individual's involvement in the fraud when making this application as the liability is apportioned between the defendants, dependent upon the benefit they received from the fraud and also the level of control they had in carrying out the fraudulent activity. Fraudulent trading is also a criminal offence with serious consequences for those being found guilty and the mere threat of such action can act as strong incentive for a director to make settlement proposals.

The threshold for bringing a successful claim is high as it has to be shown that there is genuine dishonesty on the part of a director involving real moral blame. For this reason, more often than not, a wrongful trading action is the preferred claim although fraudulent trading actions remain useful where remedies are sought against blameworthy third parties.

Wrongful trading

Section 214 of the Act allows a liquidator to apply to court where a director knew, or ought to have known, that there was no reasonable prospect that the company could avoid insolvent liquidation – the so called 'point of no return' – and he or she failed to take every step from the 'point of no return' to minimise potential losses to the company's creditors.

The test as to a director's knowledge is both objective and subjective such that a highly skilled/experienced director will be taken to have a higher level of knowledge than that of a less experienced director although in practice the courts tend to put a greater weighting on the objective element of the test. Unlike fraudulent trading, there is no need to show dishonesty involving real moral blame and, as such, wrongful trading applications are far easier to establish than fraudulent trading actions as the evidential threshold for knowledge/intent is much lower.

It is critical that liquidators correctly identify the 'point of no return' and this will often require a forensic analysis of the company's financial position. If a liquidator fails to prove his case for the date pleaded, he is not entitled to substitute that date. As a result, liquidators tend to err on the side of caution and select a date nearer to the date of liquidation, which often means seeking a lower financial settlement as the losses relate to a shorter time period.

> Fraudulent trading is also a criminal offence with serious consequences for those being found guilty.

Wrongful trading, despite the reference to 'trading', does not in fact require any trading or the incurring of further debts and liabilities on the part of a company to enable a successful claim to be made. For example, wrongful trading would still apply to a company that allows its assets to be depleted by the payment of excessive director's fees and can cover single transactions entered into after the 'point of no return'.

A successful wrongful trading action will see the court ordering that the director makes a payment to the company for an amount equivalent to the loss that the company suffered as a result of the director's actions. If there are a number of directors the courts often give an order on a several basis, as opposed to a joint and several basis, with the court assessing each director's individual contribution to be made. In practice, this approach can have a significant bearing on the likelihood of recovery if only some of the directors are of financial worth and they turn out to be the least culpable and so are ordered to pay the least.

Although the limitation period to bring a wrongful trading claim is six years from the date of insolvent liquidation, liquidators should be aware that any unreasonable delay may justify a striking out order.

Misfeasance and directors' duties

During the liquidation of a company, if it appears that a director has misapplied, retained or become accountable for any company property, the Official Receiver, liquidator, creditor, or a contributory (eg shareholder) can bring a claim for misfeasance or a breach of a director's fiduciary duties pursuant to section 212 of the Act.

> "Wrongful trading applications are far easier to establish than fraudulent trading actions…"

The courts can order that the director account for the misappropriated property by way of payment to the company up to the value of the misappropriated property. A misfeasance claim under s212 of the Act is not just limited to a director and can extend to third parties who knowingly assisted in the misfeasance. If it is established that a director acted on the advice of a professional adviser in respect of the misfeasance, it is open to the director to claim a contribution from that adviser.

It should also be remembered that any amount ordered by the court to be paid to a company by a director for misfeasance or a breach of director's duties cannot be set-off against sums owing by the company to that director.

In the case of *ED Games Limited*[1] in the High Court was presented with a liquidator's claim against a former director who, in the months before the company went into liquidation, had prevented the company making VAT payments to HMRC. It was the director's position that the loss suffered to HMRC was a loss purely to a creditor and not the company and, therefore, the claim should be struck out. However, the liquidator successfully argued that by not paying VAT, the company was able to continue to trade. Had it not been for withholding the payments to HMRC, the company would have ceased to trade at an earlier date and, as a result of this action, the business suffered additional trading loss. The courts held that this loss was a loss to the company and so it was recoverable pursuant to s212 of the Act.

In practice a wrongful or fraudulent trading action will usually be accompanied with an overarching misfeasance claim as the latter will often get around the stricter requirements that need to be satisfied to bring a successful wrongful or fraudulent trading claim.

Directors' duties generally

The Companies Act 2006 sets out the key duties of a director, namely acting in the best interests of the company at all times, promoting the success of the company and exercising reasonable care, skill and diligence. A director must also act in good faith and not put him or herself in a position where the interests of the company conflict with personal interests or that of a third party. As a company moves to an increasingly insolvent state, those duties evolve to also act in the best interests of the company's creditors.

The company, acting through its liquidator or administrator, can bring a claim against a director for a breach of their director's duties and it is usual that such a claim is made alongside a misfeasance claim under s212 of the Act where a liquidator is appointed to add additional weight.

Defences?

There is both a common law defence and a statutory defence to a misfeasance claim. Both of these defences were addressed in the recent case of *Madoff Securities*.[2]

Common law defence – the Duomatic principle

In *Duomatic*[3] it was confirmed that if it can be shown that all shareholders entitled to vote at a general meeting 'assent to a matter which a general meeting of the company can carry into effect… then that assent is binding'. Namely, if the shareholders agree, whether or not at formal shareholders' meeting, to the misfeasant act then it becomes an act of the company, which precludes the company from asserting any liability against the director.

For this defence to be available, the company must prove that it was solvent at the time the decision to authorise the misfeasant action was made. The courts have confirmed that this is an objective test and the shareholders' opinion that the company was solvent is simply not enough.

Statutory defence

It is not uncommon for defendants to plead a defence pursuant to section 1157 of the Companies Act 2006; namely, that if a director faces proceedings for misfeasance or a breach of his duties and it appears to the court 'that the officer is or may be liable but that he acted honestly and reasonably and that having regard to all the circumstances of the case, he ought fairly to be excused, the court may relieve him, either wholly or in part from his liability on such terms as it thinks fit'.

Prior to the case of *Madoff Securities*[4] this defence was routinely used by defendants and routinely dismissed by the courts, particularly in respect of s214 where it has been ruled that s1157 is not available to a director facing wrongful trading proceedings.[5]

However, following *Madoff Securities* the courts are likely to take into account other factors such as the loss the company has suffered, any personal gain made by the defendant and whether shareholder approval was sought, prior to dismissing a defence under s1157. We could, therefore, see a resurgence of successful s1157 defences.

> "The courts can order that the director account for the misappropriated property by way of payment to the company up to the value of the misappropriated property."

Conclusion

Directors cannot simply overlook their duties when a company faces insolvency although there is every chance that a significant number of zombie company directors are doing exactly that. Should those companies enter an insolvency process, and liquidation in particular, then those directors may well be called to account financially.

References

1. *ED Games Limited [2009] EWHC 223 (Ch)*
2. *Madoff Securities International Limited (in Liquidation)* v. *Raven and Others (2013)*
3. *Re Duomatic Limited 1969 2 Ch 365*
4. *Madoff Securities International Limited (in Liquidation)* v. *Raven and Others (2013)*
5. *Re Produce Marketing Consortium Limited (Halls)* v. *David [1989] 5 B.C.C. 399*

ALICE PRATT is a partner in the corporate recovery team at law firm Clarion.

A starter for ten

What to consider when taking on a student accommodation insolvency case.

Student accommodation is one of the most dynamic and exciting parts of the property sector and for a growing number of students where they will spend at least part of their university life. Private provision now accounts for over a third of all purpose-built accommodation and at existing growth rates will not take long to surpass provision by universities. Growth in the development of new stock and investment in existing buildings continues to grow strongly, but with such dynamism and growth comes the odd inevitable business failure.

> "Reputations can be lost very quickly through Facebook, Twitter and various other social media."

About a decade ago the purpose-built student accommodation sector had the foresight to underpin its service provision with statutory-recognised codes of practice. The 2004 Housing Act recognises three codes, one administered by Universities UK (UUK), which is aimed at higher education providers, one provided by Accreditation Network UK (ANUK)/ Unipol aimed at the same audience and one provided by ANUK/Unipol that caters for private sector providers. It is this last code that is particularly relevant to this article.

Recognition of the codes in statute is helpful and in most cases membership will be viewed as a positive alternate by local authorities who have a duty under the 2004 Act to license larger multi-let buildings. The codes also recognise various other demands, however. Students are more demanding these days of their landlords and have every right to expect accommodation that is fit for purpose, as they increasingly invest thousands of pounds in their education. Parents want peace of mind that their nearest and dearest are staying somewhere safe and providers know that this is a highly visible sector, where reputations can be lost very quickly through Facebook, Twitter and various other social media.

To maintain confidence in private landlords' provision they are all subject to a rigorous inspection and audit regime. This tests that their service provision meets code standards from first marketing, to post checkout references and most aspects of service in between. The importance of accreditation cannot be over-emphasised. The vast majority of private providers are accredited and know that students and student unions value accreditation. That in turn places important obligations on the scheme administrator, Unipol and those it operates the codes on behalf of, to rigorously apply standards.

> "Like most insolvency situations communication is key."

Why bring all of this to attention of insolvency practitioners (IPs)?

Well when an IP is appointed they will take on obligations of owners and therefore of the codes. They may be unaware of codes and in the grand scheme of other issues they need to take into account, may not consider this important. Co-operating with the scheme administrator is, however, very important in ensuring students' confidence in their landlord and accommodation is maintained and ultimately their accreditation is not withdrawn.

Like most insolvency situations communication is key. Responding to the scheme administrators' queries promptly and comprehensively is imperative. In return, the scheme administrator can help the IP communicate with students and their representatives and help to reassure them that their home is in safe hands. In the administration of Opal Student Accommodation last year, EY were very impressive in their communication with students and liaison with the code administrator. There have been other examples, however, where communication has not been as good.

To help avoid this in future the scheme administrator has issued guidance that executors of an administration or receivership will:

1. be required to provide assurances that all contracts entered into with tenants living within the development/s belonging to the company/ies that have been placed into administration will be honoured;
2. ensure that if any payments that have been made by students ahead of a contract taking effect are protected in an independently held fund or held in escrow to secure them in any eventuality;

> "Ensure that levels of service… are in no way compromised or reduced as a result of the administration process."

3. permit the code administrator to arrange for verification visits to be made to one or more of any developments effected by administration to ensure that levels of service mandated by the codes and offered by the provider who has been placed into administration, are in no way compromised or reduced as a result of the administration process;
4. at the point administrative arrangements come into effect, the administrator/s should release a pre-prepared statement that is designed to address issues of operational transition and provide appropriate contact details to respond to contractual and operational issues of the residents and their parents/guardians;
5. provide the code administrator with a list of the developments that are affected by the administration process, along with details of all the management companies they have engaged to take over the day-to-day operations of these developments;
6. throughout the period of administration, notify the code administrator of any changes that take place within the administrative arrangements within 48 hours.

The codes consortium, which oversees the application of the codes, in consultation with the chair of the committee of management, will decide on the time span within which these assurances should be given with the guiding principle that any unnecessary delay in responding should result in immediate suspension from the codes until such assurances are given.

While the codes are not specifically about the finances of member organisations, or their financial arrangements, they will cover some of the financial obligations that arise in insolvency situations. Tenancy deposits on assured shorthold tenancies need to be placed in government-recognised schemes. That is not just the rules of the scheme, but the law. If a deposit is held in an insurance-backed scheme an insolvency event will usually trigger a period of notice for termination of membership. The IP will then be under a legal obligation to place the tenancy deposit money in an arm's length custodial scheme before the expiry of the notice period. (For more information on tenancy deposits see: https://www.gov.uk/tenancy-deposit-protection/overview). The scheme organiser will also want to ensure that other monies paid by students in advance are protected and that there are sufficient funds to maintain management standards.

As said, it is in the interest of all parties to communicate in situations where a student accommodation provider gets into difficulties. The code operators will want to ensure that the accommodation is being well managed and service standards maintained. IPs will want to maintain the confidence of student occupiers and ultimately the sale of the asset should be assisted if the building maintains its accreditation.

> "That is not just the rules of the scheme, but the law."

For more information on the ANUK/Unipol codes please see: www.nationalcode.org.

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

Getting the message across

R3's director of communications **Victoria Jonson** explains why lobbying MPs and journalists is important.

'I had the pleasure of meeting one of your colleagues, who lobbied me. I am always a bit suspicious of lobbyists with their vested interests and all that. I must say that I found him very persuasive that keeping the profession as one was a sensible approach.
– Kelvin Hopkins MP on meeting R3 president Giles Frampton regarding partial licences for IPs, 30 October 2013.

Insolvency fees are 'too high', pre-packs see creditors lose millions of pounds, and insolvency practitioners are always out to take advantage of others' problems. Unfortunately, it's relatively common to hear these sentiments from MPs, civil servants, or journalists – a problem, given the prominent role these play in shaping both the public's perception of insolvency and the rules that bind the profession and the insolvency framework.

The UK's insolvency profession and regime are not perfect; scrutiny and reform are welcome. However, it's often the case that there's a gap between the perception of insolvency and the reality.

> The UK's insolvency regime is ranked as the world's seventh best by the World Bank.

This gap likely stems from two things: insolvency's complexity and the fact that it's a challenging experience for creditors and debtors that are affected. For the insolvency novices, it's understandable that views about the profession are coloured by the snatches of information that are picked up from aggrieved constituents or creditors; not everyone has time to sit down and study the order of priority or the finer details of the SIPs.

Positive rescue

The thing is though, there is plenty of information out there that tells a positive story about insolvency: the UK's regime is ranked as the world's seventh best by the World Bank, returning more money, faster and at less cost, than overseas versions; in 2012, the profession rescued over 6,000 businesses and 750,000 jobs.

However, while compelling – and as much as we'd like them to – these facts don't speak for themselves. It's important that the profession is proactive in getting out there and educating key stakeholders and the public about what it is we do, including how we work and the benefits our work brings. If we're not telling MPs, ministers, journalists or civil servants what the insolvency profession thinks or is concerned about, they're not going to know.

This is where R3 comes in. We meet regularly with MPs, journalists, and other stakeholders in the personal and corporate insolvency world to bring people up to speed on the ins and outs of insolvency, talk about the profession's concerns, and discuss improvements to the insolvency regime that the profession would like to see made.

When we do sit down with MPs and journalists the effect can be noticeable: parliamentary questions or headlines that are negative about the profession one week are sometimes followed up with more positive comments later on.

Providing evidence

This isn't down to the mysterious 'dark arts' of lobbying that are often grumbled about in the press: it's about being honest, explaining how the profession works, providing evidence, and, where there are problems, offering solutions.

Policymakers and journalists look to R3 to provide credible expert input; and we look to our members to provide the credibility to what we say.

Providing evidence to policymakers from the profession is one of the most important things R3 does. Often, there is a gap in government proposals where the evidence should be: the recent fees consultation, for instance, included proposals absent from the Kempson review upon which it was based; the current proposals on partial licences for IPs originally appeared four or five years ago, but no new evidence has been provided by the government to show they're still needed.

> If we're not telling MPs, ministers, journalists or civil servants what the insolvency profession thinks or is concerned about, they're not going to know.

In both cases, input from R3 members has been invaluable in making the case against proposals that have been based on perception or assumption.

This input can take different forms: member surveys allow us to tell policymakers or journalists exactly what it is the insolvency profession thinks about a proposal (the government originally claimed partial licences would benefit small practices; our survey of small practices showed the opposite to be true); letters from members to ministers and MPs help show policymakers the weight of opinion that is out there on a subject (and that maybe the briefing they've received from civil servants or whips doesn't tell the

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

full story); while technical input from R3's committees can help address some of the more glaring problems with proposed policy.

Improving business rescue

Engaging with stakeholders isn't just about 'stopping' things from happening either. It's all very well saying to an MP or a journalist: 'we don't like this'; what really makes a difference is being able to say: 'we think it should be done like this instead'. For example, one MP recently made a series of critical comments about football

> "Insolvency is a crucial cog in the UK economy."

insolvencies; later, following a meeting with R3, the MP began speaking instead about R3's proposals for reforming football insolvency. The business rescue culture and the personal insolvency landscape can always be improved, and insolvency practitioners are often best placed to find ways this can be done.

And, where there is a potentially genuine issue with the fairness of insolvency processes, it's important that we are ready to either explain the reasons behind the issue or that we are able to explain how the processes could be reformed and problems ironed out.

Again, input from R3 members is crucial: our policy proposals almost always have their genesis in feedback from members, and they are always supported by evidence, either from member surveys or R3's own research. Our 'Personal Insolvency Landscape', our work on fraud, and our 'Rescue to Ransom' campaign all came about in this way.

Do we always achieve all that we want to achieve? No, but then policymaking is a balancing act between the political objectives of those making the policy and the input from those at the proverbial coal-face. Ultimately, both government and the profession have the same objective: a world-class, fair, and open insolvency regime; but the profession does need to speak up to achieve the balance. It won't happen automatically.

When policymakers do take on board input from the profession – whether in meetings or as a result of evidence given to parliamentary committees or consultation responses – there's a lot we have been able to achieve. Our 'Rescue to Ransom' campaign saw the law changed to prevent insolvent businesses being charged ransom payments by suppliers; the government's revised 'Red Tape Challenge' proposals included recommendations from R3's response to the consultation on the subject.

Insolvency is a crucial cog in the UK economy; it's an emotive subject too. As such, it'll always be in the spotlight, whether this is being shone by the press or by policymakers, and there will be frequent

> "Policymaking is a balancing act."

attempts at reform. So long as reform is evidence based and doesn't undermine the value the profession provides in returning funds to creditors, it isn't something to shy away from; and contributing to that evidence base and providing insight into the impact of reform is a role for R3 and R3 members. ◻

VICTORIA JONSON is the director of communications at R3.

Striking home the right message

SPG campaign – how can we combat mis-selling by unregulated advisers?

Mixed messages being given to directors of distressed businesses by unregulated advisers form part of the concerns that smaller practice members feed back to R3 on a regular basis. This activity has been discussed in previous articles in *RECOVERY* and R3's Smaller Practices Group Committee is launching an initiative to combat this further.

This problem causes difficulties for licensed insolvency practitioners because it seems that often the message given by unregulated advisers is that distressed businesses should not discuss their affairs with insolvency practitioners because of the duty owed to creditors in an insolvency situation. The implication is that business owners should seek advice from unregulated advisers before approaching an insolvency practitioner so that they can maximise their own personal position before considering the concerns of creditors.

> "The insolvency system will provide remedies against the company and its assets and the business owner personally if caught."

The owners of SME businesses are particularly vulnerable to this propaganda as they may not have the financial acumen to see that the insolvency system will provide remedies against the company and its assets and the business owner personally if caught. The messages given are attractive and persuasive and insolvency practitioners in smaller practices can find it very difficult to convince business owners of the correct advice when their views are entrenched.

R3 has been proactive in drawing the messages given by unregulated advisers to the attention of The Insolvency Service and other regulatory agencies, such as the Advertising Standards Authority. It is vitally important that members provide examples of advice from unregulated advisers to R3 whenever they see it so that R3 can keep abreast of the developments. Practitioners themselves can, of course, also directly bring these examples to the attention of The Insolvency Service.

There are notable results arising from the work that R3 has undertaken to raise these complaints with The Insolvency Service. Around eight unregulated adviser organisations have been wound up in the public interest so far and the Advertising Standards Authority has sanctioned an

unregulated adviser in respect of advertisements that he promoted that were deemed to denigrate competitors and insolvency practitioners and to mislead directors about the duties owed to their company.

The R3 Smaller Practices Group Committee has also considered how it can assist practitioners and combat these messages. We intend to produce a visually striking document that practitioners can provide to intermediaries, debtors and business owners setting out the misleading information provided by unregulated advisers and offering explanations as to:

- why such arguments are flawed;
- what consequences may flow from decisions taken on the strength of such advice; and
- the correct approach to insolvency situations and the best way to get practical advice.

A couple of examples of situations where unregulated advisers have approached practitioners or business owners are set out below:

1. An intermediary was approached by an unregulated adviser asking the intermediary to assist with referrals of clients in difficulty. The unregulated adviser confirmed that this advice would be directed to preserving the interests of the business owner and the interests of the creditors came second. The unregulated adviser indicated that a formal insolvency may be necessary but that the unregulated adviser would use a practitioner who can be heavily influenced by the adviser and would 'do as he was told'.
2. A number of connected organisations wrote to directors of companies in financial difficulty indicating that the directors may be able to limit their civil and criminal liabilities and could walk away from their responsibilities when entering an insolvency procedure, while the creditors of the distressed companies were misled about the formal status of the insolvent company.
3. Marketing literature issued by an unregulated organisation suggested that business owners should not take advice from insolvency practitioners as they would attempt to 'sell' an insolvency procedure that would be inappropriate for the company.

We believe that having documents readily available to practitioners, intermediaries and business owners to expose the messages given by such advisers will be helpful to enable practitioners to counter a reluctance to use the services of

> "As we kick-start this campaign we would be very grateful for feedback."

an insolvency practitioner when the situation arises. As we kick-start this campaign, we would be very grateful for feedback from the SPG community about the type of information that members would feel it would be useful to include within the documents produced. Please contact Emma.Hobson@r3.org.uk with your feedback.

We would also ask members who encounter examples of the behaviour, marketing literature or websites of these entities to write to R3 (GRumney@r3.org.uk and Emma.Hobson@r3.org.uk) in order that we can refer such examples to The Insolvency Service, the OFT and the Advertising Standards Authority as appropriate. We would also encourage you to refer any such examples directly to these regulatory bodies as appropriate. ◻

ANDREW TATE is R3 SPG chairman and a partner at Reeves & Co.

EMMA HOBSON is R3 assistant director.

SAVE THE DATE

18 September 2014
R3 Insolvency Conference
Crowne Plaza, Chester

16–17 October 2014
SPG Forum
Hilton Metropole, Birmingham

R3 events, courses and conferences

June

Date	Event	Venue
4	SPG Technical Review	Hyatt Regency, Birmingham
4	London Women's Group 'Giving back to the Juniors'	PwC, London
5	Restructuring Solicitors' Firms in Financial Distress	Holiday Inn Bloomsbury, London
5	Pre-pack Administrations	Holiday Inn Bloomsbury, London
5	Eastern Region Annual Dinner	Downing College, Cambridge
10	Introductory Series – Personal Insolvency 2 and Rescue 1	Deloitte LLP, Birmingham
10	Introductory Series – Personal Insolvency 2 and Rescue 1	Irwin Mitchell Solicitors, Leeds
10	Introductory Series – Personal Insolvency 2 and Rescue 1	Prospero House, London
13	North West Ladies Lunch	Lowry Hotel, Manchester
19	South West & Wales Ladies Lunch	The Grand Hotel, Bristol
20	Yorkshire Ladies Lunch	Aspire, Leeds
24	Charities and Community Interest Companies	Copthorne Tara Kensington, London

July

Date	Event	Venue
1	SPG Technical Review	Cedar Court Hotel, Huddersfield
1	Thames Valley Meeting	Reading
1	North West Golf Day	Clitheroe Golf Club, Clitheroe
3	London Women's Group 'Lunch at the Langham'	The Langham Hotel, London
7	Eastern Regional Meeting	Ravenwood Hall Hotel, Bury St Edmunds

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 2014 programme. Alternatively, call the Courses team on 020 7566 4234 to request further details.

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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.

Advertisers' index

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

APPOINTMENTS

Surveyors, auctioneers & valuers

Interview with…

Giles Frampton

Incoming R3 president **Giles Frampton**'s smiling face will be a familiar sight to many IPs and *RECOVERY* readers as he has been a regular contributor to the publication's technical update pages. A reflective man, behind his soft-spoken manner and the frequent sound of laughter that accompanies his answers is a sharp intellect and an instinct to do the right thing and protect his profession.

You've been an active member of the insolvency profession for some time now, serving on the technical committee at R3 and the insolvency licensing committee of the ICAEW as well as being an examiner for the JIEB – what drives you to get involved with so much away from direct practice?

Essentially, an interest in the topic and a thirst for knowledge. I'm particularly interested in the technical side of the profession and knowing the answer to a technical query is a very satisfying thing. It does have a direct impact on one's own practice; you learn the sort of issues that might affect you, yourself. There's also the point that if you want to get something done or something doesn't work as well as you'd like you ought to get involved yourself.

> "If you want to get something done or something doesn't work as well as you'd like you ought to get involved yourself."

Is that a theme in your life? Getting involved?

Oh yes. Because if you see something you don't much care for, or something that needs changing, or something that needs maintaining – it doesn't need to be about change, it can be about maintenance – then you should take part.

As a former examiner what do you feel about partial licensing and Jenny Willott's recent remark that it's a positive thing and will reduce the high barrier to becoming an IP?

I would be tempted to answer with a rhetorical question – why shouldn't there be a high barrier? This is a very responsible role, it's a very demanding role and it's important that you get it right. There are only 1,700 IPs in the UK – where is the demand for partial licences? Where is the need, where is the demonstrable gap? It's very hard to identify – in fact, we can't identify it. The vast majority of our members say, 'We don't think we would use this.' Most of our smaller practices are general practices, with some exceptions. A handful of people will be happy to be partially licensed because they will be very competent, but that's not the point. For the majority, the current full licence is appropriate and the partial licence looks to be an unnecessary adjunct. A proper licence costs a lot and it's still a high barrier, because it should be. The alternative is, there isn't a high barrier and there's a danger of getting less good advice, which is self-evidently undesirable.

We find it very difficult to see why [the government] is pressing on with this.

But you need experience in any case to become an IP?

It takes 1,000 hours over five years. It's not a huge amount – then you have to do the exams, and they take a year. Now, in practice, existing practitioners will want to ensure those seeking appointment are trained up. There are quite a few non-appointment takers – I have two in my own firm. In practice the JIEB exams are a culmination of experience and training. And they're tough exams.

The number of people who don't pass all three exams in one go is significant…

Well quite a few don't pass any of them and that's because they are meant to test, to a reasonable standard, how good a candidate is – whether they're capable of being a good IP. They're not designed to trip – they're there to allow people to demonstrate [their knowledge] – and to say, look can you do this? If you can, you should pass, if you can't, then you shouldn't

> "A proper licence costs a lot and it's still a high barrier, because it should be."

and they're very much based on practical problems and procedures. You tend to write [the exams] thinking, 'How might you deal with this issue?' 'What are the topical issues of the day?' It might be a SIP9 or a SIP16, or it might be IVAs, trusteeships, insolvent estates of deceased persons or a whole range of things and of course you can't ever test everything in the exams; it's impossible, but there's enough there to ensure the candidate is technically fit and proper to be an IP.

How does the profession go about changing the general public's perspective of it?

If a financial mess needs sorting out IPs are very skilled at that. That's what we do – we bring order to chaos. In 2012 the figures [for the UK] are that IPs saved about 6,000 businesses and 750,000 jobs – that's a fact. That's a good contribution to wellbeing, that's a good contribution to the wealth of the country; it's a good contribution to employment – that's worth paying for. On World Bank terms we are seventh in the world rankings, the only other G8 country in the top ten is Japan, the rest are well behind. We collect about £5bn of assets and distribute about £4bn of it, which is quite substantial. The job that's being done is a

> "In 2012 IPs saved about 6,000 businesses and 750,000 jobs – that's a fact."

good one and getting that message to the public, repeating the fact, rather than saying, as happens far too often, that IPs do a good job but…; a few less 'buts' would be welcome because in very many cases IPs do a good job. Moreover, IPs take the hit when the job doesn't work – and not all cases work. Equally, you have cases where, if it wasn't for what the IP did, there would be no recovery for creditors.

If there were no IPs, who would do that job?

It's a very good question, somebody has to do it, because otherwise, there would be assets left doing nothing and that's self-evidently unproductive and a waste, and those assets would not only be plant, machinery and buildings, they would also be people.

And how do you tackle the headline issues of fee setting and pre-packs?

The way of tackling these issues, is to say – 'Where's the evidence? What's the rational explanation, what's a rational response? The fees consultation has taken a simplistic approach: there's noise about fees, IPs charge time-costs, IP fees are cause for noise (although you wonder really how much noise) and the solution is to stop IPs charging time-costs. But where creditors are involved, ie, where there's a secured creditors' or a committee, there's no problem at all. Under these proposals fees will be charged in some other form, either a fixed fee or percentage, but those will still be cause for noise because people are being paid for doing the job. That doesn't address the real problem of creditors not being involved. So as an answer we don't think it will work. There are certain, almost fixed, costs in any corporate insolvency – there will always be a review of directors' activities; there will always be a need to send a return to Companies House… and so in smaller cases, a far greater proportion of the realisations will go in costs – it's inevitable. The smaller cases tend to be dealt with currently by the smaller practices in the IP community and if time-costs are prohibited those IPs wouldn't take the work. Those cases would go to the OR, the Official Receiver, and they haven't got the resources [to deal with them]. So all round it seems a surprising proposal from government; nobody expected that but we very much hope government will recognise it's extreme.

You've also worked on the General Technical Committee, Policy Group and the Personal Insolvency Committee covering interesting issues such as Paymex, PPI and consumer credit licences…

We were concerned that the government hadn't considered fully that IPs do need to be exempted or excluded from the proposed legislation on consumer credit licensing and we were very pleased that the government did take steps to provide an exclusion; clearly a sensible result. It's a good example of where dialogue with government has been very helpful.

What made you take on the role of R3 president and what are you looking forward to during your year in office?

[Laughs] Why have I taken it on? I suppose it was my view of taking part and wanting to contribute. I see the role very much as *primus inter pares* – first among equals. It's like holding a baton that you pass on to the next person having picked up from your predecessor. I don't see the role as a dictatorship; R3 is run on the basis of a consensus and co-operation.

I'm looking forward to going around the regions and attending various events both within R3 and elsewhere. I was at something last week and had a chance to talk about what R3 is doing. I think that's an important part of the process, networking and getting our messages across.

> "In terms of ways the profession is regulated it does seem extraordinary that so few are regulated by so many."

I'm thoroughly sympathetic to diversity, but it's not my field of expertise. As I see it, we're facing a lot of change and issues – besides fees and pre-packs there's also regulation, both in terms of the ways the profession is regulated and in terms of the rules that we use and adopt when we run insolvency cases.

In terms of ways the profession is regulated it does seem extraordinary that so few are regulated by so many and some sort of reduction in the number of regulators might be considered, or, better, a unified regulatory process introduced. A licence holder could be an ICAEW licence holder subject to exactly the same processes as an IP licence holder or an »

ICAS licence holder… it might lead to cost savings and general benefits for the IP community and therefore in the end, for creditors, because there's less to pay.

Turning to statute, there's been quite an ongoing process of reviewing the rules and trying to make them more easily accessible. We recently reviewed a draft of these rules, which basically work on the idea there would be common parts for such topics as meetings, or reporting of fees – that sort of idea. In principle we think that's a good thing but the actual execution isn't as thorough as we would have liked, partly because there's no review of the Act, at the same time; partly because some of the rules tend to be an aggregation of what we have rather than a simplification; partly because, the forms, and inevitably there are a lot of forms in insolvency, are dropped in favour of a description. We think a prescribed form is far more desirable than a description of what's on the form, because we can see the confusion that would cause in the marketplace.

> "I handled a case that involved a wedding dress shop. There were a lot of brides and their mothers at the creditors' meeting…"

Has Liz shared any key advice with you during the handover?

The president, the vice-president, the deputy vice-president and the chief executive provide some continuity, so there shouldn't be any surprises. We meet every month and it should just continue smoothly on, which is a good thing because you can't do a great deal in one year; it's part of a whole process. It goes back to my point about the president being a figurehead, but also being first among equals and no more than that. It's really important to have that continuity.

What do you do in the year that you finish?

You sit on council as past president and then you pass on the baton to others. I've been doing something or other for years and years. I think I started as a marker in 1999 and I've been doing something ever since. There will still be plenty for me to do one way or another; there is a practice to run and I might even spend time in my garden or singing, or watching cricket.

You're based in the South-West – do you feel insolvency legislation and practice is too city focused?

No, I don't think so at all. The basic insolvency issues are the same whether you're in a small business or a big one. Small businesses throw up all sorts of interesting conundrums. But no, I don't think there's any undesirable London pull or anything. The rules are pretty even.

Tell us something of your typical day or don't you have one?

I come up to R3 most weeks. When I'm in the office I get in early but I tend to go home at half-past five, I rarely stay beyond that. The day will involve partly administering the business and partly catching up on cases and moving them forward. I tend to eat lunch at my desk, which is not very good, but I try to read something different at lunchtime, by which I mean technical reading rather than the case I am working on, something like *RECOVERY* or *economia*.

I'm a church warden and church matters take up some time as well… getting walls painted and so on. I sing two or three evenings a week, I'm a tenor. It takes you out of your day's work. You can go there feeling you don't want to be there but you come away feeling so much better.

I used to play violin in a string quartet; I remember the cohesion of those four players when you got it right, the satisfaction in that sound. But I just like music and if I go on holiday for a week without music I feel very thirsty for it.

We sang *The Crucifixion* recently and to get through that was quite hard. That was a service but it's quite rewarding in many senses, spiritually… it's a profound piece, a profound message.

What's the most tricky insolvency case you've ever had to handle?

I can think of two. The first was Ford Park Cemetery Company, it involved 32 acres of Plymouth full of people's ancestors and that caused a lot of upset. People said, 'What's going to happen to our war heroes, our Titanic victims, our deceased friends and relations?' We had to consider if redevelopment was appropriate and fortunately, and I use the word advisedly, the cost of disinterring and reburying far outweighed the value. But it involved one particularly difficult public meeting. We had to find a way round to get rid of this onerous asset to somebody who was prepared to deal with it. A trust was formed, but to achieve the transfer we had to disclaim it, so it went from the liquidation to the Treasury to the trust. The local MP was very helpful at the time. I know it's still operating as a trust and still being looked after.

The other case involved a wedding dress shop. There were a lot of brides and their mothers at the creditors' meeting…

What do you enjoy most about being an IP?

Resolving problems – and investigation is really interesting. It's rewarding when you get an understanding of what it is that's caused a business to fail. It's part of our job, for example, to find transactions that should not have taken place. The cases with missing assets are interesting if frustrating; to this day we believe there's a digger buried somewhere in Cornwall but we've been unable to find it.

Do you have to have a thick skin to be an IP?

I think you develop a thicker skin. Having a thick skin is useful, but I don't think all IPs do by any means – I don't – but it's thicker than it was.

Is that because when you're doing your job you know you're doing it to the best of your ability in the interests of the creditors?

I'm doing my job, yes. It's right to be challenged, it makes you reflect: am I doing this in the correct way, is there a better way? If you're clear about the rules and the principles that should govern an insolvency estate the rest should follow.

As a final question – what made you join the profession and why should a new generation step up to become IPs?

Because it's a job worth doing. There will always be financial failure, it's as sure as death and taxes and it raises issues that need to be resolved and sorted and doing that in the best possible way with a set of fair, just parameters is important. I would really like to keep on emphasising in my year and in future the good stuff IPs do and that the profession is valuable and worthy of support, rather than discredit and attack. We are in extraordinary times; from the profession's point of view I can't think of anything that isn't up for scrutiny.

> "Having a thick skin is useful, but I don't think all IPs do by any means."

Giles Frampton

Giles Frampton qualified as a chartered accountant in London with Thomson McLintock. In 1984 he joined Peat Marwick Mitchell in Plymouth, becoming involved with the Berkeley Applegate liquidation. He obtained his insolvency licence and became a partner in 1991. In 1994 he joined Richard Smith.

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